Contemporary Legal and Economic Issues V

Editors
Ivana Barković Bojanić and Mira Lulić

Publisher

Faculty of Law Osijek, Josip Juraj Strossmayer University of Osijek, Croatia

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Printed:

Krešendo, Osijek

ISBN 978-953-8109-00-3
ISSN 1847-6171
EAN 9789536072729

CIP record is available in the electronic catalogue of the City and University Library of Osijek under the number 140310005.

The book is published every two years and its publishing is authorized by the Senate of the Josip Juraj Strossmayer University of Osijek (Croatia). The book is also indexed in the EBSCO Publishing, Ipswich, Massachusetts (USA) and ProQuest Research Library, Ann Arbour, Michigan (USA).

Publishing of this book is authorized by the Senate of the Josip Juraj Strossmayer University of Osijek at its Second Session in the academic year 2015/2016. held on 1st December 2015.

CONTEMPORARY LEGAL AND ECONOMIC ISSUES V

Editors

IVANA BARKOVIĆ BOJANIĆ AND MIRA LULIĆ

Josip Juraj Strossmayer University of Osijek
Faculty of Law Osijek, Croatia
2015

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The book series "Contemporary Legal and Economic Issues" represents an international forum on major legal and economic problems confronting a contemporary society. It is organized in relatively rare format of a short monograph based on set of chosen scientific papers in the fields of law and economics, which is an advantageous way to construct a promising framework, to offer some scientific and practical comments and to arouse readers' interest in the overall approach, without having to carry the burden of the necessity to strive for completeness or detail.

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Ivana Barković Bojanić and Mira Lulić

SIGNIFICANT FEATURES OF DEPRIVATION OF LIBERTY IN CROATIA WITH REFERRENCE TO PRACTICE OF EUROPEAN COURT OF HUMAN RIGHTS

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ABSTRACT

This paper provides an overview of regulation, execution and monitoring system over prison sentence in Croatia. In this regard, the main features of deprivation of liberty are presented, as well as regulation changes adopted in new Croatian Criminal Code. Short-term and long-term imprisonment are analysed in line with new provisions. Also, a short overview regarding alternative sanctions is provided. When it comes to prison overcrowding, it should be noted that Croatia faces problems that cause a number of other negative consequences. Special attention is drawn to judicial practice of European Court of Human Right regarding case law v. Croatia, where applicants were prisoners seeking protection of their rights.

Key words: criminal law, imprisonment, penitentiaries, human rights protection, European Convention of human rights.

1. INTRODUCTORY REMARKS

The mood and temper of the public in regard to the treatment of crime and criminals is one of the most unfailing tests of the civilisation of any country.

Winston Churchill

House of Commons speech, given as Home Secretary, July 20, 1910

Deprivation of liberty or prison sentence in the Republic of Croatia has changed its regulation in relation to the previous «arrangement» in Criminal law. This specially relates to possible restrictions on the imposition of short-term prison sentences where one of adequate alternatives is the community service. The recognized regulatory problems regarding prison sentences have been partially corrected with the new Croatian Criminal Code of 2013. Although generally subjected to criticism under the influence of modern tendencies, imprisonment is still the most important state response to (serious) offenses. Particular emphasis will be placed on current problems in the execution of prison sentence in Croatia. The most important one is probably the overpopulation of penitentiaries or prisons. The European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (further: CPT) has repeatedly highlighted the problem of inadequate conditions in serving prison sentences. Even though the field of execution of prison sentences has a modern regulatory framework, it can be argued that precisely the quality level of the execution procedure is the greatest influence for perpetrator when returning to the path of respect for law. The connection between the problem of overcrowded penitentiaries and alternative ways of punishment is a challenge for legislator. The possibility of judicial protection of prisoners from prison administration`s illegal conduct is crucial for meeting the legal standards in execution period. In line with modern trends, the Croatian executive criminal law (law of criminal sanctions enforcement) accepted the institution of judge of sentence execution. The prisoner who considers that there has been a violation of his rights can seek judicial protection and reparation and the right to this protection is not limited to mechanisms at national level. United Nations Organisation as well as the Council of Europe adopted a number of acts, structured precisely to protect the basic human rights of prisoners. Therefore we give the overview of European Court for Human Rights case law regarding these rights.

2. THE NOTION OF „PUNISHMENT" AND „CRIMINAL SANCTIONS" AND THEIR IMPOSITION IN REPUBLIC OF CROATIA

Criminal law sanctions can be described as disapproving state reaction to the culpable criminal wrongfulness, associated with the social-ethic wrongfulness estimation.[1] This is a wider concept than punishment. Sanction is the notion that includes punishment (prison and fine) and security measures. This system is called dualistic and is the basic feature of contemporary criminal law. There are three types of sanctions in Croatia: punishment, security measures and educational measures (for minors).

Until the late 19th century, criminal law was accepting so called monistic system (the principle of *Einspurigkeit*). This means that only one type of sanction was provided: punishment. Considering that penalty *per se* is not able to protect society against all types of offenders, there was a need for other types of sanctions, whose foundation is not culpability, but perpetrator`s danger.[2] These are security measures. In cases of mental incapacity of perpetrator, when punishment cannot be imposed at all (since there is no culpability), or in cases of considerably diminished mental capacity (the possibility of mitigated punishment), security measures are aiming at achieving social security. However, in this dualistic system of criminal sanctions, punishment remains the sanction that primarily achieves the purpose of sanctioning. This «double track system» (the principle of *Zweispurigkeit*)[3] is represented in the Croatian criminal law.

The culpability is a fundamental precondition for the imposition of punishment. It has double meaning. First, as a basis for punishment (*Strafbegründungsschuld*), it includes assumptions for reproach (the elements of culpability). Second, as penalty measure (*Strafmaßschuld*) it refers to the «weight» of reproach, addressed to the perpetrator.[4] This dual legitimacy of punishment stems from the principle

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1 Stree/Kinzig in Schönke, A., Schröder, H., *Strafgesetzbuch, Kommentar*, 28. Auflage, Verlag C. H. Beck, 699. Criminal law and it`s sanctions are necessary to maintain order in the community, thus enabling the maintenance of the society itself. Therefore, the goal is to preserve the rights of society and its members from the harmful behavior.

2 Novoselec, P., Bojanić, I., *Opći dio kaznenog prava [General Part of Criminal Law]* Faculty of Law, University of Zagreb, 2013, p. 368. One other definition is that criminal sanctions are all state measures imposed in criminal proceedings against perpetrators of criminal offenses or unlawful acts, that consist in the loss or restriction of their rights. p. 367.

3 See: Stree/Kinzig u Schönke, A., Schröder, H. (eds.), op. cit. in fn.1, pp.705-706.

4 More, Turković, K., Maršavelski, A.: *Reforma sustava kazni u novom Kaznenom zakonu [Reform of the System of Penalties under the new Criminal Code of Croatia]*; Hrvatski ljetopis za kazneno pravo

of culpability (Art. 4 of the Criminal Code; hereinafter: CC)[5] and from provision on sentencing (Art. 47 of the CC). It is the principle of culpability[6] that has the task of protecting the perpetrators from excessive encroachment of repressive state institutions and provides punishment for actions that deserve social and ethical estimation.[7]

Punishment is regulated in fourth Chapter of CC. Art. 40 para. 1 of CC enumerates three types in Croatian criminal law: fine, imprisonment and long-term imprisonment. There is no death penalty in Croatia.[8]

The importance of fine is emphasized with specific sequential order of punishment types, which also highlights the fact that imprisonment is not necessarily a priority penalty.[9] A fine may be imposed as the main and as an accessory penalty, while a prison sentence and long-term imprisonment may be imposed only as the main one. Before considering some of the specific forms, it is necessary to mention the purpose of punishment. This corresponds with provisions layout in the CC. Croatian legislator (in Art. 41 of the CC) stipulates that the purpose is in general

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i praksu, Vol. 19 , No. 2, 2012, pp. 795-817, p. 797.

5 Criminal Code, Official Gazzete 125/11, 144/12, 56/15, 61/15.

6 The principle of culpability is *explicite* provided in the CC, Art. 4: "No one can be punished if he is not culpable for a crime." Such definition represents a change in relation to prior formulation (the problem was inconsistent implementation of dualistic system of criminal sanctions). The CC / 97 stipulated that "No one shall be punished, nor other criminal sanction can be imposed, if he is not culpable for the offense committed." Considering that a precondition for security measures imposition is not culpability (but danger), such formulation prevented their imposition to dangerous but mental incapacity offenders. In addition to changes related to the role of the principle of culpability, there was a change in its composition, which was expanded with one negative condition: lack of grounds of excuse. See, Herceg, B., *Ispričavajući razlozi u kaznenom pravu [Grounds of excuse in Criminal Law]*, unpublished doctoral dissertation, Faculty of Law, University of Zagreb, 2014.

7 Bojanić, I., Mrčela, M.: *Koncepcija krivnje u novom Kaznenom zakonu [The concept of culpability in the new Criminal Code]*, Hrvatski ljetopis za kazneno pravo i praksu, Vol. 19, No. 2, 2012, pp. 389-407, p. 393.

8 It was abolished by the Croatian Constitution of 22nd December, 1990. At the same time, a prison sentence of maximum 20 years became the most severe punishment. This was until 1st January 1998, when long-term imprisonment was introduced.

9 In all criminal offenses with imprisonment up to three years, the court may impose a fine as the main penalty. For criminal offenses against honour and reputation, fine is provided as only possible sanction. Unlike the case where is prescribed as an alternative, for criminal offenses committed for personal gain there is a possibility of imposing a fine as an accessory penalty, cumulative with imprisonment. If a prison sentence was replaced with community service or a suspended sentence, a fine may be imposed as an accessory. See Turković, K., et. al.: *Komentar Kaznenog zakona [Commentary of the Criminal Code],* Official Gazette, 2013, p. 59.

and special prevention and retribution.[10] The positive general prevention aspect is expressed in the part related to strengthening of society`s confidence in legal system based on the rule of law as well as the impact on others not to commit criminal offenses by enhancing their awareness of the danger of committing criminal offenses and of the fairness of punishment. Special prevention is visible in the part related to impact on the perpetrator not to commit criminal offense again. Expressing social condemnation for offenses committed represents retribution. It is also visible from protection of the victim`s rights.[11]

Even though the modern Criminal law mostly emphasizes the penal function of deprivation of liberty, in the ancient and medieval law imprisonment had an accessory role. This means that it was used if the other forms of penalty were not able to achieve reparation for the breach of the legal order or if other factors have hindered the execution of other penalties. In previous periods, death penalty, physical punishment or fines were the main sanctions, aimed at life, physical integrity or property of perpetrators. Deprivation of liberty had, in its original form, primarily procedural function: ensuring the presence of the accused and guarding the convicted person who was expecting an execution of major penalty, for example, death penalty. It is appropriate to mention the famous Ulpijan´s saying: *Carcer ad continendos, non puniondos homines*, according to which the purpose of prisons was holding people, not punishing them.[12] Until the end of the middle ages, imprisonment had an accessory role[13] and then the early forms of deprivation of liberty as we know it today appeared.

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10 This is a new definition, which replaced the old provision of the CC / 97. By its nature, it is a declaratory provision. The correct composition of all the punishment objectives/purposes is a complex legal question. At the same time, it is the reason for the general lack of these provisions in modern criminal codes. The modality of expressing the purpose of punishment within the usual way of legal provision writing is problematic since the provisions have to be relatively simple and easy to understand. However, in an effort to indicate at least a certain framework "which is necessary to take into account when determining the sentence", the Croatian CC contains this provision, in accordance with the modern mixed theories regarding the purpose of punishment. Details in Novoselec, P., Bojanić, I., op.cit. in fn. 2, pp. 376-377.

11 Turković, K., et. al., op. cit. in fn. 9, p. 60.

12 Vukušić, I., *Povijest i sadržaj kazne zatvora;* Zbirka radova suradnika na projektu *„Europske značajke i dvojbe hrvatskog sustava izvršenja kazne oduzimanja slobode [History and content of the prison sentence;* The collection of papers of associates on the project *"European features and concerns of the Croatian system of execution of sentence of deprivation of liberty]* Faculty of Law, Split, 2012; p. 17.

13 Radić, Ž: *Zatvor u srednjevjekovnom trogirskom pravu [Imprisonment in medieval law of Trogir]* Hrvatski ljetopis za kazneno pravo i praksu, Vol. 12, No. 1, 2005, pp.89-115, pp. 89-91.

3. DEPRIVATION OF LIBERTY DE LEGE LATA

As mentioned before, there are two types of deprivation of liberty in Croatia: imprisonment (Art. 44 of CC) and long-term imprisonment (Art. 46 of CC). New provisions on long-term prison sentence are placed in a separate article since differentiation between imprisonment and long-term imprisonment was to be emphasized.

3.1. IMPRISONMENT

Regulation of "ordinary" imprisonment was subjected to changes in the new CC. First, the changes are related to the duration. The overall minimum was raised from thirty days to three months. The reason for this was a desire to emphasize the distinction between criminal offenses and misdemeanours.[14] Overall maximum was also increased from fifteen to twenty years. This has filled a void that existed in the previous regulation between the upper limit of imprisonment (fifteen years) and lower limit of long-term imprisonment (twenty years). Furthermore, it is now possible that prison sentence of up to one year may be exercised at home.

The new regulation contains the provision expressing the limitation in imposing a sentence of imprisonment up to six months. It is so called short-term imprisonment, limited to cases where it is "expected that a fine or community service will not be able to execute, or if a fine, community service or a suspended sentence would not be appropriate to achieve the purpose of punishment".[15] Reasons for this limitation can be described as impossibility of implementing any serious program of rehabilitation and re-socialization, stigmatization of primary delinquents who receive the mark of a serious offender, exposition to negative influence of experienced criminals, the risk of recurrence due to the loss of fear of imprisonment, loss of employment and the deterioration of family relationships.[16] Role models were provisions from the German, Austrian and

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14 See Turkovic, K., et. al., op. cit. in fn. 9, p. 65., and Novoselec, P., Bojanić, I., op. cit. in fn. 2, p. 384.

15 Art. 45. of CC.

16 Turković, K., Maršavelski, A., op. cit. in fn. 4, p. 813, and Turković, et. al., op. cit. in fn. 9, p. 66.

Swiss criminal law.[17] Arguments *contra* imposition can be summarized in its inefficiency and inadequacy to achieve the purpose of punishment.[18]

An important reason for the exemption of short-term prison sentences are statements of CPT on overcrowded prisons and penitentiaries in Croatia.[19] The Committee has found that the area of 4 m2 for each prisoner is a minimum standard, and failing to ensure such minimum standard is a violation of the European Convention Human Rights and Fundamental Freedoms. Also, the European Court of Human Rights (hereinafter: ECtHR) has confirmed this condition in judicial practice.

According to some studies, an overcrowded prison is defined as a situation in which prison is functioning with 115% capacity.[20] According to the Annual Report of the Prison Administration, the total statutory capacity in 2013 in penitentiaries and prisons was to accommodate 3771 prisoners. Significantly lower rate of reception of prisoners with sentences less than 6 months is a result of more frequent imposition of alternative sanctions.[21]

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17 For example, the German CC in § 47 *Kurze Freiheitsstrafe nur in Ausnahmefällen*, states that the court imposes this sentence only if special circumstances related to the offender or the offense are justifing it and it is necessary in order to influence the perpetrator or to preserve of the rule of law. (*Eine der sechs Monaten Freiheitsstrafe verhängt das Gericht nur wenn besondere Umstände, die in der Tat oder der Persönlichkeit des taters liegen die Verhängung einer Freiheitsstrafe zur Einwirkung auf Täter oder zur Verteidigung der Rechtsordnung unerlässlich machen*). Stree / Kinzig in Schönke, A. Schröder, H., op. cit. in fn. 1, p. 794.

18 The problem of the influence of criminals to those who were given short-term deprivation of liberty analyzes Vidović, V., *Razvoj i osnovni problemi kazne lišenja slobode [Development and basic problems of prison sentence]*, Banja Luka, 1979, pp. 168-170.

19 So far, visits to Croatia have occurred in 1998, 2003, 2008, 2012. CPT delegations have unlimited access and unrestricted movement in places where persons deprived of liberty are situated. Also, they can talk in private and communicate freely with prisoners and anyone who can provide relevant informations. The last report is available on http://www.cpt.coe.int/en/states/hrv.htm (01 May 2015). See also, Turković K., Maršavelski, A: op. cit. in fn. 4, pp. 803-804. The problem of overcrowded prisons (as oppose to penitentiaries) is even more stressed because investigative and substitute imprisonment are executed here. Therefore, special attention is drawn to a problematic situation in the Osijek prison. The data about twice the number of prisoners than the system can accommodate are published: http://www.jutarnji.hr/zatvorenici-iz-protesta-odbili-hranu-u-osjeckom-zatvoru/796451/, http://www.glas-slavonije.hr/129397/3/U-osjeckom-zatvoru-20-ak-zatvorenika-spava-na-podu, http://www.glas-slavonije.hr/241989/1/U-osjeckom-zatvoru-208-posto-vise-zatvorenika-od-kapaciteta(01May 2015).

20 UN Office on Drugs and Crime: Report on crime and its impact on the Balkans; March 2008

21 During the 2013 imprisonment was executing over 6862 prisoners. Ministry of Justice, Prison Administration, Annual Report on the situation in penitentiaries, prisons and correctional institu-

The Republic of Croatia has been a respondent in front of ECtHR *inter alia*, for violation of the minimum standard for each prisoner. Andonov[22] stipulates that the provision of Execution of Prison Sentence Act (hereinafter: EPSA) regarding minimal size of the bedroom[23] cannot be applied in reality in existing prisons due to overcrowding. Also, Ombudsman report for 2014 emphasizes the same problem. According to the data of the Central Office of the Prison Administration of the Ministry of Justice, on 31 December 2014, Croatian prison population density was 96% (the percentage of occupancy of prisons as of 29 October 2012, which amounted to an average of 125.22%).[24] Important fact is that this is an average dense population, because some prisons have significantly higher population density than the average: in Osijek Prison 157%, 141% in Požega and in Varaždin 140%.[25] Overpopulation, as a result of the continuing increase in the number of prisoners, is causing a number of other negative consequences. Among the most important are the lack of officials and technical resources, the inability of the implementation of individual treatment programs which should lead to the re-socialization of prisoners[26], violation of standards of accommodation, making it difficult to maintain security in prisons, preventing the system of categorization of prisoners...etc.[27]

With the expansion of alternative sanctions and mitigation of sentence in case of a settlement of state prosecutor and the defendant, restrictions of short-term prison sentences were introduced: the court can impose short-term prison

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tions for 2013, p. 11 and 15 The report is available online: https://vlada.gov.hr/UserDocsImages//Sjednice/2014/178%20sjednica%20Vlade//178%20-%2022.pdf (01 May 2015).

22 Andonov, A., *Primjena pojedinih odredaba Zakona o izvršavanju kazne zatvora [Application of individual provisons of the Execution of the Prison Sentence Act];* Hrvatski ljetopis za kazneno pravo i praksu, Vol. 20, No. 1, 2013, pp. 101-118, pp. 104-105.

23 Art. 74. para. 3: Rooms must be clean, dry and of adequate size. For each inmate must be at least 4 m2 and 10 m3 of space. *Zakon o izvršavanju kazne zatvora* [*Execution of Prison Sentence Act*], Offical Gazette 128/1999, 55/2000, 59/2000, 129/2000, 59/2001, 67/2001, 11/2002, 76/2007 , 27/2008, 83/2009, 18/2011,48/2011, 125/2011, 56/2013, 150/2013.

24 Turković, K., Maršavelski, A., op. cit. in fn. 4, p. 803.

25 The Croatian Ombudsman Report, http://www.ombudsman.hr/index.php/hr/izvjesca/2014/finish/41-2014/562-izvjesce-pucke-pravobranaiteljice-za-2014-godinu (10. May 2015)

26 Mihoci, M.: *Sigurnost kaznionica i zatvora [Security in Penitentiaries and Prisons],* Hrvatski ljetopis za kazneno pravo i praksu, vol. 13, No. 2, 2006. pp 879-905, p. 904.

27 Vukota,Lj., Žulj, J.: *Jačanje rehabilitacijskog modela izvršavanja kazne zatvora;* Zbirka radova suradnika na projektu *„Europske značajke i dvojbe hrvatskog sustava izvršenja kazne oduzimanja slobode, [Strengthening rehabilitation model of serving prison sentences;* The collection of papers of associates on the project *"European features and concerns of the Croatian system of execution of sentence of deprivation of liberty]*, Faculty of Law, Split, 2012; p. 90.

sentence only according to conditions stated in CC, Art.45 para.1. A judge, who still imposes a prison sentence shorter than 6 months, should further clarify the reasons why he has not opted for a fine, community service or a suspended sentence. With the new CC entering into force, a number of alternatives to short prison sentences were enabled so the imposition of short deprivation of liberty has significantly reduced. The effort of the legislator to reduce this penalty is to be accepted in practice. Signals from the Council of Europe and the European Union on prison overpopulation, as well as expert statements about the negative effects of short-term prison sentences, were reflected in the criminal procedure law. The new Criminal Procedure Code (hereinafter: CPC) went for reducing investigative prison as the most severe measure to ensure presence of the defendant in criminal proceedings.[28] The similarity with substantive criminal law provisions is certainly in the fact that the judge who decides to impose such a measure, would have to explain the reasons in detail. Such a decision is, of course, subjected to supervision.

It should be mentioned that the provision of Art. 48 para. 3 of the CC allows a milder sentence than one provided for a criminal offense, when the state attorney and the defendant have bargained so. In this case, the limit for mitigation of punishment is one half of the general limits for mitigation (Art. 49 para. 2 CC). So, it may be reduced to half the minimum sentence provided under the provisions of mitigation (Art. 49, para. 1) but cannot be more lenient than three months in prison, which is a overall minimum of prison penalty. When considering the arguments *in favorem* of the plea bargaining, Damaška emphasizes cost reduction and a better position of defendant, since he may obtain a more favourable judgment. At the same time, as arguments *contra* the plea bargaining he states the lack of symmetry in a position of the negotiators, public interest in the transparency of justice and the interests of the third affected party.[29]

Finally, in this section it should be mentioned that the time spent in detention, investigative prison or any deprivation of liberty in relation to a criminal offense is to be included in the sentence. It is regulated by a separate provision of the CC

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28 Turković, K.: *Okviri reforme sustava kaznenopravnih sankcija u Republici Hrvatskoj [The Framework of the Reform of the Criminal Sanctions in Republic of Croatia]* ; Hrvatski ljetopis za kazneno pravo i praksu, Zagreb, Vol. 16, No. 2, 2009, pp. 809-841, pp. 814-815.

29 More, Damaška, M., *Napomene o sporazumima u kaznenom postupku [Note on bargaining in Criminal procedure]*, Hrvatski ljetopis za kazneno pravo i praksu, vol.11, No.1, 2004. pp.3-20, pp. 14-15.

(Art. 54). One day of detention, investigative prison or any other deprivation of liberty and a daily amount of the fine is equal to one day in prison.

3.2. THE PROVISIONS OF THE CRIMINAL CODE THAT PROVIDE AN ALTERNATIVE TO PRISON SENTENCES

Given the aforementioned problem of overcrowding in prisons and penitentiaries, we can also add the amount of the costs of the prison system and questions of the efficiency of a prison sentence. Therefore, a development of alternative sanctions gains at importance. These are sanctions and measures implemented in the community (community sanctions).[30] An important international instrument for alternative sanctions is the UN Standard Minimum Rules for non-custodial measures (Tokyo Rules).[31]

The fine, community service and suspended sentence are sanctions that are alternatives or substitutes to imprisonment in the Republic of Croatia.[32] The Council of Europe reports on the measures that are alternative to prison, listing various institutional and non-institutional modified sanctions and measures that exist in the Member States (Conference of Directors of Prison Administration, CDAP 85).[33]

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30 «The application of community sanctions and measures should seek to find a point of balance between the essential components of the penal response, that is the protection of the legal order in society and the resettlement of the offender» Recommendation No.R (92)16 of the Commitee of Ministers to Member States on the European Rules on Community Sanctions and Measures http://pjp-eu.coe.int/documents/3983922/6970334/CMRec+%2892%29+16+on+the+European+rules+on+community+sanctions+and+measures.pdf/01647732-1cf7-4ea8-88ba-2c041bc3f5d6, (27 April 2015)

31 United Nations Standard Minimum Rules for Non-custodial Measures, available at http://www.unodc.org/pdf/compendium/compendium_2006_part_01_03.pdf. (27 April 2015)

32 A detailed analysis of alternative sanctions in the Republic of Croatia and the research on the sanctions imposed see in Kokić Puce Z., Kovčo Vukadin, I.*, Izvršavanje alternativnih sankcija u Republici Hrvatskoj, [Implementation (execution) of alternative sanctions in Croatia],* Hrvatski ljetopis za kazneno pravo i praksu, vol. 13, No. 2, 2006, pp. 745-794.

33 The modified institutional sanctions:, semi imprisonment, release to work, the weekend imprisonment, house arrest, serving in another institution (hospitals, centres for addiction). Non-institutional sanctions: financial penalties (confiscation, compensation, payment of non-profit or charitable organizations), sanctions that restrict or denies some of the rights (license suspension, confiscation, restitution, prohibition of performing occupation, educational measures, moral sanctions (judicial admonishment, special obligations), supervision , measures of probation, unpaid work in the community. Measures to postpone enforcement of the sentence: delaying the execution of institutional penalties, delay sentencing, lack of sanction imposition. For details, see Kovčo, I: *Kazna zatvora- zašto i kuda? [Prison sentence-why and where?]* Hrvatski ljetopis za kazneno pravo i praksu, Vol. 8, No. 2, 2001., pp.117-136, p. 129.

Alternative forms of sanctions, supported by numerous international organizations, have many positive effects. As the most important we can stipulate: reduced costs of expensive prison system, avoidance of harmful effects of incarceration to offenders, preservation of connections with family and community, success in reducing recidivism.[34] Perhaps the best alternative is community service. The Croatian legislator introduced this legal institute for the first time in CC/ 97, naming it "community service at liberty", which was later shortened to "community service" (*gemeinnützige Arbeit*). The CC labelled community service as an alternative to a fine or imprisonment or as a modification of these types of sentences (Art.55).[35]

It should be noted that in addition to community service, some of the special obligations and protective supervision can be imposed simultaneously. Combining a variety of alternative sanctions can achieve greater individualization of punishment. The tendency of replacing prison sentences with community service is in constant increase. The deadline for the execution of community service is two years and the consent of the convicted person is needed. This consent is given to the Probation Office. [36]

Community service is frequently used alternative to short-term prison sentences in most European countries, but also in American and Asian ones. This is not a surprise, considering the possible positive effects. Perpetrator´s work days

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34 Bagarić, Ž. : *Prava zatvorenika u Republici Hrvatskoj – percepcija zaposlenika u kaznionicama [The rights prisoners in the Republic of Croatia - the perception of employees in penitentiaries]* Education – Rehabilitation Faculty , University of Zagreb, 2009, p. 32.

35 According to Art. 55 para.1 of CC, the court can replace a fine of up to three hundred and sixty daily amounts or imprisonment up to one year with community service. It also states the obligation that a sentence up to six months to be replaced by community service, unless this cannot achieve the purpose of punishment. In para. 2 the precize criteria on replacing prison sentences and fines are given: one day of imprisonment or one daily amount is equivalent to two hours of work.

36 Probation Office should promptly invite the person to give consent for the community service. If the convicted person does not give consent within 8 days or withholds it, the sentence pronounced by the Court (and afterwards replaced) will be applied. See, Art. 55, para. 6 of *Zakon o probaciji* [*Probation Act*], Official Gazette 143/12. The CC stipulates the procedure in case of nonfulfillment of community service on behalf of the offender. The court shall issue a decision that unexecuted part has to be replaced with the originally imposed sentence. There is also possibility of extending the deadline for the execution of community service (Art. 55 par. 7). In addition to community service, court can simultaneously determine the specific obligations or protective supervision which duration cannot be longer than the time in which the offender must perform the community service.

can partially "compensate" harm caused to society and this aspect contributes to the increasing selection of alternatives to imprisonment.[37]

3.3. LONG-TERM IMPRISONMENT

This is a special type of liberty deprivation prescribed for a total of twenty one criminal offenses, always an alternative to the corresponding imprisonment. This penalty cannot be imposed in duration under than twenty one or longer than forty years. In exceptional cases can last up to fifty years: in the case of specific serious crimes committed in concurrence. Long-term imprisonment is regulated in Art. 46 of CC.

The prison of this kind was first prescribed in CC / 97, with a range of twenty to forty years in prison.[38] However, practice has shown that this solution was not appropriate one. The perpetrators of serious crimes (committed in concurrence), such as a multiple rapes and murders, are predominantly young offenders aged between 18 and 30 years. This means that even with a pronounced maximum sentence (provided at that time) will have to be released at an age when they are still able to repeat the offense.[39] In order to solve this problem, the possibility of deprivation of liberty for a period of fifty years was introduced, when two or

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37 Grozdanić, V., Kazne – *nova rješenja u Kaznenom zakonu i njihova provedba u sudskoj praksi [Penalties-new solutions in Criminal Code and their implementation in practice]*; Hrvatski ljetopis za kazneno pravo i praksu, Vol. 7, No. 2, 2000, pp. 331-332.

38 Considering that in 1990 death penalty was abolished, the most severe provided punishment became a imprisonment that could be imposed for a period of twenty years. This situation is today described as "unacceptable legal situation" Cf. Novoselec, P., Bojanić, I., op. cit. in fn. 2, p. 384. Criminal law sanctioning thus became very mild (when it comes to offenses for which previously a death penalty was regulated) and inefficient in terms of general prevention (for all other offenses). This is why the legislator introduced the long-term imprisonment for a maximum period of 40 years in the CC/97.

39 Turković, K., Maršavelski, A., op. cit. in fn. 4, p. 798. Due to this, the group working on a draft of the new CC led a discussion about the introduction of lifelong imprisonment, the security accommodation, successive prison sentence and the sentence which we have today. The introduction lifelong imprisonment was foreseen by Act on Amandmants of CC/97 from 9 July 2003, which caused much criticism, although the general public largely approved a new sentence. This is corroborated by one survey on a sample of 2,046 respondents as to the merits of introducing life imprisonment. Positive attitude was expressed by 80.11% of respondents. On the other hand, the reaction of professional "circles" has been extremely negative, citing numerous reasons against the introduction of lifelong imprisonment. The main argument against it was its undefined duration, but also the fact that it is contrary to the principles of justice, individualization of punishment and thus the requirements of general and special prevention. Cf. Novoselec, P., Bojanić, I., op. cit. in fn. 2, p. 387., i Mitrović, D., Tomičić, Z.: *II. interkatedarski sastanak nastavnika kaznenopravnih predmeta Pravnih fakulteta hrvatskih sveučilišta i Visoke policijske škole u Zagrebu, [II. Interchair*

more specific offenses were committed, with provided imprisonment whose sum exceeds fifty years (Art. 51, para. 3, CC). However, there is explicitly specified limitation (art. 46, par. 4 CC), that it cannot be imposed on a perpetrator who, at the time of commission of the offense, has not yet reached the age of eighteen years.

Croatian legislator therefore opted to avoid a lifelong imprisonment. Among the other European countries following this path are Norway, Portugal and Spain. On the other hand, countries that have criminal law regulation extremely compatible to Croatian one, have adopted lifelong imprisonment. In some it is even prescribed as the only penalty for certain offenses. This can be seen in Germany, where the imposition of lifelong imprisonment (*lebenslange Freiheitsstrafe*) is relatively often.[40] This is the only provided punishment for aggravated murder (*Mord*, § 211 StGB), and also for certain criminal offenses contained in the Code of International Crimes (*Völkerstrafgesetzbuch*). Although the compliance of this punishment with the German Constitution has been in question for several times, the German Federal Constitutional Court ultimately upheld the lifelong imprisonment in accordance with the German Constitution if it is provided the possibility of parole/conditioned release.[41]

Criminal law has the purpose to protect the common life of people in society. This is achieved primarily through state coercion applying the strictest form:

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meeting of teachers of criminal subjects at Croatian Law Faculties and the High police school a in Zagreb] Hrvatski ljetopis za kazneno pravo i praksu, vol. 9, No. 2, 2002, pp. 583-589, p. 589.

40 One overview of lifelong imprisonment in German is available in Jescheck, H.-H., Weigend, T. *Lehrbuch des Strafrecht*, Allgemeiner Teil, Duncker & Humblot 1996. p.35. Data is given for the period from 1967 to 1991. Annual average is about 60 imposed sentences of this type, sometimes even 85 (1974) and 86 (1985). As for the more recent data, Breneselović states that the sentence is today imposed in about 100 to 110 cases per year. Breneselović, L.: *Kazna doživotnog lišenja slobode prema nemačkom Krivičnom zakoniku [Life long imprisonment according to German Criminal Code],* Uvod u pravo Nemačke; Institut za uporedno pravo, Beograd, 2011.; str. 342.

41 BVerfGE, 45, 187. Urteil vom 21.06.1977., available at http://openjur.de/u/60105.html, (29 April 2015), and also in numerous magazines. Also, Stree/Kinzig in Schönke, A., Schröder, H., op. cit. in fn. 1., p. 715; Jescheck, H.-H., Weigend, T., op. cit. in fn. 40, p. 758. However, the authors note that serving this sentence is problematic given that many years of deprivation of liberty lead to significant personal disturbances. The latter was also the part of the argumentation of the National Court in Verden (Landgericht Verden) in his requests for the compatibility of lifelong imprisonment to German Constitution. Ultimately, Bundesverfassungsgericht (Federal Constitutional Court) held that lifelong imprisonment is consistent with the Constitution if each of convicted person is available the possibility of parole. Details about the verdict see Breneselović, L., op. cit. in fn. 40, pp. 333-339. The latter author points out the extensive practice of the institute of amnesty that is allowed for ones sentenced to life long imprisonment.

punishment. Punishment is primarily a response to what has already happened in the past, so it represents repressive nature of the criminal law. Modern criminal law, on the contrary, no longer finds the main purpose in repression, but in prevention. Preventive nature of the punishment and the modern criminal law is increasingly getting its importance in the end of 20th century. At that time extensive research, studies and analysis appeared regarding the impact of imprisonment to recidivism of convicted persons. For example, one interesting study was conducted continuously by a group of authors on the subject of the effects of imprisonment in terms of recidivism, with the conclusion that this kind of punishment did not lead to a decrease in recidivism and in certain cases even increase was discovered.[42]

In Croatia, Gracin conducted an interesting research at Lepoglava Penitentiary, where she sought to determine the correlation between long-term imprisonment and multiple recidivism. She concluded that convicted recidivists constitute almost 60% of the population. Furthermore, most of the convicts serving long term sentence of deprivation of liberty have in their criminal "career" had at least one murder and of other crimes mainly property offenses.[43] On the other hand, research that Martison carried out in 1974, on the effectiveness of imprisonment which includes treatment programs (compared to the standard execution of the prison sentence: sentencing, imprisonment, punishment) has denied the positive effect of a treatment approach with regard to special prevention. Martinson believes that there is no difference compared to "normal" prison, that actually "nothing works" and that it is impossible to implement adequate treatment in prison conditions.[44] Nevertheless, numerous recent studies regarding effectiveness of treatment or rehabilitation programs during the execution of prison sentences show positive results.[45]

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42 Smith, P., Goggin, C., Gendreau, P., Department of Psychology and Centre for Criminal Justice Studies University of New Brunswick, Saint John: *The Effects of Prison Sentences and Intermediate Sanctions on Recidivism: General Effects and Individual Differences 2002-01*, available at file:///D:/My%20Documents/Downloads/Smith%20Goggin%20&%20Gendreau%202002.pdf (20 May 2015).

43 Gracin, D.: *Višestruki povrat i dugotrajna kazna zatvora na primjeru Kaznenog zavoda Lepoglava [Multiple recidivism and long-term imprisonment in Lepoglava Penitentiary]* ; Hrvatski ljetopis za kazneno pravo i praksu, Vol. 5, No. 1, 1998; p. 103.

44 Maloić, S.: *Zatvor kao izbor – paradoksalna istina [Imprisonment as a choice - a paradoxal truth]* Kriminologija i socijalna integracija, 2006.

45 Šarić, J., *Individualizacija kažnjavanja u fazi izvršavanja kazne zatvora [Individualisation of Punishment in the stage of execution of prison sentence];* Hrvatski ljetopis za kazneno pravo i praksu, vol. 13,

4. EXECUTION OF PRISON SENTENCE

Imprisonment is executed when the judgment is final. Primary legal instrument is the before mentioned Execution of Prison Sentence Act (EPSA).[46] Compliance with international standards of execution can be seen from the very purpose of prison sentences (Art. 2, EPSA), which emphasizes humanly treatment and respect for the dignity of the person who is serving a prison sentence. Also, fundamental rights protection is recognized in Constitution of the Republic of Croatia and international agreements. This proclamation is actually different from the initial purpose of imprisonment, which consisted of retaliation and atonement of the one who has committed a criminal offense.[47] Modern criminal (executive) law stipulates that deprivation of liberty, if needed, is as less painful for the prisoners as possible and preserves their dignity.[48] In order to achieve this aim, Maloić believes that certain preconditions are necessary: treatment activities (maximum use of resources), good interpersonal relations, adequate atmosphere, personal development and progress.[49]

Performance of activities in prison sentence execution has been allocated to the Central Office of the Prison System Administration. It is a unique administrative organization in ministry in charge of justice. The organization units of this Administration are penitentiaries and prisons.[50] Imprisonment is generally served in prisons, although the CC provides the possibility of home serving, in accordance with the provisions of a special act. Penitentiaries can be closed, semi-open or open type and can be found in Lepoglava, Turopolje, Glina, Požega, Lipovica and Valtura, while the prison hospital in Zagreb is a special penitentiary. The exception to the rule that the prison sentence is executed in penitentiaries is the case of short-term prison sentences and investigative prison (custody), which are served in prison.

Croatian prison system is arranged so that the prisoners can have useful activities and special programs with an aim to enable them to life at liberty. Republic of

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No. 2, 2006, pp. 867-878.

46 Official Gazette, 128/1999, 55/2000, 59/2000, 129/2000, 59/2001, 67/2001, 11/2002, 76/2007, 27/2008, 83/2009, 18/2011,48/2011, 125/2011, 56/2013, 150/2013

47 Vranj, V.: *Primjena restorativne pravde u izvršenju kazne zatvora [The use of restorative justice in the execution of imprisonment],* Yearbook of the Faculty of Law in Sarajevo, 2014.,p. 273.

48 Knežević, M., *Zatvor i otuđenje [Imprisonment and alienation],* Penološke teme No. 5, 1990; p. 20.

49 Maloić, S.*:* op. cit. in fn. 44. p.19.

50 More, Mihoci, M., op. cit. in fn. 26.

Croatia has also a rehabilitation system.[51] In order to respect the human rights of prisoners, humanly treatment, prevention of bad mutual influence of prisoners and to ensure the conditions for a better implementation of treatment programs, the EPSA regulates special penitentiaries considering prisoners age, gender, health and criminal recidivism. In order to avoid the negative consequences of life within the prison, execution of sentence of imprisonment should be adapted to the individual and enable a greater range of activities.[52] For this purpose, individual programs are formed. EPSA determines that it is a set of pedagogical, labour, health, psychological, social and safety procedures appropriate to needs of prisoners that commensurate with the nature and possibilities of the penitentiary or prison (Art. 69 EPSA). The purpose of these programs is to prepare prisoners for reintegration and life at liberty. In order to succeed in this plan, it is necessary that each individual program meets certain criteria.[53] The task of creating a single draft program and implementation monitoring in penitentiaries and prisons is in authority of Diagnostics Centre in Zagreb, within the Croatian Ministry of Justice at the District Prison in Zagreb. The task of the Centre is to propose a program that contributes to the elimination or reduction of risk traits.[54]

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51 Pleić, M.: *Zaključna razmatranja o hrvatskom sustavu izvršenja kazne zatvora;* Zbirka radova suradnika na projektu *„Europske značajke i dvojbe hrvatskog sustava izvršenja kazne oduzimanja slobode* [*Concluding observations of the Croatian system of the imprisonment*; The collection of papers of associates on the project *"European features and concerns of the Croatian system of execution of sentence of deprivation of liberty*,] Faculty of Law, Split, 2012, p. 185.

52 Josipović, M., Babić, V.: *Komentar Zakona o izvršavanju kazne zatvora [Commentary on the Execution of Prison Sentence Act]*, Novi informator, Zagreb, 2006.

53 Sufficient information are needed to determine to which type of prison does an individual belong, to organize their work in appropriate manner, enable them to use free time in accordance with the capacity of each prison facility, to prevent the isolation of communication with the outside world (the availability of the press, television programs, correspondence and visits), to enable education. Therefore, each program includes: risk assessment during the execution of prison sentences and prison according to the level of security (closed, semi-open, open), work ability, work habits, type of job and working conditions in which prisoners may be transferred, educational level and the need for education or vocational training, health, need for treatment, participation in special programs (for addiction to drugs, alcohol, suffering from PTSD), according to the court decision or assessment of an expert team of the need for specific psychological, psychiatric, social or legal assistance, the proposal of special forms of individual or group work, contents and forms of leisure activities (cultural and sports activities), contact with the outside world (correspondence, phone calls, family visits and others) and a program of preparation for release and assistance after him.

54 Centre analyzes prisoner`s psychological, social and health features, applies standardized personality questionnaires, examines overall prisoner`s documentation. Based on the results, for each of prisoners is provided the level of risk during execution of sentence and selected the most appropriate type of prison. Šarić, J., op. cit. in fn. 45, pp. 867-878.

4.1. JUDICIAL REVIEW OF EXECUTION OF PRISON SENTENCES

The whole procedure, that begins with pronouncing a sentence and ends with its execution, is focused on returning the convicted person on the «right path». This is supported with the earlier mentioned purpose of imprisonment, aimed at enabling the convicted person to life in freedom in accordance with the rule of law and social rules. And this provision, like *pari passu* every other, would remain "a dead letter", if adequate monitoring system is not provided as well as system of forced realization and sanctions in case of violations.

Following the example of modern democratic legislation, Republic of Croatia has accepted the position that the most appropriate body to review the legality of imprisonment proceedings is the court. Thus Croatia had adopted administrative-judicial supervision over the execution of criminal sanctions. The idea of so called "judicialisation" of prison sentences began to gain at importance under the influence of French and German legal solutions, during the periods after Croatia got its independence. The idea of judicial control over the administrative authorities in the execution procedure dates back to the time of Enricco Ferri, the protagonist of the positivist school, who considered that engaging the judiciary in execution of imprisonment, will achieve more success in neutralizing and re-socialization of the perpetrator.[55]

Position of courts as the right institution for providing greatest guarantee of legality in the process of execution of sentence, was adopted in numerous of European countries, in Italy, Portugal, Germany, France, Spain.[56] Croatian legislator has accepted the institution of judge in imprisonment execution as a form of supervision (judicial authority) on execution of prison sentences (or penal administration). This was a major step forward in the protection of human rights during the execution of the prison sentence.[57] Prisoners may appeal to him

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55 The analyses of the problem of authority of the bodies in the Prison Sentence Execution, Ljubanović, B., *Tijela državne uprave u sustavu izvršenja kazne zatvora [Administration institutions in the system of prison sentence execution]*, Hrvatska javna uprava, Zagreb, No. 4, 2006, pp.57-89.

56 More, Bagarić, Ž. op. cit. in fn. 34.

57 The judicial participation in the execution of prison sentences is provided through the decisions that were previously the domain of penal administration (first stage), but also as the appellate authority, which mainly consist from reviewing the legality of certain decisions of prison or penitentiary management. It is this second instance authority, the most important judicial review on the execution of the prison sentence. This judge, as a county court judge, decides on the transfers to prisons, postponement of the execution, and suspended execution of the sentence. As a member of the commission for conditional release of prisoners, the executing judge shall participate in the decision on conditional release, but will monitor and provide assistance after release. Appellate

regarding decisions of the prison/ penitentiary governor, to file a complaint to procedures and decisions of prison/penitentiary staff ... etc.[58] Also, there is a duty of the competent judge to, at least once a year, visit and talk to detainees as well as refer them on their rights and ways of exercising these rights.

Standard Minimum Rules for the Treatment of Prisoners[59] require that free submission of requests /complaints to the central prison administration, judicial authority or other competent authorities must be provided. The lack of the prior regulation consisted, *inter alia*, in the fact that the prisoners were sending their petitions and complaints regarding violation of their rights through the prison administration to competent judge. This arrangement was contrary to the guaranteed right of the free approach to these institutions. That is why some Croatian authors have rightly approved the deletion of this provision and declared it a progress in the regulation of the execution of imprisonment.[60] A similar provision is contained in the Bosnia within Execution of Criminal Sanctions Act.[61]

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jurisdiction of the executive judge, as noted above, is the most important segment of judicial protection and consists of deciding on an appeals against any decision or act of unlawfully denying or limiting some of the rights.

58 Complaint submitting procedure is in accordance with the rules of the European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT), that require that the handover of complaints takes place in a protected envelope to the prison administration, the court or other authorities, Van Zyl Smit, D.: *Principles of European prison law and policy;* Oxford University Press, 2011. p. 306

59 http://www1.umn.edu/humanrts/instree/g1smr.htm, adopted at the First Congress of the UN on the Prevention of Crime and the Treatment of Offenders in Geneva in 1955. See *Zbirka međunarodnih dokumenata o izvršavanju kazne zatvora: dokumenti UN; [A collection of international documents on the execution of prison sentences: UN documents]* Hrvatski ljetopis za kazneno pravo i praksu, vol. 17, no. 1, 2010, p. 373.

60 Turković, K., *Osvrt na europska zatvorska pravila u svjetlu garancije ljudskih prava [Review of the European Prison Rules in the light of human rights guarantees*]; Hrvatski ljetopis za kazneno pravo i praksu, Vol. 3, No. 2, 1996, p. 919.

61 Prisoners must have a right to conversation with the Inspector, the Ombudsman, the competent national and regional courts and elected attorney. It is the right to communicate outside a prison establishment. That conversation is conducted without the presence of prison staff /officials. For sending letters appropriate conditions have to be provided. Also, it is prohibited to open the letters on behalf of prison officers (the inviolability of the consignment is guaranteed). When it comes to overall regulation of the communications of prisoners and the complaints to the conduct of prison administration, there are no significant differences between Croatian and Bosnian regulation within Criminal executive law. More, Petrović, B., Jovašević, D., *Položaj osuđenih lica u penintensijarnom sistemu Bosne i Hercegovine; Godišnjak Pravnog fakulteta u Sarajevu; [The situation of prisoners in the penitentiary system of Bosnia and Herzegovina];* Yearbook of the Faculty of Law in Sarajevo, 2006; p. 324.

Although the limits of this paper do not allow us more detailed analysis, we point out that significant progress has been made in protecting the rights of prisoners by harmonizing Croatian criminal executive law provisions with the generally accepted standards expressed through a number of documents of the European Union and the Council of Europe. Contemplations on the duties and activities of the court, even after sentencing or during sentence to represent a continuation the criminal treatment, have a large number of supporters.[62] Despite the compliments to normative redacting of qualitative protection of the rights of prisoners, this should be taken *cum grano salis,* given that the implementation of these provisions is the true test of quality.

4.2. THE REGIME OF CONDITIONAL RELEASE

An overview of features of imprisonment would not be complete without the conditional release, having in mind that the prisoner can be released before he fully served his sentence (paroled convicted person). The conditional release, in the Croatian legislation, is regulated through the three separate acts: CC, EPSA and the Probation Act.[63]

The CC stipulates that a possibility of release on parole is after having served half of the prison sentence, if there is a reasonable expectation that convicted person will not commit a criminal offense again. When deciding, the court is guided with substantive assumptions on conditional release, on which the favourable forecast the future behaviour of the perpetrator is based.[64] An

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62 At the time, some authors emphasized the main shortcomings of the previous legal regulation, given that it had not laid down the judicial protection of the convicted person's rights, which was contrary to the European Prison Rules. Josipović, M, Tomašević, G.,: *Prijedlog novog sustava izvršavanja zatvorskih kazni u Repulici Hrvatskoj [The proposal of a new system of execution of prison sentences in the Republic of Croatia],* Hrvatski ljetopis za kazneno pravo i praksu, vol. 5, No. 1, 1998 p. 7.

63 CC (Art. 59 to 61), EPSA (Art. 157-162) and the Probation Act (Art. 27- 29). Official Gazette No. 143/12, entered into force on 1 January 2013.

64 Determination of the conditional release is motivated with re-socialization. The court examines "personality of the convicted person, his previous life and convictions, whether against him is other pending criminal proceeding/s, relation to the crime committed and the victim, the behaviour during his prison term, successful ingagement to program in prison, is there a change in his behaviour after the offense or is expected to occur when supervision measures will be applied on parole, and life circumstances and willingness of the person to include in a life at liberty "(Art. 59, para. 2 CC).

important change, compared to the CC/97, is that CC now *explicite* requires the consent of perpetrator.[65]

Conditional release is possible only if a certain part of the sentence is already served. This is different from suspended sentence (not preceded by the execution of the sentence). Accordingly, conditional release is not a modification of a prison sentence, but one way of its execution.[66] Minimum time that convicted person has to spend in prison is three months, which is consistent with the overall minimum of imprisonment period. When person is released, the time of supervision starts and it is equal to the rest of sentence. Precisely, conditional release lasts until the day of expiration of sentence. Conditional release is always optional and shall be decided by the court. It can be conditioned with one or more special obligations and protective supervision. Given that this regime expects a good behavior at liberty, if the person does not justify this confidence, it is possible to revoke the conditional release.[67]

Overall, conditional release is an important measure to stimulate convicted person to appropriate behaviour while serving a prison sentence. Since the release is declared only when estimated with certainty that there is no longer an unacceptable risk to the community, it can be said that the idea of individualization of punishment (with the participation of convicted person) has experienced it's fully realization.[68]

5. ROLE OF INTERNATIONAL ORGANIZATIONS AND INSTITUTIONS IN PROTECTING RIGHTS OF PRISONERS

In providing protection of human rights of prisoners, we differentiate the role of the instruments and mechanisms of the United Nations on the one hand and the

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65 This consent was previously implied, given the fact that prisoner proposed conditional release, but is important if the release is proposed by other authorized persons. More Novoselec, P., Bojanić, I., op. cit. in fn. 2, p. 397, Turković, K., et. al., op. cit. in fn. 9, p. 88.

66 Same in Novoselec, P., Bojanić, I.,. op. cit. in fn. 2, p. 397. Authors stipulate that this is a a dominant position in the German criminal law. Differently, Turković, K., Maršavelski,A, op. cit. in fn. 4, pp. 807-808, where conditional release is considered to be a modification of sentences with a suspended sentence and partial suspended sentence.

67 The revocation may be mandatory or optional, depending on the basis of the revocation. It is decided by the one court that imposed punishment (in case when new criminal offense has been commited) or the executing judge (in case of failure to fulfil responsibilities or when avoiding the protective supervision)

68 Petrović, B., Jovašević, D., *Osnovne karakteristike sistema izvršenja kazne zatvora u Bosni i Hercegovini [Main features of the imprisonment in Bosnia and Herzegovina],* Pravna misao, 5-6, Sarajevo 2006, p. 49-50.

Council of Europe, on the other.[69] The basic rights of prisoners, but also of each individual, are stemming primarily from the United Nations Universal Declaration on Human Rights, the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights. Croatia, as a member of the UN, is a signatory party to these documents, and they have legal precedence in Croatian legislation. UN established the institutions for monitoring the implementation of conventions and other documents with the purpose to fight against torture and other cruel, inhuman and degrading treatment or punishment,[70]

Besides this, human rights protection system within the Council of Europe (the oldest political organization) is of great importance. This is a regional organization aimed at promoting human rights, democracy and the rule of law. Croatia is a member of the Council of Europe since 1996, and a signatory to key documents such as the European Convention on Human Rights and Fundamental Freedoms and the European Convention for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment. These documents, along with European Prison Rules are the basis in protection of human rights of persons deprived of liberty.[71] The Council of Europe envisages the competence of the authorities in order to examine the compliance with their conventions and other documents. In addition to the Parliamentary Assembly, the Committee of Ministers and the Commissioner for Human Rights, a specialized supervision is provided. A judicial review through the European Court of Human Rights is designed, followed by specific monitoring. It is conducted by a group of independent experts, such as the Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment and also supervision by representatives of the Member States.[72]

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69 More in Bedrač, I., *Sustav nadzora zaštite ljudskih prava zatvorenika u Republici Hrvatskoj [The monitoring system of protection of human rights of prisoners in the Republic of Croatia]* – doctoral thesis; Zagreb, 2011, pp.7-132.

70 Primarily, the Committee against Torture, which was established by the Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment. It has a task to monitor the implementation of the provisions of the Convention into national legislation and practice. This function is realized through the consideration of reports of States Parties, examination information about torture of other cruel treatment, examination of complaints of a State Party against another and through perhaps the most important mechanism, examining individual complaints.

71 Papović, J.: *Evropska zatvorska pravila – segment zaštite ljudskih prava u evropskom pravnom prostoru [The European Prison Rules - a segment of human rights protection in the European legal area]*; Collection of papers Faculty of Law, Niš, Serbia, 2012, p. 617.

72 Bedrač, I., op. cit. in fn. 69.

The ECtHR provides an effective judicial mechanism for protection of the human rights. It has jurisdiction to decide on the request of any person, nongovernmental organization or group, claiming to be the victim of actions which constitute a violation of rights guaranteed by the ECHR.[73] Particularly significant are the judgment on the prohibition of torture, inhuman treatment or punishment, in which the applicants were prisoners. It therefore seems reasonable to devote part of this paper to complaints against Croatia, where applicants were prisoners warning to the violation of their rights. It is a violation of the prohibition of torture, regulated in Art. 3 of the ECHR: «No one shall be subjected to torture or to inhuman or degrading punishment or treatment. »

In review we selected only those cases in which the violation was confirmed and the judgment became final. The aim was to present the framework status by the end of May 2015. According to Bedrač, the first case of complaint of this type ever was Benzan v. Croatia, which ended with friendly settlement on 08 November 2002. The applicant submitted a complaint on the accommodation conditions in the penitentiary in Lepoglava.[74]

The first case of conviction is the judgment in Cenbauer v. Croatia[75], where a similar complaint was filed, on the conditions of accommodation in the same prison (Lepoglava) and Court confirmed degrading treatment. In the case Štitić v. Croatia[76], the applicant presented a complaint on two disciplinary proceedings which were conducted against him in Lepoglava and the Gospić prison, accommodation conditions in the latter and the state failure in providing

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73 Pleić, M. *Međunarodni instrumenti zaštite prava zatvorenika i nadzora nad sustavom izvršavanja kazne zatvora [International instruments for the protection of prisoners´ rights and control of the system of execution of the prison sentence],* Hrvatski ljetopis za kazneno pravo i praksu, vol. 17, No. 1, 2010, pp. 301-331, p. 310.

74 Application br.62912 / 00. Overpopulation and bad accommodation conditions were subject of complaint. A friendly settlement was achieved and Croatia has committed to pay the applicant 12,000 euros and to renew the controversial part of the prison. This has improved conditions for other prisoners in the same area. Bedrač, I.: Sustav nadzora zaštite ljudskih prava zatvorenika u Republici Hrvatskoj – doktorska disertacija; Zagreb, ožujak 2011. godine, 95-96.

75 Application no. 73786/01, judgment of 09 03 2006, final 13 09 2006. Available at http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-72704., accessed on 15 06 2015. Due to degrading treatment court ordered the payment of 3,000 Euros.

76 Application no. 29660/03, judgment of 08 112007, final 31 03 2008. The applicant also pointed out the violation of the right to correspondence and effective remedy. Available at http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-83120., accessed on 15 06 2015 The Court confirmed the violation of Art. 3. for the conditions of accommodation in prison in Gospić, but did not awarded compensation as the applicant has not submitted a claim.

appropriate health care. In the case Testa v. Croatia[77] applicant has presented a complaint about the conditions of accommodation in Požega penitentiary and Prison hospital and also poor healthcare regarding his chronic disease. Then, in Pilčić v. Croatia[78], the applicant filed a complaint for failure to provide adequate medical care in prison Lepoglava.

In the case Dolenec v. Croatia[79] the applicant pointed out the violation of Art. 3. due to the conditions in prison, assault of prison officers and lack of investigation about it. In the case Gladović v. Croatia[80] the applicant presented a complaint regarding conduct of prison officers in prison Lepoglava and further failure to conduct appropriate investigation about it. A complaint on the beating by law enforcement officials was set forth in the case Mađer v. Croatia.[81] At the time the applicant was a prisoner in Lepoglava. In the case of Longin v. Croatia[82] the applicant presented a complaint about conditions of accommodation in prison in Zagreb. In the case Lonić v. Croatia[83], the applicant, among other

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77 Application no. 20877/04,judgment on 12 July 2007, final 30 01 2008. Available at http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-81641. Even though the part of the application was rejected as untimely, the lack of adequate health care on chronic disease of hepatitis was declared as inhuman and degrading treatment. Court ordered payment of 15 000 euros of non-pecuniary damage and 3,200 euros ofcosts.

78 Application no. 33138/06, judgment on 17 January 2008, final on17 04/2008, available at http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-84482. The court found that the failure to provide adequate health care, especially considering that this is a long-term prison sentence, represents inhuman and degrading treatment and ordered the Republic of Croatia to pay 2,000 euros for non-pecuniary damage.

79 (Application no. 25282/06), judgment on 26 November 2009, final 26 02 2010, available at http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-95896. The Court found only a violation of the procedural aspect of Art. 3 and ordered the payment of € 1,000 non-pecuniary damage and € 2,500 costs.

80 (Application no. 28847/08) judgment 10 May 2011, final 10 08 2011, available at http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-104708. The Court found violations of substantive and procedural aspects of Art. 3 and ordered the payment of EUR 9,000 non-pecuniary damage and 1,350 euros costs.

81 Application no. 56185/07, judgement 21 June 2011 final 21/09/2011. Available at http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-105293. Amviolation of the substantive and procedural aspects of Art. 3, but was not awarded compensation since the claim was not placed.

82 Application no. 49268/10, judgement 6 November 2012, final 06 02, 2013, available at http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-114247. In addition to poor accommodation conditions, his further complaint was the inadequacy of contact with the family. Regarding the accommodation conditions Court found the violations of Art. 3 and ordered the payment of 5,000 Euros for non-pecuniary damage and 1,000 costs.

83 Application no. 8067/12, judgment 4 December 2014, final 04 032015, available at http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-148284. The Court found violations of Art.

things, complained about the inadequate conditions of accommodation in prison in Pula.

In all these cases the Court found a violation of rights guaranteed by the Convention. Given that two-thirds of all complaints referred to bad accommodation conditions (six out of nine, on prisons/penitentiary in Lepoglava, Gospić, Požega, Pula, Zagreb), which the court cosidered as a degrading treatment, we can say that the poor accommodation conditions already form a standard violation of the ECHR. Of other reasons, we can mention failure to provide adequate health care and complaints regarding prison officers conduct, which also amounted to degrading treatment. Amount paid by the Republic of Croatia only after these verdicts is in total 45 000 Euros (57 000 if we count the Benzan case) for non-pecuniary damage and 12 175 Euros for costs and expenses.

From this overview it is clear that decent accommodation conditions, as the basis of proper treatment of prisoners, have not remained mere proclamations in the provisions of international instruments dealing with the rights of prisoners, but are also confirmed in the case law of the ECtHR. This is a form of degrading treatment, which has been recognized also in other countries. In this context, Croatia has the place for improvement: increase in prison capacity is possible, as well as moderations in the field of alternative sanctions and modification of execution of prison sentences. We emphasize that the new CC introduced the possibility of execution of this sentence at home, if it is not longer than one year. This option is the standard of prison execution in some European countries, while in Croatia there are still no significant analyses on this topic or the real possibilities of the implementation of this positive legal solution.

6. CONCLUDING REMARKS

The purpose of this paper was to present the prison sentence regulation in Croatian criminal law. In this regard, significant changes have been adopted in the new CC to improve the overall sanction system and to harmonize it with adopted international documents. Also, the changes in the field of culpability have had influence on mentioned changes. Frequent critics regarding deprivation of liberty were particularly directed to short-term imprisonment. Therefore, the ideas of stronger approach to alternative sanctions and modification of

3, and due to that violation, along with others, imposed compensation of 10,000 Euros for non-pecuniary damage and 4 125, 68 euros for costs.

imprisonment execution were accepted. In this respect, the option to replace short-term prison sentences with community service is important. Accordingly, the number of imposed suitable substitution is increasing. However, the prison sentence is still the most important state response to serious crimes. This is especially obvious when serious criminal offenses are committed in concurrence. Then the Court has the possibility, under the new arrangement, to impose a long-term imprisonment up to fifty years. Anticipated application of this possibility is for offenders who commit serious crimes relatively young and the circumstances relevant to sentencing make it justifiable to impose this sanction. The modernization of criminal executive law was made with Execution of Prison Sentence Act, which foresees two forms of prisoner's right protection: by the executive power, that performs supervision on prisoner's treatment legality and by judiciary, authorized to examine international and European standards in terms of protecting their rights. In the context of European standards, a special reference was made to judgments of the European Court of Human Rights. Croatia was repeatedly convicted for violation of Art. 3 of European Convention of Human Rights. Two-thirds of analyzed judgment contained a complaint about inappropriate accommodation conditions in prisons, which the court has recognized as a form of degrading treatment. We can conclude that progress in this field is a challenge and should be considered as improvement on three fields: slight increase of prison capacity, moderation of alternative sanctions and modification of prison execution in future.

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THE ISSUE OF JUDICIAL ACTIVISM IN THE CONSTITUTIONAL TRIBUNAL'S DECISIONS AND STATEMENTS OF LEGAL DOCTRINES IN POLAND[1]

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ABSTRACT

Judicial activism is observed in the activity of courts around the world. A sharp increase in judicial rights is observed in all societies organized in the form of democratic states of law. The article focuses on these interpretations of the Polish Constitutional Tribunal, which seem to be the most representative for the description of the title phenomenon. Discussions about the issue of judicial activism that are on-going in the Polish legal theory, particularly focus on the issue of the interpretation by the Constitutional Tribunal of the principle of the democratic state of law expressed currently in Article 2 of the Constitution of 1997. Exceptional multiplicity of so-called detailed rules "discovered" by the CT in a concise clause of the "democratic state of law" has resulted in a broad discussion on the admissibility of such an interpretation and questions about their normative function. The analysis of decisions of the Polish Constitutional Tribunal concerning the interpretation of constitutional principles gives a picture of the body which is often forced to choose between different alternative possibilities of interpretation of a particular provision, in other words, to pursue the best decision from some point of view. The article presents the statements of the Tribunal together with the comments of representatives of the constitutional law and legal theory, the most typical ones from the point of view of the issues discussed in the article.

Keywords: judicial activism, Poland, Constitutional Tribunal, state of law, interpretation of the constitution.

[1] This article is an English speaking version of the article published in Brazilian Journal of the Faculty of Law of the Sao Bernardo do Compo under title "A questão do ativismo judicial nas decisões do Tribunal Constitucional e as apresentações de doutrinas legais na Polônia [w:] Revista da Facultade de direito de Sao Bernardo do Campo 19/2013, ISSN 1516-0947, s. 110-120. The author has received mutual consent of the editors.

1. INTRODUCTORY REMARKS

Judicial activism as the theme of theoretical and legal considerations present in the Polish legal doctrine is a continuation of previous discussions on the issue of creative interpretation of the law. These discussions focused on the question of the admissibility of the non-linguistic directives of interpretation in judicial decisions. While analysing the problem of active or passive attitudes of judges, the advantages and disadvantages of argumentative or syllogistic models of law enforcement are compared in particular. Also it is resolved what can be the basis for jurisdiction - all the rules and facts which allow to make the right decision, or just specifically and *explicite* expressed norms.

These phenomena are in fact a manifestation of the same trend, a changing role of law enforcement organs, including the courts, especially the constitutional ones. In modern, pluralistic and marked by complex problems societies they are no longer only *nul pouvoir*, and the judges are not only the "mouths of law". They have become an influential force known as the "third house of parliament".

This tendency is observed in the activity of courts around the world[2]. A sharp increase in judicial rights is observed in all societies organized in the form of democratic states of law. Consequently, the role of statutory law in the current legal system is being proportionally reduced[3]. In the U.S. the theory of the so-called dynamic interpretation is gaining popularity. It assumes an active role of interpretation in conducting social policy. Its proponents seek to shift the decision-making centre from the legislature to the courts, believing that the interpretation of the law is the means by which the interpreter can overcome legislative inertia and boost the legal system[4]. The German Federal Constitutional Court's decisions are particularly clear and well researched[5] and the Polish Constitutional Tribunal bears a number of similarities with it. The French Constitutional Council acts

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2 An overview of the varying degree of activism of the courts in selected countries is presented in the book B. Banaszaka i M. Bernaczyka, *Aktywizm sędziowski we współczesnym państwie demokratycznym*, Warszawa 2012.

3 B. Rüthers, *Grundlagen des demokratischen Rechtsstaates: Begriff, Ursprung, Entwicklung (Podstawy demokratycznego państwa prawa: pojęcie, geneza, rozwój),* [w:] *Kultura i prawo. Podstawy jedności europejskiej*, Lublin 1999, s. 77.

4 B. Brzeziński, *Współczesne amerykańskie teorie wykładni prawa,* PiP 2006, nr 7, s. 35–38.

5 See e. g. Th. Würtenberger, *Zur Legitimität des Varfassungsrichterrechts,* [w:] *Hüter der Verfassung oder Lenker der Politik ?*, B. Guggenberger, Th. Würtenberger, Baden–Baden, 1998, s. 57–80.; E. Morawska, Klauzula państwa prawnego w Konstytucji RP na tle orzecznictwa Trybunału Konstytucyjnego, Toruń 2003 s. 55 i n. and German literature cited there.

similarly. As a part of reviewing the constitutionality of law it finds a number of "principles recognized by the law of the Republic" and "principles particularly necessary in our times"[6] not included explicitly in the text of the Constitution. Other examples include the actions of the Supreme Court of South Africa for reconciliation between black and white residents of the country, Canada, where the Supreme Court is trying to reconcile Francophones and Anglophones or Hungarian Court bringing to life the idea of the "invisible constitution"[7]. This also applies to the European Union whose legal system to a significant extent is determined by the law of the EU Court of Justice. Therefore, the question about the legitimacy of the constitutional judiciary in a democratic state of law arises, and especially how to reconcile its "expansion" with the principle of the separation of powers[8]. The issue of judicial activism often opens the discussion on the political involvement of judges and the attempts to boost their own social and political visions. This article focuses on these interpretations of the Polish Constitutional Tribunal, which seem to be the most representative for the description of the title phenomenon. Discussions about the issue of judicial activism that are on-going in the Polish legal theory, particularly focus on the issue of the interpretation by the Constitutional Tribunal of the principle of the democratic state of law expressed currently in Article 2 of the Constitution of 1997. The following are the statements of the Tribunal together with the comments of representatives of the constitutional law and legal theory, the most typical ones from the point of view of the issues discussed in the article.

2. THE INTERPRETATION OF THE PRINCIPLE OF THE DEMOCRATIC STATE OF LAW

Since its appearing in constitutional provisions in 1989, this principle, to a degree incomparable to any other, has been a subject of an undoubtedly creative interpretation. Exceptional multiplicity of so-called detailed rules "discovered"

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6 Compare: A. Sulikowski, Tworzenie prawa przez sądy konstytucyjne i jego demokratyczność, PiP 2005, nr 8, s. 21.

7 L. Morawski, Główne problemy współczesnej filozofii prawa. Prawo w toku przemian, Warszawa 2003, s. 286. On the subject of active approach of constitutional courts in Central and Eastern Europe see A. Ludwikowska, Sądownictwo konstytucyjne w Europie Środkowo-Wschodniej w okresie przekształceń demokratycznych. Studium Porównawcze, Toruń 1997, s. 177–182.

8 See L. Morawski, *Zasada trójpodziału władzy. Trybunał Konstytucyjny i aktywizm sędziowski, Przegląd Sejmowy 4 (93)/2009*; M. Granat, Problem legitymacji sądownictwa konstytucyjnego w demokratycznym państwa prawa, [w:] Polska lat 90-tych. Przemiany państwa i prawa, tom 1, Lublin 1999, s. 310.

by the CT in a concise clause of the ”democratic state of law” has resulted in a broad discussion on the admissibility of such an interpretation and questions about their normative function. These are both substantive rules concerning constitutional rights and freedoms (the right to life, the right to privacy, the right to protection of the dignity, the right to justice, the individual's right to protection of personal data) and the so-called formal rules (the principle of proportionality, the prohibition on retroactive operation of law, an order to maintain the appropriate application period (*vacatio legis),* respect for justly acquired rights, specificity of legal provisions, the protection of the so-called 'interests in the course', the prohibition of changes in tax law during the fiscal year and others). Due to the constitutional amendments of 1997 for expressing *explicite* in the text of the Constitution a number of these principles (especially those of a substantive nature), the wording of the state of law is no longer the basis for their deriving from the constitution. On the other hand, according to a clear declaration of the CT, it is open and it is still considered very broadly: "A multiplicity of content that makes up the essence of the "democratic state of law " is not specifically stated in particular constitutional provisions. Still so this content can and should be drawn from the Article 2 of the Constitution. Wherever there is no specific constitutional norm or there is the need to harmonize the various standards, the principle of the democratic state of law may be the starting point for reviewing the constitutionality of a clause.

Firstly, it should be noted that the Polish Constitutional Court is not willing to admit that its adjudication is marked by activism. According to the consistently presented position by the CT on its interpretation "[...] nothing is removed nor added to the system of legal norms, but only affirmed what the content of those norms is. Thus one can talk about the "declaratory" and not legislative character of interpretations by the Constitutional Court."[9] This position is justified by referring to the classic priciple of separation of powers and court's place in the political system. This is a very brief explanation[10].

One way to justify a wide range of content found by the CT in the principle of the state of law is a reference to the so-called technique of reasoning "from a norm about a norm." The principle is presented as a collective one consisting of specific rules seen as directives; in other words, it is a collective expression of a

9 Resolution from 07.03.1995 r., W 9/94.

10 T. Gizbert-Studnicki, *Teoria wykładni Trybunału Konstytucyjnego,* [w:] *Współczesne prawo i prawoznawstwo*, Toruń 1998, s. 77.

number of principles, each of which may be an intrinsic basis for the assessment of constitutionality[11]. According to the definition of constitutional principles approved by the CT, they are not only constitutional standards expressed *expressis verbis in the text* of the Constitution, but also norms "implied" by its content[12]. The CT uses so-called two-step inferential reasoning, which means that it "derives" a general principle from the state of law and then "deduces" next principles from it. And thus the principle of the state of law implies the principle of the protection of confidence and the latter implies the specific rules mentioned above.

In accordance with a settled statement of the Court, while assessing the constitutionality of legal provisions the Court considers not only their conformity to the literal wording of the norm which is reviewed. It also takes into account the view of the doctrine and jurisprudence and must take into account "the full constitutional context of the issues which are being resolved." This is the so called *acquis constitutionnel* or "set of rules and the consequences resulting from them, expressed not only explicitly in the content of provisions, but also from the interpretation of the Constitution."[13] The process of deriving the contents of the *acquis* and the way of its justification is the main source of controversy. Critics of the approach presented by the CT ask about the theoretical justification for the interpretation techniques used by the Court. They point out that it leads to turning the principle of the state of law into a "bottomless bag", "pseudolegitimacy" or "a passkey opening all the doors."[14]

The Court itself in its jurisprudence does not specify which reasoning is used. It merely states in general terms that a specific rule "is derived from", "is deduced-on" or "is the result of" norms from Article 2 of the Constitution. This reasoning is well established in the jurisprudence of the Constitutional Tribunal and accepted by the representatives of the dogma of constitutional law. It is understood that particular rules of a state of law are simply the consequence of adopting a doctrinal concept of the state and there is no question of establishing

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11 For details see E. Morawska, *Klauzula państwa…,* s. 201 i n.

12 Already in case from 05.11.1986 r., U 5/86.

13 Case from 20.11.2002 r., K 41/02.

14 More on this subject see E. Morawska, *Klauzula państwa …,* s. 207–208. The author writes about a similar criticism in Germany directed against the Federal Constitutional Court, *op. cit.,* s. 91. In relation to the Hungarian Constitutional Tribunal one can meet opinions about its "joyful creation". Zob. również A. Sajo, *Jak rządy prawa zabiły węgierską reformę systemu opieki społecznej",* East European Constitutional Review, 1997.

rules by Court while defining them[15]. This argument is a consequence of the CT positivist position and continuously emphasized relationship that exists between the principles derived from Article 2 of the Constitution and its text.

A number of complaints against such an attitude, both from the position of legal anti-positivism and legal positivism, can be found. Firstly, according to the supporters of the former, the basis for the detailed provisions of a state of law must be sought not in the norm telling about the state of law, but in unwritten principles of equity and justice[16].A similar approach applies to natural law, according to which the law-making judgments of constitutional courts are a reflection of the fact that they are dealing with not one, but two constitutions. In addition to "statutory law which is limited in its content" there is a "complete constitution – a normative constitution of a state (a kind of "spirit" of the system), which is cognizable for the constitutional judges. If a written constitution remains silent on the matter, the judges not being able to evade the question of the constitutionality of the act under examination decided on the basis of norms of complete constitution (absolutely binding)."[17]

When it comes to the positivist conception of interpretation, first of all it must be noted that the findings of this trend in jurisprudence have undergone very far-reaching modifications. Not only did the so-called "soft" positivism appear but also a thesis that since its advocates had neglected its basic assumptions, it is essentially "dead"[18]. The Tribunal's claim that in its interpretation the Tribunal only "states what is the content of the norm" could be maintained only on the basis of a hard version of positivism, represented by J. Austin[19]. However, the most important proponents of positivism today withdrew from the claim that

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15 Compare e. g. K. Działocha, W. Gromski, *Niepozytywistyczna koncepcja państwa prawnego a Trybunał Konstytucyjny,* PiP 1995, nr 3, s. 4–16; podobnie S. Wronkowska, *Klauzula państwa prawnego,* [w:] *Podstawowe problemy stosowania Konstytucji Rzeczypospolitej Polskiej. Raport wstępny*, Warszawa 2004, s. 11–28.

16 Zob. L. Morawski, *Spór o pojęcie prawnego,* PiP 1994, nr 4, s. 3–12.. Zob. M. Smolak, *Uzasadnianie sądowe jako argumentacja z moralności politycznej,* Kraków 2003, s. 194.

17 Por. J. C. Douence, B. Faure, *Y a-t-il deux constitutions?,* RFDA 2000, s. 746 i n. za A. Sulikowski, *op. cit.,* s. 30.

18 Zob. L. Morawski, *Pozytywizm „twardy", pozytywizm „miękki" i pozytywizm „martwy*", Ius et Lex, 1/2003, s. 321-345; T. Pietrzykowski, *„Miękki" pozytywizm i spór o regułę uznania* [w:] Studia z filozofii prawa, red. J. Stelmach, Kraków 2001, s. 97 i n.

19 The theory, according to which the interpreter only reconstructs the content of existing rules, was defended in a book published in 1832, *The Province of Jurisprudence Determined*. Por. L. Morawski, *Pozytywizm „twardy"…,* s. 334

the law is a complete system and application of the law is merely a deduction of consequences of legal norms and thus accepted the phenomenon of its creative interpretation. L.A. Hart said about *open texture of law*, and therefore about semantic openness and indefinite character of concepts which construct legal system, and admitted that a criterion of interpretation may be a source of legal norms[20]. R. Dworkin considers law as a "fact of interpretation", which only in the process of its application becomes a subject to an appropriate elaboration. The task of judges and legal theory is to search for the best understanding of the law in the context of cultural norms and values[21]. J. Raz accepts, in a situation of social need, innovative interpretation by judges, which consequently leads to changes in the understanding of the original text of the Constitution[22]. These statements, regardless of the differences among the authors on particular issues, are clearly challenging the characteristic positivist conception of written law, according to which the concept of law is identical in all existing legal texts.

The purpose of the interpretation of the law is to define the meaning of certain provisions or their extracts in accordance with the system of directives adopted in jurisprudence and doctrine. The CT writes that a legal interpreter in a state of law must always take into account the linguistic (literal) meaning of a legal text above all[23]. To exceed the linguistic meaning "strong axiological justification referring primarily to constitutional values" is necessary[24]. Declaring such a position is associated with the belief of the Tribunal that it is the linguistic (grammatical) method of interpreting that mostly guarantees the derivative nature of interpretation. Demonstrating an attitude based on the traditional perception of the role of courts in the system of separation of powers the CT aims to refute any upward accusations against lawmaking. Note, however, that the assessment of whether, in a particular case, there was a "strong axiological justification " belongs to the CT. Unlike other Polish courts it is CT that relatively often resigns from the literal interpretation[25].

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20 Zob. L. A. Hart, *Pojęcie prawa*, Warszawa 1998, s. 171 i n.

21 R. Dworkin*, Imperium prawa*, Wolters Kluwer 2006, s. 33-35.

22 A. Sulikowski, *op. cit.*, s. 31. The author refers to J. Goldsworthy, *Raz on constitutional interpretation,* Law and Philosophy nr 22, 2003.

23 Compare case from 28.06.2000 r., K 25/99. L. Morawski notes that in jurisprudence the priority is regarded as "almost a basic condition for the functioning of law in the state of law ",*Idem, Wykładnia w orzecznictwie sądów. Komentarz,* Toruń 2002*,* s. 20.

24 K 25/99.

25 B. Banaszak, M. Bernaczyk, Aktywizm …, s. 256.

Due to a distinctive interpretation of the principle of the state of law accusations of inconsistent switching from the linguistic context to non-linguistic rules[26], or the lack of a coherent theory of interpretation[27] are directed against the CT. Derivation of a broad set of detailed principles from the principle of the state of law was in fact possible by frequent use of the system and functional directives. The use of various methods of interpretation, in view of the very strong axiological entanglement of a term: state of law, can lead straight to the conclusion that the choices made by the CT are not of legal nature, but they are justified e.g. politically or ideologically. Without going deeper into this subject it can only be noted that there are controversial decisions from this point of view in discussed jurisprudence. As an example we can cite a judgement, widely commented in the legal doctrine, finding the liberalization of abortion law unconstitutional. The CT was in favour of the protection of life from the moment of conception, and therefore deeply interfered in personal freedom of pregnant women, denying them the right to abortion, even – as the contested provisions provided- in certain exceptional situations. The CT referred among others to the principle of a state of law and the Articles 38 of the Constitution of 1997, which provides for the legal protection of everyone's life. The criticism of a doctrine resulted especially from the fact that the CT *de facto* objected to the clearly expressed will of the Parliament, and took a position contrary to the opinion of the majority of citizens reflected in the constitutional referendum. During the proceedings the Constitutional Commission clearly and unequivocally rejected the proposals of the protection of human life from the moment of conception. On the grounds of the judgment it is also clear that the CT adopts the competence of the legislator naming directly which values "higher" than others "should" be protected by law, which is close to the legal moralism and paternalism, which involves imposing various prohibitions for the good of the community. The CT was not able (or willing) to distance itself from general political, philosophical, or medical aspects. The fact that it chose not to postpone the resolution of the case until the entry into force of the Constitution of 1997, which created a clearer normative basis for the interpretations, confirms it. Relying on the principle of a state of law, it

26 Compare A Kozak, *Rodzaje wykładni prawa w uchwałach Trybunału Konstytucyjnego,* Acta Universitatis Wratislaviensis, Wrocław 1997, s. 66.

27 Compare T. Gizbert-Studnicki, *Teoria wykładni…,* s. 75.

ignored in fact one of the most important aspects expressed in the principle *in dubio pro libertate*[28].

The existence of a number of difficulties in setting a precise line between interpreting the law and making it[29] results in the formulation of different, but imperfect, proposals of solving this problem. We should agree with one of the authors that a criterion of the purpose of resolution seems to be relatively useful. According to it, an interpreter should first of all determine the importance of the provision even with "new, just created interpretative activities, not used so far in the legal proceedings."[30] However, if the judge is focused on the implementation of some social objectives and does so with the help of an " instrument created *ad hoc* and does not justify its use with the existing law, or by treating the justification as a camouflage for the motives of his actions (first decision, then the construction of argument) [...][31]" it is a lawmaking interpretation. Among the decisions of the Polish Constitutional Court one will find examples in which the judges seem to push a specific vision of social order, e.g. the above-mentioned decision on the abortion law. The criticism of the law doctrine resulted from variable approach to the principle *lex retro non agit*, once as material criterion and later as formal one. It has been written that the Tribunal is "as gentle as a lamb," when it comes to violations of political and civil freedoms, but "dangerous as a lion" when it protects pensioners against "parsimony of a socialist People's Government, poorly - in the opinion of the CT - pursuing the idea of social justice. It would be difficult, however, to determine if the Polish Constitutional Tribunal is guided by the idea of implementation of a single guiding social purpose. Different targets appear to be constitutionally protected values, which the Tribunal often has to choose from. The application of the criterion presented here also, unfortunately, does not uniquely determine what the nature of the Tribunal's decision interpreting the state of law clause is; especially when assessed against much activisticly oriented courts in other countries, such as the Supreme

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28 See W. Lang, *Glosa do orzeczenia Trybunału Konstytucyjnego z dnia 28 maja 1997 r., (sygn. Akt K. 26/96)*, Przegląd Sejmowy 6 (23)/97, s. 171.

29 What is more, according to R. Sarkowicz, it cannot be resolved by classification which judgments are, and which are not creative, you can only determine the degree of their creative nature. According to him, this distinction is contractual in nature, as it depends on the reference point, which may be the linguistic meaning of the text or the linguistic context along with the non-linguistic one. Por. *idem*, *Uwagi o współczesnej interpretacji prawniczej,* [w:] *Polska kultura prawna a proces integracji europejskiej*, pod. red. S. Wronkowskiej, Kraków 2005, s. 26.

30 A. Sulikowski, *op. cit.,* s. 29.

31 *Ibidem*, s. 29.

Court of South Africa. The court openly and consistently implements the state's policy goal, which is national reconciliation overcoming the social divisions of the apartheid period. Without a doubt, the reasoning from a norm about a norm can be criticized as a process that each time involves equipping the concept of the state of law in certain values, only to interpret these values later on[32].

The second way to deny the allegations of the lawmaking decisions while interpreting the principle of the state of law is to point out that Article 2 of the Constitution contains a general clause, and therefore the construction of a general nature, whose essential feature is opening of the legal system for certain values, making it flexible and more open for decisions[33]. In case of general clauses some bases for judges' discretionary decisions appear naturally. Their open nature makes it reasonable to search for meaning of a clause by reference to different than linguistic interpretation methods. The authority applying the law can denote the content of a general clause applying both positive law and the system of extra-legal evaluations, standards and rules. The legalistic style of interpretative decisions, dominating in jurisprudence, which is characterized by professionalism and the formulation of legal justifications in legal jargon, disappears in case of evaluative clauses and terms to be replaced by substancialist style, thus referring to ethical and economic reasons or principles of rationality[34].

In its jurisprudence the Tribunal stated the criteria for lawful use of clauses, thus allowing to avoid law-making decisions and the danger of the maximum predictability of the decision to be taken on the basis of the provision. Violation of these requirements appears in three situations: evidence for understanding the general clause is not only objective but also subjective in its nature; the content of a clause does not create sufficient guarantees that its interpretation will be uniform and clear so as to provide the possibility to predict a particular outcome; the lawmaking powers for the courts can be derived from the wording of the clause[35].

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32 J. Nowacki criticized it most forcefully arguing that the reasoning applied by the Tribunal is "totally unacceptable", and that from the principle of the state of law "applying any understanding of the implication, results nothing: neither that the provisions of the so-called retroactive application can be established, or that they should be established […]." J. Nowacki, *Rządy prawa. Dwa problemy,* Katowice 1995, s. 109.

33 See e. g. cases from 15.09.1998 r., K 10/98, 03.10.2001 r., K 27/01 on the references to "well-established doctrine," and from 17.10.2000, SK 5/99 on reference to jurisprudence.

34 M. Zirk-Sadowski, *Wykładnia i rozumienie prawa w Polsce po akcesji do Unii Europejskiej,* [w:] *Polska kultura*…, s. 95.

35 Compare cases from 17.10.2000 r., SK 5/99 and 11.05.2004 r., K 4/03.

An attempt to define precisely the scope of interpretation, which is acceptable in the application of the clause, is another declaration of a legalistic and passive position by the CT. The literature, however, underlines the fact that no clause (regardless of how "accurately" it is specified) cannot guarantee such consistency and accuracy of interpretation as described by the CT. It results not only from the linguistic reasons, but primarily from "axiological involvement."[36]

The analysis of the ways how the CT justified numerous interpretations of the clause of the state of law presented above leads to the following conclusion: no matter if it is justified on the grounds of its complexity (it consists of detailed rules conceived as directives) or of being a general clause, it is not a perfect justification and various controversies may arise. Both presented methods of reasoning lead in fact to challenging the textual concept of law. The concept of law in the jurisprudence of the Constitutional Tribunal, regardless of its declaration, is not identical to generally existing legal texts. On the one hand, we have to deal with non-conclusive rules of interpretation in law, in particular the functional interpretation and *analogii iuris.* On the other hand, the Tribunal considers referring to *acquis constitutionnel* as natural.

Some representatives of the law in Poland point out that the CT should abandon the use of spurious arguments (about reasoning or a norm resulting from norms) and officially acknowledge that its interpretation must sometimes be creative. In case of the state of law principle it is not only acceptable in view of the existence of such a concept in the doctrine of law but it is also natural, especially due to the broad axiological context of this principle and imperfection of linguistic interpretation. Finally, this is the consequence of the fact that cannot be challenged that modern law is a series of directives of non-linguistic character, even if they were not expressed directly by the legislature. It is therefore absolutely false conviction of the CT that the methods of interpretation it uses do not add anything to the system of legal norms and only state what is their content. Representatives of the legal doctrine presenting different views on the evaluation of the actions of the CT agree that, "the fact that the interpretation made by the Tribunal is (or sometimes is) "creative" rather than declaratory does not determine yet the fact that the Tribunal makes law"[37] and "the ban on law-making interpretation does not contradict the

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36 Compare L. Leszczyński, *Glosa do wyroku Trybunału Konstytucyjnego z dnia 17 października 2000 (sygn. Akt SK/5/99),* Przegląd Sejmowy 3 (44) / 2001, s. 69.

37 T. Gizbert-Studnicki, *Teoria wykładni…,* s. 83. This article argues with the position presented by L. Morawski in *Precedens a wykładnia,* PiP 1996, nr 10, s. 6 i n.

fact that the law, in exceptional circumstances, tolerates creative interpretation or at least allows to withdraw from the literal meaning of the provision."[38] Consistent declaration of this position by the Court can be only explained by the fear of the judges of even more criticism in case of adopting the role of the "third chamber". This method of legitimisation of abstract control provided by constitutional courts, calls into question the reasons for maintaining the current composition of the court composed exclusively of lawyers[39].

3. ARGUMENTATIVE ACTIVISM

Complexity is the characteristic feature of the majority of cases handled recently by higher courts. The elaborate nature of the processes of law enforcement has a direct and natural impact on the choice of a argumentative model in such situations and actually abandoning a purely syllogistic one. The analysis of decisions of the Polish Constitutional Tribunal concerning the interpretation of constitutional principles gives a picture of the body which is often forced to choose between different alternative possibilities of interpretation of a particular provision, in other words, to pursue the best decision from some point of view.

The argumentative nature of the application of law in case of legal principles was highlighted by R. Dworkin in his well-known concept to distinguish the norms-rules from the norms-principles. According to this article, non-definitive nature of norms-principles is essential[40]. In case of competing principles, the authority applying the law uses the so-called weighing, trying to use any of them to the greatest possible extent. The priority of a particular principle is determined by evaluation of its relevance to the outcome of the case. R. Dworkin emphasizes that there is no accurate method of measuring the importance of principles, therefore, decisions concerning them may be the subject of controversy[41].

In case of jurisprudence of the Polish Constitutional Court a discursive style of interpretation is said to dominate. Referring to the arguments of the applicant

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38 L. Morawski, *Wykładnia w…,* s. 21.

39 W. Sadurski, *Prawo przed sądem. Studium sądownictwa konstytucyjnego w postkomunistycznych państwach Europy Środkowej i Wschodniej*, Wydawnictwo Sejmowe 2008, s. 70. The author says in this context about the representative role of constitutional court, as a body, whose activity connected with current complex matters is not so much connected with the exegesis of legal concepts but rather with making basic choices in the area of values.

40 R. Dworkin, *Biorąc prawa poważnie*, Warszawa 1998, s. 56 i n.

41 *Ibidem,* s. 64.

and the other parties of the proceedings, the CT presents its decision which balances the arguments *pro and contra*[42]. This attitude, when accompanied by using the so-called extra-legal arguments, is defined as argumentative activism. It is not, however, a situation in which legal regulations refer to such criteria, but seeking support in such arguments is initiated by a judge. It results from judge's belief that "only in the light of these arguments it is possible to determine which solution of a problem or decision is the best."[43] According to the activist ideology a judge takes responsibility for the consequences of their decisions to be not only lawful but the best in terms of complex functions of the law.

When it comes to activism of the Polish Constitutional Court, it can be called a weak variation. Judges of the Tribunal refrain from open formulation of new rules, even if the legal provisions manifestly violate the elementary demands for justice and rationality.

Firstly, the CT invariably declares that the starting point for reviewing the constitutionality of the law is the assumption of rationality of the legislator and the presumption of conformity of laws with the Constitution. There is a certain legal fiction that requires to assume that all actions are the result of legislators' "in-depth consideration of the issue and a mature decision rationally justified", which, in turn, suggests that "the law is well-grounded in rationalism beforehand[44]." The presumption of constitutionality is reversible in all those cases when the legislator abandons some general rules of construction of the legal system. The Tribunal also states in general terms that the intervention is justified when the legislator drastically violates the rules of rationality, even if that legislation meets all the formal eligibility criteria[45].

Secondly, the CT presents reviewing the constitutionality of the law as only limited to supervising the compliance of the legal norms of lower rank to those considered superior, while the criterion of purpose and accuracy is not within its scope. In particular, complex cases, examples of which are presented below, it is difficult sometimes to assess the rationality of a regulation without reference to these criteria; these concepts are partially overlapping. The CT after all admits to relatively wide use of functional interpretation (and its special variation, teleological

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42 M. Zirk-Sadowski, *Wykładnia i …*, s. 95.

43 L. Morawski, *Główne problemy …*, s. 296.

44 See e. g. case from 17.05.2005 r., P 6/04.

45 Compare e. g. case from 22.06.1999 r., K 5/99 i P 6/04.

interpretation), whose complex context requires to take into account all the facts affecting the understanding of the text, including the objectives of the law[46].

Thirdly, no matter how broadly the Tribunal interprets the principle of the state of law, presenting indications used for it, the CT definitely tries to identify their "roots" in the written law. Yet identifying the whole set of specific rules of the state of law not written in the text of the Constitution or anywhere else and justifying a number of exceptions to them, was only possible when referring to extra-legal criteria. The complex nature of general principle and frequent occurrence of competing detailed principles in a natural way compel the Court to manoeuvre between all sorts of arguments for a more convincing justification of their decisions. With regard to the technique of weighing conflicting constitutional values there are opinions according to which it changes the "constitutional discourse into a general discussion on the legitimacy of the authorities' actions" and thus places the court in the explicitly legislative role[47].

Let us, therefore, analyse selected decisions of the Constitutional Court concerning the principle of the state of law, where there is an element of activity in the above-mentioned meaning. This body is quite often forced to seek the opinion of the relevant ministers about the financial consequences of any decision and take into account the fact that a balanced budget is very important constitutional value. Economic reforms must be implemented within the possibility of the state budget. Balanced budget secures state's ability to act and to perform a variety of tasks[48]. The CT is willing to treat as irrational (and therefore unconstitutional) these legislator's actions that even as issued in the name of protecting the principle of acquired rights to salary adjustments[49] and the protection of confidence of workers of specific industry in the state and its laws[50], can lead to an imbalance of state finances[51].

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46 K 25/99.

47 W. Sadurski, *Prawo przed*…, s. 149.

48 Case from 04.12.2000 r., K 9/00.

49 Case from 17.11.2003 r., K 32/02.

50 Case from 07.12.1999 r., K 6/99

51 According to the Tribunal, balancing the budget comes before the requirement, resulting from the clause of the state of law, to reflect the financial obligations imposed on the state in the budget act. The CT does not explain fully enough by what criteria it used to decide on the order of preference but it writes, in a typical way, that in reference to two opposing values there is an "obligation to reconcile them harmoniously, with the focus, however, on the former." See case from 26.11.2001 r., K 2/00.

Consideration for economic criterion has become a standard for assessing the constitutionality of rules by the Tribunal and it means that each time the CT is looking for such a decision, which will not only be lawful but also the most rational from the point of view of that criterion[52]. The CT shall often function as if the last resort (as the third chamber of the parliament) which is able to correct the absurd decision of the parliament, which - from the point of view of the quality of law - is certainly a positive aspect of its active role.

In a number of decisions it is apparent that the CT tries to present their decisions as right or fair in terms of certain values that are important to society. Assessing the regulation, the Tribunal refers to the axiology of democratic changes, constitutional system of values or the system of assessment resulting from legislation of the 1990s. The latter, for example, is the justification for excluding from payment for current work in the civil service, as on this occasion one should not pay for "activities to strengthen the political basis of the previous system, opposing (i.e. from the axiological point of view) the democratic state of law.[53]"

Axiological criterion, however, usually only supports reasoning of the Tribunal based on the written law. This positivist approach of accepting only rules, principles and values directly expressed as the self-contained source of law is illustrated by the following extract from the decision: " Omitting systemic solutions the legal norms refer to standards, rules and principles which by the single fact of referring to, do not become legal norms. However, obeying them may be the duty of the recipient of legal norms. In this way, the law not only plays the role of an immediate regulator of economic relations but also can be means of communication with other regulators.[54]"

There are few interpretations in which the Tribunal openly presents an activist approach and admits that there may be values "relevant to legal system, even if they are not [...]expressed directly and *expressis verbis* in the text of the constitutional provisions.[55]"

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52 See I. Wróblewska, *Kryterium ekonomiczne w rozstrzygnięciach Trybunału Konstytucyjnego,* Edukacja Prawnicza 03/2008.

53 See case from 28.04.1999 r., K 3/99.

54 K 6/99.

55 Case from 17.11.2003 r., K 32/02.

It is hard to find Tribunal's constraint in situations when the CT states that "the claim of unconstitutionality may concern both issues that the legislator regulated in the act and the ones that were omitted in this act, but according to the constitution should have been regulated,"[56] which *de facto* could be interpreted as adopting the powers of "positive legislator". This raises a separate question whether the absence of such a regulation is the actual loophole in a particular case or we consider it as intended by the legislator. In that case it would be a seeming loophole, purely evaluative (axiological loophole). The distinction between the two situations requires the knowledge of positive law as well as axiological preferences and desired objectives that the legislator set[57]. Personally, I believe that if the Tribunal, on the basis of a thorough and balanced analysis of both criteria, concludes that the legislator committed an obvious mistake which cannot be justified by reference to these criteria, omitting in the regulation a sphere of social relations (and even more if it was a result of incomprehensible omission in the new regulation of an issue previously regulated), the Tribunal has the right to question the constitutionality of the regulation regarding this omission.

However, in the case cited above, there are doubts as to the validity of this argumentation. The CT citing among others the principle of the protection of acquired rights (actually legitimate expectation), questioned the amendment to the Cooperative Law of 1990, depriving the agricultural cooperatives of the privileges of the purchasing the land from the State Land Fund. If we consider that the purpose of the legislator was to eliminate from the legal system a privileged purchase of property, the Tribunal has no jurisdiction to undermine this position and to restore this privilege. Noteworthy is the fact that this practice is contrary to disapproval towards preserving the privileges of the previous period for the so-called public property, consistently presented by the CT[58]. The analysed verdict can also be read as an example of adopting additional powers by the Tribunal. It recognizes the fact that the challenged provision is unconstitutional, but only if it relates to a cooperative "for which - violating the regulations concerning deadlines for administrative cases - a decision was not issued." Constitutional control within the model adopted in our country shall be of general and abstract character and cannot be used to deal with the consequences of the law infringements occurring during its application[59].

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56 Case from 24.10.2000 r., SK 7/00. Earlier similary in a case from 03.12.1996 r., K 25/95

57 Por. L. Morawski, *Wykładnia w …*, s. 191 i n.

58 See a dissent of Lewaszkiewicz-Petrykowska In case SK 7/00 .

59 *Ibidem.*

In conclusion, the above-cited examples of decisions show that the active approach, as defined above, appears in activity of the Polish Constitutional Tribunal. Without a doubt, among the "weighted" arguments affecting the standard of correct decisions, in addition to the legal arguments, there are also extra-legal ones, and the final decision whose potential consequences the judges are trying to bear in mind, is presented not only as lawful but the most fair and reasonable one. However, the CT definitely upholds the postulate, characteristic of the doctrine of restraint, that the judge is not to correct (let alone make) the law, even if they find the law unjust or unreasonable. In such cases the CT is more willing to indicate the need to change it by the parliament.[60]

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MARRIAGE V. COHABITATION IN THE LEGAL PRACTICE OF THE EUROPEAN COURT OF HUMAN RIGHTS

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ABSTRACT

The upward trend of people who, instead of living in marriage, opt for a life in cohabitation has spread, though with different rates, almost all over the European continent. As a consequence thereof, national legislators are facing complex issues requiring swifter, more efficient and socially acceptable responses in law. Depending on traditional, cultural and religious specificities, the reactions of national legislators have greatly varied, so in the European context, legal protection of people living in cohabitation is today one of the least harmonized areas of family law. Since all the signatory states to the European Convention on Human Rights (formally European Convention for the Protection of Human Rights and Fundamental Freedoms) have recognized the jurisdiction of the European Court of Human Rights, its practice is surely an indispensible factor in the search for adequate answers to many issues bothering national legislators. The goal of this paper is to analyse whether and how the rising socio-demographic tendency of living in cohabitation has exercised influence on the practice of the European Court of Human Rights, is this Court willing to adapt its interpretations of the provisions of the Convention adopted over six decades ago to the changes in family formations and if there is discrimination, from the Court's point of view, against cohabitants with respect to spouses in legal systems which deprive the former of the legal status of the latter.

Key words: marriage, cohabitation, legal protection, family life.

I. INTRODUCTION

In the last couple of decades, one has been witnessing intensive changes in family formations. Since the 1970s, Europe has experienced a sharp rise in the number of cohabitations and children born out of wedlock[1] and this socio-demographic trend has not still been put on hold. K. F. Savigny said ages ago that the essence of law refers to people's lives[2] and hence these socio-demographic changes in people's lives require legal responses. Whereas the issue of the legal status of children born out of wedlock was adequately dealt with long time ago,[3] the issue of the legal status of cohabitants with respect to spouses still represents a great challenge for the legislation of European countries. During the decades-long pursuit for the best solutions, national legislators seem to have developed completely different models of legal protection of cohabitation.[4] The legislation, judicial practice and legal theory of European countries have provided rather different answers to the question of the need for expansion of the legal effects of marriage to cohabitants, if cohabitants, resulting from their unequal legal status, are discriminated against with respect to spouses, and whether such expansion will jeopardize the central position of marriage in family law or not etc.[5]

Since all the signatory states to the European Convention for the Protection of Human Rights and Fundamental Freedoms (hereinafter: ECPHRFF) have recognized the jurisdiction of the European Court of Human Rights (hereinafter: ECHR), its practice is surely an indispensible factor in the search for adequate answers to many issues bothering national legislators. Therefore, the paper first

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1 See data available on Eurostat website: http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tps00018&plugin=1, as of 10 September 2015

2 *"Law itself does not have an essence, its essence actually refers to people's lives."* Quoted according to VRBAN, Duško, *Sociologija prava: uvod i izvorišne osnove (Sociology of Law: Introduction and Source Fundamentals)*, Golden marketing-Tehnička knjiga, Zagreb, 2006, pp. 21.

3 The awareness of the need for legal equalization of children born out of wedlock with children born in wedlock on the entire European continent was first proclaimed in the 1970s. As a reaction to the fact that at that time national legislation was still featured by numerous differences in the regulation of the legal status of children born out of wedlock, it came to adoption of the *European Convention on the Legal Status of Children Born out of Wedlock*. Available on Council of Europe website: http://conventions.coe.int/Treaty/EN/Reports/Html/085.htm (1.9.2015).

4 On different approaches to the legal protection of cohabitants using the example of Latvia and Croatia see LUCIĆ, Nataša; BEINAROVIČA, Olga, *Challenges of the Legal Regulation of Non-Marital Cohabitation in Europe: Some Lessons for Latvia from Croatia, in: Jurisprudence and Culture: Past Lessons and Future Challenges, University of Latvia Press, 2014.*, pp. 373.-382.

5 For more details see LUCIĆ, Nataša, *Izvanbračna zajednica i pravna sigurnost (Cohabitation and Legal Security)*, doctoral thesis, Law School of the University of Zagreb, 2015.

revolves around the provisions of the ECPHRFF relevant for the respective issue and then investigates how the Court has, through its interpretations, accommodated those provisions to contemporary socio-demographic trends and what kind of a message, if any, the Court sends to national legislators considering the issue of the legal status of cohabitants with respect to the legal status of spouses.

On this occasion, it should be emphasized that cohabitation implies an informal union of a strictly heterosexual couple. In the authors' opinion, in legal systems that grant marriage exclusively to heterosexual couples, which is the case with most members of the Council of Europe,[6] the legal status of homosexual couples opens up completely different questions from those relating to the legal status of heterosexual couples in an informal union since heterosexual couples, unlike homosexual ones, can at any time conclude marriage and enjoy its legal effects. For that reason, this paper limits the term of cohabitants to partners in an informal heterosexual union.

II. RELEVANT PROVISIONS OF THE EUROPEAN CONVENTION FOR THE PROTECTION OF HUMAN RIGHTS AND FUNDAMENTAL FREEDOMS IN THE LIGHT OF CONTEMPORARY SOCIO-DEMOGRAPHIC TRENDS

The most significant document of the Council of Europe - ECPHRFF was adopted in 1950 and came into force in 1953. It was adopted with the aim to undertake the first steps in Europe towards collective strengthening of some rights which were on global level foreseen by the United Nations Universal Declaration of Human Rights adopted in 1948.[7]

The provisions of the ECPHRFF relevant for the respective legal issues involve the provisions that protect the right to respect for private and family

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6 See data of the *Pew Research Center*, available at http://www.pewresearch.org/fact-tank/2015/06/09/where-europe-stands-on-gay-marriage-and-civil-unions/ (1 Sep 2015). The issue of the legal status of heterosexual partners in an informal union with respect to the legal status of spouses matches the issue of the legal status of homosexual partners in an informal union with respect to registered homosexual partners.

7 KORAĆ, Aleksandra, *Hrvatsko obiteljsko zakonodavstvo i čl. 8. Europske konvencije za zaštitu osnovnih prava i sloboda čovjeka(Croatian Family Law Legislation and Article 8 of the European Convention for the Protection of Human Rights and Fundamental Freedoms*, Pravni vjesnik (Legal Herald), Vol. 11, no. 1-4, 1998, pp. 142/143.

life and the right to found a family and the provisions stipulating prohibition of discrimination.

The right to respect for private and family life is set forth in Article 8 of the ECPHRFF which reads as follows:

"*Everyone has the right to respect for his private and family life, his home and his correspondence.*

There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others." [8]

The ECPHRFF refers to the right to conclude marriage and found a family in its Article 12 which reads as follows:

"*Men and women of marriageable age have the right to marry and to found a family, according to the national laws governing the exercise of this right*."

In terms of resolving the issue of possible discrimination against cohabitants with respect to spouses, one should check Article 14 of the ECPHRFF which reads as follows:

"The enjoyment of the rights and freedoms set forth in this Convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status."

One needs to bear in mind that the ECPHRFF was adopted at the time when marriage was absolutely superior to cohabitation from the sociological and consequently, legal viewpoint. The so-called "golden age" of marriage was at its peak between 1950 and 1970 when marriage was deemed almost universal9 and

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8 As D. Harris *et all stated* "article 8 places on the states the obligation to respect a wide range of undefined personal interests which embrace a number of overlapping and inter-related areas". None of the four interests coverd by art. 8. (private life, family life, home or coresporends) is defined in the Convention and their content is a matter of interpretation. See more in HARRIS, David; O'BOYLE, Michael; BATES, Eduard; BUCKLEY, Carla, *Law of the European Convention on Human Rights*, Oxford University Press, 2014., pp. 522.-524.

9 KIERNAN, Kathleen, *Cohabitation and Divorce across Nations and Generations*, CASE paper 65, Centre for Analysis of Social Exclusion, London, 2003,
available at http://eprints.lse.ac.uk/6371/1/Cohabitation_and_divorce_across_nations_and_generations.pdf (26.9.2015.)

regarded as a sociological and legal institution. The dominancy of the ideology of family as a union which emerges after marriage conclusion consequently reflected on the provisions of the ECPHRFF which thus became the milestone of the European supranational legal architecture.[10] According to R. Probert and A. Barlow, the traditional family resulting from marriage was still a dominant family form at the time of the emergence of the ECPHRFF, so it was logical and convenient to introduce marriage-based family as a social unit regulated by the law.[11] Concerning the time of its adoption, it is understandable that the ECPHRFF does not actually contain provisions which directly protect the right to establish extramarital unions and/or the rights arising therefrom.

However, starting in the 1970s, the institution of marriage began to change fundamentally in many parts of Europe, and more couples began to live together outside marriage. During this period, values and attitudes about sex, gender relations, women's employment, and the role of the individual and society changed dramatically.[12] One started to abandon then omnipresent standpoint on the European continent that life in cohabitation is an immoral and socially unacceptable form of conduct and accordingly, the number of couples who opted for living in cohabitation rose rapidly.[13] This socio-demographic tendency, which commenced in the 1970s, has continued ever since.[14]

The socio-demographic changes that clearly point to the fact that more and more people decide to enter into a life partnership other than marriage have led

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10 Commaille and De Singly (1997), quoted pursuant to BARLOW, Anne, *Regulation of Cohabitation, Changing Family Policies and Social Attitudes: A Discussion of Britain within Europe*, Law and Policy, no. 1, 2004, pp. 58/59.

11 PROBERT, Rebecca; BARLOW, Anne, *Displacing Marriage – Diversification and Harmonisation within Europe*, Child and Family Law Quarterly, Vol.12, no. 2, 2000, pp. 153.

12 Similar PARELLI-HARRIS, Brienna; SANCHEZ GASSEN, Nora, *How Similar Are Cohabitation and Marriage? Legal Approaches to Cohabitation across Western Europe*, Population and Development Review Vol. 38, no. 3, 2012, pp. 437.

13 "Probably the most prominent fact about cohabitation is actually rapid growth in cohabitation rates since the 1970s." International Encyclopaedia of Marriage and Family, available at http://www.encyclopedia.com/topic/Cohabitation.aspx (3 Jan 2014) International Encyclopedia of Marriage and Family | 2003

14 N. Lowe and G. Douglas made a good remark that "whilst extramarital cohabitation might be assumed to be a modern phenomenon, it is clear that what has changed in the past half-century has been a decline in the social stigma that attaches to it, and hence its degree of visibility and acceptability". N. Lowe and G. Douglas took the UK into consideration, but their assertion can be applied to the whole continent. See LOWE, Nigel; DOUGLAS, Gillian, *Bromley's Family Law*, Oxford University Press, 2015, pp. 934.

to the need to interpret some provisions of the ECPHRFF in a way which would provide cohabitants and not only spouses with protection stipulated thereby. Pursuant to N. Gavella, "realization of the ideas hidden in the background of the Convention shall not be prevented by restrictive interpretation of its wording. On the contrary, one should keep track with the evolution of those ideas and interpret the Convention in line with their contemporary perception and not how the signatory states comprehended human rights when they joined the Convention".[15] When interpreting the provisions of the ECPHRFF, the Court demonstrated the willingness to honour modern socio-demographic trends and incorporated cohabitants in the application of some of its provision, although concerning the time of the adoption of the ECPHRFF, its creators did not have cohabitation in mind at all.

In regard therewith, the following lines contain analysis of the standpoints of the Court on issues such as whether cohabitants enjoy the protection of the right to family life laid down in Article 8 of the ECPHRFF despite the lack of a formal document proving establishment of a family union, whether Article 12 of the ECPHRFF restrains the right to found a family to marriage conclusion and whether cohabitants are discriminated against with respect to spouses in the national legislations in which cohabitation does not produce the legal effects of marriage.

III. KEY STANDPOINTS OF THE EUROPEAN COURT

3.1. RIGHT TO RESPECT FOR PRIVATE AND FAMILY LIFE

Terms family life and private life are not defined in the Convention and their content is a matter of interpretation. The right to respect for family life is included in the most important international and regional instruments.[16] The right to respect for family life is defined in the ECPHRFF as an independent notion,

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15 GAVELLA, Nikola, *Privatnopravni aspekt djelovanja Europske konvencije za zaštitu ljudskih prava i temeljnih sloboda te dodatnih protokola (The Private Law Aspect of the Action of the European Convention for the Protection of Human Rights and Fundamental Freedoms and Additional Protocols)* in "Europsko privatno pravo" (European private Law), Gavella, N. *et al.*, Law Scholl of the University of Zagreb, Zagreb, 2002, pp. 246/247. On the interpretation of the ECPHRFF see also LETSAS, George, *A Theory of Interpretation of the European Convention on Human Rights*, Oxford University Press, Oxford, 2009.

16 So claims FAYE JACOBSEN, Anette, *Human Rights Monitoring: A Field Mission Manual*, BRILL, 2008, pp. 380.

i.e. as an independent value, and it does not appear as a subordinate notion to the right to respect for private life but these are two notions which contents overlap.[17] Every family life is also a private life but every private life cannot always be classified as a family one since the former comprises much more situations.[18] Indeed, beside the right to respect for family life, all families also enjoy the right to respect for private life, so what remains is the issue if extramarital unions are simultaneously family unions or in other words, under which conditions, if any, cohabitants are granted the right to respect for family life.

The first cases in which the Court discussed the existence of family life in *de facto* extramarital unions relate to legal relationships between parents and children and not to relationships between cohabitants. As regards children born out of wedlock and related issues, Strasbourg organs adopted an assertive policy of review in reliance on evaluative interpretation as a principal tool.[19] When analysing the Court's judgements, D. Gomien noticed that "children have been part of a family union since their birth[20] and hence the Court believes that it should be assumed that a bond developed in such a way is extremely strong and require from the state firm reasons for its dissolution."[21]

Family life as a fact dependant on the existence of close personal ties was encompassed by the Court's adjudication already in 1979, precisely in the case of

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17 KORAĆ, Aleksandra, *Sadržaj i doseg prava na poštovanje obiteljskog života u hrvatskom pravnom sustavu (The Content and Scope of the Right to Respect for Family Life in the Croatian Legal System)* in "Europsko privatno pravo" (European Private Law), Gavella, Nikola *et al.*, Law School of the University of Zagreb, Zagreb, 2002, pp. 255.

18 Same KORAĆ GRAOVAC, Aleksandra, *EU Charter of Fundamental Rights and Family Law,* in *"Europsko obiteljsko pravo" (European Family Law),* ed.Korać Graovac, Aleksandra and Majstorović, Irena, Narodne novine, Zagreb, 2013, pp. 37.

19 ARAI-TAKAHASHI, Yutaka, *The Margin of Appreciation Doctrine and the Principle of Proportionality in the Jurisprudence of the ECHR*, Intersentia, 2002, pp. 66.

20 So writes CURCI, Jonathan, *The Evolution of the Legal Concepts of "Family" and "Marriage" in the EU Legal System and its Impact on Society*, St. Thomas Law Review, Vol. 18, 2006, pp. 239; ROAGNA, Ivana, *Protecting the Right to Respect for Private and Family Life under the European Convention on Human Rights*, Council of Europe human rights handbooks, Council of Europe, Strasbourg, 2012, pp. 28; STALFORD, Helen, *Concepts of Family Under EU Law - Lessons From the ECHR*, International Journal of Law, Policy and the Family, Vol. 16, no. 3, 2002, pp. 419.

21 GOMIEN, Donna, *Europska konvencija o ljudskim pravima (European Convention on Human Rights),* Naklada d.o.o., Law School of the University of Rijeka, Zadar, 2007. To support this assertion Gomien puts forward the cases of *Berrehab v. Netherlands, ECHR 10730/84 21 Jun 1988; Hokkanen v. Finland, ECHR 19823/92, 23 Sep 1994; Gul v. Schwitzerland, ECHR 23218/94, 19 Feb 1996* and *Ciliz v. Netherlands, ECHR 29192/95, 1. Jul 2000.*

Marckx v. Belgium.[22] Although this case is not about heterosexual cohabitation, it laid foundations for subsequent cases relating to cohabitation. In this case "the Court recognises that support and encouragement of the traditional family is in itself legitimate or even praiseworthy. However, in the achievement of this end, the recourse must not be had to measures whose object or result is, as in the present case, to prejudice the "illegitimate" family; the members of the "illegitimate" family enjoy the guarantees of Article 8 on an equal footing with the members of the traditional family." With this case the Court called for final dismantling of the legal disabilities that had been imposed for centuries on "non-marital" children throughout Europe.[23]

The Court refused to recognise the right to dissolve a marriage as a right protected under the ECHR in the case of *Johnston and Others v. Ireland.*[24] The first applicant was married, but he and his wife consented on living separately and eventually, on seeing other people and during that time, he started a relationship with the second applicant. Years passed and the first two applicants got a daughter who is the third applicant. The first applicant was, under Irish law, unable to get dissolution of marriage in order to marry the second applicant. Regarding the third applicant, she was an illegitimate child; and that there were no ways for her parents to recognize her with full rights of support and succession. Regarding both questions, the applicants complained about violation of Article 8. The Court decided that there was violation of Article 8 regarding only the legal status of the third applicant. It is important to emphasize that the Court stated that the first and the second applicant, having been together for some fifteen years at the time, constituted a family as an element which falls under Article 8 even if their relationship existed outside marriage. The Court argued that the normal development of the natural family ties between the first and the second applicant and their daughter requires that she should be placed, legally and socially, in a position akin to that of a legitimate child.

During the 1980s and 1990s, the adjudication was characterized by growing proneness to attach the issue of family life to real existence of close ties. The Court

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22 *Case of Marckx v. Belgium, ECHR 6833/74, 13 Jun 1979.*

23 SALZBERG, Marc, T*he Marckx Case: the Impact on European Jurisprudence of the European Court of Human Rights*, Denver Journal of International Law and Policy, Vol. 13:2-3, 1984, pp. 283

24 *Case of Johnston and Others v. Ireland, ECHR 9697/82, 18 Dec 1986.*

resorted to what W. M. Schrama called 'family function over family form',[25] which was disclosed in many of its judgements. One of the cases that speak in favour of this assertion is the case of *Keegan v. Ireland,*[26] In this case the Court stated that family can encompass relationships other than marriage. The applicant met his girlfriend in May 1986. They lived together from February 1987 to February 1988. Around Christmas 1987 they decided to have a child. They got engaged and she got pregnant. She gave birth around seven months after they had split. During the pregnancy, the mother made arrangements to have the child adopted and on 17 November 1988 she had the child placed by a registered adoption society with prospective adopters. She informed the applicant of this in a letter dated 22nd November 1988. The applicant challenged that decision of hers in front of national courts, but in the end, an adoption order was made in respect of the child. The applicant complained that Article 8 of the Convention had been violated because he argued that his links with the child were sufficient to establish family life (which would enable him to be awarded custody and, subsequently, stop the adoption process). The Court recalled that family cannot be confined solely to marriage-based relationships and may encompass other *de facto* family ties where people live together outside their marriage. The child born in that relationship is automatically part of that family from the moment of his birth and by the very fact thereof. The Court decided that there had been violation of Article 8 on the grounds of that mutual enjoyment by a parent and the child of each other's company constitutes a fundamental element of family life even if the relationship between the parents has broken down.

In the *Kroon and Other v. Netherlands*[27] case, the Court followed the practice of the *Keegan* case suggesting that family life includes *de facto* relationships, not only those based on marriage. The circumstances of this case are as follows: the first two applicants were not married and were not living together, but they had a stable relationship within which the third applicant was born. The problem was that the boy's mother, the first applicant, Mrs Kroon, was at the time still married, although she had not lived with her husband for years. She divorced her husband after her son had been born. The parents tried to provide their son with his father's name and thus enable the second applicant to recognize his son.

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25 SCHRAMA, Wendy M., *The Dutch Approach to Informal Lifestyles: Family Function over Family Form?*, International Journal of Law, Policy and the Family, Vol. 22, no. 3, 2008, pp. 311.-332.

26 *Case of Keegan v. Ireland, ECHR 16969/90, 26 May 1994.*

27 *Case of Kroon and Others v. the Netherlands, ECHR 18535/91, 27Oct 1994.*

They were denied because at the time of birth, Mrs Kroon was still married to the man who was legally the boy's father. They were rejected at all national instances. The applicant complained about violation of Article 8 and Article 14 taken in conjunction with Article 8, but the Court held that there was no need to address the issue of violation of Article 14 taken in conjunction with Article 8 because the same question was posed under Article 8 taken alone. In terms of Article 8 alone, they complained that, due to the fact that the child was born in wedlock, it was not possible to change the data in the register of births; consequently, the father was not allowed to recognize his child. The Court stated that, as seen in the *Keegan* case, *de facto* relationships and ties can also, not just marriage, amount to family life. As a rule, there was a requirement prescribing that couples should live together, which here was not the case; however, there were other factors demonstrating that there is a *de facto* relationship – in this particular case Mrs Kroon gave birth to four children of the second applicant. The Court decided that there had been violation of Article 8 stating that due to existence of family, the State had obligation to permit complete legal family ties to be formed between the second and third applicant. The Court requires that biological and social reality prevails over a legal presumption. Until then, the only way to recognize a legitimate child had been to first deny legal paternity and in this concrete case, it could only be done by Mrs Kroon's former husband.

The *X, Y and Z v. United Kingdom*[28] case shows that the Court is consistent with its opinion that *de facto* relationships can create family life. The Court proceeded with the practice from previous cases and provided relevant factors for regarding cohabitation as family life. X was a female-to-male transsexual who lived with Y, a woman, in a stable and permanent union. Y bore them a son, Z, via artificial insemination by an anonymous donor. Z was given X's surname, but X was not allowed to be registered as the father in the register of births because biologically he was not a man. The applicants complained that Article 8 had been violated since there was a lack of legal recognition of the relationship between X and Z. The Court decided that there was no violation of Article 8, but the important thing the Court defined here is that the Court recalled that the notion of "family life" laid down in Article 8 is not confined solely to marriage-based families and may encompass other de facto relationships. "When deciding whether a relationship can be said to amount to "family life", a number of factors may be relevant, including whether the couple live together, the length of their

28 *Case of X, Y and Z v. the United Kingdom, ECHR 21830/93, 22 Apr 1997.*

relationship and whether they have proved their commitment to each other by having children together or by any other means (*Kroon and Others*)".[29]

In the case *of K. and T. v. Finland,*[30] the Court confirmed its practice set out in its earlier case-law**.** The first applicant is a mother, K., who had two children – a daughter and a son who were sired by different fathers. T., the second applicant, was at one point cohabitating with K. and her children lived with them. Before and after that, K. was hospitalized a few times on account of schizophrenia and psychosis. Because of K.'s own mental problems, her son also started having behavioural problems and the competent authorities decided to put him in a children's home for three months. K. also got involved in other incidents which were detrimental for the view of her mental health. After K. had given birth to J., the child was put in a children's ward and after that, it ended up in emergency care because of K.'s illness and since it was considered that the child's father, T., would not be able to guarantee child's safety and development by taking care of both children simultaneously. A Social Welfare Board decided to put J. and K's son in public care revealing reasons similar to those in emergency orders. K. was allowed to see children only in company of her personal nurse. According to a social worker, T. had taken good care of J. There was a chance for the baby to move in with her father later on. T moved out from K but they continued their relationship. After T.'s paternity had been established, T. and K. were granted joint custody of J, but the baby and K's son were put in a foster home. In the meantime and after the dislocation of the children, K. and T. opposed the decisions on public care but were rejected at every national instance. The applicants complained that Article 8 of the European Convention of Human Rights had been violated on account of the placement of J. and K.'s son in public care. The question raised herein is whether K. and T. (and their children) fall within the category of "family life" as defined in Article 8 or not. K. and T. were not married, but the Court pointed out that the existence or non-existence of family life is a question encompassing real existence of close personal ties (as said in the *Marckx* case). K. and T. were not married, but they were living together with K.'s son and that intent was the same after the birth of J. According to that assessment, the Court did not make any distinction between applicants K. and T. as regards the scope of their "family

29 In *Case of X, Y and Z v. the United Kingdom* , X was a transsexual who had lived with Y as her male partner for fifteen years. They were jointly granted artificial insemination which resulted in the birth of Z. Since then, X has been Z's father. Eventually, the Court acknowledged existence of *de facto* family ties.

30 *Case of K. and T. v. Finland, ECHR 25702/94, 12 Jul 2001.*

life", which they jointly enjoyed with the two children. The Court decided that there had been violation of Article 8 only in respect of the emergency care order concerning J. Taking a newborn into public care at the moment of its birth is a harsh measure which must be supported by "extraordinarily compelling reasons". The Court asserted that the Government's reasons for dislocating the baby were relevant but not serious enough to be extraordinarily compelling to interfere with the family life of the applicants. Also, the authorities did not even examine other, less intrusive types of interference.

Where it concerns a potential relationship which could develop between a child born out of wedlock and its natural father, the Court holds that relevant factors include the nature of the relationship between the natural parents and the father's demonstrable interest and commitment to the child both before and after its birth. In the case of *Nylund v. Finland,*[31] Mr Nylund cohabitated and then got engaged with his girlfriend. A few months later it was confirmed that his fiancée is pregnant but a month later their cohabitation ended and they broke off their engagements. His girlfriend then married to another man. She gave birth in wedlock. The competent court denied the applicant's paternity on the ground of the wedlock and because his former girlfriend said she was already in a relationship at the time of conception. The applicant request a voluntary DNA test at his own expenses, but was denied because according to a Finnish law, he did not have the right of action. He referred to the Court of Appeal asking "whether a woman who became pregnant while living in a relationship similar to marriage can prevent examination of paternity and judicially kidnap the child on the formal ground that she has married somebody else". He was denied. The applicant complained about violation of Article 8 saying that the legal presumption of the husband's paternity violated his rights. He explained his complaints by saying that the family unit once consisted of himself and the then pregnant fiancée had not been protected. He also complained on violation of Article 14 because the mother's right under the national law prevented him from establishing paternity, which was an act of discrimination against him. The Court found both the reference to the Articles and the application as a whole ill-founded and therefore inadmissible. What is important in this case is that the Court stood in "defence" of marriage when deciding on Article 14 by advising that marriage continues to be characterized by a corpus of rights and obligations that differentiate it from cohabitation. The Court stood with the mother stating

31 *Case of Nylund v. Finland, ECHR 27110/95, 29 Jun 1999.*

that she had the right to prevent him from establishing paternity because the child was born when she was already married to another man. The Court found that "though in some fields a *de facto* relationship between cohabitants is recognized, there are still differences between married and unmarried couples, in particular, differences in the legal status and legal effects".

The case of *Serife Yigit v. Turkey*[32] opens up the question of social rights between people who were not formally married. The applicant, Mrs Serife Yigit, was, as is customary and practiced, in religious marriage with Omer Koc from 1976 and now they have six children, five of whom were recognized during Mr Koc's life. Her husband got ill and died in 2002 while making preparations for official (civil) marriage. The applicant asked the competent court to recognize their religious marriage. She was denied. At an unknown time, she submitted a request for pension and health insurance cover on the basis of her late partner's entitlement. The fund she had applied to refused her request. She referred to another court which rejected her application to overrule the fund's decision because her marriage has not been legally recognized and that means she is not qualified for the deceased man's rights. She was rejected at a further national instance. Mrs Yigit filed a complaint stating that Article 8 of the Convention had been, among other Articles thereof, violated because she had not been awarded survivor's pension and social security benefits based on her late partner's entitlement. Application of Article 8 requires existence of family life and that depends on real existence of close personal ties. Since Article 8 applies to both legitimate and illegitimate families and relationships, in this case one could really speak about family life. The court's judgment saw no violation of Article 8. The reason for such a judgment is that Member States enjoy a certain margin of appreciation which is wider in areas where a consensus does not exist between the countries and Turkey has set some rules regarding religious and civil marriage and their benefits. Article 8 protects individuals from state's unnecessary interference with their lives. Here a fair balance needed to be stricken – between the interests of the individual and the State. The applicant and her late husband chose religious marriage in which there was no interference by the authorities. To conclude with, Article 8 cannot be interpreted in a way that it can pose an obligation to the national authorities to recognize religious marriage and the applicant's, *de iure*, cohabitation did not imply inheritance of social rights.

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32 *Case of Serife Yigit v. Turkey, ECHR 3976/05, 2 Nov 2010.*

The Court decided that there was no violation of Article 8 due to the inability of a biological father to legally establish his paternity of children born to a married woman with whom he had been cohabiting in the *Chavdarov v. Bulgaria* case. In 1989, the applicant set up a home with a married woman (who was living separately from her husband); she gave birth to three children, in 1990, 1995 and 1998 respectively, while they were living together. The woman's husband was registered as the children's father on their birth certificates and the children were given his surname. At the end of 2002, the woman left the applicant and the children in order to set up a home with another partner. Until that moment, the applicant had lived with the three children. At the beginning of 2003, he consulted a lawyer with a view to initiate proceedings for recognition of paternity. However, the lawyer informed him that domestic law did not enable him to challenge the presumption of paternity in respect of his former companion's husband. In consequence, the applicant applied directly to the European Court.[33] The Court concluded unanimously that there had not been violation of Article 8.

The Court stated that although cohabitation, in the principle, may be a requirement for such a relationship, exceptionally other factors may also serve to demonstrate that a relationship has sufficient constancy to create *de facto* "family ties". That happened in the case of *Lebbink v. the Netherlands.*[34] In this case, the Court again emphasized that the existence or non-existence of "family life" with respect to Article 8 is essentially a question dependant on real existence of close personal ties. A. Faye Jacobsen noticed well that a relationship between spouses comes under the notion of family life regardless of the absence of cohabitation. As far as unmarried couples are concerned, only evidence of *de facto* family life (cohabitation, a common project, children) shall permit an application for recognizing the right to respect for family life.[35]

When deciding in the case of *Van der Heijden v. Netherlands,*[36] the Court confirmed that long and stable relationships make "family life", but also that testimonial privileges in these kinds of informal unions fall within the Member State's margin of appreciation. A man was killed and Mr A., the life partner of the applicant, Mrs Van der Heijden, was accused thereof. It was understood

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33 Fact downloaded from *Information Note on the Court's Case-Law*, ECHR, 2010, available at: http://www.echr.coe.int/Documents/CLIN_2010_12_136_ENG_885245.pdf (20.9.2015.)

34 *Case of Lebbink v. the Netherlands, ECHR 45582/99, 1 Sep 2004.*

35 FAYE JACOBSEN, Anette, *loc. cit.*

36 *Case of Van der Heijden v. the Netherlands, ECHR 42857/05, 3Apr 2012.*

that she was in company of Mr A. at that time. She was summoned as a witness before the competent court, but she refused to testify on the basis that even if they were not married and they had not entered into a registered partnership, she and Mr A. had been cohabitating for eighteen years and in that relationship they had got two children who were both recognized by Mr A. Because of that, the applicant believed that she should be granted a testimonial privilege which was available only to spouses and registered partners. To her disappointment, she was denied. Among other articles, Van der Heijden complained on violation of Article 8 of the Convention saying that she was the victim of a lack of respect for her "family life" because she was compelled to give testimony against Mr A. with whom she was in a stable, although never formalized family relationship. The Court's assessment was that the family life governed by Article 8 may encompass a *de facto* relationship and not only marriage. Whether or not that kind of a relationship is family life, a number of factors need to be taken into account, such as the length of the relationship, how long the partners have lived together and whether there is commitment to each other by having children or any other means. Considering that the respective couple had two children and had been together for eighteen years, the Court found that it came to "family life" in this particular case. Yet, deciding on the *meritum*, the Court's decision was that there was no violation of Article 8 on the grounds that the Member States can make assessment as to where the fair balance lies in assessing the need for putting a public interest before an individual's rights under Article 8. The margin of appreciation will be wider where there is no consensus between the Member States, which was here the case. In this case, the Court stated that there were two conflicting public interests: prosecution of a serious crime and protection of family life from interference. The interest of family life was more important for the Government to protect, but the term of family life was limited to its "formalized" form. The Court concluded that the applicant's relationship with Mr A, although being equal to marriage in societal terms, should not attract the same legal consequences as formalized unions should because "states are entitled to limit the scope of testimonial privileges and to draw the line at marriage and registered partnerships". The Court stressed that there were no suggestions that the applicant was unaware of the fact who has a testimonial privilege. Consequently, detaining the applicant was also in accordance with national law.

In the case of *Kalucza v. Hungary*,[37] the Court extended the protection against violent spouses, formal spouses and formal partners to informal ones. While the applicant was married, she and her husband bought an apartment. Her husband possessed one third of it. After their subsequent divorce, the applicant entered into an unregistered partnership with Mr Gy. B. who bought off her former husband's share of the apartment. Eventually, they broke up, but he continued living in the apartment against her wishes. Meanwhile, their relationship was deteriorating in such a way that she was subjected to verbal and physical abuse. On several occasions, the applicant requested protection from national authorities, but she was rejected at every instance (when she requested a restraining order, the competent court denied the request since, amongst other reasons, the "conditions … between the accused and aggrieved party have not been fulfilled"). The applicant complained on violation of Article 8 saying that the Hungarian authorities failed to undertake positive measures to protect her from her violent former partner (the term used was a common law husband). The Court decided that it did come to violation of Article 8 on the grounds of that private life, as defined in Article 8, incorporates protection of an individual's physical and psychological integrity and that states may have positive obligations in protecting it. In this case, Hungary should have protected the applicant even though she and her partner were only former cohabitants. The relevant national law – the Act on the Restraining Order due to Violence among Relatives protects only married people, divorced people and former registered partners but not those who were in *de facto* cohabitation where the tie between partners was not registered with the authorities, which the Court found unjustified.[38]

The Court drew the line at the rights of the cohabitants in the case of *Stubing v. Germany,*[39] but nevertheless decided that they had private and possibly family life in the sense of Article 8. The applicant was in a sexual relationship with his sister. They lived together for several years and had four children together. The three elder children were taken to foster homes and the applicant and his sister were charged and convicted on the account of incest. The applicant complained to the Constitutional Court that charge and conviction "had violated his right to sexual

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37 *Case of Kalucza v. Hungary, ECHR 57693/10, 24 Jul 2012.*

38 For more details on this case see LONDONO, Patricia, *Human Rights, Positive Obligations and Domestic Violence: Kalucza v Hungary in the European Court of Human Rights*, International Human Rights Law Review, Volume 1, Issue 2, 2012, pp. 339.– 348.

39 *Case of Stubing v. Germany, ECHR 43547/08, 24 Sep 2012.*

self-determination, had discriminated against him and was disproportionate and that it interfered with the relationship between parents and their children born out of incestuous relationships". He was rejected. It was stated by the Constitutional Court that the sexual intercourse between the siblings contravened the traditional picture of family. He complained on violation of Article 8 which provides the right to respect for his private and family life. The Court declared the application admissible, but decided that Article 8 had not been violated. The Court assessed "that the applicant's criminal conviction had impact on his family life and, possibly, attracted protection under Article 8 as he was forbidden to have a sexual intercourse with the mother of his four children and that such a ban violates his private life (sex life is included in private life)". The Court reiterated that the margin of appreciation shall be restricted if a particularly important facet of an individual's existence or identity is at stake. That means that there must be a very serious reason for interference with the most intimate aspect of private life such as sex life. On the other hand, where there is no consensus between the Member States, particularly in cases of sensitive moral or ethical issues, the margin is wider. In this case, the authorities enjoy a wide margin of appreciation, notwithstanding that it concerns private life. The European Court agreed with the Federal Constitutional Court of Germany who considered that sexual relationships between siblings could seriously damage family structures and, as a consequence, society as a whole.

3.2. THE RIGHT TO FOUND A FAMILY

The practice of the Court shown above undoubtedly ascertains that the Court has expanded the right to respect for family life stipulated in Article 8 of the ECPHRFF beyond the scope of the traditional family founded by two people of the opposite sex. The Court also affirms that protection of the right to family shall also be granted to people living in steady and stable heterosexual and, according to the latest practice, homosexual unions[40] other than marriage. However, Article 12 of the ECPHRFF still reminds us of the time when this European document was adopted. It may seem that the provision prescribing that "*men and women of marriageable age have the right to marry and to found a family*" is contrary to

40 "... the Court considers it artificial to maintain the view that, in contrast to a different-sex couple, a same-sex couple cannot enjoy "family life" in the light of Article 8. Consequently, the relationship of the applicants, a cohabiting same-sex couple living in a stable de facto partnership, falls within the notion of "family life", just as a relationship of a different-sex couple in the same situation would." *Schalk and Kopf v. Austria, ECHR 30141/04, 24Jun 2010.*

the Court's standpoints that a family can also be constituted by cohabitants in a stable and steady *de facto* union.

What is imposed here is the issue if it is justified to interpret Article 12 as the right of a man and woman to conclude marriage and to found a family in a way different from marriage. In other words, whether the right to conclude marriage and found a family should be interpreted as two separate rights whereat marriage conclusion leads to exercise of both of these rights and the right to found a family by two people of the opposite sex is not exhausted in the right to conclude marriage. Such an interpretation entails that the right to found cohabitation should be granted by Article 12 of the ECPHRFF. Considering the fact that social shifts from the traditional nuclear family which is based on marriage have been taken into account by the European Court expressing the viewpoint that cohabitants should also be entitled to the protection set forth in Article 8 of the ECPHRFF, separation of the right to conclude marriage from the right to found a family can be really deemed necessary. Indeed, it makes no sense to interpret the provisions of the ECPHRFF in a way that cohabitants shall have the right to protection of their family life and that establishment of a family can only be derived from marriage.[41]

Contemporary legal theory includes intensive discussions about the manner in which Article 12 needs to be interpreted and consequently, various ways how this Article should "catch up with the times" without amending its content are proposed. C. Sörgjerd is, for instance, prone to the opinion that Article 12 of the ECPHRFF ought to be interpreted in compliance with the evolution of family relationships and offers a solution how to apply this Article to homosexual couples: "The article establishes that man and woman have right to marry, without explicitly expressing the view that they have right to marry *each other*. From this point of view and having regard to the dynamics of Court's interpretations of the Convention in general, Art. 12 could be reinterpreted in the future to include same-sex relationships without changing its wording." [42]

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41 Such considerations originate from the fact that the EU Charter on Fundamental Rights detaches the right to conclude marriage from the right to found a family. It lets national legislations decide on the exercise of 'these rights' and not 'that right' as formulated by the ECPHRFF.

42 SÖRGJERD, Caroline*, Reconstructing Marriage: The Legal Status of Relationship in a Changing Society,* Intersentia, Cambridge/Antwerp/Portland, 2012, pp. 298. However, as C. Arúyo Dias emphasized "despite the possibility of a new interpretation, the Court believes that it should not yet consider homosexual marriage as lacking protection in the light of Art. 12, granting the Contracting States the freedom, which allows them to prohibit or accept same-sex marriage." ARÚYO

It is beyond any doubt that the content of Article 12 of the ECPHRFF needs to be compliant with the contemporary changes in social formations as well as with the evolution of the Court's posture on the right to protection of family life. The authors believe that seeking the best solutions for accomplishment of such a goal should nonetheless impose boundaries on the interpretations which are going to fully amend the goals and scope of the ECPHRFF.

3.3. Discrimination on the grounds of family status

There is a complex interplay between art. 8. and the other articles in the Convention.[43] Speaking of the legal protection of extramarital couples, there is a strong corelation between art. 8. and art. 14. After analysing the Court's practice related to Article 8 of the ECPHRFF, it has been undoubtedly concluded that the protection of family life in the light of Article 8 of the ECPHRFF is not reserved only for married people but cohabitants can also enjoy the right to protection of family life. Now it is to be answered whether both forms of family unions shall produce the same legal effects or not. Differently said, is there discrimination on the grounds of family status in national legislations which do not provide spouses and cohabitants with the same rights? The below lines offer an analysis of a few cases initiated before the Court, which can cater for the answer to this question.

In the case of *Quintana Zapata v. Spain,*[44] the applicant lived with her husband for 65 years. When he died, she requested widow's pension but was denied on the grounds that she could not prove that they had been married. She argued then that even if they used to take them as cohabitants, 65 years of living together and five children who bear their father's name in the register of births should make her qualified for the pension. Her application was rejected. The applicant complained on violation of Article 14 taken in conjunction with Article 8 since she felt that she was, after living together for 65 years and having five children, suffering discrimination in her family life. The Commission reiterated from previous cases that an illegitimate family is the same as a legitimate one and thus the applicant and her late husband had family life pursuant to Article 8. Discrimination exists under Article 14 if, among other conditions, there is "no objective and reasonable justification" and if there is no "legitimate aim". In this

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DIAS, Cristina M., *De facto relationship as a new family form in the jurisprudence of the European Court of Human Rights*, International Family Law, 2014, pp. 24.

43 Same D. Harris *et al., op. cit. (note 8), pp. 523.*

44 *Quintana Zapata v. Spain, ECHR 34615/97, 4 Mar 1997 on the admissibility*

case, the Commission held that the differences between spouses and cohabitants regarding widows' pension were justified and pursued a legitimate aim: and that is protection of the traditional family. The Commission noted that the applicant had enough time to "marry" her late partner in order to properly enjoy the benefits of marriage. In the end, the Commission regarded the application as ill-founded, which meant inadmissibility.

Although willing to keep track with contemporary socio-demographic trends concerning a growing number of cohabitations, the Court cannot hide its preference for marriage. In the case of *Saucedo Gomez v. Spain*,[45] the applicant cohabitated with her partner for eighteen years while she was still married because when they started living together in his home, divorce was not permitted in Spain. Their relationship broke down in 1992 and she required from the competent court to declare her separated from her partner and grant her use of the family home and pecuniary provision. She was denied at all instances. The Court of Appeal's argumentation was that the right she requested could only arise if the couple were married and that cohabitation could not be equated with marriage. She complained to the Court that Article 8 in conjunction with Article 14 had been violated. The Commission said there was family life in compliance with Article 8, but also that there was no discrimination because the differences in treatment between spouses and cohabitants with regard to family home pursued a legitimate aim and can be thus justified. That legitimate aim and objective and reasonable justification refers to protection of the traditional family. The Commission explained that the applicant had more than ten years (In 1981, Spain legalized divorce; the applicant broke up with her partner in 1992) during which she could seek divorce from her husband and marry her partner. Here the Commission noted that is not up to the Court to dictate what measures should be taken with regard to cohabitants, but that right belongs to the Member State in which they enjoy its margin of appreciation as long as they meet the requirement of respect for family life. This application was declared inadmissible.

In the case of *Shackell v. the United Kingdom,*[46] the applicant cohabited with her partner for seventeen years, all the way to his death. They had three children together. Upon his death, the applicant requested widow's benefits, but she was rejected. The applicant lodged a complaint under Article 14 taken in conjunction

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45 *Case of Saucedo Gomez v. Spain, ECHR 37784/97, 26 Jan 1999 on the admissibility*

46 *Case of Shackell v. the United Kingdom, ECHR 45851/99, 27 Apr 2000.*

with Article 8 (and in conjunction with Article 1 of Protocol 1). The applicant claimed that the lack of a provision regulating benefits provided to unmarried surviving partners discriminates against her and her children on the grounds of her unmarried status and their illegitimacy. The Court declared the application inadmissible, but what is important is that the Court recalled the decision of the Commission in the case of *Lindsay v. the United Kingdom*: the case where the unmarried cohabitants sought to compare themselves with a married couple. The Commission decided that these were not analogous situations. The Commission noted that the *Lindsay* case dates back to 1986, which makes it fourteen years older. The question here was whether there were any changes regarding increasing social acceptance toward stable relationships between partners who are not married. Whatever the answer, the Court concluded that "marriage remains an institution which is widely accepted as conferring a particular status on those who practice it".

Even in the 21st century, the Court remains consistent with its standpoint that there can be no discrimination against cohabitants with respect to spouses if they do not enjoy the same rights in respective national legislation. In the *Burden v. The United Kingdom*[47] case, the Court observed in particular that just as "there can be no analogy between married and Civil Partnership Act couples, on the one hand, and heterosexual or homosexual couples who choose to live together but not to become a husband and wife or civil partners, on the other hand, the absence of such a legally binding agreement between the applicants rendered their relationship of cohabitation, despite its long duration, fundamentally different to that of a married or civil partnership couple. This view was unaffected by the fact that the Member States have adopted a variety of different rules of succession for survivors in marriage and civil partnerships and for survivors in a close family relationship and have similarly adopted different policies regarding the grant of inheritance-tax exemptions to various categories of survivors; States, in the principle, remain free to devise different rules in the field of taxation policy."

Four years later in the case of *Van der Heijden v. the Netherlands,*[48] the Court again assumed a similar posture on the difference in the legal status of formal and informal unions, precisely between marriage and cohabitation. On this occasion, the Court excluded not only violation of Article 8 of the ECPHRFF

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47 *Case of Burden v. the United Kingdom, ECHR 13378/05, 29 Apr 2008.*

48 *Case of Van der Heijden v. the Netherlands, ECHR 42857/05, 3 Apr 2012.*

but also violation of its Article 14 which were referred to by the submitter of the application for legal protection due to deprivation of a testimonial privilege in criminal proceedings which were pending against her unregistered partner for suspected murder. This instance was of the opinion that the Member States are entitled to restrain the possibility of testimony to spouses and registered partners and that despite the fact that some Member States, including the Netherlands, put spouses and cohabitants in a stable extramarital union in a similar legal position with respect to housing rights, social insurance and taxation, this restriction does not have anything to do with the public interest of prosecuting serious crimes. Besides, the Court ascertained that the applicant was not prevented to conclude marriage with the accused and that in no way she was criticized for that, but also that she, by making such a decision, was aware of the legal consequences of her decision. In this concrete case, the applicant found herself "beyond the scope of "protected" family relationships which were recognized by the Dutch legislation for the purpose of release from giving testimony".[49]

It is clear that the Court is continuously adapting, through its judgements, to the changes in family formations, on the one hand, and thus expresses the willingness to protect the scope of Article 8 of the ECPHRFF depending on the content and not on the form of a family relationship. On the other hand, the Court claims that there is no discrimination against cohabitants with respect to spouses in the light of Article 14 of the ECPHRFF since cohabitants are people who can at any moment conclude marriage and acquire the rights and liabilities arising therefrom.[50] Moreover, the Court holds that protection of traditional marriage is a legitimate goal which is wished to be accomplished by European countries by imposing the same rights and liabilities on spouses and cohabitants.

Someone might think that the Court, by revealing its standpoint that the issue of the legal effects of cohabitation is a matter of national legislation and that there could be no discrimination against cohabitants with respect to spouses where they do not enjoy the same rights, 'closes its eyes' to the fact that the

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49 For more details on this case see FITZPATRICK, Shae, *Cohabiting with the Accused: The Formal Limits of Spousal Privilege Affirmed in Van der Heijden v. Netherlands*, Boston College International and Comparative Law Review, Vol. 36, no. 3, Electronic Supplement, 2014, pp. 1.-16.

50 Similar C. J. Harvey: "...Court has so far declined to find violation of articles 8 and 14 where unmarried differnet-sex partners (rather than their children) are treated less favourably than married differnet-sex partners, a key factor in reasoning has been that the aplicant unmarried differnet-sex partners were legally able to marry and chose not to do so. " HARVEY, Colin J., *Human Rights in the Community: Rights as Agents for Change*, Hart Publishing, 2005., pp. 192.

number of cohabitations is constantly growing. However, the Court is certainly aware of the danger of disappearance of legal security in the event of spreading the legal effects of marriage to informal unions,[51] which is very often warned about in legal theory.[52] If the Court affirmed that the difference in the legal status of cohabitants and spouses represents discrimination on the grounds of family status, it would have far-reaching implications since in many European legal systems, extramarital unions produce a much smaller number of legal effects than marriage does.[53]

IV. CONCLUSION

While analysing the practice of the Court throughout almost four decades, the authors came to several conclusions. Firstly, the study of its relevant practice has demonstrated that the Court does not abound with cases in which it decides on the rights of people involved in informal heterosexual unions. The lack of initiation of such cases before the Court is not easy to explain. Namely, it is not very likely that people in a heterosexual *de facto* union will initiate proceedings before the European Court of Human Right after their complaint about being prevented from enjoying a right arising from marriage has been rejected at a competent national instance. It is more probable that they will, instead of opting for long and complex judicial proceedings, simply enter into marriage and thus in a much easier way exercise the desired right arising therefrom.[54] The Court's

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51 For example, problem of proving of informal life unions, its existence and duration; need of protection of autonomy of will of those who do not want to marry to stay out of (property) effects of marriage etc.

52 See considerations of M. Antaloskaia about the conflict of the principle of autonomy of will and the principal of the protection of weaker party in a legal equalization of cohabitation with marriage in ANTOKOLSKAIA, Masha, *Economic Consequences of Informal Heterosexual Cohabitation From Comparative Perspective: Respect Parties Autonomy or Protection of Weaker Party*, in "Confronting the Frontiers of Family and Succession Law", ed. Laurent Verbeke, Alain *et al.*, 2012., Cambridge/Antwerp/Portland, 2012., pp. 41.-63.

53 Croatia has, from the European perspective, developed quite an unusual system of legal protection of people living in informal family unions. Indeed, the latest family law legislation, the Family Act (Official Gazette no. 103/15) and the Same-Sex Life Partnership Act (Official Gazette no. 92/14) is oriented towards full legal equalization of people in informal relationships (cohabitation and informal partnerships) with those in formal relationships (marriage and registered life partnerships).

54 Naturally, if this is a right which is still to be exercised. It is true that the problem often arises when the family unity terminates. But the reason why cohabitants calling for law after the termination of cohabitation commonly are not the questions regulated by the ECPHRFF. The most common is the question of regulation of property relations after the termination of cohabitation. In such cases, the Court can only answer the question whether there is a discrimination against the co-

viewpoints on cohabitation have been mostly derived from its case-law referring to legal relationships between parents and children born out of wedlock or between partners in homosexual unions, which has enabled us to disclose the Court's opinion on the right to protection of family life in *de facto* unions in general.

What arises from our analysis of the relevant practice of the Court is that it considers existence of family life a matter of vital nature which depends on existence of close family ties in practice. In other words, the Court prefers the content over the form of a family relationship. Accordingly, cohabitants can, like spouses, enjoy the right to the protection of family life laid down in Article 8 of the ECPHRFF. Yet, the Court finds that cohabitants are not discriminated against in the light of Article 14 of the ECPHRFF if they come from legislations where they do not enjoy the same rights as spouses do. The difference in the legal status of spouses and cohabitants in some national legal systems in Europe is regarded as their own way to accomplish a legitimate goal – protection of the traditional marriage-based family.

The Court justifiably states that there is nothing controversial in the fact that marriage and cohabitation do not always imply the same legal effects since partners can freely choose to conclude marriage or to live in cohabitation. In regard therewith, cohabitants and spouses accept the legal consequences of their decisions or differently said, they commit to and accept the legal effects of the form of a family union which they have decided to found. Such a position of the Court does not entail that the Court's practice is not being accommodated to the changes in social relations. On the contrary, by expanding the scope of Article 8 of the ECPHRFF far beyond the scope of the traditional marriage concluded between two people of the opposite sex, the Court encourages the social and legal perception of these changes. At the same time, it, by justifying the existence of differences in the legal effects of marriage and cohabitation in national legislations in Europe, stresses that the tradition and social changes do not have to be neglected.

One can conclude that the Court "is catching up with the times" and adapting the provisions of the ECPHRFF to the fact that cohabitation on the European continent is social reality requiring a legal response. While going through such

habitants in relation to the spouses, if their life community does not produce the same property effects, without the consideration of the way of resolving property relations.

an adaptation, even the latest practice of the ECHR still favours marriage with respect to cohabitation. Surely, as long as cohabitation does not imply the legal effects of marriage, marriage will keep its central position in the family law legislation of European countries. The legal distinction between cohabitation and marriage might consequently help marriage retain the central position in the European society. How long the Court will insist on its standpoint that there is nothing dubious that national legislators protect the traditional marriage and thus strengthen the protection of marriage as the central institute of European legislations and the European society is yet to be seen.

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THE REINTERPRETATION OF THE NOTION – CONSTITUTIONALISM

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ABSTRACT

The supremacy of constitution in the legal order can be reached as a result of the implementation of constitutionalism interpreted as a political philosophy or can be effect of the theoretical concept of the system of norms with levels of higher and lower norms in which the constitutional norm has the principal influence on other ones. The interpretation of constitution as a result of either one or other former assumption, may be governed by constitutionalism or only by other norms of legal system without any guidance by political and social arguments. The compare of this two ways of constitutional orders, results different role of constitutional courts. The first one treats these kinds of institutions as guardian of people, the second one - the guardian of the system of norms.

Key words: constitutionalism, constitutionalisation of law, supremacy of constitution, constitutional norms, guardian of constitution.

1. INTRODUCTION

The constitutionalism is the main judicial and political thought that influence the written constitutions in modern times, it is philosophical ground of legal culture that focuses on constitution as a supremative act. This is the notion that implies evolution of thinking about the content of constitutional norm, the methods of interpretation of constitution and the role of constitutional application of law. The coherence between constitution as an act of sovereign and the constitutionalism as the expression of the most important legal background of political power can be notified as one conception of legitimization of the constitutional control of legislature. The other one situates constitution in the center of legal system because of the supremative role of constitutional norm in the act of creation of statutory norm. These two approaches are the basic philosophical and theoretical inspirations of judicial control of legislative acts.

2. THE SUPREMACY OF CONSTITUTION

The most important evaluative moments in the development of constitutionalism was the appearance in political practice the written constitutional act and the institution of constitutional control. This first moment – "the constitutional moment", was the effect of historical, economical and political particularizes in individual states[1]. The factors which were the basis for such difference in legal order were concerned with the political agreement to treat the constitution as the highest act the system of law. There are two possible models which explain the role of the constitution in the legal culture. The first one, observed in United States culture, is the consequence of the sustained basic role of the constitution, which is being an act of people. This ground of supremative role of constitution, influence the main core of constitutional provisions. The American constitution is supposed to be the guidance of people and what is the most important the guidance of political power. The application of law and political practice in constitutional order is no longer arbitrative. The separation of powers is the main idea of constitutional thought, the consequence of this principle is not only the pragmative one but primarily is the axiological one. The constitutional ground of exercising the legal rules establishes the order in which the individual has an autonomy. The constitutional provisions, the separation of powers and bill of rights, are aimed at this goal. In this model, constitutional thought-constitutionalism, reflects in constitutional text, and constitutional interpretation. The main idea of constitutionalism is that the constitution is the act of people so the legitimization of the constitutional provisions and its interpretation are based on the acceptance of people. The consequence of later is that the notion constitutionalism originally is connected with the sources of constitutional text and its influence on social and political practice[2]. The answer what is constitution and who should be the guardian of constitution in this model is the reflex of legal discourse as the element of practical discourse of American society. The ratification of constitution and the text of constitution which expresses values common to different social groups are the basis for social acceptance and the supremative role of constitution in American legal culture. The people identificate with constitution, this text is direct

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1 S. Tanasescu, The constitutionalisation of EU law In Romanian Jurisprudence, ed. K. Topidi, A. Morawa, Constitutional Evolution In Central and Eastern Europe: Expression and integration In the EU, Asgate Publication 2001, 43.

2 R. S. Kay, American constitutionalism, ed. L. Alexander, Constitutionalism. Philosophical Foundations, Cambridge 1998, 31.

expression of individual interests, and limitation of public power. Constitution limits the public (also statutory) activeness, states autonomy of individual in relations with public interest. American constitution restrains only political power, interpretation of American constitution does not consider the horizontal application of its provisions, this means that constitution is not limitation in the relation individual-individual. The constitution is expressed to protect the power of sovereign-the people, and this is the reason why this act is the highest one in legal order[3].

The other model of superior role of constitution can be described as the theoretical one. Constitutional act is situated in the highest level in hierarchical system of law and that normative presumption indicates the main role in the legal order. Constitution in this model is not expressed as an act of sovereign in the main idea but as the kind of act, different than others because of the specific procedure of establishment. The inferentive, normative consequence of this procedure is that constitutional norm is the formal ground of other norms. The relation between constitutional norm and statutory and lower norms is based on formal conditions, legal norms create system. This notion implicates logical structure, the order, coherence but not material one, only the formal one. The system of law does not necessary express legal culture, the sovereign will. Constitution is pure, does not consists of any illegal argumentation, the interpretation and generally the application of constitutional norm is not the part of political and moral discourse, it is the scientific-legal process[4]. The idea of this kind of legitimization of constitution is the consequence of the specific definition of law. The author of normative or pure concept of law, Hans Kelsen, reduces system of law only to legal norm[5]. This means constitutional application of law, the interpretation of constitutional norm does not consist of any social or moral indications. This presumption is the Kelsenian consequence of recognition of ethical norms. He sustained that social and moral discourse does not ends with objective conclusion, the moral conclusion is not verifiable. This ambivalence of moral arguments which is reflected in political pluralism of moral norms

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3 S. M. Griffin, Constituent Power and constitutional change in American constitutionalism, ed. M. Loughlin, N. Walker, Paradox of constitutionalism. Constituent power and constitutional form, New York,Oxford University Press 2007, 49.

4 S. L. Poulson, Kelsen on legal interpretation, Legal Studies vol.10,1990, 136-143.

5 H. Kelsen, The pure theory of law, tr. Max Knight, The Lawbook Exchange ltd., Clark, New Jersey, 2005.

must be the taken into account in definition of law[6]. The legal order have to be considered as closed and separate of the sphere of facts and morals. The law and the constitution are the concepts derived from the notion - legal norm[7]. Legal norms creates multi-level system of law, in which the recognition of norm as legal one is based on the higher norm – it states authority of lower norm[8]. The valid constitutional norm does not mean the necessary acceptance of sovereign but only the dynamic coherence with the system of law, in the case of constitutional norm this validity must be sustained. This assumption is called the basic norm. This concept of constitution has the implication in interpretation of constitution and the concept of the guardian of constitution and the constitutionality of law. This model of constitution is detached from the sovereign will and is common in redefinition of constitutional court in continental European countries. This model is reductive one, it means it does not consider the political ground of law and the accordance with constitution. This model is an answer in the light of political discourse who should have the power to express the peoples interests. It is the resolution to the factual conclusion that parliaments are no longer representation of sovereign interests, this model of legal norm and in consequence, the model of constitutional court, is one of possible way to overcome of the omnipotence of parliaments. Specially in Europe the principle of parliaments sovereignty, and the presumption of its best representation of the peoples will were strong in the political thought, so the examination of statutory and the proclaiming its not constitutionality were the different from the main intuition about democracy and democratic legitimacy. The constitutional act in political philosophy was not so closely related to the peoples will. One of the fathers of liberal democracy,of the autonomy of individual and the limitations on parliaments' acts - John Locke and his conception of individual rights as a border of political power[9], was no longer popular in European constitutionalism as it was in American one. The principle of the people as the sovereign is still declared in modern constitutions but is not the ground of its interpretation. This principle is forgotten in European political philosophy and in constitutional adjudication. This political way of thinking

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6 J. Brand-Ballard, Kelsen's unstable alternative to natural law:recent critiques, The American Journal of Jurisprudence vol. 4, 1996, 143.

7 S. L. Poulson, Four phases In Hans Kelsen's legal theory? Reflections on a Periodization, Oxford Journal of Leal Studies vol.18, 1998, 154.

8 The concept of law as Multi-level system originally comes from Adolf Merkl. See S. L. Poulson, Four…, 165.

9 J. Locke, Two treaties of governmentfor Whitmore and Fenn, and C. Brown, London 1821.

that situated parliaments in the center of the system of protection of individual rights and the strong democratic routs of the legitimacy in this aspect of legal order, maintained the conception that between constitution and statutory as parliaments act there is not any necessary collision. Consequently the existence of constitutional judiciary were pointed as lacking of democratic legitimacy. In this political atmosphere Kelsen's conception, with its reduction of social, moral and political argumentation, was the compromise. The European constitutionalism connected with state faces mainly the problem of connection of the political and philosophical aspect of this idea and the interpretation of constitutional provisions in the light of this idea.

3. THE GUARDIAN OF CONSTITUTION

In accordance with the presumption of the most important role of the constitution in the legal order, the very important moment in the evolution of constitutionalism was the appearance of constitutional control of parliaments acts. Equally important is the factors and justification or legitimacy to control statutory acts.

In American model – named judicial review, the justification of such a control is the minimum of social acceptance of constitution and its substance[10]. The constitution is supposed to be the act of the people, superior to legislative power. Legislative power and statutory represents majority, so the individual interest can collapsed in democratic process but the constitutional substance expresses minority and individuals interests that there must be taken into account in political process. In Locke's conceptions conflicts between rights and liberties were supposed to be resolved by courts, and this thought inevitably influenced legal practice, but not only this one. Judicial review - courts control and legislative acts and practices appeared as in concreto control. This means that constitutional control in judicial review model is incidental to the main dispute in litigation. This institution appears in the case and the litigant sustains unconstitutional any act or practice of public power and the court is treated as the one that has social and political legitimacy to represent the peoples will expressed in the constitution. Judical review is based on courts practice, the precedent, but also on the social acceptance of this kind of jurisdiction. Courts have authority to be guardian

10 R. S. Kay, American constitutionalism, Ed. L. Alexander Constitutionalism, Philosophical Foundations, Cambridge 1998, 33.

of constitution. This political practice is compatible with supremative role of constitution justified by the presumption that this act is the direct expression of sovereign will. The supremative clause states that the constitution is superior because of the states sovereignty, it means the people of the state are sovereign[11], any power also legislative one are only obliged to fulfill such will. There is possible collision between legislator and the substance of constitution, and the judiciary power is obliged to act in accordance with constitution so in the situation of collision judge has to take a into account the priority of constitutional provision in particular case. Judges decisions generally does not declare statutory invalid, only in resolved case, but the higher court declares act or action unconstitutional, the importance and influence on other decision is broader. This a consequence of precedent de iure as the one of the sources of law. This kind of constitutional control is not so endangered by aversive argumentation especially concerned with judges lack of democratic legitimization to act as legislator. Abstractive control of constitution would be more evident to political discourse as having legislative competences. In American constitutionalism judicial review was supported by political argumentation that judges are the ones who should represents constitutional rights and liberties. The interpretation of constitution is treated as realization of preexisting rules and is not determined by text of constitution[12]. This approach is coherent with the coexistence in constitutional interpretation arguments not only based on the text but also the ones which are derived from the idea of constitutionalism. Judical rewiew and constitutional interpretation are reflexes of two constitutions: the written and unwritten but influenced by constitutionalism. Judges are the important links of constitution because of the process of its interpretation[13]. This evolution of the idea of constitutionalism is connected with the doubts that the ones who governs, especially legislators, are no longer the one who are governed. This conclusion appears also on the European ground, but here it is rather political and historical conclusion, than the philosophical one. The authorial and totalitarian regimes which Europe faced were factors that influenced the conception that rulers and ruled are not the same sovereign, this two sides represents different interests, and parliaments forfeited there political position of the best representation of individual interests. These

11 W. L. Ferran, Political suvereignty: The Supreme Authority In the United States, Southern Liberty Press, 2005, 76.

12 R. S. Kay, America…,37.

13 R. Hirschl, C. L. Eisgruber, Prologue: North American Constitutionalism, International Journal of Constitutional Law, vol. 4 no. 2, 2006, 203.

factors assured European constitutionalism that there is a need of other than parliaments guardian of constitution. The conception of Hans Kelsen's separate constitutional court had the political support. In this conception the guardian of constitution should be different than other tree powers. It is supposed to be the institution that does not exercises the power. Constitutional judges are in Kelsenians thought are rather scientists, their main role is to control logical coherence of the system of law. The constitutional judgment should be the effect of scientific process of comparison of norms. This process does not-in Kelsen's conception-engage unnormative argumentation. The collision with the constitutional norm can be ascertain in isolation, without any moral or political argumentation. Normative definition of legal system is pure, does not engage broader then normative perspective. There are not any other con stitution than constitutional norms. In Kelsen's theory interpretation of constitution can be determined by legal norms. It means that constitutional judge does not reflects the peoples will but legal norm. Normative presumption of constitutional interpretation taking in abstraction can be taken as coherent with the constitutional court vision as apolitical organ. The theoretical conception of constitutional judgments treated as process of logical verification of hierarchical accordance of lower norm with higher norm must be confronted with practical application of constitution by constitutional courts. Practical conclusions are concerned with the notion of constitutional norm. Kelsen treated constitution as the superior act in legal system because of specific authority, which is derived from the authority of the basic norm. The most controversial accent in the Kelsenian theory is the authority of the basic norm – it is stated as presupposed by layers as the consequence being the first link in the chain of the validity of norms[14]. Kelsen's theory is concerned with the notion of norm but lacks the norm's interpretation but besides this it could be susteind if constitutions were written only in rule manner. It means that if constitutional norm were kind of norm which rules are his concept of legal system and constitutional control as logical process would not be so evitable not coherent with the application of constitution in European constitutional practice. The main problem with confrontation the theory with legal practice is the specific application of constitutional norm – the way that Ronald Dworkin called necessary aplication manner but relevant manner[15].

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14 J. Raz, Kelsen's theory of Basic norm, The American Journal of Jurisprudence, vol.19, 1974, 96.

15 R. Dworkin, The model of rules, The University of Chicago Law Review vol.35 no. 14, 1967-68, 26.

4. THE CONSTITUTIONAL NORM

The constitutional judgment is not always the clear case, it is rather hard case[16], it means constitutional text does not have determine the judgment. This kind of reflection that can be observed in constitutional adjudication is mostly the reflex of the principle as the most common norm which appears in constitutions, and axiological engagement of constitutional text. Kelsen's concept of constitution is based on the vision that constitutional norm should regulate the structure of power and the main institutions in the state. In Kelsen's concept there is also possible the material constitution with the provisions that concern bill of rights but it is not the core of constitution in his theory[17]. Nevertheless constitution is the reflex of the idea of constitutionalism, even if is not obvious in constitutional interpretation so the notion "constitution" implies the protection of human rights in confrontation witch public interest. Constitution provisions are originally thought to be limitation on public power, nowadays this aspect of constitutionalism is hidden by the provision of the structure of public institutions, there are in some interpretations not exposed. Abstractly taken constitutions can be treat in this manner but the application of constitutions in particular cases exaggerate the main constitutional issue – the limitation of public power and the autonomy of individual in confrontation witch public power. It means that the constitutional control of legislative acts – the exercising of constitutional provisions, is one of the basic moments in evolution of the idea of constitutionalism. Constitutional control indicates beside the previous one, the characteristic of constitutional norms. These are usually principles, especially provisions which protect individual rights and liberties, so it means that this kind of norm is optimalised[18] in legal order. Principles are not applicable in definite manner, mostly this is not absolute kind of norm. It means the principle can be limited by other norms. The legislator is obliged to fulfill the constitutional

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16 On hard cases see R. Dworkin, Hard Cases, Harvard Law review vol. 88 no. 6, 1975, 1057-1109 or R. Dworkin, No right answer, New York University Law Review, vol. 53 no.1, 1978, 1-32. Dworkin sustain that even if the legal norm does not determine the constitutional case, there is one right answer which reflects institutional support and political morality.

17 H. Kelsen, Istota i rozwój sądownictwa konstytucyjnego, Studia i Materiały Trybunału Konstytucyjnego Tom XXXI, Warszawa 2009, 21.

18 The conception of principles as optimalisation commands is R. Alexys' conception. The author treates the notion of principle and the conception of principle of proportionality as the necessary concept that can be observed in application of principles. See R. Alexy, A Theory of Constitutional Rights, Oxford New York 2002 and R. Alexy, On the Structure of Legal Principles, Ratio Juris vol. 13 no. 3 September 2000, 296-298.

norms but proportion between realization of constitutional norm and the conflicting other, usually statutory, norms is no longer sustained to legislative power. The evolution of constitutionalism as an idea considers the violation of constitution by legislator, so the proportion of limitation is supposed to be controlled by constitutional court. The idea of principle as a norm considers its limitations, and more or less application. This means that legal system does not indicate where is the line of proportion and disproportion, the line between legal action of legislator and the unconstitutional discretion. The accordance with constitution inferentially lead to balancing of norms and the application of the principle of proportionality- the limitation clause. The principle does not directs the scope of its application. The other characteristic of principle is it is open to different interpretation, it does not determine the substance it contains. There are possible multiplications of interpretation of principle. The main reason of such conclusion is that in principle provisions are prepossessed axiological values. Constitutional principles are thought to be the expressions of constitutionalism as an idea, it articulate the liberal thought of individual as an autonomous legal subject. It means that if we treat the constitution as the supreme act in legal order because of its coherence with constitutionalism as an idea of legal culture, we can not reject the axiological or moral ground of constitutional norm. Constitutional judgments in these concept are the part of legal discourse in which the notion constitutionalism, and the substance of constitutional norm is fulfilled in evaluative manner by constitutional case law. This case law is in that sense part of cultural and political argumentation. Constitutional judge but not in Kelsen's sense have to take into account not only legal arguments, and the resolution of constitutional dispute is not objective. The legal norm without its interpretation does not determine the constitutional judgment, so the application of constitution is hard to predict. The constitutional adjudication reflects in this sense the identity of legal culture. Each constitutional court has the margin of appreciation in determining the weight of principle in particular legal order. It means that it is margin, it is not the discretion interpreted as arbitrariness. The conception of constitutionalism implies the similar interpretation of constitutional norm which embraces axiological substance. The burden of the application of constitutional norm is situated in the application of the principle of proportionality. The last one reflects the identity of legal order. Modern constitutions in its declarations are rather similar, constitutional norm treated only as the text one does not differ in the main idea in other political order. The identity appears in its application, in balancing principles in particular legal culture.

The consequence of the similarity of constitutional texts of different countries creates other interpretations of the notion constitutionalism, that is not necessary connected with the state. It can be treated as the next moment of reinterpretation of the notion "constitutionalism". Constitutionalisation of international law an European law or the global constitutionalism-the constitutionalism without a state are the recent accents that can in perspective influence the constitutional thought. In traditional interpretation of constitutionalism concerned with state, the main idea that reinterpretates this notion is horizontal application of constitutional norm. It means that individual is no longer endanger only by public power but also by other individual. The constitution in that sense can express not only autonomy of individual in relation with public interest but also in relation with private interest.

5. CONCLUSION

The constitution can be treated in legal order as formal basis of other norms or as the expression of the idea of constitutionalism. These two approaches sustains different directions to constitutional interpretation. The first one considers constitutional norm as clear, which means the application of it does not take into consideration any elements that can be identified as legal ones. Constitutional control other legal acts in that sense are the comparison of norms and declaration of unconstitutionality is based on lack of authority of norm situated on lower level in the multilevel conception of the system of law. Constitutional court in that conception is declared as neutral, not engaged in exercising of power, is situated outside of the concept of separation of power. This kind of court is defined to be negative legislator which judgments are effect of objective reasoning concerning testing the accordance with higher norm. The relations between norms are the dynamic ones, constitutional norm is not the substantive basis of lower particular norms. In this concept constitutional court is not thought to be the one that expresses sovereign will, the one that redefines the notion constitutionalism, the one that guides the resolutions of conflicting interests. The constitutional court is supposed to be not political one but technical one. This concept faces the difficultness of the coherence this theoretical idea with the way the constitutional norm is applicable in constitutional dispute. Descriptive appreciation of the constitutional adjudication indicates that constitutional norm is determined not only by the text of constitution and the scope of fulfillment of constitutional principles is the consequence of the balancing of

norms- the process that from the theoretical perspective entail the application of the principle of proportionality, and that entail from the political perspective the resolution of the conflicting interests. The second approach necessarily connects the constitutional interpretation and the notion constitutional norm witch the idea of constitutionalism. The constitution in that sense is the basis of other norms because of the substance of constitutional provisions. The notion constitution, and the interpretation of constitutional norm is opened on evolution as the consequence of the reinterpretation of the idea of constitutionalism but also as the consequence of social and cultural needs of the sovereign. Constitution in that conception has the dimension of axiological value in legal order, its supreme role is derived from that dimension. Originally that dimension justifies the constitutional control of especially acts which have democratic legitimization and ascertain its unconstitutionality. This conception is coherent with theoretical analyses of the constitutional norm which declare its undetermined manner of application. Constitution as an expression of very different interests is the effect of the peoples agreement so the exercising of constitutional norms are aimed at finding this interests balanced. Applying principle of proportionality, constitutional courts are concerned with express this idea of agreement that were the basis if the constitutionalism as political thought. Constitutional court or courts has this main role, and that fact justifies the competence to control acts of parliaments. Constitutional judge expresses the people will in political process, and the constitution is, because of constitutional control of other legal acts, still the basic expression of that will unlike at least piece of legislation.

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OMBUDSMAN AS A NATIONAL PREVENTIVE MECHANISM FOR THE PREVENTION OF TORTURE AND OTHER CRUEL, INHUMAN OR DEGRADING TREATMENT OR PUNISHMENT IN THE REPUBLIC OF CROATIA

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ABSTRACT

This paper gives a brief outline of the background of the adoption of the Optional Protocol to the Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment and basic characteristics of its system of preventive visits. The conditions determined by the Optional Protocol for establishing the national preventive mechanisms and the authorities these mechanisms must have, as well as the way in which the provisions of the Optional Protocol have been implemented in the Republic of Croatia are also addressed. Entrusting matters of the national preventive mechanism in the Republic of Croatia to the Ombudsman and his activities are viewed within the context of the existing legislative framework, its proposed amendments and the basic efficiency criteria of the national preventive mechanisms: regularity of visits to the places where persons are deprived of their liberty, independence of the national preventive mechanism and the dialogue with the bodies of state authority. The legislative framework and the activities of the Ombudsman of the Republic of Croatia are compared to the Slovene "Ombudsman plus" model, on which, with some particular derogations, the proposed amendments of the legislative framework for the activities of the National Preventive Mechanism in the Republic of Croatia are based.

Key words: Optional Protocol to the Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment, national preventive mechanism, Ombudsman, Republic of Croatia.

I. INTRODUCTION

Whether it is the flagrant acts of torture or poor living and hygiene conditions in the places where persons are deprived of their liberty, torture and other cruel, inhuman or degrading treatment or punishment occur in most world countries. The (in)efficiency of the existing international, regional and national instruments which contain the provision on the ban of such behaviour and the mechanisms foreseen by them was therefore discussed for decades. The Optional Protocol to the Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment (2002)[1] (hereinafter referred to as: the Optional Protocol) introduces some new concepts into the system of protection of human rights. The most important ones are definitely the focus on prevention and not punishment, and introduction of the system of preventive visits in which the activities of two mechanisms are combined: the international and national one. The Optional Protocol obligates states parties to establish the national preventive mechanism for prevention of torture and other cruel, inhuman or degrading treatment or punishment (hereinafter referred to as: the national preventive mechanism) and determines the basic conditions and authorities which one such body must have, letting states parties decide on their own which body or bodies will carry out the duties of the national preventive mechanism. In the Republic of Croatia the Ombudsman[2] is determined as a body competent for carrying out the duties of the national preventive mechanism.

With the aim of better understanding the system of preventive visits established by the Optional Protocol, the paper will give a brief outline of the background of the adoption of the Optional Protocol and basic characteristics envisioned by its system. In addition, we will review the conditions set by the Optional Protocol for establishing the national preventive mechanisms, the authorities these mechanisms must possess, and the way in which the provisions of the Optional Protocol have been implemented in the Republic of Croatia. Entrusting matters of the national preventive mechanism in the Republic of

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1 *Fakultativni protokol uz Konvenciju protiv mučenja i drugih okrutnih, neljudskih ili ponižavajućih postupaka ili kažnjavanja,* Official Journal of the Republic of Croatia – International agreements, Nos. 2/2005 and 3/2007.
The Republic of Croatia ratified the Optional Protocol on 5 April 2005 and it came into force on 22 June 2006.

2 Words and conceptual collocations that have gender significance (e.g. Ombudsman), regardles of whether they are used in this paper in masculine or feminine gender, relate equally to masculine or feminine gender.

Croatia to the Ombudsman and his activities will be reviewed within the context of the existing legislative framework, its proposed amendments and the basic efficiency criteria of the national preventive mechanisms: regularity of visits to the places where persons are deprived of their liberty, independence and the dialogue with the bodies of state authority. The legislative framework and the activities of the Ombudsman of the Republic of Croatia will be compared to the Slovene "Ombudsman plus" model, on which, with some particular derogations, the proposed amendments of the legislative framework for the activities of the National Preventive Mechanism in the Republic of Croatia are based. Because of the extensive subject matter, the paper will not go into detail on defining the terms "torture and other cruel, inhuman or degrading treatment or punishment", "places where persons are or may be deprived of their liberty (places of detention)" and "persons deprived of their liberty".

II. THE OPTIONAL PROTOCOL TO THE CONVENTION AGAINST TORTURE AND OTHER CRUEL, INHUMAN OR DEGRADING TREATMENT OR PUNISHMENT

II.1 BACKGROUND OF THE ADOPTION OF THE OPTIONAL PROTOCOL TO THE CONVENTION AGAINST TORTURE AND OTHER CRUEL, INHUMAN OR DEGRADING TREATMENT OR PUNISHMENT

Protection from torture and other cruel, inhuman or degrading treatment or punishment is one of the fundamental human rights and the prohibition against torture nowadays has the status of *ius cogens* norm in international law.[3] Nevertheless, the cases of torture and other cruel, inhuman or degrading treatment or punishment still occur in many countries.[4] Therefore, for the last few decades the problem of establishing the efficient mechanisms for the prevention of torture has been one of the fundamental questions in supporting the protection of persons deprived of their liberty of the above listed forms of forbidden treatment or punishment. In order to better understand the importance and innovativeness

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3 For more details, see de Wet, Erika: „The Prohibition of Torture as an International Norm of *jus cogens* and Its Implications for National and Customary Law", *European Journal of International Law,* Vol. 15, No 1, 2004, pp. 97 – 98.

4 For more details, see *Report of the Special Repporteur on torture and other cruel, inhuman or degrading treatment or punishment, Juan E. Méndez,* A/HRC/22/53/Add.4 (12 March 2013), the official websites of the High Commissioner for Human Rights, http://ap.ohchr.org/documents/dpage_e.aspx?m=103

of mechanisms foreseen by the Optional Protocol, its inception will be addressed further in the text.

The provisions on the prohibition of torture are contained in the fundamental international and regional human rights documents and international humanitarian law adopted after the Second World War. Such provision is contained, *inter alia*, in Article 5 of the Universal Declaration of Human Rights (1948)[5], Article 7 of the International Covenant on Civil and Political Rights (1966)[6], Article 3 of Convention for the Protection of Human Rights and Fundamental Freedoms (1950)[7], Article 5 of the African Charter on Human and People's Rights (The Banjul Charter) (1981)[8], Article 5 of the American Convention on Human Rights (1969)[9], Article 31 of the Geneva Convention Relative to the Protection of Civilian Persons in Time of War (1949)[10], Articles 13, 14, 17 and 130 of the Geneva Convention Relative to the Treatment of Prisoners of War (1949)[11] Articles 5 and 7 of the Protocol Additional to the Geneva Conventions of 12 August 1949, and relating to the Protection of Victims of International Armed Conflicts (1977)[12]. However, during the 1970s it was recognized that the prohibition against torture itself and the existing human rights mechanisms to monitor states' obedience of the prohibition such as periodic state reports and the possibility of filing individual and interstate complaints, were not enough to prevent the occurrence of torture and other cruel, inhuman or degrading treatment or punishment.[13]

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5 *Opća deklaracija o ljudskim pravima,* Official Journal of the Republic of Croatia – International agreements, No. 12/2009.

6 *Međunarodni pakt o građanskim i političkim pravima,* Official Journal of the Social Federal Republic of Yugoslavia – International agreements, No. 7/1971 and Official Journal of the Republic of Croatia – International agreements, No. 12/1993.

7 *Konvencija za zaštitu ljudskih prava i temeljnih sloboda,* Official Journal of the Republic of Croatia – International agreements, Nos. 18/1997, 6/1999, 14/2002, 13/2003, 9/2005, 1/2006 and 2/2010.

8 *African (Banjul) Charter on Human and People's Rights,* the official websites of the African Union, http://au.int/en/sites/default/files/banjul_charter.pdf

9 *American convention on human rights,* the official websites of the Organization of American States, http://www.oas.org/dil/treaties_B-32_American_Convention_on_Human_Rights.htm

10 *Ženevske konvencije i dopunski protokoli,* Official Journal of the Republic of Croatia – International agreements, No. 5/1994.

11 *Ibidem.*

12 *Ibidem.*

13 Kessing, Peter Vedel: „New Optional Protocol to the UN Torture Convention", *Nordic Journal of International Law,* No. 72, 2003, p. 574.

Two different positions emerged on how to prevent torture more efficiently. The proponents of the first position believed that it was possible to prevent torture by fighting impunity of perpetrators of torture and other cruel, inhuman or degrading treatment or punishment, that is through criminalization of such acts in international and national criminal law.[14] This position resulted in adopting the Declaration on the Protection of All Persons from Being Subjected to Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment (1975)[15], and later in adopting the Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment (1984)[16] and Inter-American Convention to Prevent and Punish Torture (1985)[17]. On the other hand, in the mid-1970s Jean-Jacques Gautier was first to put forward the idea of preventing torture *via* system of preventive visits to places where persons are deprived of their liberty.[18] This idea prevailed during the adoption of the European Convention for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (1987)[19], and finally, with the adoption of the Optional Protocol.

However, over 30 years passed from the very idea of adopting the Optional Protocol to its actual adoption. Back in 1980 the Republic of Costa Rica formally submitted to former United Nations Commission on Human Rights the text of the Draft Optional Protocol to the Draft International Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment[20], which foresaw the establishment of the system of preventive visits to places where

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14 *Ibidem.*

15 *Declaration on the Protection of All Persons from Being Subjected to Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment,* General Assembly Resolution 3452 (XXX) (9 December 1975), the official websites of the United Nations, http://www.un.org/documents/ga/res/30/ares30.htm

16 *Konvencija protiv torture i drugih surovih, neljudskih ili ponižavajućih kazni i postupaka,* Official Journal of the Social Federal Republic of Yugoslavia – International agreements, No. 9/1991 and Official Journal of the Republic of Croatia – International agreements, No. 12/1993.

17 *Inter-American Convention to Prevent and Punish Torture,* the official websites of the Organization of American States, http://www.oas.org/juridico/english/treaties/a-51.html

18 Evans, Malcolm D., Haenni-Dale Claudine: „Preventing Torture? The Development of the Optional Protocol to he UN Convention against Torture", *Human Rights Law Review,* Vol. 4, No. 1, 2004, p. 22.

19 *Europska konvencija o sprečavanju mučenja i neljudskog ili ponižavajućeg postupanja ili kažnjavanja s protokolima,* Official Journal of the Republic of Croatia – International agreements, No. 14/1997 and 11/2000.

20 *Draft Optional Protocol to the Draft International Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment,* E/CN.4/1409 (10 April 1980)

persons are deprived of their liberty.[21] It was not until 1992 that the Commission on Human Rights finally established an open-ended working group with the aim of putting together the Draft Optional Protocol based on the text proposed by the Republic of Costa Rica.[22] In February 2001 the United States of Mexico proposed that the main role in the prevention of torture should be played by national as opposed to international visiting mechanisms.[23] As opposed to the Mexican proposal, the Swedish/EU proposal leant heavily towards the concept of a stronger international mechanism, which would carry out the preventive visits.[24] The final Draft Optional Protocol contained the elements of both proposals and foresaw the establishment of a strong international preventive mechanism complemented with an obligation to establish equally strong national preventive mechanisms in states parties.[25] The Optional Protocol was adopted on 18 December 2002 and came into force on 22 June 2006, the thirtieth day after the date of deposit of the twentieth instrument of ratification with the Secretary-General of the United Nations.[26]

II.2 SYSTEM OF PREVENTIVE VISITS

The Optional Protocol does not contain a list of new substantial rights, but the objective of the Optional Protocol is to establish a system of regular visits undertaken by independent international and national bodies to places where persons are deprived of their liberty[27], in order to prevent torture and other cruel, inhuman or degrading treatment or punishment (Article 1 of the Optional Protocol). Therefore, in literature, the Optional Protocol is not viewed

21 For more details, see Evans, Haenni-Dale, op. cit. (note 18), pp. 23 - 24.

22 *Ibidem,* pp. 25 – 26.

23 *Ibidem,* p. 27.

24 For more details, see *ibidem,* pp. 41 – 42.

25 *Ibidem,* p. 43.

26 In January 2015, 76 states are full states parties to the *Optional Protocol.* For more details, see the official websites of the United Nations, https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IV-9-b&chapter=4&lang=en

27 Pursuant to Article 4 Paragraph 1 of the *Optional Protocol* each state party is obligated to allow visits of the Subcommittee on Prevention of Torture and of the national preventive mechanism or mechanisms to any place under its jurisdiction and control where persons are or may be deprived of their liberty, either by virtue of an order given by a public authority or at its instigation or with its consent or acquiescence (places of detention). Pursuant to Aricle 4 paragraph 2 of the *Optional Protocol* deprivation of liberty means any form of detention or imprisonment or the placement of a person in a public or private custodial setting which that person is not permitted to leave at will by order of any judicial, administrative or other authority.

as a standard-setting instrument for the protection of human rights, but as an operational treaty, which presumes the establishment of specific mechanisms, which help states parties to fulfill their obligation to prevent torture.[28] The Optional Protocol introduces several new concepts into the United Nations human rights system: it emphasizes the importance of prevention; it combines activities of international and national mechanisms; it emphasizes the importance of cooperation, and not condemnation, and it establishes a triangular relationship between the states parties, the Subcommittee on Prevention of Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment (hereinafter referred to as: the Subcommittee on Prevention of Torture) and national preventive mechanism or mechanisms in the states parties.[29]

The system of preventive visits established by the Optional Protocol shares similarities with the system of preventive visits of the Council of Europe established by the European Convention for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment.[30] Unlike the European Convention for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment that established the European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment, the Optional Protocol features a dual system in which national preventive mechanisms supplement the work of the international Subcommittee on Prevention of Torture.[31]

The Subcommittee on Prevention of Torture is an international body, which visits places of detention, and makes recommendations to states parties regarding the protection of persons deprived of their liberty against torture and other cruel, inhuman or degrading treatment or punishment (Article 11 Paragraph 1 Point a) of the Optional Protocol). The Subcommittee on Prevention of Torture pays four different types of visits: regular visits, control visits, advisory visits

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28 Dixon, Amy: „The Case for Publishing OPCAT Visit Reports in New Zealand", *New Zealand Journal of Public and International Law,* Vol. 11, No. 3, 2013, p. 555.

29 Geamănu, Radu-Florin: „Implementing a National Preventive Machanism for the Prevention of Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment in Places of Detention in Romania", *Lex ET Sciencia, Juridical Series,* Vol. 2, No. 19, 2012, p. 47.

30 From its inception in 1990 to 13 January 2015, the European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment carried out 369 visits (220 regular and 149 *ad hoc* visits) and published 318 reports. For more details, see the official websites of the Council of Europe, http://www.cpt.coe.int/en/about.htm

31 Edwards, Alice: „The Optional Protocol to the Convention against Torture and the Detention of Refugees", *International and Comparative Law Quaterly,* Vol. 57, 2008, p. 794.

to the national preventive mechanism and Optional Protocol advisory visits.[32] The Subcommittee on Prevention of Torture is also authorized to cooperate with national preventive mechanisms, as well as with relevant bodies and United Nations mechanisms and other international, regional and national institutions and organizations working towards the strengthening of the protection of all persons deprived of their liberty against torture (Article 11 Paragraph 1 Points b) and c) of the Optional Protocol). However, with regards to method of work and available resources, the Subcommittee on Prevention of Torture is able to visit each state party of the Optional Protocol once in 20 years.[33] For example, the Subcommittee on Prevention of Torture carried out only six official visits to states parties in 2013.[34] Considering the above, national preventive mechanisms play an important role in protecting persons deprived of their liberty against torture and other cruel, inhuman or degrading treatment or punishment, because they are closer to local realities and have more capacity to visit places where persons are deprived of their liberty.[35]

III. NATIONAL PREVENTIVE MECHANISMS FOR THE PREVENTION OF TORTURE AND OTHER CRUEL, INHUMAN OR DEGRADING TREATMENT OR PUNISHMENT

III.1 ESTABLISHMENT OF NATIONAL PREVENTIVE MECHANISMS IN STATES PARTIES OF THE OPTIONAL PROTOCOL

The Optional Protocol requires states parties to set up, designate or maintain at the domestic level, at the latest a year after the entry into force of the Optional Protocol or of its ratification or accession (Article 17 of the Optional Protocol), one

32 *Optional Protocol to the Convention against Torture (OPCAT), Subcommittee on Prevention of Torture,* the official websites of the United Nations, http://www.ohchr.org/EN/HRBodies/OPCAT/Pages/OPCATIntro.aspx

33 *Fifth annual report of the Subcommittee on Prevention of Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment,* CAT/C/48/3 (19 March 2012), the official websites of the United Nations, http://tbinternet.ohchr.org/_layouts/treatybodyexternal/Download.aspx?symbolno=CAT%2fC%2f48%2f3&Lang=en , paragraph 44.

34 *Seventh annual report of the Subcommittee on Prevention of Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment,* CAT/C/52/2 (20 March 2014), the official websites of the United Nations, http://tbinternet.ohchr.org/_layouts/treatybodyexternal/Download.aspx?symbolno=CAT%2fC%2f52%2f2&Lang=en , paragraphs 11 – 14.

35 de Beco, Gauthier: „The Optional Protocol to the Convention against Torture and Other Cruel, Inhuman or Degrading Treatmen ar Punishment (The OPCAT) in Europe: Duplication or Reinforcement", *Maastricht Journal on European and Comparative Law,* Vol. 18, No. 3, 2011, p. 263.

or several visiting bodies for the prevention of torture and other cruel, inhuman or degrading treatment or punishment (Article 3 of the Optional Protocol). The implementation of this obligation may be postponed for a maximum of six years.[36] The Optional Protocol does not provide detailed provisions on the setting up, designation or maintenance of national preventive mechanisms or the detailed provisions on institutional characteristics which such mechanisms must have.[37] Nevertheless, the Optional Protocol requires states parties to guarantee the functional independence of the national preventive mechanisms as well as the independence of their personnel, to take necessary measures to ensure that the experts of the national preventive mechanisms have the required capabilities and professional knowledge, and to strive for a gender balance and the adequate representation of ethnic and minority groups (Article 18 Paragraphs 1 and 2 of the Optional Protocol). The Optional Protocol also requires states parties to make available the necessary resources for the functioning of the national preventive mechanisms (Article 18 Paragraph 3 of the Optional Protocol). When establishing national preventive mechanisms, states parties must give due consideration to the Principles relating to the Status of National Institutions for the Promotion and Protection of Human Rights (The Paris Principles) (1993)[38] (Article 18 Paragraph 4 of the Optional Protocol). In order to facilitate the implementation of provisions of the Optional Protocol in the states parties, the Subcommittee on Prevention of Torture issued Guidelines on National Preventive Mechanisms (2010)[39] which contain basic principles for the national preventive mechanisms and guidelines regarding their establishment and operation.

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36 Upon ratification of the *Optional Protocol,* states parties may make a declaration postponing the implementation of their obligations under either part III or part IV of the *Optional Protocol.* This postponement shall be valid for a maximum of three years. After due representations made by the state party and after consultation with the Subcommittee on Prevention of Torture, the Committee against Torture may extend that period for an additional two years. (Article 24 of the *Optional Protocol*).

37 Steinerte, Elina, Murray, Rachel: „ Same but Different? National human rights commissions and ombudsman institutions as national preventive mechanisms unter the Optional Protocol to the UN Convention against Torture", *Essex Human Rights Review,* Vol. 6, No. 1, 2009, p. 58.

38 *Principles relating to the Status of National Institutions (The Paris Principles),* A/RES/48/134 (20 December 1993), the official websites of the United Nations, http://www.un.org/documents/ga/res/48/a48r134.htm

39 *Subcommittee on Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment, Guidelines on national preventive mechanisms, CAT/OP/12/5* (9 December 2010), the official websites of the United Nations, http://www.ohchr.org/EN/HRBodies/OPCAT/Pages/NationalPreventiveMechanisms.aspx

According to the basic principles contained in the Guidelines on National Preventive Mechanisms, the mandate and powers of the national preventive mechanism should be in accordance with the Optional Protocol and they should be clearly set out in a constitutional or legislative text.[40] The relevant legislation should specify the period of office of the members of the national preventive mechanism and any grounds for their dismissal.[41] The national preventive mechanism should be determined by an open, transparent and inclusive process which involves a wide range of stakeholders, including civil society.[42] However, states parties have the liberty to choose between setting up a new body, which will perform the tasks of the national preventive mechanism, or entrusting these tasks to existing bodies. From 76 states parties to the Optional Protocol, only 53 states parties formally chose bodies that perform the tasks of national preventive mechanism.[43] In practice states parties deal with the matter of establishing national preventive mechanism in different ways. The bodies entrusted with the tasks of the national preventive mechanisms fall broadly into four categories:

1. the existing or soon to be established national human rights institutions become the national preventive mechanisms,
2. an existing ombudsman takes on an additional position of the national preventive mechanism,
3. the national preventive mechanism is a combination of existing statutory or constitutional bodies or non-governmental organizations,
4. a specific body is created for the purpose of acting as the national preventive mechanism.44

Regardless of the type of the national preventive mechanism, its efficiency depends on its independence (functional as well as the independence of personnel), its credibility, the scope of its mandates, its ability to operate freely and sufficient funds for its functioning.[45]

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40 *Ibidem*, paragraphs 6 and 7.

41 *Ibidem,* paragraph 9.

42 *Ibidem,* paragraph 16.

43 The list of states parties to the Optional Protocol and national preventive mechanisms is available at the official websites of the United Nations, http://www.ohchr.org/EN/HRBodies/OPCAT/Pages/NationalPreventiveMechanisms.aspx

44 Murray, Rachel: „National Preventive Mechanisms under the Optional Protocol to the Torture Convention: One Size Does Not Fit All", *Netherlands Quaterly of Human Rights,* Vol. 26, No. 4, 2008, pp. 487 – 488.

45 Steinerte, Murray, op. cit. (note 37), p. 57.

III.2. POWERS OF NATIONAL PREVENTIVE MECHANISMS

Under Article 19 of the Optional Protocol states parties are required to grant the national preventive mechanisms minimum powers which include regular examinations of the treatment of persons deprived of their liberty in places of detention, to make recommendations to the relevant authorities with the aim of improving the treatment and the conditions of persons deprived of their liberty and to prevent torture and other cruel, inhuman or degrading treatment or punishment, and to submit proposals and observations concerning existing or draft legislation. In order to enable the national preventive mechanisms to fulfill their mandate, states parties are required to grant access to all places where persons are deprived of their liberty, access to all the information regarding those places of detention, as well as access to information referring to the treatment of those persons and their conditions of detention, the opportunity to have private interviews with persons deprived of liberty as well as with any other person who the national preventive mechanism believes may supply relevant information, and ultimately, the liberty to choose places they want to visit and the right to have contacts with the Subcommittee on Prevention of Torture (Article 20 of the Optional Protocol). The states parties also undertake the obligation to publish and disseminate the annual reports of the national preventive mechanisms and to examine their recommendations and enter into a dialogue about the possible implementation measures (Articles 22 and 23 of the Optional Protocol).

As mentioned earlier, in accordance with the basic principles contained in the Guidelines on the National Preventive Mechanisms, the mandate and powers of the national preventive mechanisms should be clearly set out in a constitutional or legislative text by states parties.[46] That way, the legally binding framework for the activities of the national preventive mechanisms on the national level of each state party to the Optional Protocol is created and their efficiency is improved. With time the national preventive mechanisms should enter a constructive dialogue with a state party to reconsider all recommendations and measures for improving the status of persons deprived of their liberty, and achieve the goal of the Optional Protocol, namely the prevention of torture and other forbidden treatment or punishment. On the other hand, the publication of annual reports of the national preventive mechanisms aims at transparency and strengthening

46 *Guidelines on national preventive mechanisms,* op. cit. (note 39), paragraphs 6 and 7.

the independence of these mechanisms.[47] To address practical issues regarding the work of the national preventive mechanisms and the issues regarding the functional independence of these mechanisms, in 2012 the Subcommittee on Prevention of Torture prepared a Preliminary guide by the Subcommittee on Prevention of Torture regarding the functioning of an NPM (the Analytical Self-assessment Tool for the National Prevention Mechanisms) [48].

IV. DESIGNATION AND POWERS OF THE NATIONAL PREVENTIVE MECHANISM IN THE REPUBLIC OF CROATIA

IV.1 DESIGNATION OF THE NATIONAL PREVENTIVE MECHANISM IN THE REPUBLIC OF CROATIA

With the ratification of the Optional Protocol on 5 April 5 2005 and its coming into force on 22 June 2006, the Republic of Croatia obliged itself to give the Subcommittee on Prevention of Torture the right to visit places of detention under the control and jurisdiction of the Republic of Croatia and also, it obliged itself to designate a national preventive mechanism. By the Act on National Preventive Mechanism Against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment (2011)[49] (hereinafter referred to as: the Act on National Preventive Mechanism) the activities of the National Preventive Mechanism are carried out by the Ombudsman. The first meeting of the National Preventive Mechanism was held on12 July 2012, by which the activities of the National Preventive Mechanism in the Republic of Croatia started.[50]

Considering the conditions for the establishment of the national preventive mechanisms defined by the Optional Protocol, the designation of Ombudsman as the National Preventive Mechanism in the Republic of Croatia is justified

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47 Olowu, 'Dejo: „Calibrating the Promise of the Optional Protocol to the Convention against Torture, and Other Cruel, Inhuman and Degrading Treatement or Punishment", *Stellenbosch Law Review,* Vol. 18, No. 3, 2007, p. 490.

48 *Analytical self-assessment tool for National Prevention Mechanisms, A Preliminary guide by the Subcommittee on Prevention of Torture regarding the functioning of an NPM,* CAT/OP/1 (6 February 2012), the official websites of the United Nations, http://www.ohchr.org/EN/HRBodies/OPCAT/Pages/NationalPreventiveMechanisms.aspx

49 *Zakon o Nacionalnom preventivnom mehanizmu za sprečavanje mučenja i drugih okrutnih, neljudskih ili ponižavajućih postupaka ili kažnjavanja,* Official Journal of the Republic of Croatia, No. 18/2011.

50 *Godišnje izvješće o obavljanju poslova Nacionalnog preventivnog mehanizma,* Ombudsman of the Republic of Croatia, Zagreb, 2013, p. 9.

for several reasons. First, the Ombudsman is a commissioner of the Croatian Parliament for the promotion and protection of human rights and freedoms laid down in the Constitution of the Republic of Croatia[51], laws and international legal acts on human rights and freedoms accepted by the Republic of Croatia, and as such the Ombudsman has the reputation of an independent institution with an extensive experience in the field of human rights protection. Second, since 2008, the International Coordinating Committee of National Institutions gave the Ombudsman's Office an "A status" as an institution for the promotion and protection of human rights, the highest status given to an institution for the protection of human rights which meets the criteria of the Paris Principles.[52] Third, in conformity with his legal powers under the Ombudsman's Act (2012)[53], the Ombudsman had previously regularly visited places of detention. Actions taken under the Ombudsman Act are reactive, and are based on the examining of the individual complaints of persons deprived of their liberty. On the other hand, under the Act on National Preventive Mechanism the Obmudsman takes preventive actions in order to strengthen the protection of persons deprived of their liberty from ill-treatment.[54]

In order to increase the perception of independence and transparency of the national preventive mechanisms, and thus their credibility, states parties to the Optional Protocol often include non-governmental representatives in activities of the national preventive mechanisms in various ways.[55] The Republic of Croatia also opted for this approach, so aside from the Ombudsman, two representatives of non-governmental organizations, registered for carrying out activities in the area of human rights protection, and two representatives of the academic community, appointed by the Ombudsman on a suggestion of human rights organizations or higher education institutions on the basis of a public invitation, have to take part in carrying out the activities of the National Preventive Mechanism (Article

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51 *Ustav Republike Hrvatske*, Official Journal of the Republic of Croatia, Nos. 56/1990, 135/1997, 8/1998, 113/2000, 124/2000, 28/2001, 41/2001, 55/2001, 76/2010 and 85/2010 – consolidated text, Article 93 Paragraph 1.

52 The official websites of the Ombudsman of the Republic of Croatia, http://www.ombudsman.hr/index.php/hr/2014-02-21-22-30-08/nadleznosti/nacionalna-institucija-za-ljudska-prava-nhri

53 *Zakon o pučkom pravobranitelju,* Official Journal of the Republic of Croatia, No. 76/2012, Article 4.

54 *Izvješće pučke pravobraniteljice za 2013. godinu,* Ombudsman of the Republic of Croatia, Zagreb, 2014, p. 134.

55 For more details, see Murray, op. cit. (note 44), p. 500.

2 Paragraphs 1 and 2 of the Act on National Preventive Mechanism). When necessary, the Ombudsman also includes other independent experts (Article 2 Paragraph 3 of the Act on National Preventive Mechanism). While conducting regular visits to places in which persons are or may be deprived of their liberty, aside from the Ombudsman or an authorised person from the Ombudsman's Office, the participation of at least one representative from non-governmental organizations registered for carrying out activities in the area of the protection of human rights, or a representative of the academic community, is required (Article 4 of the Act on National Preventive Mechanism). However, this way of inclusion of civil society and academic community representatives has shown to be ineffective, so the process of the amendment of the Act on National Preventive Mechanism is in progress, as discussed in the next sections.

IV.2. ACTIVITIES AND POWERS OF THE NATIONAL PREVENTIVE MECHANISM IN THE REPUBLIC OF CROATIA

The Act on National Preventive Mechanism differentiates between the activities and the powers of the National Preventive Mechanism. Under the term "activities of the National Preventive Mechanism" three minimum powers have been implemented into the Croatian legislation, which, according to the Article 19 of the Optional Protocol, states parties have to ensure to the national preventive mechanisms: regular visits to places where persons are or may be deprived of their liberty, giving recommendations to competent government bodies and institutions and making proposals and observations concerning the existing laws and regulations or their drafts (Article 3 of the Act on National Preventive Mechanism). The list of activities of the National Preventive Mechanism also includes the cooperation with the Subcommittee on Prevention of Torture, which in the Optional Protocol is not originally included in minimum powers, but in the list of powers which must be ensured by the states parties, in order for the national mechanisms to fulfill their mandate.

Pursuant to Article 5 of the Act on National Preventive Mechanism, the persons carrying out the activities of the National Preventive Mechanism have the following powers: to pay announced visits to places or institutions and examine the facilities where persons deprived of their liberty are kept; to have free access to all information concerning the places and institutions where persons deprived of their liberty are kept; to have free access to all information concerning the number of persons deprived of their liberty in the visited places or institutions

and to have free access to all information concerning the treatment of persons deprived of their liberty in accordance with the law. They also have the power to conduct private interviews with persons deprived of their liberty, by choice and without the presence of the officials of the visited place or institution of detention and to talk to other persons who may provide relevant information regarding the suspected violation of human rights by the treatment given in the place or institution visited.

The main task of the National Preventive Mechanism is paying visits to places where persons deprived of their liberty are or may be. In the Republic of Croatia, there are more than 870 such places within the jurisdiction of five different ministries: Ministry of Justice, Ministry of the Interior, Ministry of Health, Ministry of Social Policy and Youth and Ministry of Defence.[56] On the basis of the minutes of the visit, the Ombudsman writes a report and sends it to the visited place or institution, and in the case of any irregularities detected during the visit, he also sends the report to the body competent for the supervision of the visited place or institution (Article 8 Paragraph 2 of the Act on National Preventive Mechanism). If any forms of torture or other cruel, inhuman or degrading treatment or punishment are detected during the visit, the Ombudsman will warn and give recommendations and deadlines for taking measures to the visited place or institution where the violations have occurred. Upon such warning or recommendations given by the Ombudsman, the body or the institution where such violation has been established is bound to take measures within the deadline specified in the report and inform the Ombudsman without delay on such measures. If the body or the institution fails to take measures within the deadline given by the Ombudsman, or does not follow his recommendations, the Ombudsman will inform the Croatian Parliament accordingly (Article 8 Paragraph 3 of the Act on National Preventive Mechanism). By submitting a report on the identified cases of torture and other forms of misconduct to the body which supervises the visited body or the institution, and to the Croatian Parliament if the body or institution does not follow the recommendations of the Ombudsman, that body or institution can be pressurized, and thus the role of the Ombudsman as the National Preventive Mechanism is reinforced. The obligation to prepare and publish an annual report on the performance of the

56 List of places of detention in the Republic of Croatia is available in *Godišnje izješće o obavljanju poslova Nacionalnog preventivnog mehanizma,* op. cit. (note 50), p. 10.

National Preventive Mechanism, and its submission to the Croatian Parliament, ensure the transparency and efficiency of the Ombudsman's work.

V. ANALYSIS OF TO-DATE ACTIVITIES OF THE OMBUDSMAN AS THE NATIONAL PREVENTIVE MECHANISM

The independence of a national preventive mechanism, regularity of its visits to places where persons are or may be deprived of their liberty and its engaging in dialogue with the government with the aim of preventing torture and other cruel, inhuman or degrading treatment or punishment, are the basic criteria in assessing the efficiency of national preventive mechanisms. Further on, the to-date activities of the Ombudsman as the National Preventive Mechanism and the Proposal of the Act on the Amendments to the Act on National Preventive Mechanism Against Torture and Other Cruel, Inhuman, or Degrading Treatment or Punishment (2014)[57] will be analyzed within the context of the above criteria. The legislative framework and the activities of the National Preventive Mechanism in the Republic of Croatia will be compared with those in the Republic of Slovenia. Namely, if the proposed amendments to the Act on National Preventive Mechanism get adopted, the National Preventive Mechanism in the Republic of Croatia will be structured in a similar way to the one in the Republic of Slovenia. The model in question is the so-called "Ombudsman plus" model, in which the activities of national preventive mechanism are carried out by the Ombudsman, and in agreement with him non-governmental organizations selected on the basis of a public invitation.[58]

V.1 REGULARITY OF VISITS TO PLACES WHERE PERSONS ARE DEPRIVED OF THEIR LIBERTY

Since the establishment of the National Preventive Mechanism in the Republic of Croatia, limitations which adversely affect the efficiency of its work have already been noticed. The main limitation is the insufficient number of visits to places where persons are deprived of their liberty. The philosophy behind the idea of a system of preventive visits was built, *inter alia,* on experiences of

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57 *Prijedlog Zakona o izmjenama i dopunama Zakona o nacionalnom preventivnom mehanizmu za sprečavanje mučenje i drugih okrutnih, neljudskih ili ponižavajućih postupaka ili kažnjavanja,* the official websites of the Croatian Parliament, http://www.sabor.hr/prijedlog-zakona-o-izmjenama-i-dopunama-zakona-o-n

58 Geamănu, op. cit. (note 29), p. 57.

the International Committee of the Red Cross, which had shown that merely the fact that an independent organization could carry out visits to places of detention, preferably without notification, had considerable preventive effect on the occurence of torture and other cruel, inhuman or degrading treatment or punishment.[59] If such visits are rare, the effectiveness of the system and its mechanisms is questionable.

What is meant by "regularity of visits" is not elaborated neither in the Optional Protocol nor in the Act on National Preventive Mechanism. The Subcommittee on Prevention of Torture also does not clarify this issue in detail, but it recommends in its Guidelines for National Preventive Mechanisms that the national preventive mechanisms should plan their work and use of resources in such way and with sufficient frequency to ensure that their contribution to the prevention of torture and other cruel, inhuman or degrading treatment or punishment is effective.[60] Association for the Prevention of Torture[61] recommends that the national preventive mechanism should at least once per year carry out an in-depth visit to places of detention with high risk of the occurrence of torture (police stations with known problems plus a random sample of other police stations, remand or pre-trial detention centres, places with high concentrations of especially vulnerable groups and any other places known or suspected to have problems with torture and other illegal treatment).[62] Association for the Prevention of Torture also recommends that the national preventive mechanism should carry out an in-depth visit to each place of detention at least once in every three or five years.[63] Longer in-depth visits should be combined with shorter *ad hoc* visits.[64] The frequency of visits to any particular place of detention depends on the type of visit, the category of the place being visited, the findings of the

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59 Kessing, loc. cit. (note 13)

60 *Guidelines for national preventive mechanisms,* op. cit. (note 39), paragraph 34.

61 Association for the Prevention of Torture (APT) is a non-governmental organization founded in 1977 by Jean-Jaques Gautier, the creator of the idea of preventive visits. For more details, see the official websites of the Association for the Prevention of Torture, http://www.apt.ch/en/about-us/

62 *Establishment and Designation of National Preventive Mechanisms,* Association for the Prevention of Torture (APT), Geneva, 2006, p. 36.

63 *Ibidem.*

64 *Ibidem.*

previous visits and the availability of information about the place where persons are deprived of their liberty.[65]

From the beginning of its activities in July 2012 till the end of 2013, the National Preventive Mechanism in the Republic of Croatia visited only 19 such places (seven places in 2012 and twelve places in 2013)[66], whereas the National Preventive Mechanism of the Republic of Slovenia visited 46 such places in 2012 and 48 such places in 2013.[67] The following reasons have been identified for the small number of visits of the National Preventive Mechanism in the Republic of Croatia: the lack of sufficient funds for the non-governmental organizations representatives and the representatives of the academic community fees, the inability of conducting visits without the presence of the academic community and organizations' representatives, and the fact that the inspections of the places of detention, which are performed by the Ombudsman pursuant to Article 28 of the Ombudsman Act, are not considered visits by the National Preventive Mechanism, because the representatives of the academic community and non-governmental organizations do not participate in them.[68] The up-date normative regulation, along with the insufficient funds, has largely prevented the Ombudsman from carrying out the National Preventive Mechanism tasks efficiently. According to the proposed amendments to Article 2 of the Act on National Preventive Mechanism, just like in the Republic of Slovenia[69], the tasks

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65 Pirjola, Jari: „The Parlamentary Ombudsman of Finland as a National Preventive Mechanism under the Optional Protocol to the United Nations Convention against Torture and Other Cruel, Inhuman or Degrading Treatemant or Punishment", *Nordic Journal of International Law,* Vol. 77, No. 1, 2008, p. 166.

66 For more details, see *Prijedlog Zakona o Nacionalnom preventivnom mehanizmu,* op. cit. (note 57), p. 1, *Godišnje izvješće o obavljanju poslova Nacionalnog preventivnog mehanizma za 2012. godinu,* op. cit. (note 50), pp. 13 – 22. and *Izvješće pučke pravobraniteljice za 2013. godinu,* op. cit. (note 54), pp. 141 - 149.

67 *Poročilo o izvajanju nalog DPM v letu 2013, Državni preventivni mehanizem po Opcijskem protokolu h Konvenciji OZN proti mučenju in drugim krutim, , nečloveškim ali poniževalnim kazni ali ravnanju (Implementacion of The Duties and Powers of the NPM in 2013 (National Preventive Mehanism under the Optional Protocol to the UN Convention agains Torture and Other Cruel, Inhuman or Degrading Treatement or Punishment,* Ombudsman of the Republic of Slovenia, Ljubljana, 2014, p. 11.

68 For more details, see *Prijedlog Zakona o izmjenama i dopunama Zakona o Nacionalnom preventivnom mehanizmu,* op. cit. (note 57), pp. 1 – 2.

69 For more details, see *Zakon o ratifikaciji Opcijskega protokola h Konvenciji proti mučenju in drugim krutim, , nečloveškim ali poniževalnim kazni ali ravnanju (MOPPM),* Official Gazete of the Republic of Slovenia, No. 114/2006, International agreements, No. 20/2006 (9 November 2006), Articles 4 and 5.

of the National Preventive Mechanism would be carried out by the Ombudsman, who would collaborate with the organizations registered for carrying out activities in the field of human rights protection, which would be selected on the basis of public invitation.[70] Unlike the Slovene "Ombudsman plus" model, the Ombudsman of the Republic of Croatia has an additional option of cooperating with special ombudsmen, pursuant to the proposed amendments to the Act on National Preventive Mechanism.[71] Since the special ombudsmen (ombudsman for children, ombudsman for persons with disabilities and ombudsman for gender equality) within their jurisdiction visit places where persons are deprived of their liberty, their cooperation with the Ombudsman in the activities of the National Preventive Mechanism will certainly allow for a greater number of visits. The proposed removal of the word "regular" in the Article 3 Paragraph 1 Subparagraph 1 of the Act on National Preventive Mechanism should contribute to the greater number of visits.[72] Namely, the Ombudsman as the National Preventive Mechanism does not only have to pay regular visits to places where persons are deprived of their liberty, but also carry out control and *ad hoc* visits, which is accepted by the proposed amendment.

If the proposed amendments get adopted, during the planning of activities of the National Preventive Mechanism it would be advisable to combine shorter *ad hoc* visits, which the Ombudsman (or his employees authorized for carrying out visits) and special ombudsmen would carry out on their own, with regular, in-depth visits of specific places where non-governmental organizations selected on the basis of public invitation and independent experts would participate. Considering that, pursuant to the proposed amendments of Article 11 of the Act on National Preventive Mechanism, independent experts and members of selected non-governmental organizations are entitled to a fee for carrying out the activities of National Preventive Mechanism, and considering the fact that those funds are limited, this way of carrying out of preventive visits would enable a greater number of visits, but also inclusion of both civil society representatives and independent experts during in-depth visits. This should ultimately result in the strengthening of protection of persons who are deprived of their liberty from torture and other cruel, inhuman and degrading treatment or punishment.

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70 *Prijedlog Zakona o izmjenama i dopunama Zakona o Nacionalnom preventivnom mehanizmu,* op. cit. (note 57), Article 1.Paragraphs 1 and 2.

71 *Ibidem,* Article 1 Paragraphs 3 and 4.

72 *Ibidem,* Article 2.

V.2 INDEPENDENCE OF THE OMBUDSMAN AS THE NATIONAL PREVENTIVE MECHANISM

Independence of the national preventive mechanism means that this mechanism must be capable of acting independently and without coercion by state authorities, and it must also be perceived as such in public.[73] This goal can be achieved by separating the national preventive mechanism from executive and judicial powers of the state, ensuring financial independence and by having an appropriate composition of the national preventive mechanism.[74] As mentioned earlier, the Ombudsman meets these criteria, and its designation as a National Preventive Mechanism in the Republic of Croatia was justified. The Ombudsman in the Republic of Croatia is an independent body, separated from executive and judicial powers of the state, the activities of which are based on the Constitution of the Republic of Croatia. Even though the Ombudsman is elected by the Croatian Parliament, he is independent of legislature and does not take orders from legislators. The Ombudsman alone decides on the internal structure, method of working, personnel, and other important issues related to his work.[75] The financial independence is the prerequisite to the functional independence. So, the funds for the activities of the National Preventive Mechanism are allocated in the state budget as a special item within the budget assigned to the Ombudsman's Office (Article 10 of the Act on National Preventive Mechanism). It should be noted that although the Ombudsman uses the state-assigned funds, his work as the National Preventive Mechanism depends greatly on the amount of budget assigned.

V.3. DIALOGUE WITH THE BODIES OF STATE AUTHORITY

The purpose of the Optional Protocol is not only prevention from torture and other cruel, inhuman or degrading treatment or punishment, but also acting in a proactive manner to improve the conditions of detention and treatment of persons

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73 Pirjola, op cit. (note 65), p. 165.

74 *Ibidem.*

75 The Ombudsman of the Republic of Croatia adopts *Poslovnik pučkog pravobranitelja,* Official Journal of the Republic of Croatia, No. 99/2013, *Pravilnik o unutarnjem redu Ureda pučkog pravobranitelja,* the official websites of the Ombusman of the Republic of Croatia, http://www.ombudsman.hr/index.php/hr/propisi, *Pravilnik o postupku imenovanja i načinu rada predstavnika udruga i predstavnika akademske zajednice u Nacionalnom preventivnom mehanizmu za sprečavanje mučenja i drugih okrutnih, neljudskih ili ponižavajućih postupaka ili kažnjavanja,* Official Journal of the Republic of Croatia, No. 22/2012 etc.

deprived of their liberty.[76] With the same purpose, a constructive dialogue between the bodies of state authority and the national preventive mechanism should be established. The dialogue on prevention and improvement of conditions in places where persons are deprived of their liberty is a long-term process that happens at many levels (with government ministers, legislators, prison system directors, prison staff etc.).[77] In order for the dialogue to be established, it is important to build mutual confidence.[78] The establishment of dialogue between the national preventive mechanism and the bodies of state authority is of vital importance when facing with issues, the dealing of which requires substantial funding and legal changes. One of such issues in the Republic of Croatia is the overpopulation in the Croatian prisons, which results in many other issues (inadequate living conditions etc.).[79]

The cooperation of the bodies of state authority with the Ombudsman as the National Preventive Mechanism in the Republic of Croatia is generally considered a success, except for the cooperation with the Ministry of Justice during 2012, which was viewed as unsatisfactory.[80] In the 2013 report of the Ombudsman it was stated that since a quality cooperation is one of the prerequisites for strengthening the protection of rights of persons deprived of their liberty, it is necessary to strengthen the dialogue with the bodies of state authority.[81] Relatively successful establishment of dialogue between the National Preventive Mechanism and the bodies of state authority in the Republic of Croatia owes a great deal to the fact that these activities were entrusted to the Ombudsman. Namely, by acting in accordance with his powers given by the Ombudsman Act, the Ombudsman has already protected the rights of persons deprived of their liberty, and paid visits to places where such persons reside. The Ombudsman has also built up the reputation of the institution which promotes and protects human rights and freedoms and rule of law, by examining the complaints of the existence of unlawful practices and irregularities in respect to the work of

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76 Pirjola, op. cit. (note 65), p. 172.

77 Casale, Silvia: „The Importance of Dialogue and Cooperation in Prison Oversight", Pace Law Review, Vol. 30, No. 5, 2009-2010, p. 1494.

78 *Ibidem.*

79 Babić, Vesna *et al:* „Hrvatski zatvorski sustav i zaštita ljudskih prava zatvorenika", *Hrvatski ljetopis za kazneno pravo i praksu,* Vol. 13, No. 2, 2006, p. 724.

80 *Godišnje izvješće o obavljanju poslova Nacionalnog preventivnog mehanizma,* op. cit. (note 50), p. 34.

81 *Izvješće pučke pravobraniteljice za 2013. godinu,* op. cit. (note 54), p. 161.

government bodies, bodies of local and regional self-government unites and legal persons vested with public authority and legal and natural persons in accordance with special laws.

VI. CONCLUSION

Torture and other cruel, inhuman or degrading treatment or punishment are prohibited by the numerous international, regional and national regulations. However, the experience has shown that prohibition alone is not enough to stop these kind of behaviors. Therefore the issue of establishment of efficient mechanisms for protection against torture and other prohibited treatment or punishment is a prerequisite for strengthening the protection of persons deprived of their liberty. The system of preventive visits to places where such persons reside which is foreseen by the Optional Protocol consists of two mechanisms (international and national) which share the same goal: to prevent torture and other cruel, inhuman or degrading treatment or punishment. Innovativeness and efficiency of this system resides on the national preventive mechanisms.

Appointment of the Ombudsman in the Republic of Croatia for carrying out the activities of the National Preventive Mechanism was logical since this institution fulfills the criteria set by the Optional Protocol and possesses experience in the area of protection and promotion of human rights, including the protection of persons deprived of their liberty. However, the way in which representatives of non-governmental organizations and academic community were included in carrying out the activities of the National Preventive Mechanism was inadequate. On one hand, that system has resulted in small number of visits to places where persons are deprived of their liberty, which brought in question the efficiency of the mechanism. On the other hand, the system has enabled participation of a small number of representatives of non-governmental organizations and academic community. The question is why was the National Preventive Mechanism established in such way, when the Republic of Croatia could have observed the situation in the neighbor countries (especially the Republic of Slovenia), which had earlier established the efficient national preventive mechanism, and on whose model the suggested amendments to the Act on National Preventive Mechanism are based. It is certain that the amendments will be adopted, so it remains to be seen whether they will lead to the increased number of visits to places where persons are deprived of their liberty, and to greater efficiency of the National Preventive Mechanism. It also remains to be seen in which way,

and in what measure the Ombudsman will establish cooperation with special ombudsmen, organizations and independent experts in carrying out the activities of the National Preventive Mechanism.

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THE DIVISION OF THE COMPETENCES IN THE EUROPEAN UNION IN THE CONTEXT OF THE REGULATION NO 1309/2013 ON THE EUROPEAN GLOBALIZATION ADJUSTMENT FUND (2014-2020)

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ABSTRACT

The Lisbon Treaty has set a clear division of the competences between the European Union and the Member States of the European Union. In the context of the Regulation (EU) No 1309/2013 of the European Parliament and of the Council of 17 December 2013 on the European Globalization Adjustment Fund 92014-2020) and repealing Regulation (EC) No 1927/2006 it is stated that according with the principle of subsidiarity as set out in Article 5 of the Treaty on the European Union, the Union may adopt measures since the objectives of this Regulation by reason of their scale and effects cannot be sufficiently achieved by the Member States. At the same time this Regulation points out that this does not go beyond what is necessary in order to achieve those objectives.

This is an example of how the European organization-the European Union, which is the only one in the world with such a competences in relation to its Member States, manages to handle the tough situation of global financial and economic crisis and globalization giving its assistance but at the same time not replacing but where possible complementing the activities of the Member States of the European Union.

Keywords: EU competences, subsidiarity, social policy, cohesion policy, globalization.

1. INTRODUCTION:

The presentation is a thorough analysis of various EU legal acts and opinions on how the EU social policy is implemented. The aim is to prove that the EU competences help combat a growing unemployment rate in the Member States.

It is useful to look at the main findings of a comparative study on the labour market in several Member States of the EU carried out by a voluntary group of researchers from several countries[1]. The aim of those studies was to develop approaches and methodologies for comparing tax and benefit systems across countries (Denmark, Finland, Great Britain, Italy, The Netherlands, Spain and Sweden). In particular, the interest was focused on the examination of incentives to work and their impact on labour market. The analysis enables a better understanding of national specific conditions as well as to compare them at the international level. Long term unemployment was considered as a social exclusion route.

The period for which a person is entitled to unemployment benefits varies largely across countries. Moreover, the duration of the unemployment benefit receipt in some countries depends on how long the insured has to pay contributions to the scheme. For example in the Netherlands receipient must have worked in 26 out of the previous 36 weeks before the first day of unemployment and may receive 75 per cent for the first two months and thereafter 70 per cent of the last earned salary (there's a maximum daily rate of EUR 195.96)[2]. In Poland you become entitled to the allowance for every calendar day with effect seven daysafter registering with the relevant local labour office, if:

a/ there are no offers of employment, training, internships, traineeships with an employer, or public works appropriate for you as an unemployed person, and

b/ you were employed for at least 365 days over the 18 months prior to the date you registered, and you were paid an amount which was not lower than the minimum amount upon which the contribution to the Labour

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1 European Commission, Directorate-General for Economic and Financial Affairs, Economic Papers No. 193. *Remain in or withdraw from the labour market? A comparative study on incentives by Aino Salomäki,* (October 2003) // http://ec.europa.eu/economy_finance/publications/publication839_en.pdf (accessed March 28, 2015).

2 European Commission, *Your social security rights in the Netherlands*, EU 2013 // http://ec.europa.eu/employment_social/empl_portal/SSRinEU/Your%20social%20security%20rights%20in%20Netherlands_en.pdf (accessed March 28,2015).

Fund must be paid, or you fulfil the requirements by documenting another period qualifying you for the unemployment allowance[3].

The gross basic amount of the unemployment benefit is currently PLN 823.60 (€ 190) per month for a period of three months, and PLN 646.70 (€ 149) thereafter[4]. An unemployed person whose qualification period for the allowance is less than 5 years is eligible for an allowance equal to 80% of the basic amount[5]. An unemployed person whose qualification period for the allowance is at least 20 years is eligible for an allowance equal to 120% of the basic amount.

The duration of the unemployment benefit depends notably on the unemployment rate in the area in which you live, and can either be 6 or 12 months, i.e.:

a/ 6 months in areas with an unemployment rate less than 150% of the national average,

b/ 12 months in areas with an unemployment rate of at least 150% of the national average, or if the claimant has completed a qualifying period of 20 years and is over 50 years old, or if the claimant's spouse is unemployed, not entitled to an allowance and they have at least one dependent child under the age of 15 years[6].

After such a period of varying length, when the eligibility for unemployment benefit expires, the unemployed person usually qualifies for social assistance or unemployment assistance. Social assistance is the exit scheme in most countries except in Finland, the UK and Spain[7]. In Finland, the unemployed person is entitled to labour market support, which can, however, be topped up by social assistance if the latter provides a higher level of income maintenance[8]. This can be the case especially for families with children. In Spain, the exit scheme

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3 European Commission, *Your social security rights in Poland*, EU 2013 // http://ec.europa.eu/employment_social/empl_portal/SSRinEU/Your%20social%20security%20rights%20in%20Poland_en.pdf (accessed March 28, 2015).

4 *Ibid.*

5 *Ibid.*

6 *Ibid.*

7 European Commission, *Remain in or withdraw from the labour market?*, *ibid.* // http://ec.europa.eu/economy_finance/publications/publication839_en.pdf (accessed March 28, 2015).

8 *Ibid.*

is unemployment assistance[9], and in the UK the means-tested Jobseekers Allowance[10]. Unemployment compensation often leads to incentive problems particularly at the low-income level. This is sometimes also the case at the average income level.

The insurance scheme is aimed at short to medium terms of unemployment, while the exit scheme is provided for a longer term, usually without time limit. As far as incentives to work are concerned, there is a problem with the long-term exit scheme which results in higher replacement rates than the insurance scheme. It concerns low wage levels, and sometimes also average wage levels, in particular the one-earner couple. However, the problem may be diminished since the number of households in the 'classic' family type is being replaced by two-earner couples. The net replacement rates from the two schemes examined above are often similar in the case of the UK, Denmark, Sweden and the Netherlands[11]. In Spain, continuation of unemployment has little effect on the level of net replacement rates, especially at low wage levels. The problem is that in some countries social assistance does not require availability for the labour market. In most countries, the level of social assistance is comparable to the level of unemployment benefit at 67 per cent of the average wage level[12].

2. TIME TO TAKE ACTION BY THE EU

Tibor Palankai noted that, in the last decades we entered into a new stage of development of economy and society[13]. *(…) The globalization and particularly global integration have resulted in broad socio-economic structural changes, while there is a clear mismatch in terms of institutional and regulatory responses. Globalization so far was (…) based on deregulation and liberalization, while new necessary institutions and regulatory frameworks were missing. In fact, it raises the*

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9 European Commission, *Your social security rights in Spain*, EU 2013 // http://ec.europa.eu/employment_social/empl_portal/SSRinEU/Your%20social%20security%20rights%20in%20Spain_en.pdf (accessed March 28, 2015).

10 European Commission, *Your social security rights in the UK*, EU 2013 // http://ec.europa.eu/employment_social/empl_portal/SSRinEU/Your%20social%20security%20rights%20in%20UK_en.pdf (accessed March 28, 2015).

11 European Commission, *Remain in or withdraw from the labour market?*, *ibid.* // http://ec.europa.eu/economy_finance/publications/publication839_en.pdf (accessed March 28, 2015).

12 *Ibid.*

13 T. Palankai, *The New European Union Frameworks for Confronting Global Economic Challenges*, (in:) *The European Union: after the Treaty of Lisbon; Visions of Leading policy-makers, academics and journalists,* Belgium: Luxembourg Publications Office of the EU, 2011, p.189.

problem of the proper multi-level governance and development of its corresponding structures. (…) it is clear that fundamental reforms are needed in all levels from local to national, from regional to global ones, and what is important that their coherence and coordination should be also radically improved[14].

No doubt that the welfare state is in crisis. The welfare state is, however, an achievement of the European civilization, it is a European social value, which should be reformed, but not eliminated.(…) At the European Union level more coordination is needed[15].

In my opinion, more coordination is needed at the EU level in the sphere of employment aid and reintegration into working life, which is consistent with the idea of inclusive growth promoted by the EU.

Advocate General Bot in his opinion delivered on 2 April 2009 to the case C-166/07 *European Parliament v. Council of the EU*[16], on the choice of legal basis to continue the Community contribution to the International Fund for Ireland (2007-2010) emphasized the role and the scope of the third paragraph of Article 159 TEC (175 TFEU[17]). In paragraph 54 of the opinion Advocate General Bot pointed out that the Commission had considered that the general nature of the policy established by Article 158 EC (174 TFEU[18]) is not reconcilable with a specific project which is from the outset limited to a single region of the Community (now the EU). A specific project cannot be implemented generally[19].

The term 'specific actions' in the third paragraph of Article 159 EC (175 TFEU) is by no means synonymous with *ad hoc*, or occasional projects. This view of the general purpose of the third paragraph of Article 159 EC (175 TFEU) accords with legislative practice in this area[20]. Regulation (EC) No 1927/2006 establishing the European Globalization Adjustment Fund was adopted on the

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14 *Ibid*., p. 192.

15 *Ibid.*, p. 193.

16 *Opinion to the case C-166/07 European Parliament v. Council of the EU*, Opinion of Advocate General Yves Bot (2 April 2009).

17 *Consolidated version of the Treaty on the Functioning of the EU*, Official Journal of the European Union (2012, no. C 326), art. 175.

18 *Ibid.*, art. 174.

19 In *proposal for a Council regulation concerning Community financial contribution to the International Fund for Ireland (2007-2010) presented by the Commission,* COM (2006) 564 final, 2006/0194 (CNS) // http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52006PC0564 (accessed March 28, 2015).

20 Specific Actions Necessary Outside the Structural Funds.

above mentioned legal basis[21]. According to the Commission the Regulation is of a horizontal nature[22].

In the sixth annual report of the Commission on the European Globalization Adjustment Fund[23], the Commission proved that the European Globalization Adjustment Fund had added value to what the Member States could have done in order to help redundant workers find new jobs. The Fund provided measures to a larger number of redundant workers, for a longer duration and of better quality than it would have been possible without the financial support of the European Globalization Adjustment Fund[24].

The objective, as set out in the Article 1 of the Regulation No 1309/2013[25] is to establish the European Globalization Adjustment Fund for the period of the Multiannual Financial Framework from 1 January 2014 to 31 December 2020. The aim of the European Globalization Adjustment Fund, as stated in the regulation in question, is *to contribute to smart, inclusive and sustainable economic growth and to promote sustainable employment in the Union by enabling the Union to demonstrate solidarity towards, and to support workers made redundant and self-employed persons whose activity has ceased as a result of major structural changes in world trade patterns due to globalization, as a result of a continuation of the global financial and economic crisis addressed in Regulation (EC) No 546/2009, or as a result of a new global financial and economic crisis*[26].

The Commission recognized the role of the European Globalization Adjustment Fund as a *flexible fund to support workers who lose their jobs and to help them (…) find another job as rapidly as possible*[27].

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21 *Consolidated version of the Treaty on the Functioning of the EU*, Official Journal of the European Union (2012, no. C 326), art. 175.

22 Note 18 in the *Opinion to the case C-166/07 European Parliament v. Council of the EU*, Opinion of Advocate General Yves Bot (2 April 2009).

23 European Commission, *Sixth annual report on the activities of the European Globalization (Adjustment) Fund (EGF) in 2012 from the Commission to the European Parliament and the Council, required under Article 16 of the EGF Regulation (EC) No 1927/2006*, (2013) // http://european-memoranda.cabinetoffice.gov.uk/files/2014/03/14562-131.pdf (accessed March 28, 2015).

24 *Ibid.*

25 *Regulation (EU) No 1309/2013 of the European Parliament and of the Council of 17 December 2013 on the European Globalization Adjustment Fund (2014-2020) and repealing Regulation (EC) No 1927/2006*, Official Journal of the European Union, (2013, no. L 347), art. 1.

26 *Ibid.*

27 *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions of 29 June 2011 - A Budget for*

Undoubtedly, it is also one of the means to overcome the adverse effects of globalization by the creation of jobs throughout the Union[28]. In order to help people anticipate and manage change, and build an inclusive, cohesive society, one of the three priorities of the Europe 2020 strategy[29] is inclusive growth[30]. That inclusive growth is to be maintained by empowering people through high levels of employment investing in skills, fighting poverty and modernizing labour markets, training and social protection systems.

The above mentioned goal is consistent with two titles of the policies defined and implemented by the European Union: title X of the Treaty on the Functioning of the European Union (TFEU)-Social Policy[31] and title XVIII of the TFEU-Economic, Social and Territorial Cohesion[32]. Shared competence between the Union and the Member States applies in this two areas[33]. The Lisbon Treaty is the first legally binding Union act which describes the system and defines the basic notions connected with the division of the competences between the Union and the Member States. It is rather a starting point for the further evolution than the

Europe 2020, (COM(2011) 500 final) // http://ec.europa.eu/budget/library/biblio/documents/fin_fwk1420/MFF_COM-2011-500_Part_I_en.pdf (accessed March 28, 2015).

28 See M. Rewizorski, *Prawne aspekty rynku pracy w UE* [*Legal aspects of the employment market in the EU*], (in:) R. Gabryszak, D. Magierka, eds., *Europejska polityka społeczna* [*European social policy*], Warszawa (Warsaw) Wyd. Difin, 2011, p. 132 describes European Employment Strategy as a fundamental instrument to coordinate national employment policies in the Member States of the EU.

29 A new strategy for smart sustainable and inclusive growth launched by the European Council on 26 March 2010. See *Communication from the Commission Europe 2020, A strategy for smart, sustainable and inclusive growth*, Brussels (2010, no. COM (2010) 2020), p. 3 // http://ec.europa.eu/eu2020/pdf/COMPLET%20EN%20BARROSO%20%20%20007%20-%20Europe%202020%20-%20EN%20version.pdf (accessed March 28, 2015).

30 See Z. Werra, *Nowa strategia Unii Europejskiej Europa 2020* [*EU's new strategy Europe 2020*], (in:) R. Gabryszak, D. Magierka, eds. *Europejska polityka społeczna* [*European social policy*], Warszawa (Warsaw) Wyd. Difin, 2011, p. 208.

31 See W. Hakenberg, *Prawo europejskie* [*European Law*], Warszawa (Warsaw) Wyd. C.H.Beck, 2012, p. 210-223; for interrelations between the social policy and economic policy in the EU see also D. Magierek, *Kompetencje Unii Europejskiej w zakresie polityki społecznej* [*EU cometences in social policy*], (in:) R. Gabryszak, D. Magierka, eds. *Europejska polityka społeczna* [*European social policy*], Warszawa (Warsaw) Wyd. Difin, 2011, p. 8-10.

32 *Consolidated version of the Treaty on the Functioning of the EU*, Official Journal of the European Union (2012, no. C 326), Title X: art. 151-161 and Title XVIII: art. 174-178.

33 *Ibid.*, art. 4.2 letter b and c of the TFEU.

outcome of this evolution in the *Union acquis*[34]. Article 2 TFEU[35] is the most important element of the part dedicated to the typology of the competences in the Union. Article 4.2 TFEU[36] is the one concerning the social policy. Those two articles should be interpreted together.

In the Part One-Principles, Title I-Categories and Areas of Union Competence, Article 2.2 TFEU[37] states that: *When the Treaties confer on the Union a competence shared with the Member States in a specific area, the Union and the Member States may legislate and adopt legally binding acts in that area. The Member States shall exercise their competence to the extent that the Union has not exercised its competence. The Member States shall again exercise their competence to the extent that the Union has decided to cease exercising its competence*.

Following Article 2.3 TFEU[38] states that: *The Member States shall coordinate their economic and employment policies within arrangements as determined by this Treaty, which the Union shall have competence to provide*. As such, the regulation in question was adopted having regard to the TFEU and in particular the third paragraph of Article 175 TFEU[39]: *If specific actions prove necessary outside the Funds and without prejudice to the measures decided upon within the framework of the other Union policies, such actions may be adopted by the European Parliament and the Council acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee and the Committee of the Regions*.

In order to strengthen the cooperation, Article 5.2 TFEU[40] enables the European Union to *take measures to ensure coordination of the employment policies of the Member States, in particular by defining guidelines for these policies* and additionally *the Union may take initiatives to ensure coordination of Member*

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34 Ed. A. Wróbel, *Traktat o Funkcjonowaniu UE. Komentarz. T. I (art.1-89)* [*The Treaty on the Functioning of the European Union. Commentary. Vol. I (art. 1-89)*], Warszawa (Warsaw) Wolters Kluwer Polska, 2012, p. 175.

35 *Ibid.*, p. 170-183 reflexions on art. 2 TFEU.

36 *Ibid.*, p. 207-208 reflexions on art. 4.2 TFEU.

37 *Consolidated version of the Treaty on the Functioning of the EU*, Official Journal of the European Union (2012, no. C 326), art. 2.2.

38 *Ibid.*, art. 2.3.

39 *Ibid.*, art. 175.

40 *Ibid.*, art. 5.2 TFEU; for some comments regarding art. 5 TFEU see ed. A. Wróbel, *Traktat o Funkcjonowaniu UE. Komentarz. T. I (art.1-89)* [*The Treaty on the Functioning of the European Union. Commentary. Vol. I (art. 1-89)*], *ibid.*, p. 208-210.

States' social policies[41]. At the same time the commented regulation provides that: *Since the objectives of this Regulation cannot be sufficiently achieved by the Member States, but can rather, by reason of their scale and effects, be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality as set out in that Article, this Regulation does not go beyond what is necessary in order to achieve those objectives*[42]. Article 5 of the Treaty on European Union (TEU)[43] has practical significance because it has established the principle of conferral which is the basic and prior to the division of the competences between the Union and the Member States[44]. Moreover, it doesn't relate to the delimitation of the competences as such but concerns the use of the competences. The principle of conferral was introduced in Article 4 TEC by the Treaty of Maastricht[45]. *The Lisbon Treaty makes so many references to the principle of conferral that it seems to have become almost an obsession*[46].

The European Union is in fact the only one organization in the world which has such wide competences in relation to the Member States, and therefore is able to handle the difficult financial and economic situation by providing assistance and not replacing the activities of the Member States according to the principle of subsidiarity[47].

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41 *Ibid.*, art. 5.3 TFEU.

42 *Regulation (EU) No 1309/2013 of the European Parliament and of the Council of 17 December 2013 on the European Globalization Adjustment Fund (2014-2020) and repealing Regulation (EC) No 1927/2006*, Official Journal of the European Union (2013, no. L 347), Preamble, point 25.

43 *Consolidated version of the Treaty on EU*, Official Journal of the European Union (2012, no. C 326), art. 5.

44 See ed. A. Wróbel, *Traktat o Funkcjonowaniu UE. Komentarz. T. I (art.1-89)* [*The Treaty on the Functioning of the European Union. Commentary. Vol. I (art. 1-89)*], *ibid.*, p. 175-176.

45 *Treaty establishing the European Community.* (in:) A. Przyborowska-Klimczak, E. Skrzydło-Tefelska, eds., *Dokumenty Europejskie* [*European Documents*] Lublin, Wyd. Morpol, 1996, p. 47.

46 L. Serena Rossi, *Does the Lisbon Treaty Provide a Clearer Separation of Competences between EU and Member States?*, (in:) A. Biondi, P. Eeckhout, S. Ripley, eds., *EU Law after Lisbon*, Oxford: Oxford University Press, 2012, p. 93. See: Art. 3.6 TEU; Art. 4.1 TEU; Art. 5 TEU paragraph 1 and 2; Art. 7 TFEU; Art. 51 of the Charter of Fundamental Rights of the EU; Declaration No 18 and Art. 48.2-6 TEU.

47 *Consolidated version of the Treaty on EU*, Official Journal of the European Union (2012, no. C 326), art. 5. Compare also: G. Davies, *Subsidiarity: the wrong idea, in the wrong place, at the wrong time*, (in:) *Common Market Law Review* 43 (2006), p. 84.

Moreover, the Lisbon Treaty has set a clear division of the competences between the European Union and the Member States of the European Union[48]. Although it may be interpreted critically as: *the 'obsession for conferral'* it is noticed by one of the authors that: *the 'obsession for conferral'-as well as the focus on reversibility-clearly reveal the distrustful attitude of the Member States towards European competences, (…) this is diluted by the complex interplay of values, objectives and competences*[49]. I must totally agree with this opinion.

In the Declaration to the Treaties in relation to the delimitation of competences the Intergovernmental Conference has underlined that, *in accordance with the system of division of competences between the Union and the Member States as provided for in the Treaty on European Union and the Treaty on the Functioning of the European Union, (…) when the Treaties confer on the Union a competence shared with the Member States in a specific area, the Member States shall exercise their competence to the extent that the Union has not exercised, or has decided to cease exercising, its competence. The latter situation arises when the relevant EU institutions decide to repeal a legislative act, in particular better to ensure constant respect for the principles of subsidiarity and proportionality. The Council may, at the initiative of one or several of its members (representatives of Member States) and in accordance with Article 241 of the Treaty on the Functioning of the European Union, request the Commission to submit proposals for repealing a legislative act. The Conference welcomes the Commission's declaration that it will devote particular attention to these requests*[50].

As far as Aricle 241 of the Treaty on the Functioning of the EU is concerned, it states that: *The Council, acting by a simple majority, may request the Commission to undertake any studies the Council considers desirable for the attainment of the common objectives, and to submit to it any appropriate proposals. If the Commission does not submit a proposal, it shall inform the Council of the reasons*[51].

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48 *Consolidated version of the Treaty on the Functioning of the EU*, Official Journal of the European Union, (2012, no. C 326), Part I, Title I, Art. 2-6; see L. Serena Rossi, *Does the Lisbon Treaty Provide a Clearer Separation of Competences between EU and Member States?*, *ibid.*

49 *Ibid.*, p. 94.

50 *Declaration No 18 to the Treaties in relation to the delimitation of competences*, Official Journal of the European Union (2012, no. C 326).

51 *Consolidated version of the Treaty on the Functioning of the EU*, Official Journal of the European Union (2012, no. C 326), art. 241.

Lucia Serena Rossi emphasizes that: *in fact, the weakest point of the principle of subsidiarity has always been the monitoring of its correct application. The practice before the Treaty of Lisbon showed that no institution of the decisional triangle- despite continuous declarations in support of the principle-has a real interest in strictly controlling the principle's application*[52]. Has anything changed since the Lisbon Treaty?

The Protocol on the application of the principles of subsidiarity and proportionality annexed to the TEU and to the TFEU (Protocol No 2)[53] establishes a system for monitoring the application of those principles and ensuring that decisions are taken as closely as possible to the citizens of the Union.

That system is strictly linked with Protocol No 1 on the role of national parliaments in the European Union[54], which aims to encourage greater involvement of national Parliaments in the activities of the European Union and to enhance their ability to express their views on draft legislative acts of the Union as well as on other matters which may be of particular interest to them. Conferring an 'ex ante' control on the matter of subsidiarity to the national parliaments is the correct solution to the problem of making subsidiarity an effective-and not a merely abstract-instrument. National Parliaments would have been dispossessed of its prerogatives if the principle of subsidiarity were violated by the Union[55].

3. CONCLUDING REMARKS

It is not easy to describe the methods of Europeanizing the social policy in the context of a new model of welfare state[56]. Based on the proposal from the Commission, the European Council supported on 7/8 February 2013 the continuation of the European Globalization Adjustment Fund[57] (established by

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52 L. Serena Rossi, *Does the Lisbon Treaty Provide a Clearer Separation of Competences between EU and Member States?, ibid.*, p. 96.

53 *Protocol No 2 to the Treaties on the Application of the Principles of Subsidiarity and Proportionality*, Official Journal of the European Union (2012, no. C 326).

54 *Protocol No 1 to the Treaties on the Role of National Parliaments in the EU*, Official Journal of the European Union (2012, no. C 326).

55 L. Serena Rossi, *Does the Lisbon Treaty Provide a Clearer Separation of Competences between EU and Member States?, ibid.*, p. 96-97.

56 M. Kubiak, *Perspektywy europejskiej polityki społecznej* [*European social policy perspectives*], *ibid.*, p. 239-251.

57 European Commission, *Sixth annual report on the activities of the European Globalization (Adjustment) Fund (EGF) in 2012 from the Commission to the European Parliament and the Council,*

the Regulation (EC) No 1927/2006[58]) from 2014 to 2020 as a way to provide specific support to workers made redundant as a result of major structural changes due to globalization.

The available data show that in the resent years the number of applications for the European Globalization Fund has risen[59]. Between January 2007 and August 2013 some 110 applications were submitted by the Member States and EUR 471.2 million were requested in order to help 100 022 workers (as estimated by the Member States). Most of the cases were crisis-related (64 applications) and the rest trade-related applications. 82 % of the applications received between May 2009 and the end of 2011 were related to the global financial and economic crisis.

Spain is the Member State which has submitted the highest number of applications for European Globalization Adjustment Fund (18 applications), followed by the Netherlands (16), Italy (12) and Denmark (10). Eight Member Stated had not yet applied for European Globalization Adjustment Fund by 12 August 2013: Estonia, Cyprus, Latvia, Luxembourg, Hungary, Slovakia, the UK and Croatia (which only joined the EU on 1 July 2013).

Over the whole period a total amount of EUR 471.2 million was requested from the European Globalization Adjustment Fund by 20 Member States. The greatest number of redundant workers who qualified for the support from the European Globalization Adjustment Fund were from Spain (13 396 for 18 applications). The redundant workers from the following countries received the Fund as follows: Italy (12 759 for 12 applications), Germany (11 349 for 7) and Ireland (10 267 for 7). In 12 other countries, the number of redundant workers qualified for the Fund range between approximately 8000 in the Netherlands to just under 1800 in Poland, whereas in Malta, Bulgaria, Greece and Czech Republic the number was less than 1000.

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required under Article 16 of the EGF Regulation (EC) No 1927/2006, (2013) // http://europeanmemoranda.cabinetoffice.gov.uk/files/2014/03/14562-131.pdf (accessed March 28, 2015).

58 *Regulation (EC) No 1927/2006 of the European Parliament and of the Council of 20 December 2006 on establishing the European Globalization Adjustment Fund*, Official Journal of the European Community (2006, no. L 406).

59 European Commission, *Sixth annual report on the activities of the European Globalization (Adjustment) Fund (EGF) in 2012 from the Commission to the European Parliament and the Council, required under Article 16 of the EGF Regulation (EC) No 1927/2006*, (2013) // http://europeanmemoranda.cabinetoffice.gov.uk/files/2014/03/14562-131.pdf (accessed March 28, 2015).

The Regulation No 1309/2013 of the European Parliament and the Council of 17 December 2013 extended the period for applications for the next Multiannual Financial Framework i.e. 1 January 2013 to 31 December 2020[60]. Some changes however were introduced:

a/ financial contribution shall be provided where at least 500 workers are made redundant or self-employed persons activity ceasing in an enterprise in a Member State[61] (Article 4.1 a);

b/ Member State shall carry eligible actions as soon as possible and not later than 24 months after the date of submission of the application[62] (Article 16.4).

The new provisions in the amended Regulation will continue to apply until 2020 so that the Member States may continue to support workers made redundant as a consequence of major structural changes in world trade patterns.

In the case of using the full potential of the European Globalization Adjustment Fund as well as other available instruments the workers who are eligible for the Fund support can be helped. It may be done in a tailor-made and more personalized manner in order to improve their opportunities in the labour market[63].

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60 *Regulation (EU) No 1309/2013 of the European Parliament and of the Council of 17 December 2013 on the European Globalization Adjustment Fund (2014-2020) and repealing Regulation (EC) No 1927/2006*, Official Journal of the European Union (2013, no. L 347), art. 1.

61 *Ibid.*, art. 4.1 a.

62 *Ibid.*, art. 16.4.

63 European Commission, *Sixth annual report on the activities of the European Globalization (Adjustment) Fund (EGF) in 2012 from the Commission to the European Parliament and the Council, required under Article 16 of the EGF Regulation (EC) No 1927/2006*, (2013) // http://europeanmemoranda.cabinetoffice.gov.uk/files/2014/03/14562-131.pdf (accessed March 28, 2015).

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FREEDOM OF MOVEMENT OF WORKERS IN THE EUROPEAN UNION – TRANSITIONAL PROVISIONS IN THE CROATIAN CONTEXT

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ABSTRACT

The paper will explore transitional provisions that certain Member States of the European Union can apply towards a new Member State, focusing primarily on the rights of workers. This topic is probably one of the most "just-in-time" because since Croatia joined the European Union in 2013, there are several states that have applied these kinds of provisions towards Croatian workers in the first two years, and some of them still do. Provisions limiting freedom of work can be harsh on a certain state, limiting the ability of workers to move to another state, and in some way discriminating them on the labour market. As seen from the statistics since joining the European Union, Croatian workers tend to migrate to the countries that do not apply any limitations. The risk of not fulfilling the strict criteria, the complicated paperwork, and other possible difficulties that may occur make Croatian citizens avoid other Member States. The fear is in most cases somehow justified; as seen from practice, employers are not willing to deal with complicated paperwork, pay any additional charges or take on any more responsibility.

Key words: free movement of workers, transitional provisions, Croatia.

1. INTRODUCTION

Since Croatia joined the European Union in 2013, there are several Member States that have applied transitional provisions towards workers from Croatia in the first two years, and some of them still do. Transitional provisions will be introduced, focusing on their function and limitations, especially stressing the provisions regarding Croatia, and divided into two phases, i.e., the first two years and the upcoming new era of 'fewer limitations'. Section 3 will give an overview of how workers can avoid these provisions, either working illegally, taking citizenship of a country that has no such limitations or acquiring a valid work permit.

2. TRANSITIONAL PROVISIONS

2.1. DEFINITION

The free movement of workers is one of the founding principles of the EU that constitutes one of the four fundamental freedoms of the Internal Market. According to Community rules, a worker who moves to another Member State has certain rights. These rights include in particular:

- the right to work without a work permit,
- equality of treatment in employment compared to the nationals of the Member State where work is carried out,
- entitlement to the same social benefits as the nationals,
- the right of a family to join the worker and receive family allowances,
- full social security coordination (pension rights and social security contributions), and
- mutual recognition of professional and vocational qualifications.[1]

Push factors that usually influence migration trends include unemployment, lack of job opportunities and a low income in the emigration country. The EU labour force is characterised by a low level of geographical and occupational mobility. In the period between 1991 and 2001, only 15% of EU citizens changed their place of residence for the purpose of working in another Member State.[2] Despite the fact that the EU grants all these freedoms and rights, new

[1] Kapural, Mirta, *Sloboda kretanja radnika u proširenoj Europskoj Uniji i njezin utjecaj na Hrvatsku*, Pridruživanje Hrvatske Europskoj Uniji – Ususret izazovima pregovora, Institut za javne financije, Zaklada Fridrich Ebert, Zagreb 2005, p. 85.

[2] *Ibid.*, p. 86.

Member States are subject to the so-called "*transitional provisions*" that limit the mobility of workers from new Member States. According to *Samantha Currie* transnational periods goes against the EU policy of encouraging of internal migration, providing workers of new Member States a limited range of granted rights.[3]

Transitional provisions represent the scope of measures applied by the EU and the Member States towards a new member to the Union. These measures are defined in the treaty of accession of a certain Member State.[4] During a transitional period of up to 7 years after the accession, certain conditions may be applied that restrict the free movement of workers from, to and between these Member States. These restrictions only concern the freedom of movement for the purpose of taking up a job and they may differ from one Member State to another.[5] These provisions are not obligatory, Member States can decide if they want to apply those measures or not. The legal framework for applying such provisions is laid down in:

- the Treaty on the Functioning of the European Union,
- Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services (OJ L 18, 21.1.1997),
- Directive 2004/38/EC of the European Parliament and of the Council of 29 April 2004 on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States amending Regulation (EEC) No 1612/68 and repealing Directives 64/221/EEC, 68/360/EEC, 72/194/EEC, 73/148/EEC, 75/34/EEC, 75/35/EEC, 90/364/EEC, 90/365/EEC and 93/96/EEC (OJ L 158, 30.4.2004),
- Regulation (EU) No 492/2011 of the European Parliament and of the Council of 5 April 2011 on freedom of movement for workers within the Union (OJ L 141, 27.5.2011).

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3 Currie, Samantha, *Migration, work and citizenship in the Enlarged European Union,* Ashgate, 2008, pp.2-3; Kovács, Erika and Vinković, Mario; Croatian concerns and Hunagarian experience regarding free movement of workers, in: Time Drinóczi and Tamara Tákacs (eds.) *Cross-border and EU legal issues: Hungary-Croatia,* Pecs, 2011, p. 376.

4 In the Croatian Treaty of Accession to the EU, they are defined in *Annex V: List referred to in Article 18 of the Act of Accession: transitional measures*.

5 Currently, transitional provisions concern only *Croatia.*

The transitional provisions could last up to seven years. Until the end of the first two years following the date of accession, the present Member States will apply national measures or those measures resulting from bilateral agreements regulating access to their labour markets. Before the end of the two-year period following the date of accession, the Council will review the functioning of the transitional provisions on the basis of a report from the Commission. The present Member States must notify the Commission whether they will continue to apply national measures or measures resulting from bilateral agreements, or whether they will fully apply the EU legislation on the free movement of workers. So, this means that every Member State applying the transitional provisions must make a report regarding the measures applied during these two years and justify if they want to continue to apply such measures or not. Upon these reviews, the Council will make a decision if these measures are still needed or not. In addition, these reports must elaborate on the current situation on the labour market. A transitional period may be necessary because significant concerns exist in relation to expected labour migration from candidate countries. These concerns are based on considerations such as geographical proximity, income differentials, high unemployment and propensity to migrate.6 Member States that are still willing to apply such measures can continue to do so for a period of the next three years. These measures still contain national provisions and bilateral agreements, and the free movement of workers is still derogated by these measures. After the end of the next three years, the Member State that applied these measures must submit a report to the Commission. After a five-year period of applying transitional provisions, the implementing Member States can prolong it for additional two years. However, a further two-year extension must be justified by *serious disturbances of the labour market*. After that period, the application of transitional provisions cannot be prolonged any more, and the Member State will gain full access to the labour market in all other states in the EU.

2.2. TRANSITIONAL PROVISIONS DURING PAST ENLARGEMENTS OF THE EU

As can be seen above, transitional provisions can be applied for up to seven years, i.e., in 2 + 3 + 2 periods. This kind of application of transitional provisions

[6] Resolution on the free movement of workers in the context of enlargement, URL: http://www.efta.int/sites/default/files/documents/advisory-bodies/consultative-committee/cc-resolutions/English/20Nov2001-FreeMovement-Workers-C20R030-Final.pdf, (Last accessed: 7 October 2014)

was established during accession negotiations of Hungary, Slovakia and Latvia in 2001.[7] This kind of regulation can be found in all subsequent accession negotiations, like in the case of Lithuania, Poland, Romania, Bulgaria, the Czech Republic, as well as Croatia.

The states that had joined the EU before this transitional period formula was introduced were also subject to similar provisions. Greece had a transitional period of six years. Within that period of time, workers from Greece had to possess working and residence permits, just like any other worker from any non-EU state. Spain and Portugal had a transitional period of seven years, and they were subject to limitations similar to ones applied to Greece.[8] During the 2004 enlargement of the European Union, 12 out of the 15 Member States applied these transitional provisions towards new member states[9], i.e., only United Kingdom, Sweden and Ireland did not apply them. They allowed the workers coming from new member states to get jobs in their country as freely as their own nationals do. United Kingdom, however, enforced a special registration procedure, according to which every immigrant worker had an obligation to register. With the registration procedure, United Kingdom wanted to monitor the impact of the enlargement on their labour market.[10] The other 12 Member States applied transitional provisions, i.e., they applied national measures or those measures resulting from bilateral agreements regulating access to their labour markets. During the 2007 enlargement of the EU, when Romania and Bulgaria joined the EU, 15 out of 25 Member States applied transitional provisions. Cyprus, the Czech Republic, Estonia, Finland, Lithuania, Latvia, Poland, Slovenia, Slovakia and Sweden did not apply any measures although Cyprus, Finland and Slovenia did enforce a registration procedure much like United Kingdom did 3 years ago to monitor the impact of workforce migration on their labour market.[11]

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7 Goldner Lang, Iris, Sloboda kretanja ljudi u EU – Kontekst sporazuma o pridruživanju, Školska Knjiga, Zagreb, 2007, p. 177.

8 Kapural, Mirta, *op. cit.*, p. 90.

9 The 2004 enlargement was the largest expansion in the history of the EU. Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia joined the EU on 1 May 2004.

10 Goldner Lang, *op. cit.*, p. 178.

11 *Ibid.*, p. 179.

When Croatia joined the EU, 13 out of the 27[12] Member States applied transitional provisions, i.e., Spain, Italy, Greece, France, Austria, Germany, Belgium, the Netherlands, Luxembourg, the United Kingdom, Cyprus, Malta and Slovenia. Much like previous enlargements, these states apply national measures or bilateral agreements towards the workers from Croatia.[13] Transitional restrictions generally imply a work permit for citizens of a Member State they are introduced for. Austria, Germany, Italy, Slovenia and the United Kingdom are the states with almost 95% of all Croatian citizens who enjoy freedom of movement in the EU.[14]

2.3. TRANSITIONAL PROVISIONS REGARDING CROATIA – FIRST PHASE (2013-2015)

The first phase of the transitional provisions covered the period from 1 July 2013 to 1 July 2015. In this period, 13 Member States decided to apply transitional provisions towards Croatian workers. As already mentioned, a 2+3+2 scheme can be applied. Even though the predictions were much more harsh, reciting that all 13 countries would apply transitional provisions during the whole set of seven years, on 1 July 2015 it was announced that only 5 states will continue to apply national measures or measures resulting from bilateral agreements limiting the ability of workers to access the labour market. As the regulations did end this year, we find it important to display the situation applied to workers wishing to move to another Member State. During the first phase of the transitional provisions, a very strong trend of migration towards Ireland was established as the focus of young people. Since Ireland did not apply any provisions towards Croatian jobseekers, it was the easiest way to migrate to that country. While the first two years of Croatia's membership of the EU resulted in the serious brain drain phenomenon, we are yet to determine the outcome of the limitations that will occur in the second phase.

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12 Pravila o radu državljana država članica Europske unije i članova njihovih obitelji. Available at: http://www.mrms.hr/pravila-o-radu-drzavljana-drzava-clanica-europske-unije-i-clanova-njihovih-obitelji-2/, (Last accessed: 30 October 2014).

13 EURES – The European job mobility portal. Available at: https://ec.europa.eu/eures/main.jsp?acro=free&lang=en&countryId=AT&fromCountryId=HR&accessing=0&content=1&restrictions=1&step=2, (Last accessed: 30 October 2014).

14 Commission report on transitional arrangements regarding free movement of workers from Croatia, Brussels, 29 May 2015. Available at: http://europa.eu/rapid/press-release_MEMO-15-5068_hr.htm (Last accessed: 10 November 2015).

In the next section, we will give an overview of the first phase of the transitional provisions and focus on the 13 states that applied certain measures towards workers from Croatia. We will also have a look at migration trends during these two years, and finally, we will conclude with the predictions a new phase is about to bring in the next three years.

2.3.1. Austria

Croatian citizens wishing to work in Austria still need a work permit[15] (i.e., *Beschäftigungsbewilligung*), which the employer must apply for. The Labour Market Service (i.e., *Arbeitsmarktservice*) will confirm freedom of movement once the worker has been legally employed for one year. After that period of one year, a *"confirmation of freedom of movement"* will be issued, giving access to the entire labour market. There are also access restrictions for posted workers. Family members resident in Austria will only be granted freedom of movement if they live with family members in Austria who have already been granted freedom of movement. Freedom of movement will expire once a person leaves Austria not just temporarily.[16]

2.3.2. Belgium

In the period from 1 July 2013 to 30 June 2015, Croatian citizens had to have a work permit to work in Belgium. For such a permit to be issued, an employer in Belgium must apply for an *employment authorisation* from the competent authority for the national concerned. When the authorisation to employ the worker is granted, the work permit is issued to the worker. The employment authorisation is only granted if it is not possible, within a reasonable length of time, to find a worker on the labour market that is fit to fill the post, even after appropriate vocational training. Jobseekers do not need to follow any formalities within the process. It is the employer who must make the request to the competent authority. The employer must use the *ad hoc* form to lodge a request for an employment authorisation with the competent region.[17]

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15 The criteria for issuing a working permit in Austria are as follows: non-discrimination, preferential treatment for nationals and community preference, and no prior illegal employment. To get such a permit, a jobseeker must find a job first, and then the employer applies for the permit.

16 EURES – The European job mobility portal, Austria – Croatia. Available at: https://ec.europa.eu/eures/main.jsp?acro=free&lang=en&countryId=AT&fromCountryId=HR&accessing=0&content=1&restrictions=1&step=2 (Last accessed: 30 October 2014).

17 EURES – The European job mobility portal, Belgium – Croatia. Available at: https://ec.europa.eu/eures/main.jsp?acro=free&lang=en&countryId=BE&fromCountryId=RO&accessing=0&content=

2.3.3. Cyprus

In the same period, employment of Croatian citizens took place under the *Aliens and Immigration Law*[18], which regulates employment of individuals from non-EU countries. In addition to other issues, this legislation stipulates that: "The employment of a foreigner must only take place through the issuing of the *temporary residence permit for employment purposes* required by law." The temporary residence permit for employment purposes (*Pink Slip*)[19] gives foreigners the right to have an employment contract for a specific job and a specific period of time, as set out in the permit. If the holder undertakes different work, then the work permit ceases to be valid and is considered null and void. *The Civil Registry and Migration Department of the Ministry of the Interior* was responsible for the implementation of this Law as well as the issuing of temporary residence and work permits for foreigners. As the Ministry competent for, *inter alia*, employment and labour policy issues, *the Ministry of Labour and Social Insurance* is responsible for creating a policy on employing foreigners and the issuance of approvals for employers or enterprises for employment of foreigners from third countries.[20]

2.3.4. France

Croatian citizens who wished to work in France from 2013 to 2015 needed to have a work permit if they wanted to get employed as dependent workers. Commercial, industrial, artisanal, and freelance occupations are free. During this period, a Croatian national who wanted to take up employment in France as an employee had to obtain a *work permit*. The employment situation may be raised as an objection against their employment, save in the case of a list of 291[21] occupations that was applicable to Romanian and Bulgarian nationals. The objection cannot be raised on the basis of the local situation in relation to the

1&restrictions=1&step=2 (Last accessed: 30 October 2014).

18 The Aliens and Immigration Law adopted in 1952, amended in 2002, No 3615, 28 June 2002, Official Gazette of Republic of Cyprus. Available at: http://www.refworld.org/cgi-bin/texis/vtx/rwmain/opendocpdf.pdf?reldoc=y&docid=531d8b754 (Last accessed: 20 July 2015).

19 The main criteria for issuing a "*Pink Slip*" in Cyprus are as follows: non-existence of the possibility of fulfilment of the employer's specific needs using the local workforce (Cypriot or European citizens). To get such a permit, the employer must submit an application before a Croat enters the country.

20 EURES – The European job mobility portal, Cyprus – Croatia. Available at: https://ec.europa.eu/eures/main.jsp?acro=free&lang=en&countryId=CY&fromCountryId=HR&accessing=0&content=1&restrictions=1&step=2 (Last accessed: 30 October 2014).

21 A list of 291 occupations. Available at: http://www.immigration-professionnelle.gouv.fr/sites/default/files/fckupload/Arrete_du_01-10-2012.pdf (Last accessed: 30 October 2014).

regional list of 30 occupations[22]. The departments responsible for foreign workers had the power to examine applications and issue permits. A *residence permit* was also required. Croatian nationals enjoyed the right of establishment and freedom to provide services. People who enjoy the right of establishment must apply for a residence permit from the *préfecture*. First of all, an employee must find an employer prepared to undertake the necessary administrative steps (placing job openings with *Pôle emploi*, waiting for the notice issued by the *DIRECCTE* - Regional Department of Enterprise, Competition, Consumer Affairs, Labour and Employment, paying the fee to the OFII, OFII medical examination before hiring an employee). After the departments in charge of foreign workers issue their approval, the employee must undergo a medical examination organised by the OFII (*French Office of Immigration and Integration*) and then (s)he obtains a residence permit from the *préfecture*.[23]

2.3.5.Germany

As of 1 July 2015, Croatian citizens do not need a work permit to work in Germany. This was announced just right before the transitional provisions were supposed to be prolonged. Due to heavy immigration of Croatian citizens despite the provisions, Germany decided to remove the restrictions and grant full access to the labour market. During the first two years of the transitional provisions, the labour market was accessible but with certain limitations. Only in-demand professionals could have been granted a valid work permit. During the previous two years, the situation was as follows. Croatian citizens had to obtain an *EU work permit* from the International Placement Services (i.e., *Zentrale Auslands- und Fachvermittlung - ZAV*) of the Federal Employment Agency (i.e., *Bundesagentur für Arbeit*) under the same conditions as those applicable to citizens of Bulgaria and Romania before the transitional provisions ended. Prior to the issuance of an EU work permit, the following requirements must have been met: a legislative provision granting access to the German labour market, a specific job offer, no employee available with a preferential right to that specific occupation and working conditions comparable to those of local employees. The procedure of obtaining the permit differed depending on whether you were applying for a

22 A list of 30 occupations. Available at: http://www.immigration-professionnelle.gouv.fr/sites/default/files/fckupload/arrete_du_18-01-2030_%20liste_30.pdf, 30.10.2013.

23 Professional immigration, French Ministry of the Interior. Available at: http://www.immigration-professionnelle.gouv.fr/en/procedures/shortage-occupations (Last accessed: 30 October 2014).

skilled occupation[24] or an unskilled or semi-skilled occupation[25]. For the former, you needed the following documents: an application properly filled out for an EU work permit, a job description, a draft employment contract and a copy of a document certifying entitlement to freedom of movement, or a copy of the page of an official identity document containing personal details. For the latter, an application properly filled out for an EU work permit, a job description or a placement mandate and a draft employment contract.[26]

The immigration trend to Germany needed to be determined. The fact that German is one of the most common foreign languages taught at primary and secondary schools in Croatia makes immigration of the young population even more feasible. In the period from 2013 to 2015, the total number of Croatian citizens living in Germany has increased by as much as 38,000[27], which is not negligible for the country that has 4,284,889 inhabitants according to the 2011 census.[28]

2.3.6. Luxembourg

Croatian workers were required to hold a *work permit* pursuant to Article 42(1)(2) to (4) of the Law of 29 August 2003 on the *freedom of movement of persons and immigration*, as amended, in order to access the labour market in Luxembourg between 2013 and 2015. Croatian nationals had to satisfy the conditions of entry and residence applicable to all EU citizens, i.e.:

- for a period of residence less than 90 days (without working), an individual must simply hold a valid travel document;
- for a period of residence longer than 90 days, an individual must:
  - hold a valid travel document; and

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24 An occupation that requires at least two years of prior training.

25 An occupation that does not require a period of at least two years of vocational training.

26 EURES – The European job mobility portal – Germany – Croatia. Available at: https://ec.europa.eu/eures/main.jsp?acro=free&lang=en&countryId=DE&fromCountryId=HR&accessing=0&content=1&restrictions=1&step=2 (Last accessed: 30 October 2014).

27 Zemlja u nestajanju, u dvije godine čak 50,000 Hrvata iselilo se u Europsku uniju, Jutarnji list, 8 June 2015. Available at http://www.jutarnji.hr/hrvatska-je-zemlja-u-nestajanju-u-dvije-godine-50-000-hrvata-se-iselilo-u-europsku-uniju/1362432/ .

28 *Popis 2011 jer zemlju čine ljudi, Popis stanovništva, kućanstva i stanova 2011* (Census of Population, Households and Dwellings 2011), Državni zavod za statistiku, Zagreb, 2013. Available in pdf at: http://www.dzs.hr/.

- make a declaration of arrival at a local authority where (s)he is newly resident; and
- apply for a registration certificate from the local authority where (s)he is resident.[29]

Croatian citizens who wanted to work in Luxembourg between 2013 and 2015 had to apply for a work permit, which must have been presented upon completion of a declaration of registration at the local authority administration. The Croatian citizen concerned must therefore be granted the permit before making a declaration of registration. The applicant must submit his/her application for a work permit on plain paper. The following documents must be enclosed with the application: a copy of a valid passport or national identity card for the applicant, a CV, and copies of qualifications or professional diplomas; if the document in question was issued by an authority of a non-EU Member State, a copy of the document must be certified as a true copy of the original, a contract of employment must be dated and signed by the applicant and his/her employer, which is compatible with Luxembourg employment law, a cover letter, a copy of the certificate or, as the case may be, evidence that the position has been notified as vacant (to be requested from the future employer), and where appropriate, a power of attorney.[30]

Before considering whether to hire a Croatian citizen, the employer must notify the ADEM (National Employment Administration) of the job vacancy. Depending on the sector in question, the employer must provide the following to the Croatian citizen: in the sectors that the simplified procedure applies to, proof that the position has been notified as vacant; or in all other sectors, the original of the certificate issued by the ADEM confirming that the employer is entitled to hire a person of his/her choice. In order to obtain that certificate, the employer must complete the annex to the job vacancy notification form ('form indicating intention and providing information to the ADEM with a view to requesting a certificate at a later stage') when making the initial notification. The ADEM then has a period of 3 weeks to propose a suitable candidate on the local labour market. Once that 3-week period expires, the employer may request a certificate from the foreign workers service, which authorises it to hire

29 EURES – The European job mobility portal – Luxembourg – Croatia. Available at: https://ec.europa.eu/eures/main.jsp?acro=free&lang=en&countryId=LU&fromCountryId=HR&accessing=0&content=1&restrictions=1&step=2 (Last accessed: 30 October 2014).

30 *Ibid.*

a third-country national. The certificate is drawn up within 5 working days of the employer's request. The certificate may be requested throughout the entire period in which a job vacancy exists. A job offer is closed once the certificate is drawn up or refused. The employer must provide the Croatian national with the original of the ADEM certificate, which (s)he must attach to his/her application for a work permit.[31]

2.3.7. Malta

To work in Malta, you need to acquire an *employment license*. It is granted for positions that require qualified and/or experienced workers and for those occupations for which there is a shortage of workers in the Maltese labour market. The employer needs to apply for the employment license; it costs EUR 58 and 34 for a new license and for a renewal, respectively. The following documentation must be submitted while acquiring the license; the employer needs to submit all of the following documents: an application form, one passport photo, a copy of passport, a CV, a job description, a cover letter from the employer, certificates and references from past employment and a fee has to be paid when a work permit is issued.[32]

2.3.8. The Netherlands

The employer in the Netherlands must apply for an *employment permit* for job seekers from Croatia. The permit is only issued if there are no workers available in the Netherlands or in other EU Member States and if the employer offers adequate conditions of employment and accommodation. Before an employer can hire a worker from Croatia, (s)he must be able to demonstrate that (s)he has not been able to find anyone in the Netherlands or any other Member State. Suitable accommodation must be available for the worker arriving from Croatia, who must also be paid at least the minimum monthly wage. Working conditions, conditions of employment or labour relations in the enterprise must be at least of the standard that is required by law and/or customary in the industry.[33]

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31 *Ibid*.

32 EURES – The European job mobility portal – Malta – Croatia. Available at: https://ec.europa.eu/eures/main.jsp?acro=free&lang=en&countryId=MT&fromCountryId=RO&accessing=0&content=1&restrictions=1&step=2 (Last accessed: 30 October 2014).

33 EURES – The European job mobility portal – Netherlands – Croatia. Available at: https://ec.europa.eu/eures/main.jsp?acro=free&lang=en&countryId=NL&fromCountryId=HR&accessing=0&content=1&restrictions=1&step=2 (Last accessed: 30 October 2014).

2.3.9. Slovenia

Croatian citizens need a *work permit* to work in Slovenia. They can obtain one by finding an employer who will employ them and obtain an employment permit, which is issued for a period of *one year* and extended every year. An employer will only be able to employ a Croatian citizen if there are no suitable candidates registered with the Employment Service of Slovenia. After 20 months of work, a Croatian worker can obtain a *personal work permit* valid for *three years*. Work permits are issued by the Employment Service of Slovenia. A highly skilled person can apply for a *Blue Card*. What is provided by such document is that they have an employment contract for at least one year and a guaranteed salary amounting to at least 1.5 times the average gross annual pay in Slovenia. Issuing the EU Blue Card is the responsibility of an administrative unit; the Employment Service of Slovenia merely gives its consent. The conditions for issuing a Blue Card are as follows: possession a valid passport, suitable health insurance and the consent of the Employment Service of Slovenia to the issuance of an EU Blue Card.[34]

2.3.10. Spain

The worker who would like to work in Spain must have a firm offer of employment such that the employer can initiate the application process for a *work permit*. After a worker has entered Spain, the employment permit shall not become valid until within a period of one month the worker has registered with the appropriate social security scheme. A Croatian citizen must apply personally for registration in the *Registro Central de Extranjeros* (the Central Register of Foreigner Nationals), which shall send him/her a certificate of registration, making reference to his/her work permit and validity.[35] Since 30 June 2015, Spain no longer imposes transitional restrictions to Croatian citizens.

2.3.11. United Kingdom

A Croatian national wishing to work in the UK can come to the UK without a visa but will require *permission to work*. Permission must be obtained from

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34 EURES – The European job mobility portal – Slovenia – Croatia. Available at: https://ec.europa.eu/eures/main.jsp?acro=free&lang=en&countryId=SI&fromCountryId=HR&accessing=0&content=1&restrictions=1&step=2 (Last accessed: 30 October 2014).

35 EURES – The European job mobility portal – Spain – Croatia. Available at: https://ec.europa.eu/eures/main.jsp?acro=free&lang=en&countryId=ES&fromCountryId=RO&accessing=0&content=1&restrictions=1&step=2 (Last accessed: 30 October 2014).

the *UK Border Agency* before starting work. Work authorisation will only be granted if the applicant meets the requirements for skilled economic migrants. The same restrictions on work that existed prior to 1 July 2013 continue to apply. The only difference is that a Croatian national will no longer need to apply for a visa before coming to the UK. Instead, they will need to apply for work authorisation after their arrival in the UK and before starting work. In principle, any Croatian national who intends to work in the United Kingdom will be subject to the work authorisation requirement. An accession state worker registration certificate issued under these arrangements will specify employment for which work authorisation has been granted and will remain valid for as long as the holder remains in that employment. A Croatian national who completes an uninterrupted period of 12 months in authorised employment will cease to be subject to the work authorisation requirement and will be entitled (but not required) at that point to apply for a registration certificate confirming that (s)he has free access to the labour market.

UK-based employers wishing to employ a Croatian national should continue to sponsor their employment through the existing arrangements under Tiers 2 and 5 of the points-based system. Employers wishing to employ a Croatian national will therefore need to be licensed with the UK Border Agency as a Tier 2 or Tier 5 sponsor in the same way as they are now if they wish to issue a certificate of sponsorship to a non-EEA worker under these arrangements.[36]

2.3.12. Italy

Between 2013 and 2015, Croatian citizens had to apply for a residence permit that enabled them to live and work in Italy legally. Before this can happen, a Croatian worker and an Italian employer must first apply for clearance (*nulla osta al lavoro*) at the one-stop immigration centre in their county. Every Italian province has an office that the government describes a one-stop shop for immigration (*Sportello Unico per l'Immigrazione*). These offices are responsible for the entire process of hiring foreign workers in Italy. While a jobseeker is required to submit certain documents, an employer takes responsibility for much of the application. Workers must have signed an employment contract with their employer before applying for a work permit, since it has to be submitted to

36 EURES – The European job mobility portal – Spain – Croatia. Available at: https://ec.europa.eu/eures/main.jsp?acro=free&lang=en&countryId=UK&fromCountryId=HR&accessing=0&content=1&restrictions=1&step=2 (Last accessed: 30 October 2014).

the company's local provincial immigration office as part of their application to hire a foreigner. After the employer receives clearance to hire a foreign worker, the employee can apply for an Italian work visa at their local Italian diplomatic mission. After the employee is cleared to work in Italy, the worker will be issued an entry visa at their local Italian consulate, which contains a tax code necessary for other bureaucratic processes. Foreigners who intend to stay in Italy for more than three months must apply for a residence permit. These permits allow foreigners to stay in Italy under certain conditions depending on the category.

Regardless of whether the workers apply for a permit before or after they have arrived (depending on their nationality), they will have to report to their local immigration centre within eight days of arriving in Italy. In some provinces, this can also be done at a post office. The residence permit is issued at the new arrival's local police station. This requires filling out an application form specifying the type of permit required, proof of identification, fingerprints and photos. The residence permit is an electronic smart card to guard against fraud. In order to get a residence permit, the employee will have to submit a variety of documents including application forms, a passport and photocopies, passport photos and an application fee. Expats should liaise with their Italian employer to find out when and how this should be done. The receipt applicants receive while waiting for their residence card affords them the same rights as the permit they are applying for. The duration of a working residence permit for Italy is valid as long as the applicant's entry visa is valid. Residence permit holders have access to government services and benefits. Employees with a permit valid for a year or more are required to report to the Italian Ministry of Interior (*Ministero Dell'Interno*) where they will enter into an agreement to fulfil certain integration objectives such as attending Italian language classes. A working residence permit for seasonal work is valid for six months and can be extended by extra three months. Permits for self-employment, employment at a local employer and family joining visas are valid for up to two years. Work permits for Italy are, however, position-specific and any change to the employee's position has to be reported to the immigration office. If expats loses their job in Italy, their residence permit will not automatically be revoked. Instead, it is possible to register as unemployed and stay for as long as the permit allows. Highly skilled or qualified expats often have specific requirements to fulfil. This includes executives or specialised staff belonging to large companies with the Italian headquarters, academics, translators, professional sportspeople,

artists, and expats working in theatre or opera. Under most circumstances, these expats will receive their documentation before entering Italy.[37]

2.3.13. Greece

Once separate permits, the residence permit and the work permit are now all-in-one, meaning residence permits can include the right to work. It is not possible for a non-EU national to obtain a stand-alone work permit; the permission to work is included in the residence permit. Work permits in Greece are employer-specific (although there can be exceptions), occupation-specific, and location-specific, and are normally valid for one year. Greece also links residence status for non-EU nationals to continuous employment. A worker from a non-EU country must first obtain a visa to enter Greece and then apply for the residence/work permit once in Greece. A visa (National; Type D) for work must be obtained for any non-EU national, including a Croatian citizen in the period between 1 July 2013 and 30 June 2015, planning to stay in Greece for more than 90 days and work. This visa must be obtained before arriving in Greece, from the Greek Embassy or Consular Section in the applicant's country of residence.

It is suggested to contact the Greek Embassy or Consular Section for exact documentation requirements. Documents that are generally required include a valid passport, an employment contract, proof of adequate medical insurance coverage while in Greece, and a criminal background check from the police station nearest to the applicant's place of residence. A National visa for work will only be granted if an employer in Greece has already offered the applicant a job or if the applicant is being transferred from a company in their country of residence to a Greek branch. Prior to offering a non-EU national a position, a potential employer must prove to the Greek Office of Manpower (OAED) that a Greek national or an EU national was not able to fill the position first, and the employer may be asked to provide a monetary deposit. The employer is also required to meet minimum business profit requirements. Some non-EU nationals hoping to work in Greece enter the country on a tourist (or Schengen) visa to look for an employer willing to offer them a job. If this is accomplished, they must return to their country of residence prior to the expiration of the tourist visa to apply for a work visa. Within 30 days of arriving in Greece, a visa holder must apply in person for a residence/work permit at the local municipal

[37] Expat Arrivals, local info for global expats - Work Permits for Italy, URL: http://www.expatarrivals.com/italy/work-permits-for-italy (Last accessed:1 July 2015).

office (*Δημαρχείο*/*Dimarchio*). In some areas, application may be submitted at the police station. There are numerous types of residence permits depending on the applicant's circumstances (self-employed, consultant, employee, executive). Validity periods range from one to five years. It is suggested to file the application after arrival as soon as possible, as the process can be lengthy. If the visa expires before the application for the residence/work permit is submitted, the applicant will be required to return to their country of residence and restart the process. Individuals caught working without a work permit or those who overstay their visa will be subject to fines and possible incarceration.

Prior to applying for a residence permit, applicants must obtain a tax number (*Arithmo Forologiko Mitro* - AFM) from the local tax office (*Eforia*) and a social security number from the Social Security Institute (*Αριθμος Μητρώου Κοινωνικής Ασφάλισης* - AMKA). It may be possible to obtain an AMKA number from the nearest IKA office (Social Insurance Institute) or Citizens Service Office (KEP). Application forms for residence permits should be obtained at and submitted to the local municipal office (*Δημαρχείο*/*Dimarchio*) or prefecture (*nomarxeia*). It may be possible to obtain an application form at a KEP. Applications must be submitted in Greek either in person or by a certified lawyer granted a power of attorney.

The following documentation is required to obtain a residence permit: a visa, a passport plus photocopies, at least two passport photographs, a certificate of medical insurance, a health certificate issued by a state hospital (i.e., a declaration confirming that the applicant does not have any serious communicable diseases), proof of a local address (a title deed or a rental contract), proof of the ability to support oneself – a job or resources and proof of payment of the required fee to the national tax office (*Eforia*). Construction workers, nurses and domestic workers, as well as those who work in agriculture insured by social security but who have more than one employer, do not have to submit a work contract in order to apply for the issuance (or renewal) of a residence permit.

Once the application has been submitted, the applicant will receive a blue form (*bebaiosi*) as a receipt that the application is being processed. The applicant may begin working at this time. Notification that the residence permit is approved and ready for pickup will not be sent; the applicant is responsible for following up to obtain the residence permit. The permit will be in the form of a sticker placed in the passport. Executives transferred to Greece can generally expect to

receive their residence/work permit within approximately one month. Other applicants can expect to wait longer, usually six to twelve months.

It may be possible to change employers within the same industry after one year of continuous employment. It is suggested to contact the IKA for further information. At least 60 days before the residence/work permit is to expire, an application must be submitted for renewal to the local municipal office (*Δημαρχείο*/*Dimarchio*) or prefecture (*nomarxeia*).[38]

2.4. WORKING DURING THE TRANSITIONAL PROVISIONS – FIRST PHASE

As can be seen above, all Member States that introduced transitional provisions towards Croatia required some kind of a *working permit* (also called *Pink List*, *EU work permit*, etc.) that the employer must acquire for the employee. Most of the states have certain criteria for obtaining such permit. The most common one is that there is *no available workforce* for such occupation. On the other hand, if there were available workforce with such necessary qualifications, the permit would not be granted. The obligation to obtain such permit lies with the employer, who has to go through the administrative procedure before the employee could enter the state for the purpose of taking up a certain job. In order to be able to grant the permit, the authorities require certain *documentation* that could consist of various documents depending on the Member State in question (a CV, a cover letter, a copy of valid travel documentation, etc.). Apart from the working permit, in almost every Member State a jobseeker must also apply for a residence permit. In some Member States, the employer is also required to provide *accommodation* for the employee. To conclude, Croatian citizens are still in the same position in those 13 Member States as they were before 1 July 2013. They were in the position as any other worker from a non-EU state. At that time, it was the only legal way to work as a Croatian citizen in those Member States. Later on, we will focus on the changes, but as discussed above, harsh requirements prevented the overflow of Croatian immigrants to old Member States, hence forcing them either to find alternative employment or to move to a country where the transitional provisions were not in effect.

38 AngloINFO the global expat network Greece - Work Permits for Non-EU Citizens, URL: http://greece.angloinfo.com/working/work-permits/non-eu-citizens/ (Last accessed: 1 June 2015).

2.4.1. Transitional provisions – Second phase

The first phase of transitional provisions ended on 1 July 2015. This era was marked by the massive migration towards Ireland as the main target country, which did not apply any limitations towards the overflowing workforce from Croatia. It was the top destination for Croatian immigrants, not only because there were no limitations, but also because of the language since English is taught as a foreign language at almost all primary and secondary schools throughout Croatia. On 1 July 2015, transitional provisions ended in eight Member States, i.e., Italy, Greece, Belgium, Luxembourg, France, Cyprus, Germany and Spain. Moreover, only Austria, Malta, the Netherlands, Slovenia and the United Kingdom are currently applying restrictions in the context of free movement of workers from the Republic of Croatia. The effect of this on the emigration rate is yet to be determined but predictions foresee that the main target countries of Croatian jobseekers could be Germany, Italy and France with Ireland remaining at the top.

The rate of emigration to Germany, which is already high, could rise even more; previous limitations prevented certain professions from acquiring a work permit in the country, now without any limitations, the Croatian workforce could overflow in Germany. According to some statistical data, the estimated number of immigrants to Germany multiplied in the past years and this number could easily grow in the years to come. While the immigration trend will continue and Ireland will remain the main target country, free access to the labour market will mark the start of a new wave of emigration towards the aforementioned eight countries, where jobseekers will try to find appropriate employment. Language barriers are thought to have prevented the sudden and massive immigration to countries like Sweden or Finland in 2013, and that could easily be the case now for countries like Belgium or Spain. Certainly, the number of language courses of e.g. French, German, Dutch or Spanish will rise since speaking the native tongue is a vital part of a successful job-search.

The impact of this new era is yet to be seen; it will certainly result in an even higher rate of immigration resulting in even less young people staying in Croatia and unstoppable aging of the population. The rising number of retired people will damage the balance in the job market even further and result in upcoming social challenges. However, these provisions will embark some changes in our lives as well. There will be more transportation possibilities between the countries with a high rate of immigration, cheaper and more frequent flights, bus lines,

trains. It will also affect communication companies that will offer lower rates for calls within the European Union; to cope with online and other ways of communication, they will offer specialised packages with EU minutes. Banks will offer cheaper rates for money transfers within Member States. The emigration rate will not rise drastically. However, according to our statistical data, foreign investments may rise significantly over the years. Foreign investors may purchase properties by the sea to invest in tourism since it is one of the most important sources of income, and as a tourist destination, Croatia is one of the most popular destinations in the world. Social insecurity arising from a growing number of retired people will result in even less people coming back to the motherland after retirement in a foreign country. Due to the inefficiency of the country to provide social welfare and a stable retirement system, more and more retired people will decide to stay in the country where they worked throughout their lives, and occasionally come back to Croatia only for holidays. This could potentially further damage social welfare in this country.

The main reason for emigration from this country could be quoted as the inability to provide employment to young people. Professions like lawyers, economists, bartenders, cooks, and bakers have no potential workplace in the country any more. They need to seek alternative employment in order to survive. We do understand that these professions could not be simply abolished in the education system, but a strict reform and quotas could be applicable in order to prevent further damage. Due to the inability to reform the current system, the situation will continue to worsen drastically. Creating workplaces and reforming the education system should be the first topics on the agenda; if these reforms do not take place, the emigration rate will dramatically increase even further. A very high unemployment rate[39], which ranks Croatia among the worst performing Member States, will continue to grow. We should not underestimate the causes, risks and dangers of illegal work as a result of poor economic conditions and a high rate of unemployment.

[39] According to IECONOMICS, 17.25% in October 2015. Available at: http://ieconomics.com/croatia-unemployment-rate-forecast. According to EUROSTAT, in the third quarter of 2015, the youth unemployment rate (under 25 years of age) was 43.1%. Available at: http://ec.europa.eu/eurostat/statistics-explained/index.php/Unemployment_statistics.

2.5. ILLEGAL WORK IN THE EUROPEAN UNION

The phenomenon of illegal work is also known by many names. Terms such as non-declared work, the black market, the informal economy, and the parallel economy are just a few ways to describe this trend or its characteristics. Illegal work can imply many aspects. It ranges from occasional baby-sitting to construction work in the building sector organised by professional networks of non-declared workers.[40] Illegal employment is a highly problematic issue for governments; it has been argued that business-friendly governments tend to tolerate a substantial level of illegal work, even if they cannot publicly acknowledge this goal. On the other hand, governments are also under intense pressure to control the problem, and respond to concerns about competition with domestic workers, loss of fiscal revenue, or the exploitation of workers.[41] Illegal employment is essentially a product of two factors: legislation, which restricts possibilities for legal labour migration, and the incentives of employers to circumvent the costs of employing legal labour.[42]

Researchers estimate that more than 500,000 migrants enter the EU countries illegally every year. Estimates of stocks of illegal migrants in individual countries have meanwhile set the number at around 500,000 in *Germany*, 300,000 in *France*, 200,000 in the *UK*, and around 800,000 in *Italy*.[43] It can be estimated that around 70% of these migrants are engaged in illegal labour.[44] A large proportion of this stock of illegal migrants entered EU countries legally, but subsequently overstayed their visas or permits. In other cases, foreign illegal workers are legally resident, but work without being in possession of relevant work permits.[45] Domestic workers – especially in low-skilled work – may fear being undercut by lower-cost labour. Others have argued that illegal work

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40 The Illegal Work of Migrants in the European Union, published by *Foundation pour la solidarité*, PDF available at: http://www.pourlasolidarite.eu/IMG/pdf/REPORT_illegal_work_of_migrants_in_the_EU.pdf (Last accessed: 1 November 2015).

41 *Ibid*.

42 Boswell, Christina, Straubhaar, Thomas, The Illegal Employment of Foreign Workers: an Overview, Intereconomics, Vol. 39, No. 1, 2004, pp. 4-7.

43 The Illegal Work of Migrants in the European Union, published by *Foundation pour la solidarité*, PDF available at: http://www.pourlasolidarite.eu/IMG/pdf/REPORT_illegal_work_of_migrants_in_the_EU.pdf (Last accessed: 1 November 2015).

44 *Ibid.*

45 *Ibid.*

generates huge losses to national revenue, because of the non-payment of tax or social security contributions.

The Commission set up a special strategy to fight illegal work. This strategy provides a series of *guidelines* aiming to fix shared orientations for Member State's employment policies. They are accompanied with *recommendations* concerning the application of these policies including measures specific to each Member State. The guidelines comprise three objectives, i.e., *full employment*, *improving the quality and productivity of work and strengthening social insertion* and *cohesion.*[46] These three objectives are elaborated in ten guidelines. The ninth action priority (or guideline 9) concerns transforming *non-declared work into regular work*. The first analyses and evaluations of the approaches and measures applied in 27 Member States concerning the fight against illegal work, in accordance with the European employment strategy, show that dispelling undeclared workers and enforcing sanctions are the principal instruments. There has nevertheless been a marked increase in approaches and measures that focus on prevention and policies of voluntary work since the publication of the 9th guideline in 2003.[47]

Managing migration is one of the key challenges facing nation states in the 21st century marked by closer connections and rising inequality between countries. On the other hand, it is clear that foreign irregular labour damages native workers more than regular foreign labour, but irregularity in employment is very difficult to pursue in countries with a large informal sector. Destination countries should first fight complete illegality in the country and in the job at any cost, and leave the labour office with the responsibility of providing incentives to get a legal job through frequent controls and high penalties.[48]

2.5.1. Impact on the economy and social cohesion

The first, immediate consequence of non-declared work is obviously the reduction in fiscal revenues and social contributions, which threats the finance of social provisions and public services. Therefore, the state that must provide for its citizens must raise the taxes to provide the same level of social security and welfare, and that also leads to more illegal work because the employers will try to avoid paying higher taxes. And this turns into a vicious circle. In countries where there is universal social coverage (in Europe, but less so in the United States),

46 *Ibid.*
47 *Ibid.*
48 *Ibid.*

non-declared work does not have impact on rights like healthcare or pensions. The same is applicable to people with two jobs. But, non-declared workers (who are officially inactive) are deprived of all advantages that come with a formal work contract such as training, a specific professional profile, pay rises, and the sense of belonging to an organisation. This remark must however be moderated by the fact that non-declared work is for many people the only possible source of income. Regarding social protection, the implications vary between Member States and individual situations.[49]

It is important to reduce the economic advantages of non-declared work in order to reverse the risks/benefits relationship. To fight against undeclared work, the EU has to set up a good strategy. A set of measures based on preventative and repressive actions must also be put into place. It must be ensured that different measures complement each other and that they are not opposed by other political initiatives. Member States have put in place a certain number of prioritised measures adapted to different forms of illegal work. Some countries have focused their initiatives on secondary jobs, while others based theirs on the "more industrialised" form that undeclared work can take.[50] The development of an informal economy weakens the European social model. Since 2007, the former EU Commissioner for Employment, Social Affairs and Equal Opportunities, *Vladimír Špidla*[51], assessed the black market as "extremely harmful" to EU economies. The fact that neither the employer nor the employee pays taxes strongly weakens social security systems, which has already been put to the test by the economic crisis and Europe's aging population. If the Member States do nothing, this practice will lead to a form of social dumping, which means that in some sectors salaries will become very low for companies to remain competitive. These are issues that fall within the remit of Member States. To fight against undeclared work among illegal immigrants a directive was introduced in 2009.

2.5.2. Fines according to EU Directive 2009/52/EC

Directive 2009/52/EC of the European Parliament and of the Council of 18 June 2009 providing for minimum standards on sanctions and measures against employers of illegally staying third-country nationals sets out the minimum standards the

49 *Ibid.*

50 *Ibid.*

51 Vladimír Špidla served as European Commissioner for Employment, Social Affairs and Equal Opportunities from 2004 to 2010.

Member States should implement in their national law. It sets out the following: *financial sanctions*, which will increase in the amount according to the number of illegally employed third-country nationals, *payments of the costs of return* of illegally employed third-country nationals in those cases where return procedures are carried out, and *any outstanding remuneration* to the illegally employed third-country national. The agreed level of remuneration shall be presumed to have been at least as high as the wage provided for by the applicable laws on minimum wages, by collective agreements or in accordance with established practice in the relevant occupational branches, unless either the employer or the employee can prove otherwise, while respecting, where appropriate, the mandatory national provisions on wages, *an amount equal to any taxes and social security contributions* that the employer would have paid had the third-country national been legally employed, including penalty payments for delays and relevant administrative fines, *exclusion from entitlement to some or all public benefits*, aid or subsidies, including EU funding managed by Member States, for up to five years, *exclusion from participation in a public contract* for up to five years, *recovery of some or all public benefits*, aid, or subsidies, including EU funding managed by Member States, granted to the employer for up to 12 months preceding the detection of illegal employment, and *temporary or permanent closure of the establishments* that have been used to commit the infringement, or temporary or permanent withdrawal of a licence to conduct the business activity in question, if justified by the gravity of the infringement.[52]

As seen above, this directive sets out a wide range of mechanisms of punishment that could be applicable in a certain case of illegal employment. Those measures are more oriented towards fining the employer. As previously mentioned, the authorities can go as far as shutting down the employer permanently, although it should be the last option and the harshest penalty for a really severe breach of law.

2.5.3. Illegal work in some EU countries

2.5.3.1. Germany

Germany is the leading immigration country in Europe. Since 1945, it has taken in three quarters of Europe's overall asylum seekers and attracted the

[52] Directive 2009/52/EC of the European Parliament and of the Council of 18 June 2009 providing for minimum standards on sanctions and measures against employers of illegally staying third-country nationals, URL: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:168:0024:0032:EN:PDF

greatest number of immigrant workers. In 2007, Germany had 6.7 million foreigners and 2.5 million new Germans. In 2000, it introduced a programme for the most qualified personnel, i.e., the Green Card. But, the programme did not achieve the success it had hoped for and was curtailed in 2004. In 2005, the new immigration law was adopted. This was an attempt to launch a new points-based permit inspired by the Canadian system. Germany has also made numerous bilateral agreements with Eastern European countries that concern 800,000 workers. [53]

2.5.3.2. Greece

Known as the gateway to Western Europe, Greece has a long history of emigration. With more than half a million migrants living in the Mediterranean state, a staggering 67% of them are from their neighbours, i.e., Bulgaria and Albania. With a lack of available workforce in Greece due to an ageing population, the necessity for foreign workers has become paramount. The arrival of Albanians in the early 1990s sparked the beginning of a decade of migration. At the start of the new millennium, immigrants from other Balkan nations as well as India, Pakistan and Africa, headed for the 'Greek paradise'. The majority of them gained employment in the country's thriving industries of agriculture, fishing, construction and tourism.[54]

2.5.3.3. Italy

In October 2007, the Italian Finance Minister spoke out in support of an influx of foreign workers, claiming that it was of substantial benefit to businesses that require the labour force with limited qualifications. This viewpoint was not shared with the return to power of Silvio Berlusconi in May 2008, who held a somewhat right-wing attitude towards the cross-border workforce. However, his xenophobic outlook has not stopped the arrival of a number of migrants from not only neighbouring countries, but also as far afield as Africa and Asia.[55]

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53 The Illegal Work of Migrants in the European Union, published by *Foundation pour la solidarité*, PDF available at: http://www.pourlasolidarite.eu/IMG/pdf/REPORT_illegal_work_of_migrants_in_the_EU.pdf (Last accessed: 1 November 2015).

54 *Ibid.*

55 *Ibid.*

2.5.3.4. Spain

Spain is the passing ground for migrant workers from Somalia, Eritrea, Sudan, Niger, Ghana, Togo, and Cameroon. Neighbouring migrants came from Morocco, the former colonies and bilateral manual labour policies with Ukraine. In Spain, the authorities praise the benefits of immigration. It is stated that it has "largely positive effects on economic growth". Moreover, immigrants contribute to the creation of new jobs (50% in the last ten years) and bring in around 23 billion EUR per year for public finances, i.e., 6.6% of the state budget. Spain is the country that has experienced the greatest growth in its foreign population in the last years. Since 1990, 1,145,000 previously illegal workers have been regularised. Over the last 5 years, the arrival of three million foreigners has been the cause of half the country's GDP growth.[56]

2.6. DUAL CITIZENSHIP AS A WAY AROUND THE TRANSITIONAL PROVISIONS

As seen above, transitional provisions do limit the ability of workers to take up jobs in those Member States forcing them to find a way around. Some workers will try to work illegally; some of them will try to figure out something else. Citizens entitled to hold dual citizenship in Croatia could easily avoid these provisions.[57] Croatian citizens entitled to hold dual citizenship based on their roots, national belonging or other criteria could easily work without any limitations. All they need is to hold a valid passport or other documentation from the country that is already a Member State with no transitional provisions. According to the last census held in 2011, these are the national minorities that could hold dual citizenship and avoid transitional provisions:

- Austrians – 297 (0.01%),
- Bulgarians – 350 (0.01%),[58]
- Czechs – 9,641 (0.22%),

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56 *Ibid*.

57 It should refer to the national minorities, especially the Slovenian, Hungarian, Italian, German, Austrian, Bulgarian, Polish, Romanian, Slovak and Czech national minorities.

58 Bulgaria and Romania have been the EU Member States since 2007, but not all the states apply transitional provisions towards them. For workers from Bulgaria and Romania 8 Member States (France, Luxembourg, Germany, Austria, Belgium, the Netherlands, the United Kingdom and Malta) impose restrictions. We also have to mention that a maximum period of 7 years of applying transitional provisions ended in 2014.

- Hungarians – 14,048 (0.33%),
- Germans – 2,965 (0.07%),
- Poles – 672 (0.02%),
- Romanians – 435 (0.01%),
- Slovaks – 4,753 (0.11%),
- Slovenians – 10,517 (0.25%),
- Italians – 17,807 (0.42%).[59]

Most of these countries allow acquisition of citizenship on the basis of belonging to their nation. Eight EU Member States have laws that offer naturalisation to persons residing abroad if these individuals themselves or their ancestors were their citizens. Moreover, seventeen EU countries allow for endless transmission of their citizenship to persons born abroad to a citizen parent.[60] Holding dual citizenship sometimes can cause conflicts. It is really important for a state to be certain about who its citizens are, who will have the right to vote in the elections, who will actually decide in the elections, and the way a state will develop in the future. Some states do not approve of dual citizenship for a sole reason of not wanting people from outside the country deciding on the future of the country.[61] But, there are some facts speaking in favour of dual citizenship. Maybe the most important one is that there have been many border changes in Europe, and some of the people belong to a certain nation, but reside in another country because of those changes. This is probably the most applicable in the case of Hungary after World War I, when its territory was divided among the neighbouring countries.[62]

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59 Nacionalne manjine u Republici Hrvatskoj, URL: http://www.uljppnm.vlada.hr/index.php?option=com_content&view=article&id=9&Itemid=51 (1 November 2014).

60 Bauböck, Rainer, *Dual citizenship for transborder minorities? How to respond to the Hungarian-Slovak tit-for-tat*, EUI Working Papers, Robert Schuman Centre For Advanced Studies, San Domenico di Fiesole, Italy, 2010, p. 1.

61 For example, Slovakia does not allow its citizens to hold another citizenship. If they apply for some other citizenship and get it, then by the force of law, they lose their Slovak citizenship, and hence all rights in decisions making. Germany has a similar law, which was introduced in 2004.

62 *The Treaty of Trianon* was signed with Hungary after World War I. The Treaty was signed on 4 June 1920. As a result, Hungary suffered a massive territorial loss. When compared to its pre-war borders, what was seen as *'Hungary'* within the Austro-Hungarian Empire lost nearly 75% of its territory. This land was redistributed to the newly created states of Romania, Czechoslovakia and what was to become Yugoslavia. Nearly 33% of ethnic Hungarians found out that they no longer lived in Hungary, with nearly 900,000 living in the new Czechoslovakian state, 1.6 million in the Transylvania region of Romania and 420,000 in Yugoslavia. Source: http://www.historylearningsite.co.uk/treaty_of_trianon.htm (Last accessed: 2 November 2015).

2.6.1. Case of the Hungarian dual citizenship as a way around the transitional provision

In 2008, Hungary introduced a new amendment to its law on citizenship, which allowed those who once resided at a place that was part of the "*Great Hungary*" to be naturalised, e.g., to gain Hungarian citizenship.[63] This led to an enormous interest in finding Hungarian roots, because with the citizenship, the person also gains rights to take up a job in all EU countries freely and without any further documentation. According to the information last published by April 2013, there were 422,870 naturalisation applications due to this historical cause. 283,000 applications were from Romania, 76,000 from Serbia and 50,000 from Ukraine. There is no accurate data on how many of those citizens work abroad, but there are estimations that almost half of these applicants worked in another EU country.[64]

This opportunity opened up a place for misuse. People from Ukraine, Romania, and Serbia started to apply for the citizenship, even if they did not have any connections to the Hungarian nation. There are agencies offering for a certain amount of money to acquire Hungarian citizenship and all documents needed for work in the EU (in addition to the sole paper confirming Hungarian citizenship, they need to hold a valid travel document – a passport and a residence card). There was a massive increase in the number of people attending Hungarian language courses because they were obliged to take the oath in Hungarian. Although due to this abuse processing of papers required for naturalisation got stricter last year, it is still manageable to acquire it without any relations to the Hungarian nation.

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63 Combining the following paragraphs: "*In the case of meeting the conditions set out in points b) and d) of paragraph (1), a non-Hungarian citizen whose ascendant was a Hungarian citizen, or who demonstrates the plausibility of his or her descent from Hungary and provides proof of his or her knowledge of the Hungarian language may – on his or her request – be naturalised on preferential terms."* and "*By recommendation of the Minister of Internal Affairs, the President of the Republic may grant exemption from the time limit referred to in Subsections (1)-(4) and from the requirements specified under Paragraphs c) and e) of Subsection (1) if naturalising the petitioner is in the overriding interest of the Republic of Hungary."*, Source: *Act LV of 1993 on Hungarian Citizenship*, available at: http://www.mfa.gov.hu/NR/rdonlyres/93F5CE78-6F49-4FBB-9360-D99B09BBB6D0/0/ActLVof1993onHungarianCitizenship.pdf (Last accessed: 2 November 2015).

64 Perelt a hvg.hu, már nyilvános az új állampolgárok száma, URL: http://hvg.hu/itthon/20130424_Perelt_a_hvghu_mar_nyilvanos_az_uj_allamp (Last accessed: 2 November 2015).

3. INTERVIEWS IN RELATION TO DUAL CITIZENSHIP AND WORKING ABROAD

During preparing this paper, some people were able to offer valuable and interesting information, but since there were no sources to confirm certain information, it will be presented in the form of anonymous interviews.

3.1. INTERVIEW NO.1

1. Ukraine is still not a member of the EU. Why do you think so many Hungarians from Ukraine have applied for Hungarian citizenship to work in the EU?

In Ukraine, there are about 130,000 Hungarians. According to some reliable sources, more than 30,000 Ukrainians have acquired Hungarian citizenship so far. Although it is forbidden to hold dual citizenship according to the Ukrainian laws, people still see an opportunity therein. There are no sanctions against holding dual citizenship, but if you get caught on the border, you can get an administrative fine amounting to EUR 15.

2. How many people from your area went to work in the EU?

I live in a small village with approximately 1,300 inhabitants. Almost everybody in my village acquired Hungarian citizenship. Most of them work in the EU, but there are some who import cars because used cars in the EU are much cheaper and if you are an EU citizen, you do not have to pay additional taxes to import cars into Ukraine. For example, in Ukraine, for EUR 3,000 you can get a used car like Lada or something similar, but from the EU you can get much better cars for the same amount of money. It is also much easier to travel with Hungarian papers because there are less visa limitations.

3. Do you know any Ukrainians who, despite the fact that they have no relation to the Hungarian nation, applied for the papers to work in the EU?

I do not know any by name because these actions are performed secretly and we have a limitation to hold dual citizenship. Therefore, nobody will brag about buying citizenship for the X amount of money. But, according to the Ministry of Justice, 30% of the population has a Romanian, Polish, Hungarian or Slovak passport and by 2011 there were 50,000 Ukrainians with a Hungarian passport.

4. Could you please explain in a few sentences how they could acquire citizenship?

It is no secret that there are hundreds of agencies trafficking in citizenship. The price varies very much; it ranges from EUR 6,000 to 25,000. These agencies

guarantee that for that amount of money you will obtain citizenship within six months. Some agencies even offer family discounts. For example, children up to 12 years of age free of charge, 12-18 for EUR 4,000, 18 and older - the price can vary from EUR 6,000 up to 25,000. Agencies also offer a discount of EUR 2,000 for every adult person. These agencies work with other nations as well, e.g., Russian, Belarusian and Georgian. There is a legislative proposal to change the prohibition of holding dual citizenship, but it is not certain if they will pass the law or not.

5. Do you know any agencies that deal with trafficking in citizenship?

I am not sure how forbidden this activity is but on the Internet you can find hundreds of agencies offering these services. According to official information, there are no agencies that could legally give out these kinds of documents. They would need a special permission from both of the countries and none of them approves of this kind of activity.

6. Did you help anybody to acquire citizenship and if yes, how?

Unfortunately, I haven't, but if I had a chance to do that, I would, because you could make a fair amount of money. But, I did help people fill out the required forms and write a CV; however, I did it free of charge.

7. Do you have dual citizenship or are you planning to acquire one?

Unfortunately, I don't have dual citizenship at the moment and I'm not sure if I want to acquire one because there is a chance that I could lose my Ukrainian citizenship which is at the moment important to me.[65]

3.2. INTERVIEW NO. 2

1. Ukraine is still not a member of the EU. Why do you think so many Hungarians from Ukraine have applied for Hungarian citizenship to work in the EU?

I think that there is huge potential in finding a job outside of Ukraine and certainly this opportunity allows this potential to be achieved. But, there are other benefits of being a Hungarian citizen.

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65 The respondent also provided additional links to reports in Ukrainian for confirming the details about the price of the citizenship for further reading: http://free-europe.ru/eu-citizenship/hungary/?gclid=CMzu07qDkboCFeJ4cAodB2QAEg, http://tsn.ua/groshi/ukrayinci-mozhut-bez-problem-kupiti-yevropeyskiy-pasport-za-7-tisyach-yevro-294273.html, http://www.grazdanstvo.eu/venger-skoe-grazhdanstvo, http://versal.est.ua/blog/show/article_id/52554/ .

2. How many people from your area went to work in the EU?

From my town, many people moved to Hungary or to some other EU country permanently but there are those who just work in Hungary and come home for the weekend.

3. Do you know any Ukrainians who, despite the fact that they have no relation to the Hungarian nation, applied for the papers to work in the EU?

As far as I know, some Ukrainians applied for citizenship and there were those who didn't speak Hungarian or had any relations with that nation.

4. Could you please explain in a few sentences how they could acquire citizenship?

They could acquire citizenship through certain agencies that do trafficking in citizenship although they must prepare for the oath because it must be taken in Hungarian.

5. Did you help anybody to acquire citizenship and if yes, how?

I did help some acquaintances to fill out the paperwork needed for acquiring citizenship and, of course, they rewarded my work.

6. Do you have dual citizenship or are you planning to acquire one?

I don't have dual citizenship and at the time being, I'm not interested in obtaining Hungarian citizenship because I see my future in Ukraine.

3.3. INTERVIEW NO. 3

1. How long have you been working abroad?

I have been working abroad for 6 years.

2. Have you worked illegally or have you had the contract from the beginning?

Yes, I was working illegally at the beginning. When I started to work in Austria, transitional provisions were still applied to Hungarian citizens and it was really hard to get a work permit, but when the provisions ended, I got a contract immediately.

3. Did Hungarian citizenship help you get a job abroad or was your Croatian citizenship enough?

The fact that you need to acquire a work permit makes it impossible to get a job as a Croatian citizen. You can work illegally but you can't get a contract.

4. Do Austrians have special treatment of migrant workers?

In Austria, more than 50% of jobs are taken up by migrant workers. Austrians do not discriminate against them, but if there were some form of special treatment, there are lots of trade unions that would protect the rights of workers.

5. From your experience, is it better to work in Austria or in Croatia?

It is much better to work in Austria, for sure. Salaries are higher, working conditions are better, contract workers are protected better than in Croatia. Living expenses are unfortunately much higher than in Croatia and the food also, but even after covering the costs of living, you can earn much more in Austria than by doing the same job in Croatia.

4. CONCLUSION

As can be seen above, transitional provisions do limit the ability and the opportunity in so many ways. Taking up employment can represent a better future, not just for one individual worker, but for his whole family as well. In many cases, workers working abroad support their families in need, children through their education, and loved ones in creating a better life. Limiting the ability to choose freely, to be able to take up every possible job opportunity, can harm those who are in need of a better-paying job, who are in need of money just because they need to support those counting on the certain worker.

The purpose of transitional provisions from the aspect of a certain country is also to protect its own labour market and labour force from the overflow capacity. The aim is not to harm those in need of a better job, but to protect those who are already in a certain state, and working under certain conditions. When a market is overflown with certain workers of a certain ability, it may cause a drastic decrease in the value of certain workers, and automatically the workforce will be much more affordable and cheaper.

This protection that sometimes turns into discrimination because of harsh requirements to be employed in these states can be harmful. States should reformulate some of the criteria required to grant a work permit.

Generally speaking, transitional provisions exist because of the harsh situation in the current economy, and it is normal that people who are already employed would like to protect their employment as much as they can. These provisions, however, should not apply to small states with a limited amount of workforce, such as Croatia, where the labour market is already in need of seasonal workers to cater for the needs of the rapidly growing tourism industry. Instead of these

provisions, more developed states should help those in need, mostly in need of investment, welfare states should invest in less developed states, and foreign investments should result in more workplaces, more jobs available, which would automatically lead to less migration to other states.

The reform of transitional provisions must be acquainted with other necessary changes that result in unemployment, such as the reform of the education system in the states, increasing and encouraging certain professions to be more advertised, while in the ones that are already overflown with workforce, the quotas should be cut or even stopped for a certain period of time. In general, reforms in the European labour market are needed. From the national perspective, liable statistical analyses of the labour market, recognition of the current trends and market needs, a reform of the educational system, a reform of the public sector and a set of correct action plans for further development are the main preconditions for better economic performance and the standard of living.

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COMPULSORY VOTING

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ABSTRACT

The right to vote (the *right of rights, the bedrock of democracy*) is a result of a long struggle for equal participation in making political decisions that culminated in the 20th century (right to vote for women, for those who did not have that right due to their race, for people with mental impairment etc.). Nevertheless, nowadays many modern democracies face a low voter turnout. This fact questions the principle of political equality. Empirical studies have revealed that low voter turnout leads to unequal representation of different social-economic groups. Educated people and those with higher incomes vote more often and therefore political parties adjust their programs and politics to them. In that way active voters with relatively homogenous characteristics have disproportional effect on shaping of state politics.

There are different means available to states in order to initiate voter turnout and thus gain better representativity. One of the most disputable means, despite the fact that its efficiency has been proven in many empirical studies, is implementation of compulsory voting. The reason why many states with low voter turnout do not take the implementation of this effective mean into consideration lies in liberal vision of what the right to vote actually stands for, i.e. in protection of autonomy and freedom of choice of citizens.

This paper aims to examine the right to vote and to answer the following: does the right to vote include obstacles for introducing compulsory voting, i.e. does the right to vote necessarily entail the right not to vote.

Key words: the right to vote, the principle of political equality, compulsory voting, negative liberty, the free rider problem.

1. INTRODUCTION

The right to vote, which is sometimes called "the right of rights"[1] or is depicted as "the bedrock of democracy",[2] resulted from a long-lasting struggle for equal participation in political decision-making. It peaked in the 20th century when it acquired some universal features. It was the time when the range of holders of this right was greatly expanded and now in most contemporary democracies, the right to vote comprises all citizens, regardless of their sex, race or mental disability.

Despite all those changes, many contemporary democracies are faced with the problem of low voter turnout. Empirical research has shown that there is a big difference in the turnout between different voter groups. An average voter is better educated and earns more than an average citizen. Therefore, political parties are prone, according to the studies, to adapt their political programmes to active voters. The outcome of this process is unequal representation of different social groups. Certain "relatively homogenous groups" have disproportional effect on shaping both political programmes and state policies.[3]

There are various instruments available to states to raise their voter turnout and thus constitute a more representative government.[4] It was well-noted by Richard L. Hasen in one of the most quoted articles dealing with the issue of voter abstention and justification for introduction of compulsory voting: "Carrots and sticks have been employed to increase voter turnout since the birth of democracy."[5]

"In ancient Athens, election officials corralled voters with a red dyed rope, herding them from the marketplace to the Assembly's voting area at the nearby Pnyx. Athenian officials in later years simply paid voters to attend the Assembly".[6]

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1 Waldron, J., *Law and Disagreement*, Oxford [etc.], Oxford University Press, 2004, p. 232.

2 Ciccone, A., *The Constitutional Right to Vote is Not a Duty*, Hamline Journal of Public Law & Policy, Vol. 23, 2001-2002, p. 325.

3 *Notes The Case for Compulsory Voting in the United States*, Harvard Law Review, Vol. 121, 2007, p. 597.

4 Pursuant to Lijphart, institutional mechanisms which can boost voter turnout are as follows: "voter-friendly registration rules, proportional representation, infrequent election, weekend voting, and holding less salient election concurrently with the most important national election." Lijphart, A., *Unequal Participation: Democracy's Unresolved Dilemma*, The American Political Science Review, Vol. 91:1, 1997, p. 1.

5 Hasen, R. L., *Voting without Law*, University of Pennsylvania Law Review, Vol. 144, 1996, p. 2136.

6 *Ibid.*, p. 2135. References to footnotes from the original text are left out.

Compulsory voting is one of the most controversial instruments for increasing voter turnout despite its high efficiency, which has been demonstrated in numerous empirical studies. The main reason why states with low voter turnout do not even think about adoption of this efficient instrument is hidden, claim various authors, in the liberal perception of the right to vote with respect to the protection of autonomy and freedom of choice of every citizen.[7]

The paper is divided into two parts. The first part questions the theoretical foundations of the right to vote and the arguments for and against compulsory voting. It is divided into chapters. The first chapter examines the reasons why contemporary democracies are characterized with such low voter turnout. The second one investigates the arguments against introduction of compulsory voting. The third one refers to the arguments in favour of introduction of compulsory voting.

The second part of the paper analyses countries with a compulsory voting system. It deals with the efficiency of a compulsory voting system, possible exceptions to compulsory voting, the sanctions for people who do not perform their duty, the practice of the European Court of Human Rights on this topic and other problems these systems encounter in practice.

I. THE FOUNDATIONS OF THE RIGHT TO VOTE

2. WHY DO PEOPLE ABSTAIN FROM VOTING?

The arguments for introduction of compulsory voting are closely related to declining voter turnout in contemporary democracies, so this chapter explores the causes of this tendency. Citizens are often exposed to the question whether it makes sense to vote or not.[8] During election campaigns one can frequently hear slogans such as 'come to the polls, every vote counts.[9] Every prudent person will vote if it is in his or her interest.[10] Still, how true are these words or what are

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7 Blocher, J., *Rights To and Not To*, California Law Review, 100:4, 2012, p. 777.

8 Waldron, *op. cit.* note 1, p. 237. Some ideas from the first part of this paper were presented at the 2014 Annual Central and Eastern European Network of Jurisprudence Conference *The principle of equality as a fundamental norm in law and political philosophy*, University of Lodz, Faculty of Law and Administration, and at the conference *Issues in Comparative Law and Legal Theory*, Monash University, Prato Centre, 2015.

9 Com. Lomasky, L. E., Brennan, G., *Is there a Duty to Vote?*, Social Philosophy and Policy, Vol. 17:1, 2000, p. 65.

10 *Ibid.*

the chances that a single vote will change anything? It is particularly doubtful at general election due to a large number of electors.[11]

Since the influence of individual voters on the election results is insignificant,[12] the decision not to vote can be fully rational.[13] Coming to the polls incurs certain material costs and takes time.[14] All that may be in vain considering the effect of a single vote, even in case of a voter who supports a particular candidate, party and its programme. [15] The costs usually exceed the benefits.[16]

It is the first thing that one comes up with when searching the literature for answers to this crucial question. The aforementioned suggests that people can live in a democratic society without duties and responsibilities implied by the role of a citizen.[17]

Democracy is, like other forms of collective action, subject to the issue of free riders.[18] Some of the most prominent examples of free riders include individuals who avoid to pay taxes and who refuse to vaccinate their children against infectious diseases. This issue is not benign since free riders may cause serious problems in the realization of public goods. Initial avoidance of taking action with a collective element by a single person or few people may bring to a chain reaction with an ultimate effect of universal abandonment of performing respective duties.[19] This assertion is backed by the fact that a failure of one person to participate in the costs of realization of a public good increases the costs of other members of the group.[20] The issue of free riders can thus become "self –annihilating".[21]

However, here one needs to point to a relevant problem which' rational choice theory' is facing. It is the so-called "paradox of voting":[22] "The paradox facing rational choice scholars is that many people do vote in the absence of visible

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11 *Ibid.*, 66.
12 Waldron, *op. cit.* note 1, p. 237.
13 Notes, *op. cit.* note 3, p. 591.
14 *Ibid.*
15 *Ibid.*, 591.
16 Lomasky and Brennan, *op. cit.* note 9, p. 66.
17 Notes, *op. cit.* note 3, p. 591.
18 *Ibid.*
19 Lomasky and Brennan, *op. cit.* note 9, p. 75.
20 *Ibid.*
21 *Ibid.*
22 Notes, *op. cit.* note 3, p. 591.

carrots or sticks, although not in the same numbers in comparable election or across state or national boundaries."[23] It means that a large number of people vote, being aware that are not going to benefit from their vote and effort put into coming to the polls. Hence, voting can be denoted as an irrational activity.[24] A rational voter will cast a vote only if the benefits therefrom exceed the corresponding costs, which is not often the case.[25] If people focused only on realization of their own interests, no one would vote.[26]

Yet, is voting abstention a matter of only a free individual decision or does it imply something else too? Heather Lardy refers to empirical research on this issue, which reveals that voting abstention is not a matter of a private decision, as claimed by opponents of introduction of compulsory voting, but it also encompasses social circumstances affecting a person.[27] Low voter turnout relates to those who share the experience of "social alienation" due to poverty and unemployment. Political disenfranchisement is preceded by "social disenfranchisement". At this point, it is interesting to mention that things have developed differently from the predictions of contemporaries since the introduction of universal suffrage:

"It is interesting to note that, at the end of the nineteenth and the beginning of the twentieth century, when universal suffrage was being adopted in many countries, political analysts tended to assume that it would be the better educated and more prosperous who would make the rational choice not to bother to vote."[28]

Empirical research has demonstrated that there is a positive correlation between "socioeconomic status" and "voting".[29] Major influence on voter turnout is exercised by the voters' age and education.[30] Pursuant to the US Census Bureau, an average voter is a white woman aged 45+ having attended one academic year at college.[31] Hence various social subgroups seem to be blended in this designation of an average voter. How to sum up the consequences of voter abstention then?

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23 Hasen, *op. cit.* note 5, p. 2137.

24 *Ibid.* Hasen speaks about 'the irrationality of voting'.

25 Lomasky and Brennan, *op. cit.* note 9, p. 67.

26 *Ibid.*

27 Lardy, H., *Is there a Right not to Vote*? Oxford Journal of Legal Studies, Vol. 24:2, 2004, p. 316.

28 Lijphart, *op. cit.* note 4, p. 1.

29 *Ibid.*

30 Ciccone, *op. cit.* note 2, p. 352.

31 *Ibid.*, p. 356.

In systems of government in which citizens enjoy full freedom to decide whether to vote or not, all people have formally the same democratic status of electors.[32] Nevertheless, the situation is somewhat different in reality. Active voters have "disproportionate influence" on shaping state policies. Due to voting abstention, interests of entire groups are threatened to be neglected. In Lardy's opinion, long-term non-utilization of the right to vote by members of particular groups may lead to appearance of 'electoral exiles' whose status is in reality the same as that of people who are formally deprived of that right.[33] The following chapters are aimed at re-examining whether voting abstention is really so dangerous for the rule of democracy[34] and if, for the sake of mitigating its consequences, it is justified or even necessary to introduce compulsory voting.

3. ARGUMENTS AGAINST INTRODUCTION OF COMPULSORY VOTING

This chapter deals with the most important arguments against introduction of compulsory voting. First the emphasis is put on the argument according to which the right to vote is regarded as a form of freedom of expression and therefore, it should retain its discretion element with respect to its exercise. Then comes in the spotlight the argument which provides resistance to compulsory voting based on the liberal tradition of particular countries. In the end, the focus of attention is on the allegation that enforcement of compulsory voting is likely to be inefficient and expensive. Each of the subchapters first presents the attitudes of opponents of compulsory voting and then possible answers of advocates of its introduction.

3.1. RELATION BETWEEN THE RIGHT TO VOTE AND FREEDOM OF EXPRESSION

The bond between the right to vote and freedom of expression appears to be one of the arguments for keeping the right to vote within the sphere of discretionary powers and one of the arguments against introduction of compulsory voting.[35] Many authors apply such argumentation instead of claiming that voting

32 Lardy, *op. cit.* note 27, p. 313.

33 *Ibid.*, p. 321.

34 *Ibid.*, p. 313.

35 For comparison of the freedom contained in the right to vote to the protection of freedom of conscience see *Ibid.*, 307.

abstention is a right itself.[36] Similarly, it can be heard that voting abstention is also a political expression.[37] Compulsion to vote is identical to compulsion to speech.[38] The right to vote shall, like freedom of speech, imply "the inverse right"[39] not be compelled to vote.[40]

Election, beside their primary function of election of state officials, has also a secondary, expressive function.[41] Non-voting may be, like voting, an expression of a political attitude.[42] It can be an attitude or expression of contempt towards programmes or parties who compete in election or a protest against injustice within a system, respective of electoral regulations which do not provide fair distribution of votes or of an electoral system which fail to provide a possibility of real choice between several candidates.[43] As laid down by Loren Lomasky and Geoffrey Brennan, by abstaining from voting, voters can also express their belief that election is a fraud and an illusion (election is "the opiate of democratic masses"[44]).[45]

Lardy rejects this argument. By abstaining from voting, a citizen does not convey any message. The reasons for voting abstention are not known to anyone, so one cannot speak about communication in its real sense.[46] However, in terms of an individual voter, the expressive function of election is, even in case of coming to the polls, disputable since contemporary democracies prefer the secret ballot.[47] In the case of *Burdick v. Takushi*, 504 U.S. 428, 438 (1992), the US Supreme Court clearly stated that voting cannot be deemed as an expressive activity (speech).[48]

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36 For a critique of this approach see *Ibid.*, 307.

37 Notes, *op. cit.* note 3, p. 601.

38 *Ibid.*, p. 598.

39 *Ibid.*

40 *Ibid.*

41 *Ibid.,* p. 601.

42 *Ibid.*

43 Schäfer, A., *Republican Liberty and Compulsory Voting*, MPIfG Discussion Paper 11/17 Max-Planck-Institut für Gesellschaftsforschung, 2011., pp. 13-16. Notes, *op. cit.* note 3, p. 603.

44 Lomasky and Brennan, *op. cit.* note 9, p. 86

45 *Ibid.*, p. 83.

46 Lardy, *op. cit.* note 27, p. 318.

47 Lomasky and Brennan, *op. cit.* note 9, p. 82.

48 Hasen, *op. cit.* note 5, p. 2176. In that case, the Court rejected an application of a voter who claimed that the Hawaiian prohibition of adding candidates to the ballot paper deprived him of the right to a protest note and thus of giving his vote to Donald Duck.

According to *The Case for Compulsory Voting in the United States*, these objections to freedom of expression would be justified if voters were forced to a certain choice. Still, in the event of compulsory voting, the only thing that is required from voters is to come to the polls and to have this fact registered. Whether they are really going to vote or not and which candidate they intend to choose is not a matter of compulsion.[49] If voters were required to vote for a particular party or candidate, then one could speak about compulsion as well as about violation of the right to freedom of political expression.[50]

A compulsory voting system may, thinks Lardy, resolve the problem of expressing political opinions.[51] Such a system can prescribe that a ballot paper is to involve a special column in which voters can state their reasons for dissatisfaction with presented programmes and candidates.[52]

Likewise, incorporation of "an exemption scheme or *conscientious objectors*"[53] is expected to enhance the eligibility of compulsory voting. Some authors find it necessary for political eligibility of such a system.[54] Such a possibility can be provided to everyone who fill out a rendered form and sign a statement revealing why they are doing this (reasons can be of a political, philosophical, religious nature).[55] That way their reasons for non-voting could be at least disclosed and hence laziness and collective action problems related to voting could be excluded.[56] *The Case for Compulsory Voting in the United States* suggests that two relevant problems can be resolved thereby: concern about restrictions on political expression and collective action problems related to voting.

3.2. THE DEMOCRATIC TRADITION

The second important argument against introduction of compulsory voting is the democratic tradition of certain countries.[57] What can be heard is that "philosophical and legal conceptions on the nature of American democracy and

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49 *Ibid.*

50 Notes, *op. cit.* note 3, p. 602

51 *Ibid.*

52 Lardy gives an example of the Australian Electoral Commission, Electoral Backgrounder 8: Compulsory Voting at URL=http://www.aec.gov.au. Accessed 11 August 2015.

53 Lardy, *op. cit.* note 27, p. 320 note 43.

54 Notes, *op. cit.* note 3, p. 603.

55 *Ibid.*

56 *Ibid.*

57 Lardy, *op. cit.* note 27, pp. 305-306. Schäfer, *op. cit.* note 43, p. 21.

law" represent the biggest obstacle to introduction of compulsory voting in the United States.[58] Voting is perceived there primarily as "an individual privilege".

Hasen believes that "voluntary voting has been in place too long in the United States for it to be questioned now. A call for compulsory voting may be viewed as a failure of the democratic experiment. Americans find it somehow perverse to require people to affirm their faith in the democratic system".[59] Hasen talks about the example of undemocratic regimes that have used compulsory voting to provide a candidate or party with legitimacy.[60] However, Australia is featured by the same libertarian values as the USA and makes use of compulsory voting despite.[61]

There are certain "qualitative advantages of a voting system in which people cast votes without compulsion".[62] Hasen sees them as "the most powerful instrumental objection" to compulsory voting. Introduction of compulsory voting might lead to bad decisions since empirical studies have shown that non-voters are less familiar with public affairs then voters.[63] The risk of making bad decisions represents, as suggested by Hasen, an inevitable "side effect of equalizing political capital among individuals". A vote of citizens who opt for a particular candidate habitually or of those who vote without being introduced to the programme of a party or candidate or of those who choose their favourites encouraged by billboards and TV or radio advertisements is as worth as a vote of a person who thoroughly study the whole campaign.[64]

Yet, all this is not perceived as an insurmountable obstacle to introduction of compulsory voting since such voting entails only coming to the polls and not a duty to vote, which means that uninterested voters can in the end avoid casting their votes.[65]

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58 Notes, *op. cit.* note 3, pp. 560, 591.
59 Hasen, *op. cit.* note 5, p. 2177.
60 *Ibid.*
61 *Ibid.*
62 *Ibid.*, p. 2174.
63 *Ibid.*, p. 2175.
64 Lomasky and Brennan, *op. cit.* note 9, p. 83.
65 Hasen, *op. cit.* note 5, p. 2175

3.3. OTHER ARGUMENTS AGAINST COMPULSORY VOTING

Other things which may be brought up by opponents of compulsory voting include its inefficient and expensive enforcement. Though, claims Hasen, "law need not be well enforced to be effective". Adoption of a law, familiarization of the public therewith and initial efforts to enforce it might suffice in this view.[66]

Arend Lijphart stresses that sanctions for non-voting are mild and less enforceable than, for instance, parking tickets.[67] An example of mild sanctions for non-voting can be found in Italy too: "In contemporary Italy, those who fail to vote face the prospect of having their names posted by the mayor on the communal notice wall and of being branded a non-voter in official papers".[68] Hasen also lays down examples of "carrots" which are instead of "sticks" used for encouraging people to vote: "In California, a voting stub obtained after casting a ballot has entitled voters to a free half-dozen "Yum-Yum" doughnuts or a discounted spinal adjustment by a chiropractor".[69]

4. ARGUMENTS FOR COMPULSORY VOTING

This chapter investigates the arguments of advocates of introduction of compulsory voting. The accent is put on the two, according to many, most important arguments. What is first analysed is the argument asserting that introduction of compulsory voting might strengthen the legitimacy of the government. Then the paper sheds light on the theories of freedom lying behind the right to vote as a discretionary power and the right to vote as a liability (obligation).

4.1. LEGITIMACY OF THE GOVERNMENT

Achievement of more representative polls and thereby a higher level of the legitimacy of the government occur to be the most popular reasons for introduction of compulsory voting.[70] As shown above, empirical research suggests that those who vote possess "homogenous characteristics" and that entire voter groups, these are in the principle those who suffer from social alienation, and

66 *Ibid.*

67 Lijphart, *op. cit.* note 4, p. 2.

68 Hasen, *op. cit.* note 5, pp. 2135-2136.

69 *Ibid.*, p. 2136.

70 See Lijphart, *op. cit.* note 4. Hasen, *op. cit.* note 5.

their interests are ignored by political parties. Political parties need to start taking care of these groups since they will have to come to the polls after introduction of compulsory voting.[71] Compulsory voting is "a mechanism for higher turnout that will in turn produce more egalitarian politics".[72]

4.2. THEORY OF LIBERTY BEHIND COMPULSORY VOTING

The question whether voting abstention is a right or not is narrowly connected to the question what kind of liberty lies behind it.[73] In his article entitled *Is there a Right not to Vote?,* Lardy asserts that linking compulsory voting with restrictions on the liberty of a person is derived from mischaracterization of the liberty which is implied by the right to vote.[74] The right to vote which does not foresee sanctions in case of non-voting entails the so-called negative liberty.[75] Isaiah Berlin provided for a classical overview of a negative liberty: "I am normally said to be free to the degree to which no man or body of men interferes with my activity. Political liberty in this sense is simply the area within which a man can act unobstructed by others".[76]

A request for the so-called negative liberty entails prohibition of interference by the state with decisions of a person. The right to vote does not necessarily imply the right not to vote. In Lardy's opinion, the right to vote is not founded on a negative liberty[77] but it entails freedom in the sense of non-domination – a lack of arbitrary interference by the state.[78] Philip Pettit's theory of republicanism revolves around this concept of liberty, accentuates Lardy. The concept of liberty as prohibition of every interference by the state is too narrow.[79] Pursuant to the republican vision of liberty, interference by public authorities may be justified if it results in protection of an individual from the dominancy of other people.[80]

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71 Lardy, *op. cit*. note 27, p. 317.

72 Alejandro, H., *The Sovereign Obligations of We, the People: An Argument for Compulsory Voting in the United States,* 2010.

73 Lardy, *op. cit*. note 27, p. 321.

74 *Ibid.,* p. 315.

75 *Ibid.*, p. 308.

76 Berlin, I. (1958) *Two Concepts of Liberty* in Isaiah Berlin, Four Essays on Liberty. Oxford, Oxford University Press, 1969. https://www.wiso.unihamburg.de/fileadmin/wisovwl/johannes/Ankuendigungen/Berlintwoconceptsofliberty.pdf, pp. 3-4. Accessed 15 August 2015.

77 Lardy, *op. cit*. note 27, p. 309.

78 *Ibid.*, p. 313.

79 *Ibid.*, p. 314.

80 *Ibid.*

State interferes in order to prevent the dominancy of classes who regularly cast a ballot over those who fail to do it.

Lardy shares the opinion of the authors who find irrelevant if voting results from voluntary or compulsory action.[81] Compulsory voting is justified due to its contribution to the assurance of broader participation of citizens in the rule of democracy. The existence of the right to vote is important both for individual freedoms and democratic practice.[82]

Individualism dominates numerous discussions on the right to vote.[83] An institution is exclusively perceived as a right of an individual. However, a particular right may serve as an instrument for realization of private and public interests. Even if a justification for introduction of a right is primarily personal, its effects do not necessarily refer to a particular person. In terms of the right to vote, there is powerful collective concern for establishment of a democratic rule, which may prevail over the interest of an individual to give up on this right.[84] It is not a privilege[85] of a person but his or her civic duty.[86]

A person has a duty to vote which is owed to other voters. From Lisa Hill's point of view, this obligation is owed primarily to all members of a political community and its purpose is to provide for living in representative democracies. Secondly, this duty is owed to members of the social group which a person belongs to, so that it could be equal to other groups. For instance, Hill claims that female voters owe this duty to all the other women.[87] A duty which is owed to members of the same groups is exceptionally important since current electoral systems have already built up practice by means of which politicians offer various benefits to groups in exchange for "bloc votes".[88]

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81 *Ibid.*, p. 315.

82 *Ibid.*

83 *Ibid.*, 317, note 36.

84 Notes, *op. cit.* note 3, pp. 560, 591.

85 *Ibid.*, p. 560.

86 Lomasky and Brennan, *op. cit.* note 9, p. 67.

87 Hill, L., *For Compulsory Voting*, Electoral Regulation Research Network / Democratic Audit of Australia Joint Working Paper Series, Working Paper No. 30 (March 2015), pp. 3-4. https://www.law.unimelb.edu.au/files/dmfile/WP30Hill2.pdf. Retrieved 11 August 2015. Lomasky and Brennan find this criterion controversial since individuals are not member of only one group but can be affiliated to many different groups. At this point, this issue cannot be paid much attention, so let us leave it for some other occasion.

88 Hasen stresses that the American electoral systems has developed ways how to benefit from 'selective mobilization of voters'. Hasen, *op. cit.* note 5, p. 2174.

Many rights are governed by social duties.[89] Pursuant to Hasen, "although the government tells people what to do all the time-file an income tax return, serve on a jury, register in the Selective Service Program, separate trash -- hackles rise when compulsory voting is mentioned."[90]

Voluntariness must not prevail over the purpose of the right to vote. The primary purpose of the right to vote is, in the eyes of Lardy, to protect active participation and prevent all of its unjustified restrictions.[91] According to the same author, the only advantage of non-voting is that those who practice it are interpreted as if they exercised their political freedom and not as "democracy's delinquents".[92]

II. COMPULSPORY VOTING IN PRAXIS

5. COMPULSORY VOTING AROUND THE WORLD

Currently there are more than twenty countries in the world that have a compulsory voting system. In total there are more than 740 million people living in those countries.[93] Even though the majority of these countries are in Central and South America (Argentina, Brazil, Bolivia, Costa Rica, Mexico, Peru, etc.), compulsory voting can also be found in other parts of the world. European countries and western civilization countries that have a compulsory voting system are Australia, Belgium, Cyprus, Greece, Liechtenstein and Luxembourg. In the rest of the world, compulsory voting isn't that prevalent, but it can be found in Africa (Congo, Egypt), in the Middle East (Turkey, Lebanon) and Eastern Asia (Singapore, Thailand). It should also be noted that even more European countries had, at a certain point in their history, a compulsory voting system: Austria (in some federal states), Italy (from 1945 to 1993), the Netherlands (from 1917 to 1967), Spain (from 1907 to 1923) and Switzerland (from 1904, abolished in 1974, except in the Schaffhausen canton).[94]

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89 Waldron, J., *Dignity, Rights, and Responsibilities*, Arizona State Law Journal, Vol. 43, 2012, pp. 1123-1125.

90 Hasen, *op. cit* note 5, p. 2176.

91 Lardy, *op. cit*. note 27, p. 317.

92 *Ibid.*

93 Silverberg, Simon, *Why Don't We Vote?*, 2015. URL=http://www.vanderbiltpoliticalreview.com/why-dont-we-vote/. Accessed 11 August 2015.

94 International Institute for Democracy and Electoral Assistance, *Compulsory Voting,* 2015. URL=http://www.idea.int/vt/compulsoryvoting.cfm, Accessed 11 August 2015.

6. EXCEPTIONS IN COMPULSORY VOTING SYSTEMS

Since we're talking about a huge number of countries, it is reasonable to expect that the enforcing of the compulsory voting system, as well as the sanctions for the people who don't vote, will differ from country to country. First we will mention and explain some of the exceptions which exempt the voters from their voting obligation.

Age is the first category which can exempt the citizens from their voting obligation. Before they reach the age of majority, not only do individuals have no obligation to vote, but they also have no right to vote (the age of majority varies from country to country, but it is usually between the age of 16 and 21). Also, in the countries where voting is compulsory, when the citizens reach a certain age, they are no longer obliged to vote. In Brazil, Greece and Luxembourg voting stops being mandatory for voters who have reached the age of 70, in Cyprus for voters who have reached the age of 60, in Ecuador for voters who have reached the age of 65, and in Paraguay and Peru for voters who have reached the age of 75.[95]

Countries with a compulsory voting system often exempt the mentally ill, the sick and the infirm citizens from the voting obligation. Brazil and Ecuador also exempt the illiterate citizens. Some countries exempt or forbid prisoners from voting (a system known also to countries in which voting isn't mandatory) – for example, Belgium forbids citizens from voting if they have served a prison sentence for longer than 7 years.[96] In most countries in Latin America citizens who serve in the army are not obliged to vote. Australia exempts citizens who belong to certain religious groups and abstain from voting out of religious motives.

7. POSSIBLE SANCTIONS FOR CITIZENS WHO DON'T VOTE

In the legal systems across the world we can find four ways in which the countries can influence (or not influence) their voters. The first way, known to most countries in the world (and also to the Republic of Croatia), is that voting is not an obligation and there are no sanctions for voters who don't vote. The second way, which has almost died out, implies a non-compulsory voting system which still punishes the voters who decide not to vote. Such a system could be found in the totalitarian regimes (such as the USSR) where the voter would

95 *Ibid.*

96 Kozai, K., Newman, F. C., *The Right to Vote: Interference by Voter Registration Laws*, University of San Francisco School of Law's International Human Rights Clinic, 2014, p. 13.

be informally punished because he didn't perform his civil duty (example of sanction: impossibility of advancing in his profession). Today the influences of that system can be found in Cuba where election commissions follow individuals who don't vote and can accuse them of non-patriotism and even punish them.[97] Then, there are two systems in the countries with compulsory voting. These two systems are the sanctioning and the non-sanctioning of the citizens who refuse to vote.[98] Many countries, despite the fact that voting is mandatory, don't carry out any sanctions for citizens who ignore their duty (Bolivia, Costa Rica, Dominican Republic, Greece, Guatemala, Honduras and Mexico).

The types of sanctions used by the countries to punish the citizens who don't vote are different. The weakest sanction countries can use is to demand an explanation. There are two methods in which a demand for explanation can function. In the first method, used in Australia, the country seeks an explanation from the citizen who hasn't voted before deciding whether to punish him or not. In the second method, used in Belgium, Luxembourg and in the Latin American countries, the voters must, in their own initiative, explain their absence to the institutions if they wish to avoid being sanctioned.[99]

The other sanctions that are used (or have been used) by countries are the formal reprimand, public shaming in the form of publishing the names of the people who haven't voted, fines (the most popular type of sanction), loss of the right to vote (in Belgium, a citizen who hasn't voted for four times in 15 years loses the right to vote for the next 10 years[100]), ban from working in public services and impossibility of exercising requests from public services (for example, in Greece, up to 2001, obtaining a passport or a driver's license was harder for people who hadn't voted[101]), and finally the harshest sanction – imprisonment.

Australia, Brazil, Peru and Singapore are the harshest in enforcing sanctions upon non-voters. In Brazil non-voters have to pay a fine, they are banned from taking professional exams and from obtaining a passport or a loan. Failure to

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97 Ornstein, N., Stoilov, V., *Perspectives: Should mandatory Voting Laws be Implemented in the United States?*, Insights on Law & Society 11.1, American Bar Association, 2011, p. 16.

98 Birch, S., *Full participation, A Comparative Study of Compulsory Voting*, Manchester University Press, Manchester, 2009, p. 4.

99 *Ibid.*

100 Pilet, J. B., *Choosing Compulsory Voting in Belgium: Strategy and Ideas Combined,* unpublished paper presented to the ECPR Joint Sessions Workshop on Compulsory Voting, Helsinki, May 7 – 12, 2007, p. 2.

101 The Electoral Commission, *Compulsory Voting around the World*, research report, 2006, p. 20.

vote in three consecutive elections, non-payment of fines or failure to justify absence within six months can lead to registration in the registrar of voters being cancelled.[102]

In Australia, when a non-voter doesn't perform his civil duty, authorized institutions send him a letter in which they warn him that he has to explain his absence or he will pay a 20 Australian dollars fine. If the non-voter doesn't explain his absence or refuses to pay the fine, his case may end up in court. If the court pronounces him guilty, he could pay the maximum fine of 170 Australian dollars plus court costs. Also a criminal conviction can be recorded against him.[103] If the individual refuses to pay the fine even after the verdict is final, he can be imprisoned for disrespecting the court. The highest fine ever sentenced was of 461 Australian dollars. It was sentenced to a retired diplomat who hadn't voted for 15 years and he was even arrested for not paying the fine.[104]

In Singapore, citizens who don't vote get deleted from the registrar of voters. Those individuals have to register again and pay the expenses. In Peru, people who don't vote can't perform certain bank and administrative transactions and also have to pay a fine.[105]

8. EUROPEAN COURT OF HUMAN RIGHTS

There's only one case in the court practice of the European Court of Human Rights regarding compulsory voting – X v Austria (1971). X sued Austria because he thought the compulsory voting system violated article 9 of the European Convention on Human Rights. Article 9 states that "everyone has the right to freedom of thought, conscience and religion; this right includes freedom to change his religion or belief and freedom, either alone or in community with others and in public or private, to manifest his religion or belief, in worship, teaching, practice and observance".[106] The European Court of Human Rights decided that compulsory voting doesn't violate the freedom of thought, conscience

102 *Ibid.,* p. 7.

103 Australian Electoral Commission, Voting within Australia – Frequently Asked Questions. URL=http://www.aec.gov.au/faqs/voting_australia.htm, Accessed 11 August 2015.

104 Sweanson, K. M., Sticks, Carrots, Donkey Votes, and True Choice: A Rationale for Abolishing Compulsory Voting in Australia, Minnesota journal of international law, Vol 16:2, 2007, p. 526.

105 The Electoral Commission, *op. cit.* (note 101), p. 7.

106 European Convention on Human Rights, Narodne novine (Official Gazette) No. 18/1997, 6/1999, 14/2002, 13/2003, 9/2005, 1/2006, 2/2010.

and religion guaranteed by the European Convention on Human Rights because mandatory voting doesn't actually force people to vote, only to be present at polling stations. Individuals are free to submit an empty or invalid ballot paper.[107]

9. PROBLEMS WITH COMPULSORY VOTING IN PRAXIS

The empty and invalid ballot papers are one of the biggest problems of the countries that have a compulsory voting system. For example, during the 1990 parliamentary elections in Brazil the voter turnout was 76.57%, but when the votes were counted, it turned out that 40.10% of the votes were invalid. Often in Brazil, at parliamentary elections, over 10% of all the votes turn out to be invalid.[108] In other countries where voting is mandatory, the problem with invalid votes isn't that extreme, but still the percentage of invalid votes is much higher than in Croatia. In Belgium, on average, there's 6.35% invalid votes, and in Australia about 3.20%. In Croatia the percentage of invalid votes is on average around 2%.[109]

The invalid votes are not the only problem. In practice there's also a high number of so called random votes. Voters that have to vote against their will, will often randomly select a candidate or a party on the ballot paper, usually the first one.[110]

Besides that, there is the problem of unregistered voter. In some countries (for example Chile) voting is mandatory, but registering in the registrar of voters isn't. In Australia 10% of people aren't even registered in the registrar.[111]

10. CONCLUSION

Human history has been marked by the fight for acquiring a share in the government and in shaping state policies. The right to vote used to be a "privilege for the few" instead of being "an inclusive right of all".[112] However, since the

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107 Appl. 4982/71, *X v. Austria*, Yearbook XV, 1972, p. 468.

108 International Institute for Democracy and Electoral Assistance, *Voter turnout data for Brazil*, 2015. URL=http://www.idea.int/vt/countryview.cfm?id=30, Accessed 11 August 2015.

109 Percentages were calculated by using the data provided by the International Institute for Democracy and Electoral Assistance.

110 *Loc cit.* (note 94).

111 Australian Electoral Commission, *Compulsory Voting*. URL=http://www.aec.gov.au/voting/CompulsoryVoting.htm, Accessed 11 August 2015.

112 Ciccone, *op. cit.* note 2, p. 326.

right to vote assumed universal features, contemporary democracies have been facing the issue of low voter turnout, which challenges the legitimacy of the government itself. This is a particularly delicate issue because voting abstention is not randomly disseminated among the population but there is a certain pattern thereof. Better-educated and wealthier citizens are those who regularly come to the polls and therefore, their interests can prevail over the interests of other groups.[113] Compulsory voting appears to be, based on its application in more than 20 countries, an efficient instrument for elimination of these problems and achievement of greater representativeness of the government. The first part of the paper investigates the arguments for and against introduction of compulsory voting. As the most influential theory against compulsory voting, the theory of the expressive function of election has got its share of attention herein. In compliance with this theory, voting can be best described as a way of self-expression of voters on issues of common interest.[114] Even in case of voting abstention, voters convey a certain message to the authorities and hence introduction of compulsory voting is undesirable or the same as introduction of compulsory speech. This paper also pays attention to the types of liberty lying behind the idea of the right to vote as a discretionary power (negative liberty prohibiting any interference with the choice of an individual) and the idea of the right to vote which is also an obligation (republican liberty which is aimed at preventing the dominancy of one group over the other).

The presented arguments lead us to the conclusion that introduction of "compulsion" in regard to voting and requiring "active participation of citizens" are legitimate ways to assure higher values in a democratic community in which the interests of all groups are equally represented and protected. Compulsion in this context is not an adequate word. Citizens are just required to come to the polls without having to virtually cast a ballot, which would be completely unacceptable, and without having to vote for a particular candidate.[115] It means that all the arguments for compulsory voting as a way of compulsory expression of a political opinion turn out to be ill-founded.

Currently there are more than twenty countries in the world that have a compulsory voting system. The types of sanctions and penalties for non-voters differ greatly from country to country (some countries don't even enforce any

113 Lijphart, *op. cit.* note 4, p. 1.

114 Waldron, *op. cit.* note 1, p. 240.

115 Lijphart, op. cit. note 4, p. 2.

sanctions upon citizens who don't do their duty). But all of these countries encounter the same problems when enforcing the compulsory voting system, which are invalid ballot papers and the so called random votes. The percentage of invalid ballot papers is usually higher in countries that have a compulsory voting system than in countries that don't.[116],[117]

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116 ACE Electoral Knowledge Network, Electoral Systems. URL=http://aceproject.org/main/english/es/esc07a.htm Accessed 11 August 2015.

117 *Loc cit.* (note 94).

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RECENT DEVELOPMENTS IN INTERNATIONAL ENVIRONMENTAL LAW WITH SPECIAL REFERENCE TO GLOBAL WARMING

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ABSTRACT

Over the past few decades, the world has been confronting the largest and the most complex degradation of its environment, whose scope has become global and whose anticipated effects are more severe and far-reaching than ever seen before. Simultaneously, the international community has raised awareness of environmental protection and the need for global action. The main idea of this article is to make a brief historical overview of international environmental global warming policies as well as an analysis of the current legal framework for mitigating global warming, both from normative, through international agreements adopted with the aim of reducing greenhouse gas emissions, as well as executive aspect, through instruments and measures set by relevant regulations that regulate their enforcement.

Key words: Global Warming, International Environmental Law, The United Nations Framework Convention on Climate Change, The Kyoto Protocol.

INTRODUCTION

Since the appearance of mankind, humans have been inseparably bonded with the environment they have inhabited. Any degradation of natural resources represents an impairment of living conditions and a threat to life as we know it. Nevertheless, human activities have not always been in favor of a sustainable environment. Along with the production development, human needs have grown. While living conditions have improved, environmental conditions have encountered a downward trend by arising issues that have not existed. Environmental degradation has reached its highest level along with atmospheric pollution. Human activities have altered the composition of the Earth's protective layer that prevents negative solar influence thereby disrupted and prevented its

natural functions. The most adverse byproduct of human activity are greenhouse gases, especially carbon dioxide, that are released as a result of fossil fuel combustion. Their high atmospheric concentration prevents reflecting excessive solar radiation back into space, trapping it on the Earth's surface thereby warming it. A long-term trend in changing the composition of the atmosphere has led to the Earth's surface temperature increase causing changes in its natural system.

Global warming is the leading environmental issue and one of the greatest problems of the society today. Its comprehensive effects are far-reaching and its solution requires an interdisciplinary approach. It encompasses environmental, social, political and economic components into one specific phenomenon. Its effects on the environment irreversibly affect society as well. Although all countries contribute to anthropogenic global warming, and consequences appear globally, the extent to which countries are responsible for its emergence and vulnerable to its adverse effects is variable. Due to its geographical location, small developing, especially island countries are more affected by the impacts of global warming. Furthermore, as a result of insufficient funds that results in underdeveloped industry, their greenhouse gas emission share is insignificant on the global scale, and they have no capacities for adequate global warming policy implementation.

Environmental problems require immediate action, otherwise future generations will inevitably encounter even more adverse natural impacts. The first step towards global warming adaptation is creating an international framework on combating climate change which will set the foundation for mitigating climate change through effective normative, executive and supervisory instruments.

1. INTRODUCTION TO GLOBAL WARMING

1.1. CAUSES OF GLOBAL WARMING

Life on Earth is possible primarily due to solar radiation. Earth absorbs part of the received thermal radiation and starts to radiate re-emitting it back to the atmosphere. Such energy, due to special atmospheric substances, remains on the Earth's surface, increasing its temperature. This natural process allows heat retention, thus preserving life on Earth. It is caused by certain gases that reflect the Earth's radiation back to its surface creating the greenhouse effect. They are essential for conserving life on Earth and their stable concentration is sustained by natural processes that provide balance and natural functions of the atmosphere.[1]

[1] Greenhouse Gas Effect and The Kyoto Protocol, http://www.geografija.hr/svijet/efekt-staklenika-i-kyotski-protokol-1-dio/, viewed on 20 January 2015.

The present greenhouse effect problem is not connected with the natural greenhouse effect, but with the gas concentrations emitted as a result of human activities. Throughout the history, the man has been changing the environment he inhabited. This change has been progressively growing along with man's development and it is unstoppable ever since the Industrial Revolution in the late 18th century. Scientific and technical revolution, cities and population growth, trade, industry and transport development and human activities growth have begun to act upon the balance of the earth's ecosystems. Additional greenhouse effect leads to excessive heating of the earth's surface and change of the climate balance.[2] The problem we are facing today is expanding and thickening of atmospheric layer due to excessive greenhouse gas concentration, primarily carbon dioxide. This leads to blocking infrared rays that would have otherwise left Earth's atmosphere and continued to spread into space and emitting them back to the earth's surface. The temperature of the atmosphere, oceans and seas, therefore rises.

Atmospheric gas with the largest contribution to the greenhouse effect and consequently to global warming is carbon dioxide. Although it is produced and absorbed naturally and its concentration in the atmosphere is generally stable, it has a substantial share in anthropogenic emissions. Its primary source is fossil fuel combustion as a result of the energy production process. Additionally, carbon dioxide concentration levels have been affected by deforestation and soil depletion, which causes a loss of natural ability to absorb carbon dioxide, therefore an increase of its atmospheric levels. Greenhouse gas concentration has increased since 1750, due to the Industrial Revolution and fossil fuels combustion growth. Scientific doubts in the anthropogenic carbon dioxide source have led to its atmospheric concentration measurements at the end of 60's. Polar ice sample analyses have shown that over the past 400-600000 years, and perhaps even 20 million years, carbon dioxide levels were stable and have amounted between 180 and 280 ppm (parts per million, or $1cm^3$ per $1m^3$).[3] The concentrations have increased by 40 percent since pre-industrial times, primarily from fossil fuel emissions and secondarily from net land use change emissions.[4] Over the last

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2 Piani, Gianguido *et al*: *The Kyoto Protocol - Realisation and future developments, legislation, strategies, technologies*, Graphis Ltd., Zagreb, 2011, p. 41.

3 Ibid., p. 43.

4 Climate Change 2014: Mitigation of Climate Change, Contribution of Working Group III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change, Cambridge University Press, Cambridge, United Kingdom and New York, USA, 2014.

250 years the concentration exceeded the highest level in history, exceeding the level of 390ppm, with a continuous annual growth[5] and in February 2015 it is measured to be 400.26 ppm.[6]

Despite the clear manifestations of climate changes, the issue of global warming has been the center of controversy for decades. A scientific progress has resulted in indisputable evidence in favor of the existence of climate change and man-made global warming is no longer a theory, but a fact.

1.2. IMPACTS OF GLOBAL WARMING

Recent scientific studies have shown clear human influence on the climate system and its unequivocal warming. It is virtually certain[7] that the troposphere has warmed since the mid-20th century, whereby the period from 1983 to 2012 was likely the warmest 30-year period of the last 1400 years[8], and 2014 is the warmest year in modern records.[9] The global average combined land and ocean surface temperature shows a warming of 0.85 °C over the period from 1880 to 2012. [10] Continued greenhouse gas emissions will cause further warming and long-lasting changes in all components of the climate system, increasing the likelihood of severe, pervasive and irreversible impacts for people and ecosystems. There are several scenarios predicting possible climate system changes in the future. Each of them requires the same approach – efficient mitigation policy based on significant and permanent anthropogenic greenhouse gas emissions reduction. Total anthropogenic greenhouse gas emissions have increased over decades, despite a growing number of climate change mitigation policies. Multi-model results show that limiting total anthropogenic global warming to less than 2 °C relative to the period 1861-1880 would require cumulative carbon dioxide

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5 Trends in Atmospheric Carbon Dioxide, http://www.esrl.noaa.gov/gmd/ccgg/trends/, viewed on 5 February 2015.

6 CO2 Now, http://co2now.org/, viewed on 9 March 2015.

7 The following terms have been used to indicate the assessed likelihood of an outcome or a result: virtually certain 99-100 percent; probability, very likely 90-100 percent; likely 66-100 percent; about as likely as not 33-66 percent; unlikely 0-33 percent; very unlikely 0-10 percent; exceptionally unilikely 0-1 percent.

8 Climate Change 2014: Mitigation of Climate Change, loc. cit.

9 NASA, NOAA Find 2014 Warmest Year in Modern Record, http://www.nasa.gov/press/2015/january/nasa-determines-2014-warmest-year-in-modern-record/#.VPVnbI6rFuU, viewed on 3 March 2015.

10 Climate Change 2014: Mitigation of Climate Change, loc. cit.

emissions from all anthropogenic sources since 1870 to remain below 2900 gigatonns (Gt), whereby 1900 Gt had already been emitted by 2011.[11]

The global mean surface temperature is projected to rise under all assessed scenarios. The increase of global temperature for 2081-2100 relative to 1986-2005 by the end of the 21st century is likely to be 0.3-1.7 °C, according to the most optimistic, and 2.6-4.8 °C according to the most pessimistic estimates. Global warming will continue and by the end of the century. It is projected that the global surface temperature is to likely exceed 1.5-2 °C. Consequently, along with the temperature rise, polar ice sheet will decrease and sea level will rise. The Arctic region will continue to warm more rapidly and continue to lose mass, with glaciers shrinking almost worldwide, which are calculated to decrease by 15-85 percent according to different assessments. The annual mean Artic sea-ice extent decreased over the periods 1979 to 2012, with a rate that is very likely in the range 3.5 to 4.1 percent per decade. In response to increased global surface temperature and melting snow cover, permafrost temperatures will continue to increase. It is virtually certain that the near surface permafrost area will decrease by 37-81 percent. Due to increased loss of mass from glaciers and ice sheets and increased ocean warming, the global mean sea level will continue to rise. Over the period 1901 to 2010, global mean sea level rose by 0.19 m and for the period 2081-2100 relative to 1986–2005 the rise will likely be in the ranges of 0.26-0.82 m. By the end of the century, it is very likely that sea level will rise in more than about 95 percent of the ocean area.

Furthermore, climate change will affect carbon cycle processes in a way that will exacerbate the increase of carbon dioxide in the atmosphere. Further uptake of carbon by the ocean will increase ocean acidification. Cumulative emissions of carbon dioxide will largely determine the global mean surface warming by the late 21st century and beyond. Most aspects of climate change will persist for many centuries, even if the emissions are stopped. This represents a substantial multi-century climate change commitment created by past, present and future emissions.[12]

Although the warming of the planet will be gradual, the effects of extreme weather events will be abrupt and acutely felt. Both trends may affect living conditions. Rising temperatures and more frequent droughts and floods can compromise food security. More frequent extreme weather events mean

11 Ibid.

12 Ibid.

more potential deaths and injuries caused by storms and floods. In addition, flooding can be followed by outbreaks of diseases, especially when water and sanitation services are damaged or destroyed.[13] Natural changes can cause a wave of migration and enlarge a number of environmental refugees, increasing the pressure on local natural resources, which could eventually lead to violent conflicts and wars. Possible adverse climate change effects may in the long run aggravate certain existing threats to international peace. The threat is particularly expressed as territory loss caused by sea level rise, particularly in small low-lying island countries.[14]

2. HISTORICAL OVERVIEW OF INTERNATIONAL GLOBAL WARMING MITIGATION

2.1. SCIENTIFIC AGREEMENT

Since the average annual air temperature growth has been registered, along with the greenhouse gas concentration increase, global warming has attracted attention of the international community. In 1961, the United Nations have been following scientific discoveries and invited the World Meteorological Organization (WMO) to establish the World Weather Watch (WWW)[15] for providing a basic framework for global weather surveillance, as well as the Global Atmospheric Research Program (GARP), a specialized body for providing a scientific basis for climate change monitoring.

As a result of developing climate monitoring instruments and establishing a special executive climate change experts committee, WMO was one of the first to demonstrate the existence of a new generation of environmental problems. Its 1976 statement represents a historic key step in the international climate change mitigation outbreak. It has presented the first authoritative statement on the accumulation of carbon dioxide in the atmosphere and the potential impacts on climate.[16] Driven by newly discovered results, jointly with interested environmental organizations, WMO organized the first World Climate Conference in Geneva,

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13 The impacts of climate change on human health, http://www.who.int/mediacentre/news/statements/2008/s05/en/, viewed on 15 March 2015.

14 Statement by the President of the Security Concil, S/PRST/2011/15, 20 July 2011.

15 Historica Development of the World Weather Watch, http://www.wmo.int/pages/themes/oceans/www_en.html, viewed on 20 January 2015.

16 WMO and Climate Change, https://www.wmo.int/pages/themes/climate/climate_change_services.php, viewed on 6 February 2015.

Switzerland in 1979. Intending to emphasize the climate impact on society, as well as the environmental fragility caused by human activities, the Conference called for climate protection through national environmental programs. The result was the Declaration that invited for global cooperation in the global climate study, taking into account man's present knowledge of climate in planning for the future development of human society. [17] Furthermore, the Conference founded the World Climate Programme (WCP), the international scientific body for the climate system research for the benefit of mankind.[18]

The convening of the Conference and adoption of the Programme was the starting point in encountering the global phenomenon of climate change and numerous attempts to achieve an international agreement have followed. Thus, another scientific conference took place in Villach, Austria in 1985. The main discussion topic was the impact of carbon dioxide and other greenhouse gases in climate change and global warming. They estimated a probability of an average global temperature rise due to greenhouse gas emission increase, and thus it represents the first universally accepted statement on the most likely magnitude of global warming and its consequences.[19] The Conference has delivered a number of framework recommendations to governments and international institutions regarding climate research and climate policy implementation. It invited authorized international bodies to ensure monitoring of adopted recommendations implementation and called to uptake national and international measures, provide advice and, if necessary, consider establishing a special climate convention.[20]

2.2. NEGOTIATION PERIOD

Over the next few years, scientific consensus has increasingly strengthened owing to formed data and climate model quality. The next step towards an international agreement was the World Conference on Changing Atmosphere that took place in Toronto, Kanada in 1988. Climate changes are called

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17 Declaration of the World Climate Conference, Geneva, Switzerland, 12 to 23 February, IOC/SAB-IV/INF. 3.

18 World Climate Programme, http://www.wmo.int/pages/prog/wcp/, viewed on 18 January 2015.

19 World Meteorological Organisation, http://klima.hr/razno/zanimljivosti/smo60godina.pdf, viewed on 21 January 2015.

20 Report of the International Conference on the Assessment of the Role of Carbon Dioxide and of Other Greenhouse Gases in Climate Variations and Associated Impacts, Villach, Austria, 9-15 October 1985, WMO No.661.

unintended, uncontrolled, globally pervasive experiment whose ultimate consequences could be second only to a global nuclear war, and represent a major threat to international security.[21] The Conference called upon governments to work with urgency towards an Action Plan for the Protection of the Atmosphere, what should include an international framework convention and establishment of the World Atmosphere Fund to mobilize a substantial part of the resources needed for these measures.[22] The Conference proposed a target of 20 percent below 1988 levels in the commitment period by 2005. Although this proposal was unaccepted because of lack of willingness to undertake strict measures, it was an important step in accelerating the adoption of a binding international instrument. The most important result of the Conference was raising the climate protection level by establishing the Intergovernmental Panel on Climate Change.[23] As a leading institution in charge of climate change, it represents a scientific and intergovernmental institutional synthesis responsible for the assessment of climate change and its impacts. It refers to the latest scientific, technical and economic information, which further uses as a basis for its political decisions. The Panel regularly informs public on climate change through its reports based on scientific facts and evidence.[24]

With regards to the tenth anniversary of the World Climate Program, due to revision and evaluation of its effectiveness and analyzing the first Panel's report, the second World Climate Conference was held in Geneva, Switzerland in 1990. The report confirmed the existing climate variability representing scientific agreement upon significantly increased anthropogenic greenhouse gas concentration. Its further growth will increase greenhouse effect impacts, which will result an increasing of the average Earth's surface temperature. Furthermore, in case of falling in stabilizing current emissions, it is predicted that the additional average global temperatures will increase, sea level will rise and soil will heat in the coming decade.[25] The scientific part of the Conference was consisted of

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21 The Changing Atmosphere: Implications for Global Security, Toronto, Canada, 27-30 June 1988, Conference Proceedings, WMO-No. 71.

22 Ibidem.

23 United Nations General Assembly Resolution, A/RES/43/53, 6 December 1988.

24 How Does IPCC Work?, http://www.ipcc.ch/organization/organization_structure.shtml, viewed on 17 January 2015.

25 Climate Change: The IPCC Scientific Assessment, Contribution of Working Group I to the Assessment Report of the Intergovernmental Panel on Climate Change, Cambridge University Press, Cambridge, United Kingdom and New York, USA, 1990.

scientific expert committees and working groups that brought recommendations of concrete actions. They called for necessary climate changes observation and research, which led to the establishment of the Global Climate Observing System (GCOS). Although it doesn't directly conduct required research, it sets an operational framework of climate system studying and monitoring, with the aim of future climate change prediction.[26] The result of the Conference was an adoption of the Ministerial Declaration which set a number of international climate policy principles, including the concept of climate change as a common concern and sustainable development, the principle of common but differential responsibilities, based on the level of development and the precautionary principle. It pointed out the need for further scientific climate change studies and called for elaboration of a framework treaty on climate change and the necessary protocols containing real commitments and innovative solutions.[27]

2.3. INTERNATIONAL AGREEMENT

The emphasized need for measures with the aim of atmospheric greenhouse gas stabilization, supported by scientific evidence was the last step before the adoption of an international agreement on climate protection - the main goal sought by the international community. Therefore, the United Nation General Assembly established the Intergovernmental Negotiating Committee with the task of a preparation of an effective framework convention on climate change, containing appropriate commitments, and any related instruments as might be agreed upon.[28] Negotiations had been completed and the final text of the Framework Convention on Climate Change[29] was adopted in New York, USA in 1992, while it was opened for signature at the Conference on Sustainable Development in Rio de Janeiro, Brazil, later that year. Its objective is to stabilize greenhouse gas emissions for preserving the world's climate, in accordance to the principles established in order to help countries in achieving the objective. Aware of the problems of state inequality, the Convention encourages developed countries to show initiative in taking measures and to assist developing countries

26 About GCOS, http://www.wmo.int/pages/prog/gcos/index.php?name=AboutGCOS, viewed on 17 January 2015.

27 Second World Climate Conference, http://unfccc.int/resource/ccsites/senegal/fact/fs221.htm, viewed on 21 January 2015.

28 United Nations General Assembly Resolution, A/RES/45/212, 21 December 1990.

29 United Nations Framework Convention on Climate Change, New York, USA, 9 May 1992, Treaty Series, vol. 1771, p. 107.

in the implementation of the Convention. Therefore, the only bearers of the emission reduction commitments are developed countries taxatively listed in Annexes to the Convention. No time frame nor fulfillment means have been set, the Convention represents only a call for developed countries to voluntarily stabilize their emissions.

It was clear that the Convention cannot succeed with merely declaratory provisions, it is rather necessary to impose actual quantified obligations. Therefore, the United Nations General Assembly decided to continue the work of the Intergovernmental Negotiating Committee until the first meeting of the Conference of Parties (COP), the highest governing body of the Convention, which will keep holding meetings in order to achieve a new agreement. The first meeting of the Conference of Parties took place in Berlin, Germany in 1995 and resulted in the adoption of the Berlin Mandate, a set of guidelines for taking appropriate action for the period beyond 2000, including the strengthening of the commitments of the Annex I Parties, through the adoption of a protocol or another legal instrument.[30] Concerning further negotiations, the Mandate established the Ad Hoc Working Group on the Berlin Mandate with the task of strengthening the obligations imposed by the Convention and emission limits concretization.

The state agreement was very difficult to achieve due to the lack of willingness to make a compromise at the expense of their economic development. The second meeting of the Conference of Parties held in 1996 in Geneva, Switzerland resulted only in a non-binding Ministerial Declaration, which presented a demonstration of intention to continue to take an active and constructive role in addressing the threat of climate change instructing representatives to accelerate negotiations on the text of a legally-binding instrument.[31]

The accord was finally achieved at the third Conference of the Parties held in 1997 in Kyoto, Japan. After intense negotiations a compromise solution was finally adopted. The Kyoto Protocol[32] established legally binding targets and time frame within which they must be met. The Protocol specified a quantitative overall greenhouse gas emissions reduction by at least 5 percent below 1990 levels

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30 The Berlin Mandate, Berlin, Germany, 6 June 1995, FCCC/CP/1995/7/Add.1.

31 Geneva Ministerial Declaration, Geneva, Switzerland, 29 October 1996, FCCC/CP/1996/15/Add.1.

32 The Kyoto Protocol to the United Nations Framework Convention on Climate Change, Kyoto, Japan, 11 December 1997, United Nations Treaty Series, vol. 2303, p. 162.

in the commitment period between 2008 and 2012. Thereby, only developed countries listed in the Annex I of the Protocol have the main obligation of emission reduction, with variable quota for each country. In order to facilitate the objective achievement, the Protocol sets special emissions reduction methods and procedures, especially in terms of facilitating financial emission reduction.

Although the adoption of the Protocol was a success and partially eased impressions of the Conference held in a fierce opposition, the question of the legal framework of climate change was not yet resolved – on the contrary, it has just been set. Without ratification by a sufficient number of countries, the Protocol could not come into force, and without a participation of all countries, its purpose would not be fulfilled. In order to speed up the ratification process, the Conference of the Parties continued with its meetings.

2.4. POST-KYOTO NEGOTIATIONS

Due to developed countries industrial dependence on fossil fuels, they were strongly opposed to any agreement that would lead to their economic decline, especially in a case when they are the only commitment carriers on account of their development. Therefore, after the adoption, Parties continued their fierce debate over the ratification and implementation of the Protocol. The biggest opponent was also one of the leading greenhouse gas emitter - the United States. Just before the adoption of the Protocol, The US Congress adopted the Byrd-Hagel resolution that bans the signature of any agreement regarding the United Nations Framework Convention on Climate Change, at negotiations in Kyoto, which would mandate new commitments to limit or reduce greenhouse gas emissions for the Annex I Parties, unless the it also mandates new specific scheduled commitments to limit or reduce greenhouse gas emissions for developing countries within the same compliance period, or would result in serious harm to the economy of the United States.[33] Yet, a significant turning point took place in 2004 when Russia ratified the Protocol, what was a necessary condition for its entry into force, which finally happened three months after the ratification, in 2005. The Protocol required that 38 countries reduce total global greenhouse gas emissions by at least 5 percent by 2012. The fulfillment of this objective requires enormous efforts and considering the earlier difficulties in

33 Byrd-Hagel Resolution,105th Congress, 1st Session, 25 July 1997, S. RES. 98, Report No. 105-54.

accomplishing the compromise, the Protocol's future has still remained uncertain and has been entirely relying on voluntary reduction of the Parties.

The more evident global warming impacts were, the more actual topic in the international community it has become. Meanwhile, the International Panel on Climate Change published its new report. It confirmed previously made assumptions, presenting new and stronger evidence to support this hypothesis. Newly made projections for the future are more serious than it has been previously thought. It predicts further global temperature growth followed by the sea level rise and more frequent natural disasters. Panel's 2007 report supported by scientific evidence expressed unambiguous anthropogenic global warming, with 90 percent probability of human impacts on climate change.[34] The current obligations imposed by the Kyoto Protocol are not sufficient to prevent anticipated consequences, especially taking into account existing non-compliance with its provisions. The Conference of the Parties held in Nairobi, Kenya in 2006 (COP 12) pointed out the inefficiency of the Protocol's provisions, emphasizing overly bureaucratic structure of the Convention. It pointed out difficulties regarding the discussion about concrete and practical issues, and thereby created a space for of practical issues resolution in future meetings. [35]

For the sake of empowering and concretization of the Convention, the following Conference of Parties took place in Bali, Indonesia in 2007 (COP 13), with a record number of participants.[36] Over 10,000 participants and representatives from more than 180 countries have begun a new round of negotiations in order to define the Protocol's obligations, what should create an appropriate solution for developed countries which refused to ratify the Protocol. The Conference confirmed the latest IPCC report's acknowledgement that the current climate change policy is insufficient to prevent global warming and that greenhouse gas emissions will continue to increase, and thus aggravate natural impacts of climate change. Further maintenance of the status quo in combatting climate change can lead to a long run inability to adapt to these changes. The Parties agreed that climate changes are affecting all countries, thus all of them shall be included in

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34 Climate Change 2007: The Physical Science Basis, Contribution of Working Group I to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change, Cambridge University Press, Cambridge, United Kingdom and New York, USA, 2007.

35 Piani, op. cit. p. 19.

36 Bali Climate Change Conference, http://unfccc.int/meetings/bali_dec_2007/meeting/6319.php, viewed on 15 February 2015.

the resolution of this problem. However, an agreement about emission reduction quantification has not yet been achieved. Parties' irreconcilabilities were expressed in the Conference's final document called the Bali Roadmap, which represents a detailed negotiation program in the post-Kyoto period. It has been decided not to include explicit reduction targets, but to replace them with indirect formulations in order to objectively quantify and assess these targets.[37] This document also contains the Action Plan which provides guidance to ensure the effective implementation of the Protocol through long-term cooperation. For the implementation of the Action Plan the Conference established a special Ad Hoc Working Group on Long-Term Cooperative Action under the Convention.[38]

The Conference of the Parties held in Copenhagen, Denmark in 2009 (COP 15), decided upon the negotiation process proceeding and the adoption of a new document that will determine commitments after the end of the first commitment period. Although Parties have not come to an agreement on concrete actions, they adopted The Copenhagen Accord, a call to Parties to express their views on the obligations they are willing to accept for the upcoming commitment period, which has ensured further negotiations.[39] The debate has continued to conduct in developed countries setting conditions for developing countries to take commitments. A compromise solution was reached at the Conference of the Parties held in Durban, South Africa in 2011 (COP 17). The result was The Durban Platform for Enhanced Action for the second commitment period from 1 January 2013 to the end of 2017, during which the Parties shall adopt a new legally binding agreement on climate change. The Parties are obliged to reach the agreement by 2015, and it is expected to come into force in 2020. For this purpose the Conference established a special Ad Hoc Working Group on the Durban Platform for Enhanced Action. [40] This agreement sets reduction commitments to both developed and developing countries for the first time in the history of the Convention.

Parallel with the expiry of the first commitment period, a new Conference of the Parties was held in Doha, Quatar (COP 18) in December 2012. It represented the last attempt to resolve the crisis of the Protocol, which has proved to be completely ineffective. The Conference resulted in The Doha Climate

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37 Piani, loc. cit.

38 Bali Climate Change Conference, loc. cit.

39 The Copenhagen Accord, Copenhagen, Denmark, 30 March 2010 , FCCC/CP/2009/11/Add.1.

40 Report of the Conference of the Parties on its Seventeenth Session, held in Durban, South Africa from 28 November to 11 December 2011, FCCC/CP/2011/9/Add.1.

Gateway, an amendment to the Protocol on its extension. The Parties agreed upon a new commitment period until 2020, during which they shall achieve a greenhouse gas emissions reduction by 15 percent compared to 1990 levels.[41] The new target was determined by taking into account current numbers of Protocol Parties. Therefore, the reduction commitment have countries that participate in global emissions by less than a fifth of the share. Although the Conference did not resolve the emission reduction efficiency, it has ensured the beginning of a new negotiations era that would establish it. The next Conference of the Parties (COP 19), held in Warsaw, Poland in November 2013, only confirmed the existing need to reduce global greenhouse gas emissions. It urged Parties to ratify and implement the Doha Amendment, and requested the acceleration of the development of other legal instrument.[42] The question of the Protocol effectiveness still remains.

The Kyoto Protocol is the farthest binding international climate agreement that has ever been adopted. Its failure has caused a major defeat for the international community, which has been making efforts in reaching an agreement for over two decades. Placing the man's short-term needs at the expense of long-term needs of its environment, represents the more onerous defeat.

41 Doha Amendment to the Kyoto Protocol, Doha, 8 December 2012, C.N.718.2012.TREATIES-XXVII.7.c.

42 Report of the Conference of the Parties on its Nineteenth Session, held in Warsaw, Poland from 11 to 23 November 2013, FCCC/CP/2013/10/Add.1.

3. INTERNATIONAL GLOBAL WARMING MITIGATION FRAMEWORK

3.1. UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE (1992)

One of the two international treaties opened for signature at the United Nations Conference on Environment and Development held in Rio de Janeito, Brazil on 9 May 1992 is the United Nations Framework Convention on Climate Change. It has officially affirmed human impact on greenhouse gas emissions increase, which causes greenhouse effect and subsequently increases average global earth and atmosphere temperature and has made previous global warming debates pointless, as well as global warming denial theories. Therefore, it represents one of the most significant international environmental treaties, and it is the first agreement directly regarding climate changes and global warming.

The main objective of this Convention, as well as any related legal instruments that can be adopted is to is to achieve stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system. [43] Thereby, anthropogenic climate change means a change of climate which is attributed directly or indirectly to human activity that alters the composition of the global atmosphere and which is in addition to natural climate variability observed over comparable time periods. Whereby, adverse effects of climate change mean changes in the physical environment or biota resulting from climate change which have significant deleterious effects on the composition, resilience or productivity of natural and managed ecosystems or on the operation of socioeconomic systems or on human health and welfare.[44]

The Convention's objective concretization is set through states obligations of national policies adoption and taking measures on the mitigation of climate change by limiting their anthropogenic emissions and protecting and enhancing its greenhouse gasses sinks and reservoirs.[45] Such level should be achieved within a time-frame sufficient to allow ecosystems to adapt naturally to climate change, to ensure that food production is not threatened and to enable economic development to proceed in a sustainable manner.[46] Such undefined time period is determined by prescribing the commitment of returning to earlier levels of

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43 Article 2 of the Convention.

44 Article 1 paragraphs 1 and 2 of the Convention.

45 Article 4 paragraph 2 of the Convention.

46 Article 2 paragraph 2 of the Convention.

anthropogenic emissions of carbon dioxide, what shall be achieved by the end of the present decade (i.e. 20th Century), with the aim of returning individually or jointly to their 1990 levels. At its second meeting, the Conference of the Parties granted Parties flexibility in terms of base year by allowing Parties to use base year other than 1990 for those who have made such request. [47]

The Convention sets certain principles to serve state parties as outlines for achieving the Convention's objective. The central guideline is the sustainable development principle. The Parties should protect the climate system for the benefit of present and future generations of humankind, on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities.[48] Taking into consideration scientific predictions, future generations will be facing more severe climate, therefore it is necessary to act as urgently as possible. Beside the protection measures, the Parties should take precautionary measures as well. They shall anticipate, prevent or minimize the causes of climate change and mitigate its adverse effects. Where there are threats of serious or irreversible damage, lack of full scientific certainty should not be used as a reason for postponing such measures. [49]

In meeting the Convention's objective, and taking into account their common but differentiated responsibilities and their specific development priorities, objectives and circumstances, state parties have some general commitments, including assessing, monitoring and communicating of national greenhouse gas emissions not controlled by the Montreal Protocol on Substances that Deplete the Ozone Layer[50]; providing scientific basis for future planning and objective achievement. Other commitments include long-term national planning, technology and emission control process development, sinks and reservoirs conservation, mitigation program implementation and climate change adaptation, status and archive development monitoring, data exchanging, and education, training and public awareness promoting. [51]

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47 Conference of the Parties Decision 9/CP.2, Geneva, 29 October 1996, FCCC/CP/1996/15/Add.1.

48 Article 3, paragraph 1 of the Convention.

49 Article 3 paragraph 3 of the Convention.

50 The Convention takes into consideration existing internatinal treaties that regulate greenhouse gas emissions such as Montreal Protocol on Substances that Deplete the Ozone Layer (1987), therefore does not control substances that have already been controlled by the Protocol.

51 Audiovisual Library of International Law, UNFCCC, http://untreaty.un.org/cod/avl/ha/ccc/ccc.html, viewed on 22 December 2014.

In addition to the general, the Convention stipulates certain specific commitments, imposing them exclusively to developed state parties. The basis of the principle of common but differentiated responsibilities is the equity maxime due to the fact that not all countries are equally responsible for the harmful emission concentrations, and consequently, not all of them should bear the costs equally. The Convention acknowledges primarily undeveloped countries and calls for joint cooperation in accordance with their development possibilities, wherein developed countries should serve as an example and be initiators of global action. For this purpose, state parties are divided into two groups taxatively listed in the annexes to the Convention. The first group listed in Annex I represents developed countries and countries undergoing the process of transition to a market economy, that contribute the most to global warming and have the biggest amount of resources for its mitigation. They are committed to jointly preserve anthropogenic greenhouse gas emissions below 1990 levels by implementing climate change mitigation policies and measures, thereby to taking the lead role in modifying longer-term trends in anthropogenic emissions consistent with the objective of the Convention. The Annex II list consists of developed countries listed in Annex I, without states undergoing the process of transition to a market economy. Their role is to help developing countries in fulfilling their commitments under the Convention by providing financial funds. Furthermore, developed state parties shall also assist the developing country Parties that are particularly vulnerable to the adverse effects of climate change in meeting costs of adaptation to those adverse effects. Moreover, the developed country Parties and other developed Parties included in Annex II shall take all practicable steps to promote, facilitate and finance the transfer of environmentally sound technologies and know-how to other Parties, particularly developing country Parties. [52] The third group consists of Non-Annex I parties, which includes developing countries that do not bear obligations to reduce emissions, but only general obligations under the Convention.

In order to financially facilitate the implementation of the Convention's provisions and fulfilling its objectives, the Convention has established mechanisms for the provision of financial resources on a grant or concessional basis, conducted in accordance with the representation equality principle. For the purpose of conducting and managing this mechanism, the Conference established Global Environment Facility (GEF). In addition to financial assistance, a special

52 Article 4 of the Convention.

multilateral consultative process has been established. Its task is to assist parties with difficulties in interpretation and implementation of the Convention, in order to prevent the occurrence of disputes, as well as the emergence of renewed problems in the future.

The supreme body of the Convention is the Conference of the Parties (COP). It consists of representatives of all State Parties who convene every year at its regular session. Its role is to monitor and review the implementation of the Convention, as well as any other legally binding instrument, evaluate the effectiveness of their implementation and to make decisions necessary to promote and implement the Convention. For this purpose the Conference of the Parties shall examine and evaluate obligations of the parties and national reports; make necessary recommendations and establish necessary subsidiary bodies for the implementation of the Convention; adopt the necessary acts and perform all other functions necessary to achieve the objectives of the Convention.[53] Its work is supported by two expert subsidiary bodies - the Subsidiary Body for Scientific and Technological Advice and the Subsidiary Body for Implementation, each in its domain. The Conference is helped by its Secretariat elected by the Conference itself.[54]

3.2. THE KYOTO PROTOCOL TO THE UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE (1996)

Whereas the Convention has been adopted as a framework convention, therefore it does not prescribe concrete commitments; its provisions are mainly declarative by their nature and do not constitute the reference basis for climate change and global warming mitigation, they are solely the foundation and introduction to a new, legally binding agreement. Therefore, the Conference of the Parties has decided to continue with its annual meeting in order to define new obligations through protocols to the Convention [55] After long and intense negotiations, a protocol[56] was finally adopted at the Conference of the Parties in Kyoto, Japan in 1997. It entered into force in February 2005, after Russian ratification, which was the 55th Party, including the parties listed in Annex I to

53 Article 7 of the Convention.

54 Article 8 of the Convention.

55 Piani, op. cit. p. 14.

56 The Kyoto Protocol to the United Nations Framework Convention on Climate Change, Kyoto, Japan, 11 December 1997, United Nations Treaty Series, vol. 2303, p. 162.

the Convention, that are accounted in total for at least 55 percent of the total carbon dioxide emissions for 1990. Up to now it has been ratified by 192 Parties, including the European Union. [57]

Protocol's provisions have not introduced any new commitments, but reaffirmed and strengthened existing ones. The Parties included in Annex I shall, individually or jointly, ensure that their anthropogenic greenhouse gas emissions do not exceed their assigned amounts, with a view to reducing their overall emissions by at least 5 percent below 1990 levels in the commitment period 2008 to 2012. Whereby the targets differ from Party to Party. Some of them are committed to reduce emissions below the base year level; other agreed upon limiting their emissions at the base year level, while some of them are allowed to exceed the level. Meanwhile, each Annex I Party shall, by 2005, made demonstrable progress in achieving its commitments under this Protocol.[58] Taking into consideration the industrial importance of greenhouse gases and complexity of their reduction, what has ultimately been the cause of antagonistic negotiations, a short commitment period reflects ambition, but the lack of forethought, which could lead to questionable effectiveness of the Protocol.

The Protocol also takes into account greenhouse gases emission stabilization commitments under other relevant international environmental agreements, hence is put under the control six greenhouse gases taxatively listed in the Annex A to the Protocol – carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and sulfur hexafluoride. In comparison to other greenhouse gases, carbon dioxide has the largest share in the greenhouse effect and serves as an emission measuring unit and other greenhouse gases have been assigned a specific value equivalent to carbon dioxide emission. Each Party quantitative reduction targets are given in Annex B to the Protocol, which is a de facto Annex I of the Convention in the addition to the quantified targets.

The Protocol adopted measures to facilitate Parties emission reduction, thus to promote sustainable development. These measures applied at the national levels are related to limiting and reduce emissions of greenhouse gases, enhancement of energy efficiency, protection and enhancement of sinks and reservoirs of greenhouse gases, promotion of sustainable forms of agriculture and forest

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57 Status of Ratification of the Kyoto Protocol, http://unfccc.int/kyoto_protocol/status_of_ratification/items/2613.php, viewed on 28 February 2015.

58 Article 3 paragraphs 1 and 2 of the Protocol.

management and other.[59] In order to enhance the individual and combined effectiveness of their policies and measures, the Parties should cooperate by exchanging experiences and information. The Parties shall strive to implement policies and measures in such a way as to minimize adverse effects, including the adverse effects of climate change on other Parties, especially developing country Parties and countries that are particularly vulnerable to the adverse effects of climate change.[60]

Aside with the general commitment to reduce emissions, in order to monitor the effectiveness of reaching emission targets, states are obliged to regularly monitor and accurately and verifiably notify their emissions to the Conference of the Parties. Every Annex B Party shall establish a national system for the estimation of anthropogenic greenhouse gas emissions. The concept of the national system involves all legal, institutional and organizational measures that are necessary for the preparation of national greenhouse gas emissions inventories. [61] These annually issued estimation shall be based on activity data, such as fossil fuel consumption data, industrial production, the surface of cultivated land, forested areas and numerous other parameters.[62] The Parties are required to submit periodical national communications containing information on emissions and their reduction measures. These inventories and national communications are controlled by the facilitative branch of the Compliance Committee. As the name suggests, it branch aims to provide advice and assistance to the Parties in implementing the Protocol in order to promote compliance with their commitments. Its special expert review team draws up reports to the Conference of the Parties and may provide a warning of potential non-compliance with the commitments. [63] The second branch of the Committee is the enforcement branch with the responsibility of determining whether the Party is in compliance with their commitments and deciding upon consequences in case of not meeting the commitments.[64]

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59 Article 2 of the Protocol.

60 Ibidem.

61 Article 5 of the Protocol.

62 Piani, op. cit. p. 23.

63 An Introduction to the Kyoto Protocol Compliance Mechanism, http://unfccc.int/kyoto_protocol/compliance/items/3024.php, viewed on 5 March 2015.

64 Ibidem.

State Parties can meet their commitments individually or can reach an agreement to fulfill their commitments jointly. In the latter case, they shall be deemed to have met those commitments provided that their total combined aggregate anthropogenic carbon dioxide equivalent emissions of greenhouse gases do not exceed their assigned amounts. Any such agreement shall remain in operation for the duration of the commitment period and the Parties shall notify the Secretariat of its terms. [65] Thus, the Parties are given the choice of emission reduction location, which may indirectly affect reduction costs. In order to financially facilitate the fulfillment of the commitments and to promote the implementation of the Protocol, certain flexible mechanisms have been established. The Annex B Parties are enabled to achieve their commitments through cooperation with other Parties, thus to reduce their costs. The cooperation is possible through Emission Trading, Joint Implementation or Clean Development Mechanism.

Joint implementation allows joint emission reductions of two Annex B Parties on the territory of one of them. Thus, one of them contributes financially, while other cedes its territory for the realization of the project. In this way, the state financier may transfer to, or acquire from any other such Party emission reduction units resulting from projects aimed at reducing anthropogenic emissions.[66] The aim is to enable Parties a flexible and cost-efficient means of fulfilling a part of their Kyoto commitments, while the host Party benefits from foreign investment and technology transfer.[67]

The mechanism similar to the Joint Implementation is the Clean Development Mechanism, with the difference in Parties engaged in the mechanism implementation. It allows an Annex B Party to implement an emission reduction project in a Party that has no emission limitation or reduction commitment. The purpose is to assist Non-Annex B Parties in achieving sustainable development and in contributing to the ultimate objective of the Protocol, and to assist Annex B Parties in achieving compliance with their quantified emission limitation and reduction commitments. Annex B Parties therefore have the right to use Certified Emission Reduction accruing from such project activities to contribute

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65 Article 4 of the Protocol.

66 Article 6 of the Protocol.

67 Joint Implementation (JI), http://unfccc.int/kyoto_protocol/mechanisms/joint_implementation/items/1674.php, viewed on 20 February 2015.

to compliance with part of their commitments.[68] Hence, a host Party benefits from developed countries emission reduction and technology transfer therefore promotes sustainable development and complies the Convention›s objective, whereas developed State Parties achieve cheaper emission reduction.

Another flexible mechanism established by the Protocol is the concept of emission trading. It enables Annex B Parties to trade greenhouse gas emissions, allowing them to sell excess emission units to Parties that are over their targets.[69] It serves to minimize total reducing emission costs so that the reduction are carried out in areas with the lowest costs.

Although the Protocol is the first binding international agreement with the aim to reduce global warming adverse effects, it actually imposes no adequate and effective repercussion if a Party does not meet its commitments. In case a Party fails to reach its assigned targets during the commitment period, it should compensate the reduction deficit enlarged by penalties of 30 percent during the next commitment period. Such State Party shall adopt a special action plan to specify intended steps to meet the required aim. [70] However, if a Party is not interested in any emission reduction, the additional reduction commitment is needless and irrelevant. Furthermore, Parties that are interested in meeting their commitment and still fail in their compliance because of difficulties in financial implementation of the Protocol, almost certainly will not achieve them during the next commitment period.[71] Despite its binding nature, the fate of the Protocol in reality depends on the good will of the parties that have signed it.

4. CONCLUSION

Anthropogenic global warming is unquestionable. Man is responsible for atmospheric greenhouse gas concentration increase, thus represents the leading cause of present environmental problems. These premises are stated in numerous relevant scientific reports and studies, hence they are accepted by the authoritative international bodies which have used them as a basis for the adoption of instruments for combating global warming.

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68 Article 12 of the Convention.

69 International Mission Trading, http://unfccc.int/kyoto_protocol/mechanisms/emissions_trading/items/2731.php, viewed on 20 February 2015.

70 Piani, op. cit. p. 20.

71 Ibidem.

The basic international instrument aiming to reduce and mitigate global warming adverse effects is the Kyoto Protocol to the United Nations Framework Convention on Climate Change. It is the first and so far the only legally binding document that has set a quantitative commitment to reduce greenhouse gas emissions for developed countries which are largely responsible for the present pollution, therefore are faced with major commitments. However, global accord on the need for anthropogenic greenhouse gas emission reduction by adopting legally binding instrument and finally adopting the treaty was not a guarantee of success in its effective implementation. Since the adoption of the Kyoto Protocol, no significant progress has been made at the international level. Mainly declaratory decisions adopted by the Conference of the Parties that express the necessity of implementation of the Protocol, containing only general guidelines for achieving effective cooperation have become apparent due to non existing concrete action. The lack of actual will to act and mainly administrative approach in resolving the environmental crisis, along with frequent obstructions of protesting state parties, have set the central subject aside. Inability to accomplish an agreement is the most compelling obstacle to implementation of the Protocol, hence drawing attention from environmental problems to government policies is the main reason for the failure of the Protocol.

In the meantime, the first commitment period of the Protocol has ended, yet the results of former high ambitions are discouraging. Since its adoption, measures taken at the international level are imperceptible, natural impacts are evident and predictions for the future are more onerous than ever before. State Parties are facing a new commitment period and the opportunity to alter and improve their implementation policies by correcting former inefficiencies through the oversight comprehension and adjustment. Global warming can be a solvable task, but not without crucial changes in the international normative framework and urgent action and cooperation of all countries.

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SOME REFLECTIONS ON POPPER´S APPROACH TO RATIONALITY AND ITS IMPLICATIONS FOR THE SOCIAL SCIENCES

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ABSTRACT

There are two different notions of human rationality in Popper´s work: the notion that stems from his evolutionary theory of knowledge and learning (PTKL), and the notion embodied in his methodological proposal for the social sciences known as `Situational Analysis´ (SA). The essay provides a critical analysis of the relationship between these two approaches and its implications for the social sciences. In particular, our discussion focuses on (i) the differences between PTKL and both the `objectivist´ and `subjectivist´ version of SA, (ii) Schumpeter´s distinction between the `rationality of the observer´ and the `rationality in the observed´, and (iii) Hayek´s arguments about the nature of the `facts´ of the social sciences.

Keywords: evolutionary, knowledge, Popper, rationality, situational analysis.

`The physicist who is only a physicist can still be a first-class physicist and a most valuable member of society. But nobody can be a great economist who is only an economist–and I am even tempted to add that the economist who is only an economist is likely to become a nuisance if not a positive danger´ (F. A. Hayek, `The Dilemma of Specialization´, p. 123, in *Studies in Philosophy, Politics, & Economics*, 1967).

1. INTRODUCTION

Discussions by both philosophers of science and social science methodologists on Popper´s methodological proposal for the social sciences known as `Situational Analysis´ (*SA*) have focused either on its (in)compatibility with falsification (Hands, 1985, 1991, 1992; Notturno, 1998; Hedström *et al*., 1998) or on its interpretation.[1] In the former case, the debate has revolved around Popper´s confession (Popper, 1994, ch. 8) that his `rationality principle´ (*RP*), i.e., the notion that in the construction of models in the social sciences we must assume that actors´ behaviour is adequate or appropriate to their problem-situation (P-S), is *false* but nevertheless a *good enough approximation to the truth* (Popper, 1985).[2] This surprising confession by a philosopher of science whose academic reputation grew out of the formulation of a demarcation criterion for scientific hypotheses based on the requirement that the latter be potentially falsified has led some commentators to argue that Popper´s methodological proposal for the social sciences and, specifically, his *RP* is incompatible with the criterion of refutability as prescribed for the natural sciences.[3] Some critics even argue that such incompatibility severely undermines Popper´s claim to methodological monism in the natural and the social sciences. Other critics have accused him of reintroducing a pure instrumentalism *à la* Friedman (1953) due to his methodological advice to immunize *RP* from potential refutation and of `contradicting his own explicit rejection of instrumentalist pretences to knowledge´ (Oakley, 1999, p. 32).

As for the interpretation of *RP*, the debate has centred on its role and status. For instance, Latsis (1983, p. 132) argues that `Popper´s account of the role

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1 General criticisms of Popper´s methodological proposal for the social sciences can be found in Latsis (1983), Hands, (1985), Bunge (1996), Oakley (1999, 2002), and Vanberg (2002).

2 Recently, another version of *RP* has been proposed in Lagueux (2006, pp. 201-202) who suggests that, given the fact that refinements in model-construction in the social sciences imply that theoretical models exhibit more detailed descriptions of the situation, *RP* may also be enunciated as implying that `the agent will agree with what is clearly presented by the model itself as the appropriate thing to do´. Be that as it may, for the purpose of this study we focus hereafter on Popper´s version of *RP*.

3 These ideas were expounded in his famous *Logic of Scientific Discovery*. That said, and as far as the social sciences are concerned, there is some consensus on the notion that it is not 'falsificationism' *per se* but 'critical rationalism' – of which falsification is only one possibility – that is the true message of Popper´s philosophy (Caldwell, 1991; Notturno, 1998; Boland, 2003*a*). According to Hands (1991, p. 114), who nevertheless remains sceptical of this interpretation, `critical rationalism´ is an interpretation of Popperian philosophy due primarily to Bartley (1982).

and status of the rationality principle is obscure and unsatisfactory´. He shows that, in different parts of his work, Popper notes that *RP* is `almost empty´, `not a priori valid´, `clearly false´, `a good approximation to the truth´, and `the consequence of a methodological postulate´ (*op. cit.*, p. 133). According to him, the role of *RP* is to function as a `plastic interface´ between mental states and behaviour and this is the reason why it is declared by Popper to be false but close to the truth (*op. cit.*, p. 140). Specifically, *RP* is false if interpreted in a literal way because it does not *determine* behaviour in a `cast-iron´ fashion but is close to the truth because it captures the tendency of human behaviour to follow the logic dictated by P-S.[4] Crucially, he distinguishes between an `objectivist´ (*RPo*) and a `subjectivist´ version (*RPs*), and associates the former with Pareto (1917, section 150) and Parsons (1937, p. 58), and the latter with Popper himself. If *RPo* is adopted, the theoretician reconstructs the `objective´ P-S in an oversimplified way whereas, if *RPs* is adopted, P-S is reconstructed *as it is seen by the actors*.

Building on Latsis´ distinction between *RPo* and *RPs*, Nadeau (1993) discusses the role of *RP* in Popper (1985) and maintains that *RPo* is clearly false because actors´ behaviour is not always adequate to the `objective´ P-S whereas *RPs* is irrefutable and, hence, it can only be interpreted as a metaphysical statement (*op. cit.*, p. 459). He then states that *RPs* is the correct interpretation since `the rationality principle that Popper puts at the theoretical core of all social sciences looks *more* like a "synthetic a priori truth or pure reason" in the domain of social reality than like an empirical law of nature´. Nevertheless, when asked to clarify whether *RP* is a `methodological principle´ or an `empirical conjecture´, Popper explains that `[t]his second case is precisely the one that corresponds to my own view of the status of the rationality principle: I regard the principle of adequacy of action (that is the rationality principle) as an integral part of every, or nearly every, testable social theory´ (Popper, 1994, p. 177). In other words, he views *RP* as an integral part of any empirical theory in the social sciences and, more specifically, as the animating part, just as the laws of motion of planets are an integral part of Newton´s gravitational theory. In an attempt to make sense of all this, Lagueux (2006, p. 203) argues that a methodological principle cannot be a part of a scientific theory whose constituent parts must be *empirical*

[4] In his analysis of the role and status of *RP* Latsis (1983) focuses on Popper´s analysis of the `mind-body problem´, that is, the analysis of the manner in which mental states affect behaviour as discussed in his paper `Of Clouds and Clocks´ (Popper, 1966). According to Latsis (1983, p. 139), *RP* represents Popper´s compromise solution to this problem whereby it is suggested that `our mental states control some of our behaviour and that this control is "of a plastic kind"´

rather than *a priori*. Yet, according to him, if *RP* cannot be a methodological principle, `the *decision* to immunize it can nonetheless be considered as based on a methodological principle´ (see Notturno, 1998, pp. 405-408). Although he uses a different terminology — methodological `rule´ instead of methodological `principle´ — de Bruin (2006, p. 213) also explains that the decision to adopt *RP* is a methodological rule according to which `one should always try to explain human behaviour in terms of reasons´. However, he adds that `there are good reasons to doubt whether the kind of principle of rationality that Popper discusses is really empirical at all… one could as well phrase it as a *metaphysical principle* that all actions have reasons´ (de Bruin, 2006, p. 216, emphasis added).

Despite the fact that some commentators have noted that there are two different notions of rationality in Popper´s philosophy, there has been very little discussion about the relation of *RP* and Popper´s evolutionary theory of knowledge and learning (PTKL). The essence of Popper´s theory of knowledge is that all knowledge is conjectural and that we can *never* prove that a hypothesis is true albeit sometimes it is possible to prove that it is wrong. Likewise, the essence of Popper´s evolutionary theory of learning is that all living organisms (including human beings) learn by virtue of an imperfect and unending process that consists of subjecting their conjectures or hypotheses to trial and eliminating those ones which turn out to be erroneous while keeping *provisionally* those ones that are not falsified (Popper, 1963, p. 312).[5] In other words, our knowledge grows in a `negative´ sense by discarding erroneous conjectures through a process of trial and error-elimination. As a result of it, an implication of PTKL is that the most important feature of knowledge is its fallibility. A second element of Popper´s theory of learning is that the learning process is always *imperfect* insofar as it never reaches an optimum adaptation to the surrounding environment.

Now, a number of critics have referred to the apparent *duality* in Popper´s notion of rationality. To be sure, Popper (1985, p. 365; 1994, p. 181) distinguishes between rationality as a personal attitude — which he defines as the attitude of readiness to correct one´s beliefs when they turn out to be wrong — and his *RP* which, according to him, *has nothing to do* with the assumption that men are rational in this sense. Further, when he presents *SA* as his methodological proposal for the social sciences he writes that `when we speak of "rational behaviour" or of "irrational behaviour" then we mean behaviour which is, or

[5] Interestingly, Hayek (1967*a*, p. 86) associates the notion of rationality in Classical economics to the ability to `learn from experience´ which is very close to PTKL.

is not, in accordance with the logic of the situation´ (Popper, [1943*a*] 1966, p. 97; 1944-45, sections 31 & 32). Be that as it may, Kerstenetzky (2009, p. 202) argues that the demarcation line between rationality and irrationality in Popper is the *incorrigibility* of one´s beliefs. That is, human behaviour is `rational´ if we are willing to correct our wrong beliefs and `irrational´ if otherwise. Similarly, Lagueux (2006, p. 202) points out that it is the `tendency to correct oneself by criticism´ that represents true rationality in Popper whereas Vanberg (2002, p. 19) remarks that, on the one hand, Popper presents *RP* as the methodological foundation for the social sciences but, in other parts of his work, he sketches out a framework for the analysis of human behaviour that relies on a different approach at purposeful behaviour that he defines as `conjecture-based problem-solving behaviour´. Finally, the conflict between the view of human agency depicted in PTKL and *SA* is also noted by Oakley (1999, p. 25; 2002, p. 468).

The main purpose of this essay is to analyse the compatibility or otherwise of these two seemingly different notions of rationality in Popper´s work. In the process, we will make five claims. Our first claim is that there is a certain tension between PTKL and *SA* when their relation is analysed from the standpoint of the `rationality of the agents´ whose behaviour the theoretician seeks to capture in a situational model albeit the tension disappears when the relation is treated from the standpoint of the `rationality of the theoretician´. Our second claim is that the nature of the tension between PTKL and *SA* depends on whether the theoretician adopts the `objectivist´ or the `subjectivist´ version of *SA*. In particular, we will argue below that the tension between PTKL and the `subjectivist´ version stems from the fact that, in the latter, it is implicitly assumed that agents´ view of P-S is, at least partially, wrong which implies that agents do not tend to eliminate their mistakes as PTKL posits. By contrast, we will argue that the tension between PTKL and the `objectivist´ version of *SA* stems from the fact that: (i) if agents behave according to PTKL it is not necessarily the case that their decisions will be adequate or appropriate to the `logic of the situation´ because the former *only* implies that agents tend to eliminate their (past) mistakes and, hence, in the wake of changes in the surrounding environment agents´ decisions may be inadequate to the `logic of the (new) situation´, and (ii) adoption of the `objectivist´ *SA* implies *de facto* the imposition of the theoretician´s view of P-S on agents´ but it is unlikely that if agents behave according to PTKL their view of P-S will converge to the theoreticians´. Our third claim builds on the ideas of Hayek (1943) about the nature of the `facts´ of the social sciences and is that, in the

way it is presented by Popper and his commentators, the `objectivist´ version of *SA* represents a *limit* case which presupposes that P-S is (fully) *independent* of agents´ beliefs. Our fourth claim is closely related to the previous one and consists of the idea that, if Hayek´s ideas are accepted, it follows that the natural strategy for social scientists is to seek to reconstruct P-S *as agents´ see it*. Our fifth and last claim is that, unlike what Popper and some of his commentators suggest, the difference between the `objectivist´ and the `subjectivist´ version of *SA* is not that in the former the theoretician reconstructs P-S *as it actually is* whereas in the latter she does it as *agents see it* but, rather that in the former the theoretician seeks to reconstruct P-S *as she sees it* whereas in the latter she does it *as she believes agents see it*. The content of the essay is as follows. The following section introduces PTKL. In section 3, we expound Popper´s *SA*. In section 4, we discuss the duality in Popper´s notion of rationality by addressing: (i) the implications of adopting either the `objectivist´ or the `subjectivist´ version of *SA,* (ii) Hayek´s ideas about the `facts´ of the social sciences, (iii) a reformulation of the `objectivist´ and `subjectivist´ version of *SA* that takes on board Hayek´s ideas on the methodology of the social sciences, and (iv) the division line between `rational´ and `irrational´ behaviour in PTKL and *SA*. Finally, section 5 summarizes and concludes.

2. POPPER'S EVOLUTIONARY THEORY OF KNOWLEDGE AND LEARNING

Inductive inference is reasoning from the past observed behaviour of objects to their future behaviour. The 'problem of induction' was originally raised by David Hume (1748) who pondered whether inductive evidence can go beyond the available evidence in order to predict future events. He argued that past evidence can tell us only about past experience. Hume's main argument was that we cannot rationally justify the claim that nature will continue to be uniform merely because it has been in the past, as this is using the sort of reasoning (i.e., induction) that is under question, i.e., it would be *circular reasoning*. Hume (*op. cit*.) also noticed that we *tend* to believe that phenomena behave in a regular fashion, that is, that certain patterns in the behaviour of objects persist into the future.

Next, Popper defines the philosophical 'problem of induction' as the problem of providing a rational justification for the belief that the future will be (largely) like the past (Popper, 1972, p. 2). He identifies two problems in Hume´s criticism

of induction: (i) a logical problem (*HL*), and (ii) a psychological problem (*HP*). First, Hume´s *HL* is whether we are justified in reasoning from repeated instances of which we have some experience to other instances of which we have no experience. Hume´s answer to *HL* is negative no matter how many repetitions of the instances there are. Second, Hume´s *HP* is why, notwithstanding it, all reasonable people believe that instances of which they have no experience at all will conform to those of which they have experience. Hume´s answer to *HP* is that 'the psychological mechanism of association forces them to believe, by custom or habit, that what happened in the past will happen in the future' (*op. cit.*, p. 90). According to Popper, this explains why Hume abandoned rationalism and viewed man as a product of blind habit. By contrast, Popper argues that there is no such thing as induction by repetition either in psychology or science:

'We do not act upon repetition or "habit", but upon the best tested of our theories which… are the ones for which we have good rational reasons; not of course good reasons for believing them to be true, but for believing them to be the best available from the point of view of a search for truth or verisimilitude… The central question for Hume was: do we act according to reason or not? And my answer is: Yes.' (*op. cit.*, p. 95)

Popper restates Hume´s problem of induction as follows. First, he denies that a theory can be simply justified by assuming the truth of certain observation statements. Rather, he insists that all theories are hypotheses and, hence, they can be overthrown (*op. cit.*, p. 13). Further, he states that paradoxically induction is *inductively invalid*, that is, the claim that induction is a legitimate way to acquire (true) knowledge needs to be supported by a 'higher' principle that has, in its turn, been established inductively. But this strategy ultimately leads us into an *infinite regress* insofar as we will endlessly need to resort to a superior principle that has been discovered through induction. Second, he puts forward the proposition that the claim that an explanatory universal theory is false can be justified by the truth of certain observation statements (*op. cit.*, p. 7). As the typical example goes, no matter how many white swans we come across, the finding of just one black swan will lead to the rejection of the universal statement 'all swans are white'. Consequently, he urges scientists to construct *severe* tests that help detect false theories so that, by a method of *elimination*, they may eventually hit upon a true theory even though we can never establish its truth (*op. cit.*, pp. 14-15).[6]

[6] Popper adopted Tarski´s theory that truth is correspondence with the facts or with reality (Popper, 1972, p. 44).

Thus, he argues that there is an *asymmetry* between verification and falsification; any conjecture may be true or false but even if it turns out to be true, there is no way we can *ever* prove it (*op. cit.*, p. 12). According to Popper, the method of science is 'the method of bold conjectures and ingenious and severe attempts to refute them' (*op. cit.*, p. 81). Since all theories involve universal statements, we can only 'learn' by proving that our knowledge is false. Specifically, learning takes place either when we reject one´s prior theory or when we are forced to adjust one´s theory in a way that recognizes that in its prior version it was false (*op. cit*, p. 81). In short, Popper´s ideas on scientific methodology can be seen as a sub-product of PTKL:

`Although I shall confine my discussion to the growth of knowledge in science, my remarks are applicable without much change, I believe, to the growth of pre-scientific knowledge also — that is to say, to the general way in which men, and even animals, acquire new factual knowledge about the world. The method of learning by trial and error — of learning from our mistakes — seems to be fundamentally the same whether it is practised by lower or by higher animals, by chimpanzees or by men of science. My interest is not merely in the theory of scientific knowledge, but rather in the theory of knowledge in general. Yet the study of the growth of scientific knowledge is, I believe, the most fruitful way of studying the growth of knowledge in general. For the growth of scientific knowledge may be said to be the growth of ordinary human knowledge *writ large'* (Popper, 1963, p. 216).

and, elsewhere, he writes:

`Organisms evolve by trial and error, and their erroneous trials – their erroneous mutations – are eliminated, as a rule, by the elimination of the organism which is the "carrier" of the error. It is this part of my epistemology that, in man, through the evolution of a descriptive and argumentative language, all this has changed radically. Man has achieved the possibility of being *critical of his own tentative trials, of his own theories*. These theories are no longer incorporated in his organism, or in his genetic system: they may be formulated in books, or in journals; and they can be critically discussed, and shown to be erroneous, without killing any authors or burning any books: without destroying the "carriers"… *critical reason is the only alternative to violence so far discovered'* (Popper, [1943*b*] 1966, p. 292).

Third, Popper argues that theories are genetically incorporated into all our sense organs and this predisposes us to discriminate *a priori* between relevant or absorbable input and input that can be ignored (Popper, 1972, p.72). For instance, sense organs like the eye *only* react to those selected environmental events which they 'expect'. However, according to him, this prior knowledge cannot be the result of observation; it must be the result of adaptation to the surrounding environment by trial and error. He claims that 99 percent of the knowledge of all living organisms is inborn and incorporated into our biochemical constitution (Popper, 1990, p. 46). Furthermore, he argues that there is no theory-free language to help us interpret external data because primitive theories emerge together with language. Therefore, there is no such thing as pure perception since all languages are *theory-impregnated* (Popper, 1972, p. 145). This leads him to reject any epistemology which chooses our 'direct' observations and perceptions as the starting point; the fact that theories are built into our sense organs implies that 'the epistemology of induction breaks down even before taking its first step' (*op. cit*, p. 146).

Lastly, Popper´s rejection of Hume´s *inductive* theory of beliefs formation leads him to maintain that 'logical' considerations may be duly transferred to 'psychological' considerations. According to him, not only do we reason rationally and thus contrary to the principle of induction, but *we also behave rationally*. He labels this the 'principle of transference' (*op. cit*, p. 6). By applying this conjecture to human psychology he then arrives at the method of *trial and error-elimination* in which the trials correspond to the formation of competing hypotheses whereas the elimination of errors corresponds to the refutation of (false) hypotheses. In other words, he proposes the theory that *individuals do not really think in an inductive way but rather form their beliefs by eliminating false hypotheses*. The theory of knowledge and learning that thus emerges is *evolutionary*. However, such theory implies that adaptation is always 'imperfect':

'Some of the errors that have entered the inheritable constitution of an organism are eliminated by eliminating their bearer; that is, the individual organism. But some errors escape, and this is one reason why we are all fallible: our adaptation to the environment is never optimal, and it is always imperfect' (Popper, 1990, p. 47).

Further, Popper asserts that *no equilibrium state of adaptation* is reached by the application of the method of trial and error-elimination since (i) no optimal trial solution to any specific problem is likely to be offered, and (ii) the

emergence of new structures and instructions involves a continuous *change* in the environmental situation (Popper, 1994, p. 4). More specifically, and crucially, Popper presents the growth of knowledge as bringing in its wake changes in the surrounding environment:

'Our very understanding of the world changes the conditions of the changing world; and so do our wishes, our preferences, our motivations, our hopes, our dreams, our fantasies, our hypotheses, our theories. Even our erroneous theories change the world, although our correct theories may, as a rule, have a more lasting influence. All this amounts to the fact that *determinism is simply mistaken*' (Popper, 1990, p. 17).

In short, Popper makes it clear that the past *affects* but does not determine the future, i.e., the future is not pre-determined. That is, the future is 'objectively open' (*op. cit.*, pp. 17-18). As noted in Vanberg (2002, p. 8), Popper´s theory of knowledge and learning exhibits a remarkable similarity to the arguments developed by biologist Mayr (1988) in the sense that both Popper and Mayr argue that intentional problem-solving behaviour can be interpreted as behaviour governed by programs or conjectures which are the product of evolutionary learning by trial and error-elimination. As Vanberg (*op. cit.*) explains, this approach implies that 'there is a continuum from the behaviour of primitive organisms, governed entirely by genetically coded programs, to the sophisticated, deliberated actions of "rational man" governed by conjectures or mental models that are stored in memory'. According to Vanberg (*op. cit.*, p. 27), 'even the most deliberate and conscious instances of problem-solving are no less "program-based" than any subconscious or unconscious routine behaviour, in the sense that they, too, have nothing else to rely on than *conjectures*…´. Thus, Vanberg views rationality as a problem-solving capacity that is stored on a person's catalogue of conjectures or programs that exhibits no more wisdom than that embedded in the knowledge acquired in the past. According to this view, rationality 'cannot guarantee pre-adaptedness, it is instead a matter of the backward-looking adaptedness of behavioral programs that allows for a tentative, forward-looking response to current problem-situations' (*op. cit.*, pp. 28-29). As we will see, this aspect of the notion of human rationality embedded in both PTKL and Mayr´s notion of problem-solving behaviour implies the ability to solve certain problems that agents have encountered in the past does not necessarily imply that they are endowed with the ability to solve new (and different) problems that they encounter as the surrounding environment changes.

Let us address Popper´s distinction between *subjective* and *objective* knowledge. The former consists of certain inborn dispositions of organisms and of their acquired modifications to act, whereas the latter consists of the logical content of our theories and, as such, it includes the world of language, conjectures, arguments, and scientific theories.[7] As for subjective knowledge, Popper´s diagnosis is that it is part of a complex but accurate apparatus of adjustment that, in the main, works like objective conjectural knowledge, namely, by the method of trial and error-elimination or 'auto-correction' (Popper, 1972, p. 77). As for objective knowledge he notes that only a tiny part of it can be given sufficient reasons for certain truth. Such tiny part is denoted as *demonstrable* knowledge and comprises the propositions of formal logic, and arithmetic. All else, including knowledge associated to the natural and the social sciences, is conjectural or hypothetical knowledge and, hence, there are no sufficient reasons for holding it to be true (*op. cit.*, p. 75). Thus, from the point of view of objective knowledge, all theories are *conjectural* albeit this does not preclude the possibility that some of them are true.

The method of science, according to Popper, is 'the method of bold conjectures and ingenious and severe attempts to refute them' (*op. cit.*, p. 81). Since all theories involve universal statements, we can `learn´ by proving that our knowledge is false. Specifically, learning takes place either when we reject one´s prior theory or when we are forced to adjust one´s theory in a way that recognizes that in its prior version it was false (Popper, 1972, p. 81). Thus, we can only 'learn' by refuting our prior knowledge claim. As noted in Boland (2003*b*, p. 242), an implication of PTKL is that the mere accumulation of information does not increase the odds that our theories happen to be true because, as Popper insists, all we can 'learn' from experience is that some of our theories are false. In this respect, Boland (2003*b*, p. 248) makes a useful distinction between the quantitative and qualitative views of knowledge. The former corresponds to the so-called 'bucket theory of knowledge' whereas the latter corresponds to Popper´s theory of knowledge. He then proposes the metaphor that, in Popper´s Socratic theory of learning, 'knowledge is more like health that one can improve than wealth that one can have more of'. Hence, according to Boland (*op. cit.*), learning consists of improving one´s knowledge rather than of increasing it.

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7 Popper´s notion of `subjective knowledge´ also bears a strong resemblance to the notion of 'reasoning instincts' used in evolutionary psychology (Cosmides & Tooby, 1994, p. 330).

The distinction between objective and subjective knowledge also leads Popper to distinguish between three different worlds or ontological domains: (i) the world of physical objects or states (World 1), (ii) the world of states of consciousness, or of mental states (World 2) and, lastly, (iii) the *autonomous* Platonic-like world of objective contents of thought, especially of scientific thoughts and works of art (World 3).[8] His main thesis on this respect is that almost all our subjective knowledge (belonging to World 2) depends upon World 3, that is, on *linguistically formulated* theories (Popper, 1972, p. 74). However, he argues that our mind may be connected to objects of both World 1 and 3 and this allows World 2 to act as a *mediator* between them. Further, he notes that World 3 exerts a profound influence upon World 1 through the actions of technologists who implement changes in World 1 by applying the predictions of these theories. Finally, he argues that we always select our P-S against a World 3 background which consists of, at least, a language and that 'the activity of understanding consists essentially in operating with third-world objects' (*op. cit.*, p. 164). In particular, the development of science and art presupposes the prior existence of the human language which leads Popper (1990) to argue that the latter is, by far, the most important product of the human mind:

'Language makes it possible to consider our theories critically: to look at them as if they were external objects, as if they belonged to the world outside of ourselves which we share with others. Theories become objects of criticism, like the beaver dam' (Popper, 1990, p. 51).

Next, Popper sees science as one of the greatest creations of the human mind, comparable only to the emergence of a descriptive and argumentative language, since its creation allowed men to replace: (i) the elimination of error in the violent struggle for life by non-violent rational criticism, and (ii) killing (World 1) and intimidation (World 2) by the impersonal arguments of World 3 (*op. cit.*, p. 84). He defines epistemology as the theory of the growth of *scientific knowledge*, that is, the theory of problem-solving, or of the critical discussion, evaluation, and critical testing of competing theories (*op. cit.*, p. 142). However, as we mentioned above, PTKL is not only applicable to scientific knowledge but to any type of knowledge. As such, he sees scientists acting on the basis of

[8] According to Gattei (2009, p. 58), Popper´s World 3 bears a strong similarity to Plato´s theory of Ideas, and to Hegel´s theory of the Objective Spirit although he thinks it is `closer to Bolzano´s theory of a universe of statements in themselves and truth in themselves, or to Frege´s universe of objective contents of thought´.

hunches and guesses concerning what looks promising for future growth in the third world of objective knowledge. In so doing, he identifies content and virtual explanatory power as the most important criteria for the *a priori* appraisal of theories where both are related to their degree of testability. In turn, the most important criterion for their *a posteriori* appraisal is 'verisimilitude' or 'nearness to truth' and this, he argues, depends upon the way a theory has stood up to severe tests (*op. cit.*, p. 143).[9] The evaluation process is always critical and aims at error-elimination. Lastly, the exposure of scientific hypotheses to severe tests and criticism from the scientific community guarantees their increasing accuracy at explaining phenomena:

`What is characteristic of science is that the selective system which weeds out among the variety of conjectures involves deliberate contact with the environment through experiment and quantified prediction, designed so that outcomes quite independent of the preferences of the investigator are possible. It is pre-eminently this feature that gives science its greater objectivity and its claim to a cumulative increase in the accuracy with which it describes the world´ (Campbell, 1974, p. 434).

Finally, the growth of World 3 is not a repetitive or cumulative process alike Lamarckian instruction but a Darwinian selection process which consists of systematic error-elimination (*op. cit.*, p. 149; also Popper, 1994, ch.1). He identifies three different levels of adaptation: genetic, behavioural learning, and scientific discovery. Scientific discovery is, according to him, a special case of adaptive behavioural learning. Popper asserts that, on all levels, the mechanism of adaptation to the surrounding environment is essentially the same, i.e., a Darwinian selection process by trial and error-elimination. In short, he views science 'as a means used by the human species to adapt itself to the surrounding environment: to invade new environmental niches, and even to invent new environmental niches' (Popper, 1994, p. 2).

3. POPPER'S METHODOLOGICAL PRESCRIPTION FOR THE SOCIAL SCIENCES

We now address Popper´s methodological prescription for the social sciences known as *SA* and the status of *RP*. Early presentations of the method of *SA* can be found in Popper´s *Open Society* (Popper, [1943*a*]1966, ch. 14, especially p. 97), in

[9] As he aptly notes, a tautology, though obviously true, has zero *truth content* and zero verisimilitude.

his *Poverty of Historicism*, originally published in three articles in *Economica* and, then, as a book (Popper, 1944-45, sections 31 & 32), in a French paper (Popper, 1967), and in *Objective Knowledge* (Popper, 1972, p. 179). However, the place where he presents it thoroughly is in the article titled "Models, Instruments, and Truth: The Status of the Rationality Principle in the Social Sciences" (Popper, 1994, ch. 8). This book chapter was originally written in response to an invitation that Popper received in the early 1960s from the Department of Economics at Harvard University and the lecture he delivered there on 26 February 1963. As noted in de Bruin (2006, footnote 1), in 1963 and 1964 two new sections were added and a small extract was then circulated in the London School of Economics in 1967 and 1968. This extract was translated into French and published as `La rationalitè et le statut du principe de rationalitè´ (Popper, 1967) and, then, a Spanish translation of the French translation appeared about a year later. A revised version of the English extract was published in 1983 on pages 357-365 of an anthology titled *A Pocket Popper* which is currently available in *Popper Selections* (Popper, 1985). However, the full text of the speech at Harvard University was not made available until 1994 when it was published in a collection of Popper´s essays titled *The Myth of the Framework*.

3.1. THE RATIONALITY PRINCIPLE

Popper´s thesis in that chapter is that there is no fundamental difference between the natural sciences and the social sciences since both of them resort to the construction of models or *typical* P-S to explain and predict events. If anything, models are viewed by him as being even more important in the social sciences due to the non-existence of universal laws. In any case, he argues that the models of the theoretical social sciences are always an *over-simplification* of reality and, hence, do not represent the facts truly. According to him, the fundamental problem of the social sciences is 'to explain and understand events in terms of human actions and social situations' (Popper, 1994, p. 166). In turn, the reconstruction of social situations should include the consideration of the relevant 'social institutions' which he defines as 'all those things which set limits or create obstacles to our movements and actions' (*op. cit.*, p. 167). In his autobiography, Popper makes it clear that his methodological proposal for the social sciences stems from an 'attempt to generalize the method of economic theory (marginal utility theory) so as to become applicable to the other theoretical social sciences' (Popper 1976*a*, pp. 117-118).

Next, Popper makes a distinction between 'rationality' as a personal attitude and his *RP*. In particular, he makes it clear that his *RP* has nothing to do with the assumption that men adopt a rational attitude. Rather, he defines it as an *a priori* methodological principle which assumes that *our actions are adequate to our problem-situations as we see them* (Popper, 1994, p. 181). More specifically, he remarks that *RP* is *not* true: 'The rationality principle is false. I think there is no way out of this. Consequently, I must deny that it is *a priori* valid' (Popper, 1985, p. 361).[10] Notwithstanding it, he believes it represents a good approximation to the truth. Thus, *RP* 'does not play the role of an empirical explanatory theory, of a testable hypothesis' (*op. cit.*, p. 360). Rather, he views it as an integral part of every testable theory and proposes to avoid blaming it whenever our theory breaks down in the wake of empirical tests. His methodological advice to social scientists is thus never to abandon *RP* so that, in the wake of a refutation of their model, they should always revise their models of the agent's P-S.[11]

As Koertge (1975) shows, Popper's views on the *RP* have evolved over time. As time passed by, he tended to weaken his claims about the kinds of actions that agents could be expected to perform so that 'where he had earlier spoken of actions as being `rational´ or `appropriate´, he now characterized them as `adequate´, or `adapted´, or `in accordance with the situation´ (*op. cit*. p. 441). According to him, the most likely reason for this evolution in terminology was his increasing emphasis on the fact that the P-S which played a central role in the explanation was not so much the agent's *objective* P-S but, rather, the agent's *theory* of her P-S or the P-S *as the agent saw it* (Koertge, 1975, p. 442). She explains that *RP* really consists of two clauses: the first (*RP-1*) says that 'every action (by a person) is a rational response to some problem-situation' whereas the second (*RP-2*) tells us that 'every person in a problem-situation responds rationally to it' (*op. cit.*, p. 443). In turn, *RP-1* entails: (i) that the response was issued through a *methodical* appraisal of the set of possible solutions available to the actor, (ii) that a description of both P-S and the appraisal process could be

[10] Of course, this applies to any premise aimed at providing a 'closure' for a model. As Loasby (1999, p. 14) reminds us, 'all closures are in some degree false. There can be no self-sufficient Cartesian scheme for deducing justified true knowledge from some original certainty'.

[11] This touches upon the issue of the incompatibility of Popper´s *RP* and his falsificationist methodology. For instance, Caldwell (1991, p. 13) argues that 'Popper´s rationality principle represents an immunizing stratagem that is elevated to the status of an inviolable methodological principle'. In an attempt to reconcile both principles, Koertge (1979, p. 93) interprets *RP* as the Lakatosian hard-core of Popper´s research program in the social sciences whereas the positive heuristic is 'his metaphysical theory of man as an evolving rational problem-solving animal'.

verbalized by the actor, and (iii) that the person acted as she did as a result of the appraisal process so that if a better alternative had been available to her she would have taken it. Thus, the complete *RP* formulated in Koertge (1975) emphasizes the close connection between the action and the *systematic deliberation* process from initial conditions that made the agent behave as she did. Further, Koertge (1979, p. 90) points out that requirement (i) above implies that 'some systematic non-random decision procedure be used' albeit she notices that Popper did not specify the minimal requirements which acceptable decision rules should satisfy. This means that *RP* can, in principle, be supplemented with different theories of belief formation. As Koertge (*op. cit.*, p. 92) explains, for Popper, to explain an action using *RP* does not 'imply that the agent's beliefs are reasonable nor even that her way of making decisions is the best possible one' but only presupposes that agents assess the situation in a *systematic* way.

Next, as we noted above, Popper´s methodological advice to social scientists is never to abandon *RP* so that, in the wake of a refutation of their model, they should always revise instead their model of the agent's P-S. He offers two arguments in favour of this strategy: (i) that we learn more if we blame our situational model, and (ii) that the adoption of *RP* 'reduces considerably the arbitrariness of our models' (*op. cit.*, p. 362). As for the first argument, he explains that:

'The main argument in favour of this policy is that our model is far more interesting and informative, and far better testable, than the principle of the adequacy of our actions. We do not learn much in learning that this is not strictly true: we know this already' (Popper, 1985, p. 362).

Likewise, Caldwell (1991, p. 25) argues that, although immunizing stratagems should be generally avoided 'at least in the special case of situational analyses, one is able to *criticize more severely and obtain fruitful criticisms* if one blames the model rather than *RP* whenever a falsification occurs'. As for the second argument, Popper explains that:

'The attempt to replace the rationality principle by another one seems to lead to complete arbitrariness in our model-building. And we must not forget that we can test a theory only as a whole, and that the test consists in finding the better of two competing theories which may have much in common; and most of them have the rationality principle in common' (Popper, 1985, p. 362).

As Hands (1985, p. 87) remarks, Popper's first argument above means that if we are consistent with *RP* 'the falsification of a specific theory only means that we

have misspecified the "situation", i.e., that we have attributed the wrong preferences or constraints to the individual'. In turn, Popper's second argument implies that although *RP* is potentially falsifiable *we choose to make a methodological decision that, when faced with a falsifying observation, we will stick to it* and revise instead our hypotheses about the desires, beliefs, and constraints faced by agents (Hands, 1985, p. 88). Notably, Becker (1976) resorts to a similar argument to justify the use of rational choice theory. According to him, human behaviour can be viewed from the standpoint of individuals who seek to maximize their utility from a stable set of preference and subject to a given constraint. Where action appears to deviate from the predictions of neoclassical utility theory, Becker claims that little is gained from resorting to explanations in terms of irrationality, changes in preferences or cultural values, etc… for such explanations are *ad hoc* and may even be contradictory. Furthermore, he adds that the question is left unanswered of just *why* human behaviour should be sometimes rational but sometimes not.

According to Caldwell (1991, p. 15), there are two main weaknesses in Popper´s presentation of *SA*: (i) vagueness about how it should be implemented, and (ii) Popper´s apparent belief that *SA* is the only adequate method to adopt in the theoretical social sciences. As for the first point, we have presented above a clearer explanation of how to apply it suggested in Koertge (1979). As for the second point, Caldwell (1991, p. 16) readily admits that *SA* is a powerful and fruitful method for the social sciences, yet he criticizes Popper´s idea that *SA* is the *only* legitimate method for the theoretical social sciences. Further, he recognizes that there is a tension between falsificationism and *SA* owing to the fact that *RP* adopts the status of a methodological prescription that plays the role of an immunizing stratagem.[12] A discussion of this issue is in Hands (1985, p. 89) who argues that, by Popperian standards, scientific explanations based on *RP* 'are as close to metaphysical explanations as they are to scientific explanations' and, hence, the tension between these two methodological principles can hardly be resolved. Caldwell (1985) proposes to solve the conflict between *SA* and falsificationism by adopting a broader conception of acceptable scientific practice based on 'critical rationalism' whose goal is to subject theories to an *optimal* amount of criticism. In turn, the latter will depend on both the specific problem

[12] Notwithstanding the intellectual authority of Popper, economists like Hayek (1967, p. 29) or Hutchison (1977, p. 43) question the applicability of Popper's falsificationanist methodology to economics. Indeed, the applicability of strict falsificationism to the social sciences appears to be problematic even to Popper himself as noted in Hands (1985, p. 96).

to be solved and the nature of the problem under investigation (*op. cit.*, p. 25). Such prescription was proposed in Klappholz & Agassi (1959) and, later on, it has been promoted by Boland (2003*a*) who stresses that the only generally applicable methodological rule is the exhortation to be always critical and ready to subject one's hypotheses to critical scrutiny. More specifically, he insists we should focus on the Socratic-Popper identified in Klappholz & Agassi (1959) and thus discard the Lakatos-Popper (also known as Popper the 'falsificationist') promoted by Latsis (1972) and Blaug (1975). According to him, if we put falsificationism aside in favour of 'critical rationalism' the conflict between *SA* and falsificationism vanishes.

3.2. THE TWO VERSIONS OF THE RATIONALITY PRINCIPLE

Latsis (1983) was probably the first commentator to identify the existence of an `objectivist´ version (*RPo*) and a `subjectivist´ version (*RPs*) of *RP* in Popper´s work.[13] In the former, the relevant P-S is that one as seen by the theoretician whereas, in the latter, the theoretician is supposed to reconstruct P-S as seen by agents. Latsis (*op. cit.*) denotes the former as the `strong´ version of *RP*. According to Latsis (*op. cit.*, p. 131), Popper both *weakens* and *widens* the notion of rationality in human behaviour when adopting *RPs*.[14] Building on the distinction between *RPo* and *RPs*, Nadeau (1993, p. 463) notes that `an attentive reading of the 1967 text shows that although Popper views the *RP* as an explanatory principle throughout the text, he surreptitiously changes his way of formulating it during the course of his argument, going from an objectivist formulation at the beginning of the text to a subjectivist formulation at the end´. Hands (1991, footnote 14) recognizes that `Popper is really unclear on this´, and Latsis (1983, p. 133) claims that Popper seems either `confused or deliberately elusive´ on this issue. Be that as it may, Hands (*op. cit.*) points out that in his 1985 text Popper adopts the subjectivist interpretation when he openly says that rationality is only `as agents see it´ and *SA* can thus be applied to apparently irrational behaviour such as the behaviour of a `madman´ (Popper, 1985, p. 363).[15] However, he adds that Popper also denotes *SA* `a purely objective method´ which `can be

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13 However, we will argue below that a clear antecedent of this distinction is in Hayek (1937).

14 By contrast, we will argue below that the `subjectivist´ version of *RP* is a legitimate and potentially fruitful one in the social sciences.

15 Yet, Zouboulakis (2014, p. 87) argues that it is clear that Popper has an `objectivist´ version of *RP* in mind.

developed independently of all subjective and psychological ideas (Popper, 1976, p. 172) and that, elsewhere, Popper says that *RP* is the `general law that *sane* persons as a rule act more or less rationally´ (Popper, 1966, p. 265).

Now, in a passage of his 1967 French paper, Popper (1985, p. 363) proposes his famous example of the `flustered driver´ who, by trying to park stubbornly his car in evidently too small a space, does not act in a way that is appropriate to the situation *in which he finds himself* and then recognizes that `we employ the rationality principle to the limit of what is possible whenever we try to understand the action of a madman´ (Popper, 1994, p. 179). It is in the section of the chapter where he notices that cases of neurosis have been explained by Freud and other psychologists with the help of their own version of the *RP* that he switches to a *subjectivist* version of *RP*. Then, in a key note to one of the paragraphs (footnote 19), he acknowledges that he refers successively to two versions of his *RP* and even identifies a third intermediate version according to which P-S is said to be `as the agent could (within the objective situation) have seen it´ (Popper, 1994, ch. 8, footnote 19).[16] In the aftermath of it, Lagueux (2006, p. 201) concludes that, according to Popper, `what the agent sees may or may not be considered a part of the objective situation that the model describes´. Summing up, the `objectivist´ version (*RPo*) supposes that agents possess `true´ knowledge; the `subjectivist´ version (*RPs*) supposes that the alleged knowledge that agents possess is *partially* wrong; and the third version constitutes an intermediate case. However, in all three versions of *RP* it is assumed that the agent acts in a way that is appropriate to the state of *his* knowledge (Popper, 1994, ch. 8, footnote 19; Lagueux, 2006, p. 201).

Next, building on the terminology coined in Latsis (1972), Kerstenetzky (2009, p. 201) denotes *RPo* the `maximal´ or `single-exit´ interpretation and *RPs* the `minimal´ or `multiple-exit´ interpretation of *RP*. The `single-exit´ interpretation stems from the fact that, if it is supposed that the agent perceives P-S in an objective way, there is thus only `one´ possible solution whereas the `multiple-exit´ interpretation captures the idea that, in principle, there are as many solutions as subjective perceptions of P-S exist. It is the `multiple-exit´

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16 Prior to this clarification, Popper (1972) had already recognized the existence of two versions of *SA*:

`There are many cases in which we can reconstruct, *objectively* (even though conjecturally), (a) the *situation as it was* and (b) a very different *situation as it appeared to the agent,* or as it was *understood*, *or interpreted* by the agent. It is interesting that this can be dome even in the history of science´ (Popper, 1972, p. 179, footnote 27).

interpretation that is of interest in the context of the `subjectivist´ *SA*. In particular, the issue is *whether* we can assume for methodological purposes that the different subjective perceptions of P-S held by actors actually converge on a `single´ one and, if so, *how* this convergence comes about. Alike Jacobs (1990), Kerstenetzky (*op. cit*) associates the `objectivist´ or `single-exit´ modelling to the influence on Popper of the work of Weber. By contrast, Hedström *et al*. (1998, p. 359) do not think there is textual evidence that Popper got the inspiration for the notion of *SA* from Weber´s work and suggest that if there was any influence at all it was probably *indirect* since Hayek — a friend of Popper — admired Weber. However, it could be argued that Popper´s method for the theoretical social sciences takes on board Weber´s notion of `interpretive understanding´ or `*verstehen´* — developed later on by the Austrian economists — and, especially, his notions of `ideal type´ and of `instrumental rationality´, i.e., the use of rationality to bring about change in the surrounding world in the interest of the actor (Weber, 1949).[17] Be that as it may, there is some textual evidence that points to Hayek as the most important *direct* source of influence on Popper´s work. Notably, Popper (1994, ch. 8, note 1) writes that `I was particularly impressed by Hayek´s formulation that economics is the "logic of choice"´ as expressed in his essay titled `Economics and Knowledge´ (Hayek, 1937, pp. 33ff). According to Popper, it was this that led him to the formulation of the `logic of the situation´ in his *Poverty of Historicism*.[18]

Finally, there is the issue of the status of *RP*. We have already mentioned above the profound ambiguity of Popper´s explanation about the status of RP. The subsequent discussion about the role and status of *RP* among

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[17] However, it has been argued that, although the notion of `single-exit´ modelling and *SA* originates with Weber, for him this and related concepts were tools of *historical* analysis, not of theory (Langlois, 1995, p. 230; 1998, p. 69). Interestingly, a philosophical foundation for Weber´s notion of `ideal type´ is in the school of phenomenology and, particularly, in Schutz´s concept of `second-order typifications´ (Schutz, 1972).

[18] The interrelation between the ideas of Hayek and Popper is discussed in Oakley (1999) and Caldwell (2003). For instance, Popper (1943) appears to have been inspired by Hayek (1942) when expressing his crucial idea that both our institutions and traditions are largely the `*indirect, the unintended and often the unwanted by-product*s´ of conscious and intentional human actions and, therefore, that `only a minority of social institutions are consciously designed, while the vast majority have just "grown", as the undesigned results of human actions´ (Popper, [1943*a*] 1966, p. 93). Likewise, Hayek had already argued that social studies deal `not with the relations between things, but with the relations between men and things or the relations between man and man. They are concerned with man´s actions and their aim is to explain the unintended or undesigned results of the actions of many men´ (Hayek, 1942, p. 276).

Popper´s commentators focused on the distinction between *RPo* and *RPs*. For instance, Lagueux (1993, 2006) argues that, even if we adopt the `subjectivist´ interpretation, *RP* cannot be *a priori* true because, according to him, it is simply not true that people always act appropriately according to the P-S *as they see it*. Notwithstanding it, he thinks that *RP* occupies an exceptional place in the social sciences because it constitutes a *condition of intelligibility* of any phenomenon that derives from human action. More specifically, the latter can only be intelligible, i.e., understood by an external observer, when it is motivated by reasons, that is, when it represents an appropriate response to P-S as seen by the agent (Lagueux, 2006, p. 205). He concludes that maintaining *RP* after acknowledging that it is not *a priori* true is, after all, to claim that `in spite of the fact that irrational decisions occur, human actions are nonetheless normally understandable´ (*op. cit.*).

4. THE NOTION OF RATIONALITY IN POPPER´S PHILOSOPHY OF THE SOCIAL SCIENCES

In section 2 we showed that PTKL implies that: (i) all knowledge is conjectural, (ii) that we learn through an (endless) process whereby we subject our conjectures to trial and discard those ones that turn out to be wrong, and (iii) that the learning process is imperfect and never converges to an optimum. Consequently, the most important feature of knowledge is its fallibility. By contrast, Popper´s methodological proposal for the social sciences has been denoted as 'situational determinism' (Latsis, 1972; Oakley, 2002) which suggests that there may be some key epistemological differences between PTKL and *SA*. The first thing we should like to note is that PTKL is a theory about the nature of knowledge and its growth over time while *SA* is a methodological prescription aimed, arguably, at speeding up the rate of progress of the social sciences so that these two elements of Popper´s philosophy do correspond to the positive and methodological domain respectively. That said, we believe there is also a normative element in PTKL since trial and error-elimination can also be said to be the way we *should* behave when seeking to expand our knowledge. In any case, error-elimination can only proceed *after* there is clear-cut evidence that, retrospectively, a decision made in the past was wrong. However, this does not provide us with a systematic rule for making decisions *in the future* other than to avoid repeating the same mistakes made in the past. In short, error-elimination is an incomplete guide to decision-making.

Next, we may wonder how *SA* would look like if the agents that are the object of the modelling exercise exhibited a theory of knowledge and learning akin to PTKL. To be sure, the situational model of the typical P-S consists of three elements: (i) external (and observable) elements such as the physical and social constraints agents are subject to, (ii) the knowledge and information that agents possess, and (iii) their goals and aims. Now, if agents behave according to PTKL, then the situational model of the typical P-S should incorporate the knowledge they possess which would include the experience accumulated from mistakes they made in the past given the specific circumstances that prevailed at that time. Therefore, adequate behaviour would imply, as a minimum, not repeating previous mistakes. However, as we noted above, there is no further guidance for agents stemming from PTKL as far as future decision-making is concerned in case they encounter new (and different) P-S. In short, PTKL appears to be compatible with *SA* provided the situational model includes agents´ learning from previous mistakes.

4.1. PTKL VERSUS SA: THE `RATIONALITY OF AGENTS´

We noted above that several commentators, as well as Popper (1994, ch. 8, note 19) himself, identify two different versions of *RP*: an `objectivist´ version (*RPo*) and a `subjectivist´ version (*RPs*). According to the former, the relevant P-S is the `objective´ P-S, that is, the P-S *as it actually is* whereas, according to the latter, the theoretician should reconstruct P-S *as it is actually seen by the agents*. As Popper (1972, p. 179) recognizes, in both cases P-S is *conjectured*.[19] That said, we will argue below that, if Hayek´s ideas on the nature of the `facts of the social sciences´ are taken on board, there is no reason *a priori* to expect that the theoretician´s view of P-S is *closer* to the `true´ P-S than agents´ (Hayek, 1943). This is because, as Hayek argues, the theoretician does not possess superior relevant knowledge that is not shared by agents. Be that as it may, *RPo* and *RPs* constitute two different modelling strategies in the social sciences the consequences of which, to the best of our knowledge, have not been explored so far. Notably, an antecedent is Schumpeter´s distinction between `objective rationality´ and `subjective rationality´ (Schumpeter, 1984). He defines the former as consisting of the `applicability of a rational schema to the actor´s behaviour´ and he defines

[19] In this respect, let us mention that Menger ([1871] 1950, p. 148) was one of the first social scientists to incorporate error within his model and to argue that *all* knowledge (both of the actors and of the theorist) is bound to be prone to errors.

the latter as the `conformity of the actors´ mental processes to a rational schema´ (*op. cit.*, p. 583). Crucially, he states that the former need not imply the latter and criticizes the tendency of some social scientists to *implicitly* identify the rationality of the `observer´ with the subjective rationality of the `observed´ (*op. cit.*, p. 583). He uses the example of the neoclassical theory of monopoly to illustrate the notion of `objective rationality´:

`The model just described is the product of the analyst´s mind as much as any physical theory is, and does not in itself say anything about reality or about anybody´s actual behavior or rationality… Even if the model should fit anyone´s behaviour this does not mean that the individual in question consciously aims at the result and still less that he arrives at it by processes at all similar to the analytic procedure´ (Schumpeter, *op. cit.*, p. 580).

Schumpeter´s notion of `objective rationality´ is closely associated to his notion of `rationality of the observer´ whereas the notion of `subjective rationality´ is coupled to his notion of the `rationality in the observed´. In the example of monopoly theory, he explains that the construction of a model will give us the conditions under which the maximization of profits will be attained thereby setting up a standard against which the theorist can compare actual behaviour. However, he makes it clear that such model is *entirely* a product of the `rationality of the observer´ and, hence, the usefulness of the modelling exercise will depend on the degree to which that hypothesis is justified by facts (*op. cit.*, p. 580). According to him, a common source of divergence between the type of human behaviour that stems from the `rationality of the observer´ and the `rationality in the observed´ is the existence of a multiplicity of ends in actors´ minds. To the extent that the goals of actors are also an element of P-S, the adoption of a subjectivist interpretation of *RP* will require that the theoretician *understands* the goals of actors without this necessarily implying that she shares them. Now, the relevance of his notion of `subjective rationality´ emerges clearly in those cases where the situational model constructed on the basis of the `rationality of the observer´ *does not fit the facts*. As Schumpeter notes, in such cases the task of the theoretician is to explain the reasons for the *discrepancy* between the `rationality of the observer´ and the `rationality in the observed´ (*op. cit.*, p. 586). In turn, this will require an effort by the former to adopt the point of view of the `observed´:

`Understanding an end and judging rationality of means often requires that the analyst "puts himself" into places very far distant from his time and social

location. Sometimes he has to transplant himself into another cultural world´ (Schumpeter, 1984, p. 583).

These ideas on the methodology of the social sciences were originally written by Schumpeter *circa* 1940 for a Harvard discussion group on rationality which included Parsons, Leontief, and Sweezy. The manuscript remained unpublished for more than 40 years until Professor Loring Allen of the University of Missouri in St. Louis found it among the papers of Schumpeter in the Harvard University archives. It was published posthumously in 1984 at the *Journal of Institutional and Theoretical Economics*. We believe this manuscript contains some intuitions that exhibit a high degree of affinity with Popper´s notions of *RPo* and *RPs* (Popper, 1994). However, we should like to note that it was Hayek´s *Economica* essay `Economics & Knowledge´ (Hayek, 1937) where the distinction between `objective´ and `subjective´ rationality was first formulated. In that essay, Hayek criticises equilibrium economic theory for making an illegitimate use of the concept of `data´ possessed by economic agents as well as for the methodological confusion thus created:

`But this does not solve the question whether the facts referred to are supposed to be given to the observing economist, or to the persons whose actions he wants to explain, and if to the latter, whether it is assumed that the same facts are known to all the different persons in the system, or whether the "data" for the different persons may be different… There seems to be no possible doubt that these two concepts of "data", on the one hand in the sense of the objective real facts, as the observing economist is supposed to know them, and on the other hand in the subjective sense, as things known to the persons whose behaviour we try to explain are really *fundamentally different and ought to be kept carefully apart*. And, as we shall see, the question why the data in the subjective sense of the term should ever come to correspond to the objective data is one of the main problems we have to answer´ (Hayek, 1937, p. 39, emphasis added).

We know that Popper had read Hayek´s 1937 paper in *Economica* and, indeed, he refers to it as the key source of his understanding of the core of economics (Popper, 1994, p. 181, footnote 1). According to Popper, it was Hayek´s exposition of the `logic of choice´ in that paper that led him to the formulation of the `logic of the situation´ as embracing both the `logic of choice´ and the `logic of historical P-S´. Yet, Popper does not refer explicitly to Hayek´s distinction between subjective and objective data. That said, it is very likely that Popper´s recognition, later on, of a distinction between *RPo* and *RPs* is related to

his acquaintance with Hayek´s *Economica* essay. In the following sections we will explore in some detail the relation between these two concepts as well as their relation to PTKL *from the point of view of the agents* that are the object of the modelling exercise performed by the theoretician.

4.1.1. PTKL versus the `subjectivist´ version of SA

Let us focus on the relation between *RPs* and PTKL. To be sure, *RPs* constitutes a *minimal* requirement for rationality in that agents´ behaviour only has to be adequate or appropriate to the P-S *as they see it*. This implies that, as in the Austrian School of von Mises, Hayek, and Schumpeter, rationality is associated to behaviour that is *goal-directed* or *purposive*.[20] This type of rationality is sometimes denoted as *instrumental* in the sense that reason becomes an instrument to reach a certain goal, e.g. an increase in pleasure.[21] Although there are significant methodological differences among members of the Austrian School of economics, they all viewed economics as part of a science of human action whose core is `to be found in the unique property possessed by human beings of engaging in operations designed to attain a state of affairs that is preferred to that which has hitherto prevailed´ (Kirzner, 1976, p. 148). What is crucial in our context is that the Austrian School´s conception of rationality is *subjective* in the sense of being an *a priori* assumption about human behaviour. There are two sources of subjectivity. First, there is the subjectivity of actors´ ends or, as von Mises puts it:

`Nobody else than the individual himself can decide what satisfies him better and what less... There is no such thing as an absolute state of satisfaction or happiness irrespective of the desires of the individual concerned´ (von Mises, 1944, p. 533).

Second, there is the subjectivity of knowledge itself in the social sciences. As long argued in Hayek (1943), it is only in the social sciences that our *interpretation*

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20 As von Mises explains:
`Every human action aims at the substitution of more satisfactory conditions for less satisfactory. Man acts because he feels uneasy and believes that he has the power to relieve to some extent his uneasiness by influencing the course of events. A man perfectly content with the state of his affairs would not have any incentive to change things; he would have neither wishes nor desires, he would not act because he would be perfectly happy... Strictly speaking, only the increase in satisfaction (decrease of uneasiness) should be called *end*, and accordingly all states which bring about such an increase *means´* (von Mises, 1944, p. 532).

21 The notion of `instrumental rationality´ goes back as far as Max Weber´s sociological histories of world religions culminating with his classic study of modern European Christianity (Weber, 1904-5).

of a situation no matter whether it is right or wrong becomes an integral part of the situation thus affecting subsequent developments. Further, and to the extent that we understand the surrounding world via the 'internal models' we create, our understanding of the world will affect our decisions and, in this way, it may affect the world itself. Hayek (*op. cit.*) illustrates this theme by explaining the purposive nature of human action. As he explains, just as we cannot speak of the objective properties of a tool without saying something about the purpose for which the tool is used so we cannot speak of social institutions objectively. Laws and economic institutions cannot be known apart from the intentions of the individuals who use them. In the field of economics, for instance, the value of money depends on the opinions of individuals who use it rather than on any inherent property of it. As we argue below, Hayek´s ideas on the methodology of the social sciences seem to have been ignored by most commentators of Popper´s work in that field.

Members of the Austrian School of economics like von Mises or Hayek adopted the `praxeological approach´ which consists of a theory of human action based on a set of self-evidently true *a priori* axioms on behaviour which, in turn, yields conclusions which are true regardless of time and place. However, the axioms of praxeology are not arbitrary like, for instance, those of mathematics. Rather, Austrian economists maintain that these axioms are already given to us in our minds and that, through the exercise of `introspection´ or `verstehen´, which consists of understanding the functioning of our minds, we have the possibility of understanding the behaviour of others. That said, the extreme subjectivism of the Austrian School of Economics leads to the conclusion that there is no possibility of acquiring knowledge about any social phenomena other than through `introspection´. Further, the notion of rationality proposed by von Mises (1944) as *purposive* behaviour may preclude the generation of predictions which can be subject to empirical tests. This is because the hypotheses about social phenomena derived from self-evident axioms may be close to being true but they may also possess little empirical content. This problem is addressed in Popper (1963, pp. 217-19) who makes it clear that science characterises as preferable `the theory which tells us more; that is to say, the theory which contains the greater amount of empirical information or content´. In other words, the empirical content of a theory increases with the increasing *improbability* of it being true or else with its increasing exposure to falsification. He uses the example of meteorological forecasts; a forecast according to which in some unspecified time in the future it

will rain has, as he explains, a high probability of being true yet it has virtually no empirical content, whereas a forecast which specifies the date and the time it is likely to rain has a high degree of empirical content yet it is quite likely to be false. Likewise, predictions derived from general or self-evident axioms on human behaviour like the ones of praxeology — which amount to stating little more than all human behaviour is purposeful — have a high probability of being true yet they have little empirical content because they are not falsifiable. By contrast, the subjectivist version of *SA* proposed by Popper (1985) is not subject to the previous criticism since, in addition to incorporating all the relevant elements of P-S — including the physical and social constrains and the knowledge and information possessed by agents — it also posits that actors´ behaviour is `adequate´ to P-S *as they see it*. The requirement that actors´ behaviour is `adequate´ — in addition to being purposeful or goal-oriented — implies, in turn, that the empirical content of theories constructed upon *RPs exceeds* the empirical content of theories about human behaviour derived from praxeology.

Let us distinguish between 'means-rationality', 'beliefs-rationality', and 'ends-rationality' (Hamlin, 1986). 'Means-rationality' implies the *correctness* of one´s actions *given* one´s desires and beliefs regardless of whether the latter are right. Therefore, as a minimum 'means-rationality' implies *consistency* of choice by agents. For instance, in neoclassical microeconomics, 'means-rationality' is characterized by consistency in the preferences of households or *transitivity*: if an agent prefers *a* to *b* and *b* to *c*, then *a* must also be preferred to *c*. [22] The further requirements that are usually imposed, i.e., that individuals´ preferences exhibit both 'completeness' and 'continuity', are not ones of 'means-rationality' but rather of the optimization methods through which economists seek to represent individual preferences by a 'utility function'. Thus, when economists speak of `rational´ agents what they usually have in mind is that their choices have to be, at least, consistent with one another.

Next, following Hamlin (*op. cit*), 'beliefs-rationality' implies that an individual´s (subjective) model of the surrounding world represents a good enough approximation to reality. Similarly, Bicchieri (1992) defines 'epistemic'

[22] For instance, in the neoclassical theory of the consumer, 'means-rationality' consists of the axioms of completeness, independence, reflexivity, and transitivity of preferences (Dow, 1995, p. 724). In the case of the expected utility model developed by von Neumman and Morgenstern (1947), which constitutes the modern theory of choice under risk, 'means-rationality' is satisfied if the following four assumptions or axioms are fulfilled: cancellation, transitivity, dominance, and invariance. To this, we may add the more technical assumptions of comparability and continuity.

rationality as a characteristic of beliefs that consists in their being *correct* given the evidence that is available to agents. Finally, 'ends-rationality' means that the behaviour of agents is *purposeful* or oriented to the achievement of a goal and, hence, not the result of chance (Hamlin, *op. cit.*). For instance, in neoclassical economics 'ends-rationality' is associated to the pursuit of *self-interest*. To be sure, this has been so since Edgeworth who, in his 1881 *Mathematical Psychics*, stated that 'the first principle of Economics is that every agent is actuated only by self-interest'. Prior to the emergence of 'neoclassical' economics in the second half of the 19th century, the classical statement of mainstream economics methodology is in Mill ([1836] 1967). Be that as it may, Twomey (1998, p. 435) claims that the clearest statements of this tradition were already present in the works of Bentham and Hobbes. In particular, he argues that Bentham (1789) first formulated the notion that agents are motivated to maximise pleasure whereas Hobbes (1651) provided a statement of egoism according to which individuals *always* seek their own greatest good. Therefore, we may characterise the `praxeologic´ models of the Austrian school of economics as implying `ends-rationality´ and the situational models based upon *RPs* as implying both 'means-rationality' and 'ends-rationality' but *not* 'beliefs-rationality'. As we will argue below, each of these types of models implies a different division line between `rational´ and `irrational´ behaviour.

The absence of 'beliefs-rationality' in models based on *RPs* implies that agents´ beliefs may well be wrong *ex-post*, i.e., that agents are fallible. Specifically, agents may perceive the physical and social constraints they face erroneously or may simply possess wrong information. Therefore, the adoption of *RPs* implies that agents´ beliefs are liable to error and, hence, understanding their behaviour (including their mistakes) will require the construction of a model of the typical P-S *as seen by agents*. It follows from this that the adoption of *RPs* is *a priori* compatible with PTKL since the agents in the typical model can make mistakes stemming from their wrong beliefs. Yet, the notion of adequate behaviour according to PTKL also implies, as noted above, the requirement that agents `learn´ from their past mistakes, i.e., they do not repeat them. Consequently, full compatibility of *RPs* with PTKL would require that the theoretician recognizes that agents do not repeat their mistakes in the future. As we will see below, this feature of PTKL may create a tension with *RPs* when the purpose of the modelling exercise is to make predictions.[23] We may also add that, if *RPs* is adopted, the

[23] As noted in Beinhocker (2013), in the context of the social sciences, a prediction (unlike a forecast) amounts barely to the *deductive logical consequences* of a theory. It should be noted, however, that

point of view of the theoretician *vis-à-vis* the actors becomes analogous to the position of participants in the `Beauty Contests´ that were so popular in the British tabloids in the 1930s and that were metaphorically captured by Keynes in his *General Theory* to explain the formation of prices in financial markets (Keynes, 1936, p. 156). To be sure, in `Beauty Contests´, what participants were supposed to do in order to win the prize was not so much to identify — among the photos of beautiful ladies portrayed in a panel — the lady they believed to be the most beautiful one but to `guess´ the photo of the lady they believed other participants would select as the most beautiful one. In a similar fashion, we will argue below that, if *RPs* is adopted, the theoretician seeks to reconstruct P-S not as she sees it herself but *the way she thinks agents see it*.

Next, and crucially, to the extent a *discrepancy* exists between the theoretician´s (objective) view of P-S and his conjecture about agents´ view of P-S, the generation of predictions will require making the crucial assumption that *such a discrepancy and the `situational factors´ that warrant it exhibit a high degree of stability over time*. In turn, the former implies that the `null hypothesis´ in empirical tests applied on a situational model which adopts *RPs* is that agents´ view of P-S is, at least partially, *wrong* whereas the alternative hypothesis is that the theoretician´s (objective) view of P-S is correct. If such discrepancy were to disappear over time for some reason (e.g., learning by agents), the predictions derived from it would be equivalent to the predictions generated if *RPo* were adopted. Thus, we disagree with Vanberg (2002, p. 12) when he argues that the `subjectivist´ *RP* poses a testability problem vis-à-vis the `objectivist´ *RP*. Specifically, situational models that adopt *RPs* can generate predictions albeit, as we argued above, their generation implicitly implies adopting the assumption that agents´ view of P-S *will remain constant in the future*. Unless the theoretician

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the predictions to be derived from the models in the social sciences differ from the predictions generated by the theories of the natural sciences. Building on Hayek´s distinction between `explanation in principle´ and `explanation in detail´ (Hayek, 1967*b*, p. 20), Popper (1994, p. 163) distinguishes between explaining or predicting *singular events* from problems of explaining or predicting a *kind* or *type* of event. According to Popper, the former can be solved *without constructing a model* – no more than certain universal laws and the relevant initial conditions are needed – whereas the latter is most easily solved *by means of constructing a model* (*op. cit.*, p. 164). Further, he argues (Popper, *op. cit.*, p. 165), that a model consists of `certain elements placed in a typical relationship to each other, plus certain universal laws of interaction — the "animating" laws´. Unlike theories, models try to capture the *typical* aspects of P-S in order to make statements about a *type* of event and, hence, they represent something akin to *typical initial conditions* (*op. cit.*, p. 164). In turn, a statement about a *typical* event can be either an explanation of *why* that typical event occurred in the past, or else, a prediction, that is, a logical consequence of the theory.

does so, the models´ testability will be seriously weakened. This is because, in the wake of an unfavourable empirical test, the theoretician may try to circumvent its refutation by arguing that the adverse result of the empirical test was due, for instance, to an (unpredictable) *change* in agents´ view of P-S. Thus, a *sine qua non* condition for potential refutability in this case, i.e., for the model to possess `empirical content´, is that agents´ view of P-S is assumed to remain constant over time or, else, that agents follow a constant pattern of behaviour in spite of the mistakes such behaviour may bring about. However, this assumption creates some tension with PTKL since, according to the latter, agents tend to purge their wrong beliefs over time.

Now, we have argued above that, if *RPs* is adopted, it is implicitly assumed that (i) there is a discrepancy between the theoretician´s view of P-S and agents´ view of P-S, and (ii) that the former persists over time. As we argued above, this implies (under the null hypothesis) that the agents whose behaviour the theoretician seeks to capture in the situational model *do not revise their wrong beliefs* which runs counter to PTKL. The discrepancy alluded to above is between two different conjectures: (i) the theoretician´s (objective) view of P-S, and (ii) agents´ view of P-S. According to Popper (1994, p. 178), the latter is always part of the former since the theoretician can only understand agents´ view of P-S if she reconstructs a *wider* view of P-S than their own. Specifically, if we adopt Popper´s interpretation of *RPs*, what the theoretician subjects to empirical test is the hypothesis that agents *systematically* fail to perceive the `true´ P-S and, under the null hypothesis, this implies that agents´ view of P-S will be disappointed *if* the theoretician´s view of P-S is correct. However, as we have argued above, the systematic disappointment of beliefs will come about because it is implicitly assumed that agents *do not `learn´ from their mistakes,* i.e., they tend to repeat mistakes all over. However, the above-mentioned tension between PTKL and *RPs* does not arise if the main purpose of constructing a situational model is to *explain the past* (e.g., historical interpretation) rather than to generate predictions. This is because in the former case the theoretician need not be concerned about the persistence into the future of a discrepancy between agents´ view of P-S and her `objective´ view of P-S. In short, *RPs* is more problematic than Popper recognized if the purpose of constructing a situational model is to generate predictions. [24]

[24] Notturno (1998, p. 412, emphasis added) argues that the `problem of situational analysis in the theoretical and historical social sciences, in Popper´s view, is not to construct models that predict or prophesize the future; it is to construct models that help us to *explain and understand the past´*.

To finish off this section, a clear example of this tension between PTKL and *RPs* is the Keynesian-type business cycle theory proposed by Minsky (1975) which is based on overoptimistic expectations of economic agents about their ability to honour future cash commitments which result from their inherited liability structure. According to Minsky´s `financial instability hypothesis´ (*op. cit.*), market economies are intrinsically unstable owing to the fact that economic agents become *systematically* overoptimistic during the upswing which makes them take on an excessive amount of debt and this eventually triggers off an asset price deflation and a subsequent financial crisis that precipitates the economy into a downswing. In other words, Minsky´s theory posits that, as memories from the last financial crisis fade out, agents will tend to underestimate the risk implied by the increase in the level of real indebtedness so that the upswing ends up when an external factor, e.g., an increase in interest rates, leads to an initial decrease in the price of real and financial assets which then brings about a reassessment of liability structures and, finally, leads to an asset price deflation. In other words, Minsky´s theory is an example of business cycle theory where (i): there is a discrepancy between the theoretician´s `objective´ view of P-S and agents´ view of P-S, and (ii) it is (implicitly) assumed that agents tend to repeat their past mistakes so the same phenomenon (i.e., business cycles), occurs recurrently and inevitably.

4.1.2. PTKL *versus* the `objectivist´ version of SA

According to Hands (1992, p. 28), `it is easy to see that situational analysis is the method of microeconomics (and of any macroeconomics based on micro foundations)´. Indeed, Popper recognizes that his source of inspiration for *SA* is the methodology of neoclassical microeconomics (Popper, [1943*a*] 1966,

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In this respect, Popper seems to view *RPs* as being particularly suited to the task of historical explanation:

`The historian´s task is, therefore, so to reconstruct the problem situation as it appeared to the agent, that the actions of the agent become *adequate* to the situation… Our conjectural reconstruction of the situation may be a real historical discovery. It may explain any aspect of history so far unexplained´ (Popper, 1972, p. 189).

Furthermore, Popper (*op. cit.*, p. 166, emphasis in original) explains that `the fundamental problem of both the theoretical and the historical social sciences is *to explain and understand events in terms of human actions and* [typical] *social situations´* and, hence, does not mention the generation of *predictions* as one of the aims of the social sciences.

p. 97; 1944-45, p. 82; 1976*a*, p. 93; 1976*b*, 117f).[25] However, on those few occasions when Popper makes it clear that he intends to extend the methodology of neoclassical economics to the rest of the social sciences he seems to have in mind the `objectivist´ *SA*. That said, some commentators have noticed that the rationality requirements are more demanding if *RPo* rather than *RPs* is adopted (Latsis, 1983; Farmer, 1998; Oakley, 1999; Vanberg, 2002). Notably, and in addition to fulfilment of 'means-rationality' and 'ends-rationality', *RPo* implies the fulfilment of 'beliefs-rationality'. The combination of these three types of rationality yields a type of rationality known as 'substantive rationality' (*SR*) (Simon, 1976). *SR* is a notion of rationality that is concerned solely with the *consequences* or outcomes of rational choice. Specifically, Simon (1976, p.130) denotes human behaviour as being substantively rational 'when it is appropriate to the achievement of given goals within the limits imposed by given conditions and constraints'. Thus, as with classical decision theory, the interest lies not so much in *how* decisions are made but in *what* decisions are made. In short, *SR* constitutes a special case of *RPo* in so far as, in addition to consistent and purposeful behaviour, it is assumed that *agents´ beliefs are correct on average*. As we have noted above, it is this approach to human rationality that lies at the core of the maximization assumption in neoclassical economics. Indeed, some scholars have argued that *RPo* is the key principle that underlies the methodology of mainstream economics (Farmer, 1998; Oakley, 1999).[26]

4.1.2.1. Rationalizing the `objectivist´ version of SA

Now, one can rationalize *RPo* as a *methodological decision* according to which the theoretician assumes beforehand that the mistakes made by agents (by `mistakes´ we mean decisions that are adequate from the point of view of P-S as seen by the agents but *inadequate* from the viewpoint of the P-S as seen by the theoretician) *are declared to be less interesting for the purpose of understanding agents´ behaviour*

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25 It is clear that Popper admired Neoclassical Economics. For instance, he writes that: `The social sciences never had for me the same attraction as the theoretical natural sciences. In fact, the only theoretical social science which appealed to me was economics´ (Popper, 1976*a*, p. 121). Notwithstanding it, Blaug (1985, p. 287) argues that `Popper knew little about social sciences and less about economics´.

26 For instance, Farmer (1982, p. 179) argues that the `rationality assumption´ is in the `hard core´ of the (Lakatosian) economist´s research programme. Matzner & Jarvie (1998) even suggest that Popper´s *SA* represents a *soft* version of `economic imperialism´ yet to be distinguished from a *strong* version they associate with the work of Gary Becker. In any case, they recognize that it was Popper — and not Gary Becker — who first formulated a programme for extending the logic of economics to the noneconomic social sciences (*op. cit*., p. 336).

and, especially, for generating predictions than the modelling mistakes made by the theoretician. In other words, a rationale for *RPo* is that, although agents´ mistakes cannot be ruled out *a priori* — so *RPo* would be compatible with fallibility — nevertheless the theoretician *chooses to ignore the former for methodological reasons*. What are these reasons? First, that the theoretician *gains little*, if anything, by learning that agents make mistakes because (i) she already knows it and, more importantly, (ii) that the nature of the mistakes agents make is likely to change over time in an *unpredictable* way and so learning about them is of little help for the purpose of generating predictions. To be sure, learning about the mistakes agents have made in the past may be helpful if we have the assurance that the *same* mistakes (i.e., mistakes triggered off by the very same factors) will be repeated in the future. As we explained above, it is this scenario that may justify the adoption of *RPs*. However, if such condition is not satisfied, there is arguably little we can learn from the mistakes made by agents in the past other than for the purpose of historical analysis. A second reason for adopting this methodological decision would be that, if that decision were not adopted then, in the wake of an erroneous prediction of the model the theoretician might be tempted to *sidestep* its falsification by arguing that agents´ beliefs and decisions were, on a particular episode — the one that was subject to the test — different from what one would `objectively´ expect and to utilize this `anomaly´ as a justification for the (adverse) result of the empirical test. By contrast, if *RPo* is adopted, the *onus of proof* will inescapably rest on the theoretician´s view of P-S.

According to the rationale for *RPo* we have suggested above, ascribing a role to agents´ errors in the situational model (i.e., to discrepancies between their view of P-S and the theoreticians´ view of P-S) will prevent us from generating predictions unless agents´ errors are predictable. Yet, one possible reason why agents´ errors may actually be unpredictable is that agents may `learn´ from their past mistakes so that their future mistakes will tend to *differ* from previous ones. Thus, in order to generate predictions, a hypothesis which assumes that agent´s view of P-S does not coincide with the theorist´s view of it (i.e., *RPs*) will need to be coupled to an additional assumption according to which agents´ errors tend to persist over time and, hence, are *predictable*. However, to the extent that this assumption implies that agents do not `learn´ from their mistakes, it is in conflict with PTKL. To be sure, if agents `learn´ from their previous mistakes so that they do not repeat them, their future mistakes will tend to *differ* from their previous mistakes and, unless the range of potential mistakes is limited, their

future mistakes will thus be unpredictable. By contrast, if the theoretician adopts *RPo* instead of *RPs*, this problem does not arise because there is no presumption that agents´ view of P-S differs from the theoretician´s. As we will argue below, the adoption of *RPo* actually implies the *imposition* of the theoretician´s view of P-S upon agents. Does this mean that there is no tension between the `objectivist´ version of *SA* and PTKL? We believe not. Firstly, PTKL only implies that agents `learn´ by trial and error-elimination so that behaviour that is rational according to PTKL is not necessarily appropriate to the `logic of the situation´ faced by agents. To be sure, the errors that agents made in the past occurred in the environment that surrounded them at that time so if the latter changes in an unpredictable way agents may well make new (and different) errors, i.e., they may make decisions that are not appropriate to the `logic of the situation´. Secondly, since the theoretician´s view of P-S does not necessarily coincide with agents´ view of it, several further assumptions will need to be made to justify the *coincidence* of the theoreticians´ and agents´ views. These additional assumptions are presented and discussed below. In any case, we may anticipate that these assumptions are problematic in the sense that if it is assumed that agents behave according to PTKL it is doubtful that their decisions will be appropriate to the `logic of the situation´ as it is seen by the theoretician, even on average. In short, the nature of tension between PTKL and *RPs* differs from the nature of tension between PTKL and *RPo* in that, in the former case, tension stems from the fact that the adoption of *RPs* implies that agents tend to *repeat* the same mistakes they made in the past in a way that is hardly compatible with `learning´ by trial and error-elimination as posited in PTKL whereas, in the latter case, it is simply assumed that agents´ view of P-S coincides, at least on average, with the theoretician´s view of P-S so that their behaviour is always appropriate to the objective `logic of the situation´ yet, as we will argue below, the mechanisms by virtue of which such coincidence is justified can hardly be reconciled with PTKL.

4.1.2.2. How do the views of the agents and the theoretician tend to converge?

Next, we have suggested above that the adoption of *RPo* implies *de facto* the *imposition* of the theoreticians´ view of P-S upon agents´. However, scientists do not usually see things this way. An example is mainstream economics where a number of mechanisms have been suggested in the literature to (implicitly) justify the adoption of *RPo*. To be sure, such mechanisms are seemingly viewed by mainstream economists as reasons why they need not care about agents´ beliefs when reconstructing P-S because an `objective´ P-S can be said to exist `out

there´ that is *sufficiently* independent of agents´ beliefs so that the theoretician can reconstruct P-S as she sees it. There are two mechanisms through which the neglect of agents´ beliefs by the theoretician is normally justified: (i) the operation of the `law of large numbers´ in the social domain, and (ii) the presence of `learning´ by individuals. However, as we show below, both mechanisms are problematic. Let us address the first mechanism. According to it, agents´ decisions may turn out to be objectively wrong in retrospect but nevertheless their *mistakes will tend to cancel each other out provided the number of individuals is large enough*. The former implies that the scope for fallibility at the aggregate level in this version of *RPo* is negligible since it is restricted to random mistakes associated to transitory factors. There is textual evidence which suggests that some influential social scientists have implicitly resorted to this mechanism to justify the adoption of *RPo*. For instance, Nobel Laureate in Economics John Hicks (1956, p. 55) writes that `the preference hypothesis [in the context of neoclassical utility theory] only acquires a *prima facie* plausibility when it is applied to a statistical average´. More explicitly, Gibbard & Varian (1978) describe optimizing behaviour by individuals as capturing the 'central tendency' of economic behaviour or:

'If deviations are random or more precisely, are not systematic, there might be good reason to have some faith in the conclusions of the [economic] model even though the assumptions, strictly interpreted, are implausible. Perhaps a case in point is the economist´s assumption of perfect optimizing behaviour. Of course, this assumption is strictly speaking, false, but, so long as errors in optimization are not systematic, this hypothesis may be useful in describing the "central tendency" of economic behaviour. Furthermore, in models where individual units´ behaviour is being aggregated, non-systematic errors may be expected to "wash out" in the process of aggregation' (*op. cit.*, p. 670).

Likewise, it has been argued in the sphere of sociology that it is not necessary to claim that all agents optimize but, instead, that the tendency to optimize is the most important *non-idiosyncratic* factor at work so that the operation of a sort of 'law of large numbers' guarantees that optimizing behaviour dominates (Goldthorpe, 1998, p. 169). We believe this assumption (i.e., the `law of large numbers´) implicitly lies at the core of neoclassical economics where agents are modelled *as if* they were infallible – when they exhibit perfect foresight – or as if their mistakes were random (Muth, 1961). More specifically, this assumption is implied when the optimizing assumption is be applied in modelling exercises. However, the `law of large numbers´ in statistics assumes that the different trials

of a stochastic process are: (i) independent and, crucially, (ii) have the *same* distribution so that, as the number of such trials tends to infinity, the probability distribution of a random variable *concentrates* around the finite expected value of each of the trials.

Now, it is unlikely that these conditions will be satisfied in the case of agents´ view of P-S. For one thing, there are likely to be significant interdependencies among agents´ (subjective) view of P-S owing to the presence of conventional elements so that condition (i) is likely to be violated. Further, agents´ (subjective) view of P-S may differ substantially from others agents´ which also violates condition (ii). Thus, the conditions for reliance on the `law of large numbers´ as it exists in statistics for the purpose of providing a rationale for the coincidence, on average, between agents´ view of P-S and the theoreticians´ view of P-S are not warranted. Consequently, the adoption of *RPo* can only be justified on *strict* methodological grounds. That said, we believe that some advocates of *RPo* assume that if the theorist´s view of P-S diverges significantly from agents´ view of P-S such discrepancy will tend to be eliminated over time by means of other mechanisms such as: (i) trial and error-elimination, and (ii) imitation of successful strategies by agents. In other words, advocates of *RPo* may argue that the occurrence of learning at the individual level based on trial and error-elimination or the imitation of the successful strategies of others will make agents´ view of P-S eventually converge to the theorist´s (objective) view of P-S so that, for the sake of analytical convenience, we may freely assume that agents´ beliefs are correct. However, the imitation of successful strategies requires that some other agents have previously `learnt´ to perform some tasks adequately so that the presence of some kind of learning is a *sine qua non* condition for the imitation of successful strategies to allow some other agents to make decisions that are appropriate to the `logic of the situation´. Thus, for the sake of simplicity, we will leave aside the latter. In other words, the theorist assumes in this case that the operation of a *negative* feedback mechanism whereby agents systematically revise their beliefs until the latter coincide with the theoretician´s view of P-S justifies the adoption of the methodological decision to assume that agents´ beliefs are eventually correct. In short, `learning´ is the second mechanism (additional to the `law of large numbers´) by means of which mainstream economists may try to justify the assumption that agents´ view of P-S coincides with the theorist´s.[27]

[27] An alternative rationale to agents´ learning process for the adoption of the optimization assumption in mainstream economics is the 'natural' selection argument. This argument was originally

For instance, Nobel Laureate R. Lucas characterizes the type of situations on which economic theory focuses as the *end-result* of an adaptive learning process:[28]

'Economics has tended to focus on situations in which the agent can be expected to "know" or to have learned the consequences of different actions so that his observed choices reveal stable features of his underlying preferences… Technically, I think of economics as studying decision rules that are steady states of some adaptive process, decision rules that are found to work over a range

proposed by Alchian (1950) in the context of economic competition and since then it has been advocated by a number of neoclassical theorists. Alchian (*op. cit.*) views the economic system as an *adoptive* mechanism which cleverly chooses among actions generated by the adaptive pursuit of `profits´. His argument starts with the premise that the realization of profits is the criterion according to which successful firms are selected. However, he admits that this process may be *independent* of the nature of the decision-making processes of economic agents. In particular, he recognizes that economic success does not require proper motivation but may instead be the outcome of fortuitous circumstances. Further, to the extent that profits accrue only to those firms who are better than their competitors, what matters for survival is one's competitiveness *relative* to the others rather than their absolute proximity to an optimum. Nevertheless, he recognizes that conscious or purposeful behaviour (in addition to sheer chance) also plays a role in the selection of firms by the market. Two such examples of purposeful behaviour are: (i) imitation of strategies previously adopted by successful firms, and (ii) the adoption of trial and error strategies aimed at improving one's adaptation to the environment. However, he makes it clear that the former should *not* be understood as mechanisms through which adequate or `rational´ actions can be selected thereby allowing firms to converge to an optimum in the form of profit maximization. This is because the latter would require the fulfilment of the two following convergence conditions (Alchian, 1950, p. 219): (i) that every single trial must be classifiable either as a success or as a failure, and (ii) the continual rising toward some *optimum optimorum* without the occurrence of intervening descents. In this respect, he writes:

'These convergence conditions do not apply to a changing environment, for there can be no observable comparison of the result of an action with any other… As a consequence, the measure of goodness of actions in anything except a tolerable-intolerable sense is lost, and the possibility of an individual´s converging to the optimum activity via a trial-and-error process disappears. Trial and error becomes survival or death. It cannot serve as a basis of the *individual´s* method of convergence to a "maximum" or optimum position.' (*op. cit.*).

The upshot of Alchian´s discussion is that successful adaptation within a stable environment may give *ex-post* the appearance of rational or optimizing behaviour at the individual level *even though no ex-ante rational calculation actually occurred*. Further, and as Loasby (1999, pp. 20-21; see also Vromen, 1995, pp. 32-33) insists, the economic `survival´ argument can only allow its advocates to claim that surviving firms will have achieved results which are, on average, *closer* to the maximisation of profits than those firms that did not survive and, hence, it does not allow them to use it as a justification for the occurrence of optimization at the *individual* level as Friedman (1953, p. 22), for instance, does. Although with significant qualifications, developments of Alchian´s argument can be found in Friedman (1953) and Becker (1962) and critical assessments of the `survival´ argument are in Vromen (1995), Loasby (1999) and Lagueux (2010).

28 By contrast, Arrow (1986, p. S385) criticizes the view that the optimizing assumption can be justified as being the result of a process of learning and adaptation.

of situations and hence are no longer revised appreciably as more experience accumulates…' (Lucas, 1986, p. 218).

However, for this feedback mechanism to be *effective*, it is necessary that: (i) the former is fast and accurate enough, and (ii) P-S remains constant until the convergence process has been completed.[29] Yet, as Tversky & Kahneman (1986, p. 90) insist, such conditions rarely arise in the real world. In particular, the former can hardly be satisfied when agents make decisions in a changing environment in which it is hard to ascertain whether an observed outcome is a direct consequence of our decisions or a consequence of someone else´s decisions. Furthermore, Popper (1994, p. 4) insists that *no optimal state of adaptation* is ever reached by the application of the method of trial and error-elimination owing to: (i) the continuous *change* in the environmental situation, and (ii) agents´ inability to eliminate all their errors. That said, we believe that it is the reliance on the alleged efficacy of `learning´ at the individual level that makes some scientists implicitly assume that any negative result that occurs in the wake of empirical tests can be ascribed only (or mainly) to their *own* modelling mistakes (i.e., to their own failure to capture the `objective´ P-S properly) rather than to agents´ mistakes. Thus, although *RPo* accounts for the presence of learning, it exhibits some clear differences with PTKL in that `learning´ at the individual level is unlikely to warrant that agents´ decisions will be adequate to the `logic of the situation´ as it is *seen by the theoretician*.

4.1.3. The dichotomy between `rational´ and `irrational´ behaviour

The notion of rationality that is concerned with the *consequences* or outcomes of rational choice is known as 'substantive' rationality (SR). Specifically, Simon (1976, p. 130) identifies human behaviour as being substantively rational 'when it is appropriate to the achievement of given goals within the limits imposed by given conditions and constraints'. According to this definition, rational behaviour is a type of purposeful or intentional behaviour directed towards a goal, e.g. the maximization of utility. As with classical decision theory, the interest lies not so much in *how* decisions are made but in *what* decisions are made. According to Simon (1965, p. 84), theoretical models based on 'substantively' rational

[29] Wible (1984-85, p. 271) characterizes the approach to decision-making and expectations formation embedded in neoclassical economics as one of *instantaneous rational assessment* and hypothesizes that its origin is the emphasis in the 'logic of justification' of knowledge rather in the 'process of discovery' of knowledge made by proponents of the logical positivist school of philosophy.

individuals share a common framework characterised by: (i) a set of alternative courses of action that are available to the individual, (ii) (perfect) knowledge that permits the individual to predict the precise consequences of choosing any possible alternative[30] and (iii) a clear criterion for determining *which* set of potential consequences she prefers. In such models, rationality is usually defined as 'the ability of actors to select that course of action which leads to the most preferred set of predicted consequences' (*op. cit.*).[31] SR thus assumes that the surrounding environment is either known or knowable (i.e., the stochastic environment is stable), and individuals have sufficient cognitive abilities to deal with a complex reality. SR is the type of rationality actors are assumed to exhibit in those models that adopt strong versions of *RPo* such as the ones that prevail, for instance, in mainstream economics. In particular, agents who exhibit SR must fulfil ends-rationality, means-rationality, and beliefs-rationality. This is shown in the third row of Table 1 below. In turn, this implies that behaviour that falls short of maximizing is deemed 'irrational' (Becker, 1962). Specifically, a violation by agents of either means-rationality or beliefs-rationality is interpreted in mainstream economics as signalling `irrational´ behaviour. Likewise, Popper ([1943*a*] 1966, p. 97) explains that `when we speak of "rational behaviour" or of "irrational behaviour" then we mean behaviour which is, or which is not, in accordance with the logic of the situation´. Thus, Popper´s notion of rationality in the context of *SA* bears, arguably, a strong resemblance to the notion of rationality in mainstream economics.

That said, we believe that the charge of `irrationality´ is a direct implication of the adoption of *RPo* and, particularly, of the *imposition* upon agents of the theoretician´s view of P-S. More specifically, we believe that the `irrationality´

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30 In the absence of perfect foresight, the notion of 'substantive' rationality usually requires the existence of a stable stochastic environment that allows individuals to confidently extrapolate the past into the future as in, for instance, 'subjective expected utility' (SEU) theory.

31 Although Hayek (1967a, p. 89) does not mention the term SR explicitly, he seems to have this notion in mind when he characterises the approach to rationality inherent in the philosophical tradition he denotes as `constructivist rationalism´ and which is no other that the Cartesian tradition which is directly related to Descartes and goes back at least as far as Plato in Ancient Greece and whose main representatives are, according to him, Hobbes, Rousseau, Voltaire, Hegel and Marx. In particular, he describes the approach to rationality embodied in this approach as follows:

`In moral philosophy the constructivist rationalism tends to disdain any reliance on abstract mechanical rules and to regard as truly rational only behaviour such as is based on decisions which judge each particular situation "on its merits", and chooses between alternatives in concrete evaluation of the known consequences of the various possibilities´ (op. cit., emphasis added).

charge that is applied to those agents who fail to maximize (a given pre-specified objective function) obeys ultimately to a failure to distinguish between the `rationality of the theoretician´ and the `rationality of agents´. For instance, the implicit assumption by mainstream economists that agents´ subjective view of P-S *coincides*, at least on average, with the theoretician´s view of P-S logically implies that behaviour that falls short of the rationality standard ascribed to the theoretician is `irrational´. However, we believe that if agents´ view of P-S does not coincide with the theoretician´s then the former cannot be blamed for being `irrational´. In particular, an individual cannot be said to be `irrational´ if her beliefs are incorrect. Rather, as PTKL has it, she can only be said to be `irrational´ if she refuses to revise her (wrong) beliefs.

The counterpart to SR is the notion of 'procedural' rationality (PR). According to Simon (1976, p. 131), 'behavior is procedurally rational when it is the outcome of appropriate deliberation'.[32] PR shifts attention from the consequences of choice to the *process* of choice where the emphasis is placed in the presence of a decision process based on the use of simple heuristics or 'rules of thumb'.[33] PR can thus be characterised as the ability of actors to use simple heuristics that are *adequate* for a specific purpose. Reliance on simple heuristics to make decisions assumes that, most of the time, actors face situations characterised by (i) Knightian uncertainty (Knight, [1921]1971), or (ii) where the 'optimal' solution is intractable. The former corresponds to scenarios where either we do not have an exhaustive list of potential consequences of a certain decision or else to situations where, even if such list were available, it is impossible to attach numerical probabilities to them. In turn, the latter corresponds to situations where there are insurmountable constraints on the ability of agents: (i) to identify optimal actions given a set of beliefs and desires, and (ii) to acquire the information that is relevant to the problem at hand. In contrast, SR implies that agents make decisions by following

32 Note the similarity of this definition with Koertge´s (1975) reformulation of *RP* provided above.

33 PR is coupled to its sister notion of 'bounded' rationality (BR). According to Simon (1979), economic agents´ knowledge is subject to three different types of constraints: (i) limited ability to process, analyse, and store information, (ii) uncertainty, and (iii) the presence of social institutions. BR stems from the fact that the existence of these constraints prevents economic agents from 'optimizing'. Simon coined the term 'satisficing' to denote a decision-making rule that attempts to meet an acceptability (minimum) threshold. In contrast to 'satisficing' behaviour, the purpose of optimal decision-making is to find the best option available.

the prescriptions of Bayes's rule or by maximizing expected utility, as in SEU theory.[34]

Now, we believe PR captures properly the type of rationality implied by PTKL. As we noted above, the acquisition of knowledge in Popper's account runs parallel to the *process* of adaptation to a partly unknown (and changing) environment in which some of the errors made in the past by individuals are purged by virtue of a learning process that consists essentially of subjecting their hypotheses or conjectures to trial and error-elimination. Crucially, Popper emphasises that our adaptation to the surrounding environment is often successful and often unsuccessful. More specifically, some errors will *escape* and this possibility is one of the reasons our knowledge is always fallible (Popper, 1990, p. 47). In turn, Popper (1994, p. 4) insists that the systematic application of the method of trial and error-elimination will not result in an 'optimum' adaptation to the surrounding environment. Instead, and due to the partial elimination of errors, our adaptation to the environment is always *imperfect*. It follows from this that the observed states of adaptation *can never be the result of convergence to an optimum*. Should *all* errors be systematically purged and the environment be stable, the process of adaptation to the latter would eventually be perfect and only then could the state of adaptation be interpreted as the outcome of a convergence to an optimum. In this scenario, individuals would be fallible only to the extent that the changes in the environment cannot be fully anticipated. The method of trial and error-elimination thus consists of an adaptation mechanism whereby errors tend to be eliminated and new hypotheses are then subject to trial. As some commentators note (Kerstenetzky, 2009; Lagueux, 2006), the watershed between `rational´ and `irrational´ behaviour in PTKL is marked by the *unwillingness of agents to correct their wrong beliefs* or, as it were, by the *incorrigibility* of their beliefs. This is clearly stated by Popper in the following quotation:

`The main distinction, I suggest, is that a healthy person´s beliefs are not incorrigible: a healthy person shows a certain readiness to correct his beliefs. He may do so only reluctantly, yet he is nevertheless ready to correct his views under

[34] According to Volz & Gigerenzer (2012, p. 1), most of the time we make decisions under Knightian uncertainty, while situations of known risk are relatively rare and found mostly in gambling. They note that Savage (1954, p. 16), one of the fathers of the theory of choice under uncertainty, made it clear that applying Bayesian theory to decisions in uncertain worlds would not make sense because there is no way to know all alternatives, consequences, and probabilities. Likewise, Arrow (2004, p. 54) argues that in uncertain, ill-specified worlds, maximization of expected utility 'has no meaning at all'.

the pressure of events, of the opinions held by others, and of critical arguments… the mentality of the man with definitely fixed views, the "committed" man, is akin to that of the madman… but *in so far as he is committed, he is not rational*′ (Popper, 1985, p. 364; 1994, p. 180, emphasis added).

This suggests, as noted above, that there are two different notions of rationality in Popper´s work: (i) behaviour that is in accordance with the `logic of the situation´ (Popper, [1943*a*] 1966, p. 97; 1944-45, sections 31 & 32), and (ii) willingness to revise one´s wrong beliefs (Popper, 1985, p. 364. We have argued above that there is a certain tension between these two notions of rationality when the relation is approached from the standpoint of the `rationality of the agents´ and we will argue below that there is no such tension when the relation is approached from the standpoint of the `rationality of the theoretician´.

Next, unlike models based on *RPo*, both praxeology and models based on *RPs* imply that agents´ view of P-S may be mistaken and, hence, that their decisions may turn out to be wrong *ex-post*. In the case of *RPs*, the theoretician is assumed to adopt the viewpoint of actors and, thus, she is supposed to be able to distinguish between her own view of P-S (i.e., the `rationality of the observer´) and agents´ view of P-S (i.e., the `rationality in the observed´). Further, in the case of models based on *RPs*, agents are assumed to exhibit means-rationality (in addition to `ends-rationality´) which implies that their mistakes can only be ascribed to wrong beliefs and not to an inconsistent or inadequate behaviour *given* the information available to them. However, as far as agents are concerned, there is no mechanism that ensures an adequate, let alone an efficient, use by them of the available information regardless of the accuracy of the latter. Rather, decision-making in a context of pervasive uncertainty can only be the result of a process of systematic deliberation by agents. In other words, although we cannot rule out that a *given* correct decision is the outcome of sheer chance, it is much more likely that correct decisions given the knowledge and information that agents possess will be the result of agents´ systematic deliberation. Therefore, the type of rationality agents exhibit if *RPs* is adopted can be denoted as `procedural´. In turn, this implies that PTKL and *RPs* share the feature that agents are *fallible*, i.e., their beliefs may be wrong *ex-post*. By contrast, as we explained above, agents´ fallibility is negligible in case *RPo* is adopted since, *a priori*, individuals can make mistakes but their mistakes are assumed to cancel out at the aggregate level.

Now, by adopting *RPs* the theoretician seeks to identify agents´ partially wrong beliefs and thus to explain their behaviour accordingly (i.e., by stressing

the divergence of agents´ behaviour from what one would expect if their beliefs were correct). By contrast, it is quite unlikely that the theorist can provide a `rational´ reconstruction of agents´ apparently wrong behaviour by pointing instead to their *inadequate* behaviour given their *correct* beliefs (i.e., to absence of means-rationality). To be sure, to provide such an account of agents´ inadequate behaviour by appealing to the notion that some agents exhibit, for instance, miopic behaviour or weak (or lack of) will, implies a large element of psychologism and, hence, a loss of inter-subjectivity, accountability, and transparency in theoretical analysis. Further, such a diagnose of inadequate behaviour as based on a violation of the assumption of means-rationality may apply to some or even to very few individuals but certainly it will not apply to the majority of them which, according to us, precludes its use in the social sciences. This suggests that, even though it is *not* true that agents always make an adequate use of the information that is available to them and, to the extent that we accept as universally valid the assumption that agents´ behaviour is always goal-oriented, it is unclear whether we can speak of a dichotomy between `rational´ and `irrational´ behaviour by agents in models which adopt *RPs.* By contrast, to the extent that agents only exhibit ends-rationality in praxeologic models, we cannot speak of the existence of such a dichotomy in the latter. All this is illustrated in Table 1 below.

Approach	Beliefs	Rationality	Dichotomy
Praxeology	Right or wrong ex-post	Ends-rationality (instrumental)	No
Subjectivist SA	Right or wrong ex-post	Ends & means-rationality (procedural)	?
Objectivist SA	Right `on average´	Ends, means & beliefs-rationality (substantive)	Irrationality ⊢ failure of either means or beliefs-rationality (or both)
PTKL	Right or wrong ex-post	Ends-rationality (procedural)	Irrationality ⊢ incorrigibility

Table 1. *Classification of approaches to rationality*

Finally, let us note that it is the existence or otherwise of a dichotomy between `rational´ and `irrational´ behaviour by agents in the context of *SA* that was the object of an exchange between Nadeau (1993) and Lagueux (1993, 2010). In their contributions, which focus on the epistemological status of *RP*, Nadeau

(1993) first argued that *RPs* is the correct interpretation of Popper´s Rationality Principle and subsequently argued that the former is a metaphysical statement and, as such, it is *a priori* true and irrefutable. By contrast, Lagueux (1993) held that *RP* should rather be interpreted as a methodological principle and, hence, that it is false but approximately true in the sense there may be some instances where it does not hold. Nevertheless, he (as Popper does) believes that *RP* is a sufficiently good approximation to the truth and defends a sort of `statistical´ justification of *RP* in so far as he points out that `the rationality principle can be said to be "approximately true" only to the extent that it applies to a large number of cases´ (Lagueux, *op. cit.*, p. 475). Both authors make use of Popper´s example of the `flustered driver´ to substantiate their arguments:

`For the rationality principle seems to me to be clearly false – even in its weakest zero formulation, which may be put like this: "Agents always act in a manner appropriate to the situation in which they find themselves."… In think one can see easily that this is not so. One has only to observe flustered drivers trying to get out of a traffic jam, or desperately trying to park their cars when there is hardly any parking space to be found, or none at all, in order to see that we do not always act in accordance with the rationality principle… Moreover, there are, obviously, vast personal differences, not only in knowledge and skill – these are part of the situation – but also in assessing or understanding a situation; and this means that *some people will act appropriately and others not´* (Popper, 1985, p. 361; 1994, p. 172, emphasis added).

Building on this Lagueux comments:

`Suppose that we try to explain the [Popper´s] example of the flustered driver using the rationality principle as understood by Popper, that is to say, as a principle that *is empirical and false*. It is clear that, in such a case, the rationality principle *could* be held responsible for the failure of an explanatory theory that was supported by it´ (Lagueux, 1993, p. 475).

By contrast, Nadeau (1993) writes:

`It seems to me to be evident that the *RPs* is logically irrefutable, in exactly the same way that, for Popper, probabilistic assertions or metaphysical statements are irrefutable... My critique of Popper can be clarified further by a brief examination of his example of the flustered driver... Popper uses this example to falsify the *RP*, but how does this example work exactly? It merely makes it apparent that the real or objective situation is such that, in spite of the fact that there are no

available parking spaces, the driver persists in trying to park his car. However, it is rather surprising that, in his analysis of the situation, Popper does not connect the irrationality of the driver to the *contradiction* between the information that the latter has at his disposal and the chosen course of action. For if the driver does not know or does not believe that the parking space where he is desperately trying to park his car is insufficient, then his behavior does *not* contradict the *RPs´* (Nadeau, 1993, pp. 461-62, emphasis added).

In an attempt to clarify this controversy Lagueux (2010, pp. 104f) notes that, the `flustered driver´ in Popper´s example, represents an atypical behaviour that cannot be excluded and that such behaviour can be said to be irrational. However, he recognizes that, `if we base our judgement *on the description alone*, we cannot be sure that the flustered driver´s action is really irrational´ (*op. cit.*, p. 104). This is because we can *never* be certain that the agent sees P-S in a way that renders his behaviour appropriate. In other words, according to Lagueux (*op. cit.*) the same behaviour can be interpreted as either `rational´ or `irrational´ depending on the *observer´s viewpoint*. We thus believe Lagueux (*op. cit.*) ultimately admits that there is no objective or neutral way of deciding whether someone actually exhibits `means-rationality´ when there is no assurance that her beliefs are correct, i.e., when she does not exhibit `beliefs-rationality´. We conclude that, in the particular case of *RPs*, the dividing line between `rational´ and `irrational´ behaviour is unclear.

4.1.4. What version of RP is `preferable´ in the social sciences?

The theoretician´s methodological decision to ignore agents´ mistakes if *RPo* is adopted implies, for the reasons expounded above, assuming that agents´ (subjective) view of P-S *converges* over time to, or else, does not diverge in a significant way from the theoretician´s view of P-S. More specifically, we argued above that the adoption of *RPo* implicitly implies the *imposition* upon agents of the theoretician´s view of P-S. By contrast, and despite the above-mentioned tension between PTKL and *RPs*, we believe that *a more natural strategy in the theoretical social sciences is to adopt agents´ view of P-S*. There are at least three reasons for this. First, as Popper (1972, p. 179) admits, both the theoreticians´ and agents´ view of P-S are *conjectured*. Second, and more important, there is Hayek´s notion that, unlike the facts of the natural sciences — which are largely independent of the theoretician´s viewpoint — the `facts´ of the social sciences are all *interpretations*

(Hayek, 1943).[35] That is, according to Hayek, the concepts we use in the social sciences are not just abstractions like the ones used in the physical and natural sciences but they abstract from all the physical characteristics of the objects they refer to. Hayek (*op. cit.*, p. 3) denotes the concepts we use in the theoretical social sciences as `teleological´ because, as he explains, such concepts can only be defined by postulating relations between three different terms: (i) a purpose, (ii) somebody who holds it, and (iii) an `object´ which the person in question thinks to be a suitable means to achieve that purpose. As he explains:

`We could say that all these objects are defined not in terms of their "real" properties but in terms of *opinions* people hold about them. In short, in the social sciences *the things are what people think they are*. Money is money, a word is a word, a cosmetic is a cosmetic, if and because somebody thinks they are. That this is not more obvious is due to the historical accident that in the world in which we live the knowledge of most people is approximately similar to our own… We are likely, for example, to think of the relationship between parent and child as an "objective" fact. But, when we use this concept in studying family life, what is relevant is not that x is the natural offspring of y but that either or both believe this to be the case (*op. cit.*, emphasis added).

Third, Hayek (*op. cit.*) also argues that in the type of P-S analysed in the social sciences agents´ *interpretation* of P-S becomes an `integral´ part of the latter thereby affecting subsequent developments. In particular, to the extent that agents understand P-S via the internal models they create for that purpose, their understanding of the former will affect their decisions and, through this route, they *may affect P-S itself*. Let us use the example of `bank panics´ to illustrate this idea. The occurrence of a `bank panic´ in a private bank is not necessarily related to the *actual* liquidity position of the bank. Rather, the occurrence of a `bank panic´ is more likely to depend on its depositors´ view about the ability of the bank to cash their deposits on demand. If depositors have doubts about the ability of the bank to comply with its obligations when the former attempt to withdraw money from their accounts (and *regardless* of the `true´ liquidity position of the bank), a `bank panic´ will likely ensue and the bank will *actually* become illiquid. This is not to deny that depositors commonly take into account the `objective´ indicators related to the liquidity of the bank when evaluating the likelihood of the private bank going illiquid. Rather, our argument is that

[35] This idea is discussed in detail also in Hayek (1942).

what really matters as far as depositors´ decisions are concerned is not the (objective) information provided by the liquidity indicators but agents´ (subjective) evaluation of them. However, if the latter affects the former, then P-S is *not independent of depositors´ views* and, at least in this example, it is not sound to argue that there is an `objective´ P-S which is, in principle, knowable by the theoretician but *not* by the agents. This idea, we believe, is captured in the following comment by Hayek:

`Perhaps the relevant distinction comes out most clearly in the general and obvious statement that no *superior* knowledge the observer may possess about the object, but which is not possessed by the acting person, can help us in understanding the action in question´ (*op. cit.*, emphasis added).

Unlike the presupposition by social scientists (and Popper) that the theoretician possesses a *wider* perspective of P-S than agents do, Hayek (*op. cit.*) suggests that, since P-S depends on agents´ interpretation no matter whether the latter is right or wrong, it follows that the theoretician does not stand in a privileged position to observe the `objective´ P-S. Thus, and for these reasons, we believe that the `natural´ strategy for the theoretician is to seek to capture P-S *as agents see it*. That is to say, if there is not an `objective´ P-S that is (fully) independent of agents´ views, then the theoretician has a better chance of understanding social phenomena if she adopts agents´ viewpoint. This is not to deny, however, that there may be some circumstances in which the theoretician may prefer instead, for methodological reasons, to adopt *RPo*. In particular, there may be circumstances where P-S may be sufficiently independent from agents´ beliefs as to make it convenient to adopt *RPo*. Be that as it may, the adoption of *RPo* will actually imply the *imposition* of the theoretician´s view of P-S upon agents or, as Schumpeter (1984) would put it, the model will capture the `rationality of the theoretician´ instead of the `rationality in the observed´.

Now, the former discussion suggests that *RPo* represents a *limit* or *extreme* case of *SA*. In particular, we believe *RPo represents a limit case of SA based on the implicit assumption that P-S is (fully) independent of agents´ beliefs* and that, consequently, the theoretician can acquire `objective´ knowledge about P-S that is, somehow, *superior* to agents´. By contrast, Hayek´s ideas on the nature of the `facts´ of the social sciences imply that there are several elements of P-S such as the knowledge and information that agents possess and the social (and even physical) constraints their behaviour is subject to which depend on agents´ beliefs so the theoretician cannot claim to possess superior knowledge about them. In other words, the adoption of *RPo* could *a priori* be justified if the theoretician were able to acquire

knowledge of P-S that is not available to agents but if, as Hayek (*op. cit.*) suggests, this is not the case, that is, if P-S consists, at least partly, of agents´ beliefs, if follows that *RPo* constitutes a *limit* case whose adoption implies *imposing* the theoreticians´ (allegedly superior) view of P-S on agents.

4.1.5. A reformulation of `situational analysis´

Popper apparently ignores both Hayek´s ideas about the peculiar `facts´ of the social sciences and his own ideas about indeterminism in the natural sciences in his discussion of *SA*. For instance, in his most detailed presentation of *SA* (Popper, 1994, p. 183, note 19), he argues that, if *RPo* is adopted, then the theorist reconstructs P-S *as it actually is* whereas, if *RPs* is adopted, she reconstructs P-S *as agents actually see it*. Yet, the way this is expressed by Popper is somewhat ambiguous since, in his attempt to clarify this issue, he seems to refer only to historical interpretation and, thus, it is unclear whether the distinction he draws between *RPo* and *RPs* also applies to the other social sciences. Hereafter, we assume that it does but we should like to make it clear that this is our interpretation. Specifically, he writes that:

> `It seems to me now that there are at least three senses of `rationality´ (and, accordingly, of the `rationality principle´), all objective, yet differing with regard to the objectivity of the situation in which the agent is acting: (1) *The situation as it actually was* – the objective situation which the historian tries to reconstruct. Part of this objective situation is (2) *The situation as the agent actually saw it*. But I suggest that there is a third sense intermediate between (1) and (2): (3) *The situation as the agent could* (within the objective situation) *have seen it*, and perhaps ought to have seen it´ (Popper, 1994, p. 183, footnote 19).

The previous quotation highlights that, when drawing a distinction between *RPo* and *RPs*, Popper assumes that the theoretician possesses knowledge that is superior to agents´. Otherwise, he could not have defined the third and intermediate sense of *RP* as one in which P-S is *`as the agent could* (within the objective situation) *have seen it*, and perhaps ought to have seen it´ (*op. cit.*). That is, the explicit reference by Popper to the P-S `as the agents *could* and perhaps *ought to* have seen it´ logically implies that he is assuming implicitly that there exists an `objective´ P-S and that the theoretician is in a *better* position than agents to observe it. Thus, we think Popper fails to take on board Hayek´s ideas about the peculiar `facts´ of the social sciences as well as his own views about indeterminism in the natural sciences. This takes us to our following claim. We

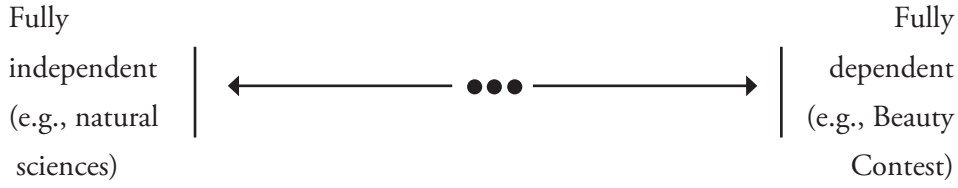
believe that, arguably, the real difference between *RPo* and *RPs* is not that in the former the theorist reconstructs P-S *as it actually is* (even if understood as being conjectural) whereas in the latter she reconstructs it *as agents actually see it* (also understood in a conjectural way) but, instead, that in the former the theorist reconstructs P-S *as she sees it* whereas, in the latter, the theorist reconstructs it *as she believes agents see it*. This suggests that the difference between *RPo* and *RPs* in this reformulated framework is not the `objectivity´ of the approach – because both the theorist´s and agents´ view of P-S are subjective – but the *degree* in which the subjectivity of the theorist manifests itself; in the case of *RPo* the implied subjectivity of the theorist is of a `first degree´ because it is her (direct) view of P-S that is at stake whereas in the case of *RPs* the subjectivity of the theorist is of a `second degree´ because in that case it is her view about agents´ view of P-S.

Let us put it another way, if *RPo* is adopted the theorist reconstructs P-S *as she sees it* and, consequently, different theorists may reconstruct it in different ways (as it is commonly the case in the theoretical social sciences). Likewise, if *RPs* is adopted the theorist will reconstruct P-S *as she thinks agents see it*. Again, in this second scenario, different theorists may have very different views about *how* agents see P-S and, hence, may produce different theories about the same phenomenon. The reason is that, *if P-S is, at least partly, as agents see it, then it follows that Popper´s distinction between P-S `as it actually is´ and P-S `as agents see it´ makes little sense*. Indeed, we may add that in the extreme case in which P-S fully coincides with agents´ views (e.g., the Beauty Contest metaphor), *P-S is as agents see it* and, therefore, *RPo* and *RPs* would become equivalent if they were defined as Popper does.

Now, this suggests that, as we show in Chart 1 below, *SA* exhibits a spectrum of potential scenarios according to the *degree of independence* of P-S from agents´ beliefs. At one extreme of the spectrum there are those cases characterized by *full* coincidence of P-S with agents´ beliefs or, as it were, by the absence of elements in P-S whose properties can be said to be (fully) independent from agents´ beliefs. Again, an example of this scenario is Keynes´ Beauty Contest metaphor in which there are no objective `facts´ the theoretician can observe because agents´ opinions about the (relative) beauty of the ladies portrayed in the photos are subjective. At the other extreme of the spectrum there is the typical scenario in the natural and physical sciences in which the `facts´ can be said to be *fully* independent from the observers´ viewpoint. Hayek´s (1943) suggests that in the social sciences

there is no such scenario since P-S is *never* independent from agents´ beliefs and, hence, if we take Hayek´s ideas on board the former can be said to be a *limit* or extreme case. Between these two extreme cases there is a spectrum of potential P-S characterized by different positive degrees of dependence of P-S upon agents´ beliefs so that the lower the degree of dependence the closer the scenario will be to *RPo*. Finally, let us add that the case known as `self-fulfilling´ expectations (Merton, 1948) would correspond to the case in which agents´ beliefs, no matter whether they are right or wrong, bring about a change in P-S so that the latter eventually *converges* to the former. In our framework, this could only occur if P-S were at one end of the above-mentioned spectrum; the one characterised by coincidence of P-S with agents´ beliefs.

Chart 1. *Spectrum of scenarios according to the degree of `independence´ of P-S from agents´ beliefs*



Let us finish off this section by adding that the former discussion highlights that, if *RPo* is adopted, the null hypothesis in an empirical test is not that the theorist´s view of the typical P-S is correct, as it is usually believed, but rather that *agents´ view of the typical P-S coincides, on average, with the theorist´s*. That is to say, to the extent that agents´ view of P-S is an integral part of the latter, only if there is a large coincidence (on average) between the agents´ and the theorist´ view of P-S will the hypothesis have a chance of withstanding the *onus of proof* when subject to an empirical test. In other words, an empirical test is not, if *RPo* is adopted, a contrast between the theorist´s view of P-S and the `objective´ facts, as is the case in the natural sciences. Rather, as we have argued above, the `facts´ of the social sciences are largely *interpretations* and, hence, rejection of the null hypothesis in this case does not imply that the theorist´s view of P-S does not capture the `objective´ facts appropriately since there are no `objective´ facts in the social sciences but, rather, that the theorist´s view of P-S does not coincide, on average, with agents´ view of P-S.

4.2. PTKL *VERSUS* SA: THE `RATIONALITY OF THE THEORETICIAN´

The last issue we should like to address is the compatibility or otherwise of the notion of rationality that stems from PTKL and *SA* as viewed from the perspective of the theoretician. If the discussion in the previous section has focused on the rationality of the agents who are the object of modelling by the theoretician, this section focuses on the `rationality of the theoretician´ or, as Schumpeter (1984) denotes it, the `rationality of the observer´. We believe that the apparently irreconcilable notions of rationality that stem from PTKL and *SA* when looked at from the standpoint of the agents *consist, when approached from the standpoint of the theoretician, of the application of PTKL to two different problems*. First, we share Lagueux´s argument that `true´ rationality in Popper actually consists of the corrigibility of one´s beliefs (Lagueux, 2006, p. 202).[36] Second, and according to Popper, science represents a particular version of PTKL characterized by the application of the `critical method´:

`The difference between the amoeba and Einstein is that, although both make use of the method of trial and error or elimination, the amoeba dislikes erring while Einstein is intrigued by it: he consciously searches for his errors in the hope of learning by their discovery and elimination. The method of science is the critical method´ (Popper, 1972, p. 70).

Now, if science is characterized as the application of the `critical method´ to the object of knowledge, *we may rationalize SA as the specific application of the ´critical method´ to the social sciences*. That is, the theoretician of the social sciences proposes a reconstruction of the P-S in which actors find themselves by formulating a conjectural situational model where they make decisions on the basis of systematic deliberation. As such, the situational model proposed is only a conjecture according to which the former constitutes an `adequate´ oversimplification of the relevant P-S or:

`By conjectural analysis I mean a certain kind of tentative or conjectural explanation of some human action which appeals to the situation in which the agent finds himself… Admittedly, no creative action can ever be fully explained.

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36 For instance, in *The Open Society and its Enemies*, Popper ([1943*a*] 1966, p. 97) states that `the method of applying a situational logic to the social sciences is not based on any psychological assumption concerning the rationality (or otherwise) of "human nature"´. In this respect, Oakley (1999, p. 35) notes that Popper stresses in his Harvard lecture (Popper, 1985, 1994) that, in the context of *SA*, `rationality had no ontological significance and was not intended as a theory of human action´.

Nevertheless, we can try, conjecturally, to give an idealized reconstruction of the problem situation in which the agent found himself, and to that extent make the action "understandable" (or "rationally understandable")…′ (Popper, 1972, p. 179).

The situational model constructed will then be subject to close scrutiny by the scientific community which will tell us the extent to which the different elements of the hypothetical P-S need to be modified. To the extent that the elements of the hypothetical P-S can be properly identified (i.e., it should consist of a set of observable elements such as physical and social constraints and assumptions about agents′ knowledge and information) both the situational model and the results of the empirical tests can be, in principle, openly criticised by the scientific community. That is, the significance of the situational model is that it is the `object′ against which criticism may be directed given the prior methodological decision to immunize *RP* from potential refutation. In turn, the role of *RP* (regardless of the specific version adopted) is to facilitate the implementation of the `critical method′ by helping scientists identify the `logic of the situation′ captured in the situational model. In this respect, it has been argued elsewhere that, in the context of Popper′s distinction among three ontological domains, the claim to *objectivity* in World 3 – which consists of knowledge or thought in an objective sense such as problems, theories, and arguments – stems from the notion that knowledge in World 3 `resides in *recorded* form outside the mind of any agent, even its originator, and is, in principle, accessible by any other agent in that recorded form′ (Oakley, 2002, p. 464; also Popper, 1972, pp. 108-9). As Sassower (2006, p. 104) has observed, Popper `saw rationality as the way to intersubjectivity, because it is too much to expect objectivity′. In the absence of an `animating principle′ such as *RP*, it would be very hard to logically connect the elements of the situational model in an understandable way.

What is crucial, however, is that the situational model will undergo successive changes and refinements (that will let it acquire greater accuracy in the explanation of social phenomena) in the aftermath of `rational′ criticism by the scientific community. Viewed from this standpoint, it does not make any difference whether the theoretician adopts *RPo* or *RPs* as long as the situational model is subject to close scrutiny by other members of the scientific community. Then, as the situational model undergoes further refinements or modifications new predictions and explanations may eventually emerge. It is clear then that, as long as social scientists modify their models in order to make them capable

of providing increasingly accurate explanations of social phenomena, *their behaviour can be characterized as being `corrigible´ and, hence, as sticking to the type of rationality we have associated with PTKL*. We may thus conclude that, although there is some tension between PTKL and *SA* when their relation is approached from the standpoint of `the rationality of agents´ such tension does not arise when such relation is approached instead from the standpoint of the `rationality of the theoretician´.

5. SUMMARY & CONCLUSIONS

A number of commentators have noted that there are two different approaches to rationality in Popper´s philosophy: the approach stemming from his evolutionary theory of knowledge and learning (PTKL) and the approach embodied in so-called `Situational Analysis´ (*SA*) and associated to his famous `Rationality Principle´ (*RP*). According to the former, we `learn´ by subjecting our hypotheses to trial and discarding those ones which turn out to be wrong. In addition, all knowledge is conjectural and fallible. In this setting, science is the `highest´ form of knowledge acquisition and is characterized by the subjecting of scientific theories to the most severe forms of criticism by members of the scientific community including, of course, empirical testing. The notion of `critical rationalism´ was coined to capture Popper´s thesis that the way to maximize the rate of expansion of knowledge is to subject theories to an optimal amount of criticism. The notion of human rationality that stems from PTKL consists of the *corrigibility* of our (wrong) beliefs. In other words, PTKL implies that being `rational´ consists of revising our beliefs when they turn out to be wrong. Therefore, individuals who fail to do so are `irrational´. *SA* represents Popper´s methodological proposal for the social sciences. In turn, *RP* is a methodological principle according to which *agents always act in a way that is adequate or appropriate to their problem-situation* (P-S). It follows that, in the context of *SA*, `rational´ behaviour consists of acting in a way that is appropriate to the `logic of the situation´ whereas `irrational´ behaviour will consist of doing otherwise. However, Popper and several of his commentators have made an important distinction between the `objectivist´ and the `subjectivist´ version of *SA*. According to them, in the former the theoretician seeks to reconstruct P-S `as it actually is´ whereas in the latter she reconstructs it `as it is seen by agents´. In this respect, we argued that the former is based on the (implicit) assumption that there is a systematic *discrepancy* between the theoretician´s and agents´ view

of P-S and that, under the null hypothesis, this implies that agents´ view of P-S is assumed to be, at least partially, wrong. We also proposed a rationalization of the `objectivist´ version of *SA* according to which the latter is based on a methodological decision to assume that the mistakes made by agents when making decisions are *less* interesting for the purpose of understanding agents´ behaviour and, especially, for the generation of predictions than the (modelling) mistakes made by the theoretician.

The purpose of this essay was to study the compatibility of these two apparently irreconcilable approaches. We have made five different claims. Our first claim was that there is a certain tension between PTKL and *SA* when their relation is analysed from the standpoint of the `rationality of the agents´ whose behaviour is captured in the model albeit the tension disappears when the relation is analysed from the standpoint of the `rationality of the theoretician´. Our second claim was that the nature of the tension between PTKL and *SA* depends on whether the theoretician adopts the `objectivist´ or the `subjectivist´ version of *SA*. In particular, we argued that the tension between PTKL and the `subjectivist´ *SA* stems from the fact that, in the latter, it is implicitly assumed that agents´ view of P-S is partially wrong which implies, in turn, that agents do not `learn´ from their mistakes as PTKL posits, i.e., that they exhibit a tendency to repeat the same mistakes so that the latter become predictable. We argued that this feature of the `subjectivist´ version of *SA* creates a tension with PTKL when the main purpose of the theoretician is to generate predictions but does not generate any tension with PTKL when the purpose is to perform historical interpretation. This raises the difficult issue of the legitimacy of adopting the `subjectivist´ *SA* when the main purpose of the modelling exercise is to generate predictions the latter being understood as the derivation of the logical consequences of theory. It was not the purpose of this study to settle this issue and, hence, issuing a verdict on it will require further work. By contrast, we argued that the tension between PTKL and the `objectivist´ *SA* stems from the fact: (i) that if agents behave according to PTKL it is not necessarily the case that their decisions will be adequate or appropriate to the `logic of the situation´ insofar as the former *only* implies that agents tend to eliminate their mistakes and, hence, we have that in the wake of changes in the surrounding environment agents´ decisions may not be adequate to the `logic of the (new) situation´, and (ii) that the adoption of the `objectivist´ *SA* implies *de facto* the *imposition* of the theoretician´s view of P-S upon agents´. Yet, we argued that it is unlikely that, if agents behave according to

PTKL by subjecting their conjectures to trial and eliminating the ones that turn out to be wrong, their view of P-S will eventually converge to the theoretician´s. Our third claim built on the ideas of Hayek (1943) about the nature of the `facts´ of the social sciences and was that, in the way it is presented by Popper and some of his commentators, the `objectivist´ *SA* represents a *limit* or extreme case based on the presupposition that P-S is (fully) *independent* of agents´ beliefs. Our fourth claim was closely related to the previous one and consisted of the idea that, if Hayek´s ideas on the nature of the `facts´ of the social sciences are duly taken on board, it follows that the natural strategy for social scientists is to seek to reconstruct P-S *as agents´ see it* rather than to reconstruct it *as the scientist sees it*. Our fifth and last claim was that, unlike what Popper and his commentators suggest, the difference between the `objectivist´ and the `subjectivist´ version of *SA* is not that in the former the theoretician reconstructs P-S *as it actually is* whereas in the latter she does it as *agents see it* but, rather, that in the former she reconstructs P-S *as she sees it* herself whereas in the latter she does it *as she believes that agents actually see it*.

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FROM IDEA TO BUSINESS VENTURE (IN PHARMACEUTICAL INDUSTRY)

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ABSTRACT

Entrepreneurial process is the road from business idea to business venture. Quite often, the decision to create a new venture is made without a prior feasibility analysis of the business idea, which means evaluation whether or not the business idea is really a good business opportunity that has potential to be developed into a successful business venture. The consequence of such a decision is very often failure of the business venture that brings huge costs (financial and emotional), which could have been avoided with a careful planning process.

This article analyses the feasibility of a business idea in pharmaceutical industry – pharmacist activity (pharmacy). From the decision to become an entrepreneur, through developing the business idea and developing that idea towards entrepreneurial venture, this article is focused on feasibility analysis of the business idea, business plan development and analysis of the industry as an important component in the process of new venture creation.

Along with the theoretical framework, this article offers an example of practical development of a business idea through business plan development and risk analysis of creation of a new pharmacy. This article also covers analysis of the situation in the pharmaceutical industry in Croatia, which, in this case was crucial for making the decision to create a business venture.

Key words: entrepreneurshio, entrepreneurial process, pharmacentical industry, Croatia.

1. INTRODUCTION

Entrepreneurial process is the road from business idea to business venture. Quite often, the decision to create a new venture is made without a prior feasibility analysis of the business idea, which means evaluation whether or not the business idea is really a good business opportunity that has potential to be developed into a successful business venture. The consequence of such a decision is very often failure of the business venture that brings huge costs (financial and emotional), which could have been avoided with a careful planning process.

The aim of this article is to present the importance of prior business planning and business opportunity evaluation and to develop a business plan for starting a business venture in the pharmaceutical industry – pharmacist activity.

The paper provides answers to the following questions: Who can open a pharmacy? Is there a difference between establishing a single pharmacy unit and several units? What are the geographic, demographic and other criteria that have to be met by the founder? What personnel prerequisites must be satisfied for the normal operation of the pharmacy? How profitable is the industry and what are the indicators for the future?

2. METHODOLOGY

The methodology used relies on the business plan development methodology that includes an analysis of the market (buyers, suppliers, competitors), analysis of the industry through the Porter's model of competitive forces (identification of barriers to entry in the industry, recognition of the bargaining power of suppliers and buyers, and identification of competitors and substitutes), financial analysis (analysis of the required resources, necessary equipment, cost analysis, planned revenue, cash flow). In addition, a risk assessment was conducted using the SWOT analysis, which describes internal strengths and weaknesses and external opportunities and threats. Secondary databases were used for data collection, with particular emphasis on the publications of the Croatian Health Insurance Fund and the Croatian Bureau of Statistics. We have also used data obtained from the 10th Conference of Pharmacists organised by the Croatian Pharmaceutical Society, Regional Branch of the Zagreb Region, which was held on May 24-26, 2012 in Šibenik.

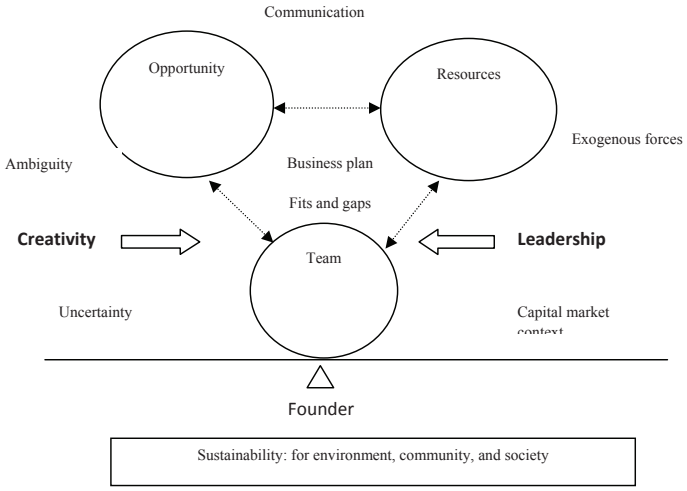
3. ENTREPRENEURIAL PROCESS

Entrepreneurial process is the journey from idea to business venture. The entrepreneurial process consists of several phases, which are mutually intertwined and enter one another (Hisrich, 2011, Barringer, 2010). Every entrepreneurial process begins with an entrepreneurial idea and assessment and analysis of that idea: how feasible it is, and whether it has potential to become a successful business venture (Oberman Peterka et al., 2012). Workflow of entrepreneurial process begins with the decision of a person to become an entrepreneur (Barringer, 2010). After reaching the decision, entrepreneur must successfully develop their business idea by recognizing opportunities, after which they should analyse their feasibility, make a business plan, analyse the economic sector and the competition, and then develop an efficient business model.

Having successfully developed the business idea, entrepreneur moves forward towards the realisation of their venture, towards establishing, managing and growing the entrepreneurial company. The first step in the creation of an entrepreneurial company is defining the ethical and legal basis, followed by an assessment of financial sustainability. The next step is the formation of an entrepreneurial team, followed by the financing of the new venture.

The key components of any entrepreneurial process are opportunity, team and resources (Timmons, 2009), as shown in Figure 1. However, the mere existence of these three elements, which the entrepreneur can control, is not enough; positive interaction between them is also required, in the sense of balance and an integrative, overall system, consisting of the three elements, but also of the surrounding environment.

Figure 1 - *Timmons' Model of the Entrepreneurial Process*



Source: Timmons J.A., Spinelli S., (2009), New Venture Creation, McGraw Hill International, USA

Despite the laity's perception, who most often believe that resources, i.e. funding, business plan or connectedness of entrepreneurs are the origin of entrepreneurial activity, entrepreneurial process essentially starts with the opportunity (Timmons, 2009). Therefore, resources and entrepreneurial team follow the potential of the opportunity, and the entrepreneur/founder is the vital factor that keeps these elements in balance.

Opportunity is at the centre of any entrepreneurial process, and it is necessary to distinguish it from the idea. Successful entrepreneurs need to know that a good business idea is not always an opportunity. The most important characteristics of good business opportunities are: market demand, structure and size of the target market, and profit margins.

Experienced entrepreneurs often claim that it is potentially dangerous to have premature availability of excessive resources, i.e., money. Entrepreneur should minimise and control the resources, rather than to strive to maximisation and possession. In doing so, the order of their importance is: people, property, business plan, and only after the fulfilment of the above one should start thinking about money (Barringer, 2010).

Entrepreneurial team is a key element of success of entrepreneurial ventures. Successful teams are led and assembled by entrepreneur leaders who are team players and coaches at the same time. The ability and skills of attracting other

team members with desirable business characteristics are valued characteristics of entrepreneurs/founders. Desirable qualities of teams are: experience in business activities, motivation (internal and external), commitment, perseverance, tolerance of risk, uncertainty and ambivalence of outcomes, creativity, adaptability, skilled communication, etc. (Timmons, 2009).

The overall consistency of the three elements is affected by other internal and external factors such as creativity, capital market, communication, uncertainty, and the entrepreneur/founder is responsible for the balance and stability of the entire system.

Before starting a business venture a person/entrepreneur first must make the decision whether they want to become an entrepreneur, i.e., start their own business. Entrepreneurial activity can be started because of a perceived opportunity or out of necessity. Dominance of entrepreneurial ventures started on the basis of perceived opportunities over entrepreneurial ventures started out of necessity contributes to increasing entrepreneurial capacity of the country, because those who become entrepreneurs because of perceived opportunity, as a rule, are more focused on the company's growth, than those who have become entrepreneurs because they were forced by the situation (Singer et al., 2006).

Regardless of the reasons for starting a business venture, owning one's own business carries a number of advantages, but also a number of disadvantages. A person-entrepreneur has to weigh the benefits and drawbacks of running a business in order to be able to make the right decision on starting their entrepreneurial journey.

4. FEASIBILITY ANALYSIS AND BUSINESS PLANNING

The most effective ventures are created from the process that encompassed identifying business opportunity, feasibility analysis, creation of a business plan and establishment of a company. Each of the aforementioned steps can help entrepreneur with the decision on starting a business venture. In cases when any of the analyses points out some shortcomings of the entrepreneurial idea, it is necessary to reshape it (if that is possible), in order to make implementation and success of the business venture more likely, or, sometimes, it is necessary to give up on an entrepreneurial idea.

4.1. FEASIBILITY ANALYSIS

In essence, feasibility analysis is a research process and a prerequisite for the evaluation of the expected feasibility of the entrepreneurial idea. A business plan is more focused on practical consideration of the planning and selling of products/services.

Failure to properly investigate the value of a business idea before making a business plan can lead to blinding the entrepreneur, so that they do not see the risks that are an integral part of the business venture, which results in a business plan that is too positive (Mullins, 2010).

Feasibility analysis consists of four interconnected analyses (Barringer, 2010):

1. Product/service feasibility – An assessment of the overall appeal of the product or service. This analysis should provide an answer to the question whether there is demand for this product or service, and why should product/service be attractive to potential buyers (competitive advantage, product's added value).
2. Industry/target market feasibility – Industry is a group of companies producing a similar product and service, while target market is a narrow group of consumers with similar needs. This analysis should help entrepreneurs in assessing the industry they are entering, characteristics of companies that already operate in the respective industrial sector and the possibilities for growth in that industry. Based on this feasibility analysis, entrepreneur should get a picture of the characteristics of the target market, and thus also of the potential for realisation and development of the business venture in the given target market
3. Organisational feasibility – This analysis is conducted in order to determine whether the proposed business will have sufficient managerial expertise, organisational competence and resources for a successful start of its operations.
4. Financial feasibility – In this phase it is particularly important to assess the total financial resources needed to start the business, perform a sort of „benchmarking", by comparing own expectations with similar companies that already operate, and assess the overall financial attractiveness of the deliberated entrepreneurial venture.

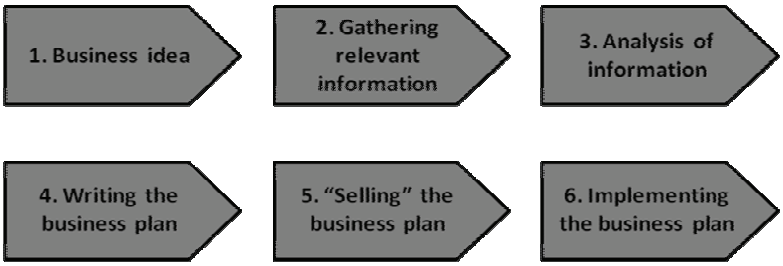
Quality feasibility analysis presumes a thoroughly conducted primary and secondary research.

4.2. BUSINESS PLAN

There are several reasons why a person who plans entrepreneurial activity should write a business plan. The process of writing a business plan from the original idea forces entrepreneurs to objectively and critically examine their entire business idea. A well-developed business plan is an efficient tool that helps entrepreneurs make correct decisions and directs them towards successful business planning. Concisely written content of the business plan acquaints all potential stakeholders with the elements of the business idea, from potential investors, lenders, partners, suppliers, the community, to all others in need of knowledge of the system in the making.

Business planning process (Figure 2) consists of several, mutually connected phases. Business planning starts from the entrepreneurial idea to start a business venture. Completion of a previous phase does not condition the start of the next phase, so that the phases of the business planning process are often mutually intertwined.

Figure 2 – *Business planning process*



Source: Oberman Peterka, S., teaching materials for the course New Ventures Creation, school year 2010/11

Business planning process, as shown in Figure 2, does not end with writing a business plan. After writing a business plan, entrepreneur needs to „sell it", which involves searching for partners, investors, that is, presenting the business plan to those for whom it was written. After we find the money, partners, employees, etc., follows perhaps the most important part of this process – implementation of what we put on paper. One of the most important characteristics of successful entrepreneurs is the ability to implement ideas, exploit opportunities and create a successful business venture. Only the successful implementation of this phase closes the business planning process, i.e., achieves its objective.

Depending on the length and content, business plans can be classified as: summary business plan (for ventures in the early stages of development, serves for testing the interest of investors and partners in the idea), full business plan (elaborates the goals of the venture and methods of achieving the goals) and operational business plan (very detailed elaboration description of internal processes) (Barringer, 2010).

The key elements of any business plan, regardless of the content of the business plan and the type of business venture are (Timmons, 2009) people, context, opportunity and risk. Every business plan should answer the questions who is the team, which will carry out the business venture, in which context is this business venture happening (the „bigger picture", which the entrepreneur cannot influence, but must be aware of it, since it significantly affects the business venture; political, economic situation, legislation, cultural and social norms and people's habits, etc.), what makes the business idea an opportunity (existence of demand for the given product/service), and what are the risks in the realisation of the business venture.

Every business plan consists of three parts: general part, financial part and additional elements. The general part of the business plan describes the company (legal form, mission, vision, business objectives, location, description of activities, description of products, competitive advantage, market analysis, marketing plan, operational plan), financial part provides an overview of the basic financial statements and financial indicators (money required to start the business venture, sources of financing, opening balance sheet, profit and loss statement for the first three years, cash flow, break-even point), while the additional part of the business plan contains all the information that may aid understanding and confirmation of claims from the previous parts of the business plan (résumés of the key people – entrepreneur and his team, product blueprints, presentation of the location, contracts and forward contracts with suppliers, buyers, etc.).

This paper will present a summary business plan for starting a business venture in the pharmaceutical industry, i.e., business plan for starting a pharmacy.

5. BUSINESS PLAN FOR STARTING A PHARMACY

The aim of this business plan is to assess the feasibility of opening a pharmacy. In accordance with relatively complex legislation, the entrepreneur has tried to find a geographic niche in the pharmacy business within the set legal framework,

focusing on the demographic and geographic characteristics of the regions of the Republic of Croatia.

5.1. DESCRIPTION OF THE COMPANY

This business plan analyses opening a pharmacy in the Primorje-Gorski Kotar County and answers the question whether this idea makes sense. The company which is the subject of this analysis is primarily service-oriented, with a small share of production (simple pharmaceutical preparations that are made in the pharmacy). Services provided by the pharmacy to buyers / patients include retail of non-prescription drugs, orthopaedic aids, food supplements and dispensing of prescription drugs prescribed by doctors. Buyers, i.e., users of the pharmacy's services are patients who live in and near the territory of the municipality in which it is planned to open the pharmacy, as well as anyone who needs the products offered by the pharmacy and happens to be in the vicinity of the pharmacy.

5.2. DESCRIPTION OF ACTIVITIES THE COMPANY IS INVOLVED IN

According to the National Classification of Activities, the planned company belongs to pharmaceutical industry, group pharmacist activity, class 47.73, pharmacy.

Pharmacy in the Republic of Croatia is regulated by the following legislation[1]: Health Care Acts, Act on Pharmacy, Medicinal Products Act, Health Insurance Act and Institutions Act. Public pharmacy in Croatia is largely privately owned, more accurately, 78% of pharmacies are private, while hospital pharmacies are exclusively owned by counties or state. According to the Ordinance on the conditions for determining the areas in which pharmacies will be established (National Gazette No. 26/07, 118/07, 81/08), the basic criteria for opening new pharmacies are demographic and geographic. Demographic criterion says that 3,000 insurance policyholders is the condition for opening the first pharmacy, 8,000 policyholders is the condition for opening the second pharmacy, and every subsequent pharmacy on 5,000 new policyholders. Geographic criterion talks about the minimum distance between pharmacies, which is 200 metres in cities with more than 500,000 inhabitants, 300 metres in cities with 100,000 – 500,000 inhabitants and 500 m in all other municipalities and cities. According to the size of the current pharmacy network, the average is 4,000 inhabitants per

[1] Source: 10th Conference of Pharmacists, Šibenik, Solaris May 24-26, 2012, lecture materials

one pharmacy, or 1,500 inhabitants per one master of pharmacy. An average of 2.6 masters of pharmacy[2] is employed per pharmacy unit. There is a significant difference in the number of retail pharmacies per capita between the countries of the European Union, which is a consequence of legal and historical factors of individual countries before they were covered by unambiguous legislation upon entering the European Union (Annex 1 Number of pharmacies per capita in EU-27 countries).

The organisational forms of pharmacy within the health care system in the Republic of Croatia are independent pharmacies (private practice of a master of pharmacy), independent pharmacies (private practice of several masters of pharmacy), pharmacy institutions with pharmacies and drugs depots as subsidiaries owned by counties, pharmacy institutions with pharmacies as subsidiaries owned by domestic of foreign natural or legal persons, community health centres with pharmacies or drugs depots as organisational units, owned by counties, hospital pharmacies owned by counties or state (Annex 2 – Ownership organisational structure of public pharmacies).

According to the Croatian Health Insurance Fund 2011 Annual Report[3], the total annual consumption of drugs in the 2005-2010 period increased on the average by approximately HRK 200 million. At the same time, since 2009, a downward trend of consumption of drugs through the Croatian Health Insurance Fund (CHIF) is observed, with which the Fund wants to achieve certain savings, and the difference in the overall increase in the consumption of drugs was compensated for by increased sales of non-prescription drugs, which are freely available for purchase in pharmacies, the so-called over-the-counter products. The segment of over-the-counter products is of great significance for financial operations of retail pharmacies because it is not subject to collection periods for receivables from the CHIF, which often exceed the legal frameworks by far, and it is in the interest of liquidity and solvency of pharmacies to have a greater proportion of the over-the-counter portfolio, which generates money and provides liquidity to the company. Pharmacies' earnings from drugs are based on charging for the pharmacy service, amount of which depends on drug type and

[2] Croatian Health Insurance Fund 2011 Annual Report, Croatian Health Insurance Fund, Margaretska 3, Zagreb

[3] Croatian Health Insurance Fund 2011 Annual Report, Croatian Health Insurance Fund, Margaretska 3, Zagreb

activities that pharmacists undertake when dispensing (the fee is, under current circumstances, between HRK 6 to 8 per drug).

Analysis of industries by sectors[4], shows that pharmacist activities in 2012 stood in 4th place by revenue, 5th place by profit, in 6th place by newly created value, in 5th place by productivity and in 7th place by the number of employees, compared to all the business subjects classified in industrial sectors according to the National Classification of Activities in 2011. From this it can be concluded that pharmacist activities are at the very top of all economic sectors when we look at annual averages of indicators such as total revenue, profit, newly created value and productivity, and it is expected that this situation will not change significantly in the future.

Analysis of the activity

Porter's model of competitive forces (Mullins, 2010) is a useful tool for industry analysis at the micro level, which, through analysis of the five forces (buyers, suppliers, barriers to entry in the industry, competition, substitutes) answers the question of whether the industry we are entering is attractive.

Buyers

Buyers and end-users of pharmacy products are different groups of people, including children, athletes, people with health risks, self-confident people, people of all ages and both sexes. Prices of all products (over-the-counter programme) are very similar in all pharmacy units, so that people usually go to the nearest pharmacy when purchasing products. Patients who need to fill a prescription do not pay for the product, and for them it is almost the same in which pharmacy they get their product, so they usually chose the one that is close to their place of residence. For all these reasons it can be said that buyers have a moderate bargaining position, because there are many of them, and there are no similar facilities in the environment in which they can satisfy their need to purchase / acquire a specific drug or another product from the pharmacy. With its ambience and the kindness of the staff, a pharmacy can create additional buyers' „affection", and strengthen its own position.

Suppliers

The supplier system in the pharmacists activity is highly regulated; this activity is carried out by pharmaceutical wholesalers. There are about 20 pharmaceutical

[4] www.poslovna.hr, October 10, 2012

wholesalers registered in Croatia, but 80% of total turnover is achieved by 20% of them. Exclusivity of supply of particular products solely through predefined pharmaceutical wholesalers is rare, especially among the major wholesalers, and the difference is in financial terms, which are usually contracted on an annual basis, according to the targeted total turnover that will be achieved by an individual retail unit, i.e., pharmacy. The cost of switching from one to another supplier is small and pharmacies usually do business with several suppliers at the same time. The differences in the mentioned terms are small, and the bargaining power of suppliers is small. Since the pharmaceutical wholesaler-pharmacy system is very well networked electronically, and product deliveries to pharmacies and other logistical services are carried out by pharmaceutical wholesalers, some of which perform deliveries several times a day, great risk and responsibility of pharmacies in the value chain is transferred to suppliers. In addition, it is important to mention the policy of collection of receivables in this activity. The average collection period by pharmaceutical wholesalers from pharmacies is almost identical to the terms of payment by CHIF to pharmacies, which has been 200 and more days in recent years. Therefore, much of the cost of insolvency of the system, in addition to pharmacies, has been substantially transferred to wholesalers, where pharmacies are not feeling the effects of such conditions on their business, particularly in the context of unlimited delivery of goods without previous payment shipments. The overall bargaining power of suppliers is evaluated as low.

Barriers to entry in the industry

Barriers to entry in the pharmacy retail industry are moderate to high. The reason for this are legally defined restrictions to the entry of new pharmacies into the existing health care network, with the main barrier being the demographic one, i.e., the precondition of a certain number of health insurance policyholders in order to meet the preliminary conditions for opening a pharmacy. As the interior and equipment of pharmacies are prescribed by ordinances, a relatively high initial capital is required to equip a pharmacy. Due to the nature of the pharmaceutical industry and a wide variety of preparations, packagings and manufacturers for similar or same illnesses, well-equipped pharmacies are required to have relatively large stocks. It is therefore also necessary to secure a rather high amount of working capital. Another current limiting factor is the deficit of masters of pharmacy with a license for independent practice, which are a prerequisite for opening a pharmacy. The overall assessment is that barriers to entry in the industry are high.

Analysis of the competition

The competition is primarily related to two pharmacies in the immediate surroundings.

Pharmacy 1 started operating in 2008 and had 3 employees. Total revenue in 2008 was HRK 3,700,000, while the net profit from operations was HRK 28,000. In 2010, pharmacy hired another employee, and according to the data from the Poslovna Hrvatska database, in 2011 it reported revenue of HRK 4,900,000 and net profit of HRK 320,000.

Pharmacy 2 is located in the centre of the city where the entrepreneur plans to open a new pharmacy. In 2011, pharmacy had 7 employees and achieved total revenue of HRK 9,400,000 (2011 data from the Poslovna Hrvatska database). Net profit in 2011 amounted to HRK 592,000.

There are no herbal pharmacies or other companies that sell products that are substitutes to pharmacy products in the territory of the municipality where opening of the pharmacy is planned.

Although an annual trend of revenue growth is present, the newly opened pharmacy will take over part of revenue from the total sales of drugs and other products in the wider geographic area, mostly at the expense of the two present pharmacies. For this reason, the strength of competition has been assessed as moderate to high.

Substitutes

When assessing the strength of substitutes, it is important to identify them. These are primarily herbal pharmacies and specialised shops (but in a certain segment also retail stores such as DM, Muller etc., which sell certain vitamin and medicinal preparations). Substitutes are more flexible in responding to customer needs and changes in the environment because it is simpler for them to start operations than for pharmacies, legislation is much more lenient and no demographic and geographic conditions have to be met in order to open new units. Besides, there are no defined or legally required qualifications of employees that should be employed in such stores. Another positive thing for substitutes is the tendency of a number of patients towards more relaxed shopping environment than that of pharmacies. The same products that are offered by pharmacies can be found in herbal pharmacies and specialised shops, but usually at lower retail price because of different retail mark-up. Despite the seemingly much more

favourable position of substitutes in relation to pharmacies, the overall threat coming from them was assessed as moderate, because approximately 70% of revenue of pharmacies comes from drugs that cannot be obtained or bought in specialised shops or herbal pharmacies.

5.3. 5.3. MARKETING PLAN

Promotion

Promotion of pharmacies is defined by the „Ordinance on the manner of advertising of the work of pharmacists working in private practice and privately owned pharmacy institutions". Although integrated marketing messages with which pharmacies may want to increase awareness of their existence among targeted clients are not applicable in the pharmacy business, there are certain promotional activities in the broad sense of the word that can be undertaken by an enterprising pharmacy.

In order to improve relationships with clients-buyers, it is necessary to work on the education of personnel in the area of sales skills and optimisation of work tasks.

Prices

Products that are dispensed and sold in pharmacies are divided into following segments: drugs, cosmetics, medical products, orthopaedic aids and dietary supplements. Pharmacies cannot add a mark-up on drugs in retail, but only charge for their service according to the valid propositions and coefficients. Thus, for every filled prescription, depending on whether the drug is on the CHIF's main or supplementary list of drugs, and whether it is a medicinal preparation, which is prepared in the pharmacy, or a final and already packaged product, the coefficients are added up (depending on the pharmacist's activities), and the resulting number is then multiplied by the applicable amount approved by the CHIF (HRK 7.15 is the current amount). On average, pharmacies charge HRK 6-8 for the service of dispensing of a prescription drug.

With regard to earnings, there are two main segments of products that are sold in pharmacies. Those are drugs that are on the CHIF's list (main and supplementary), and the over-the-counter programme. The difference between these two types of services provided by the pharmacy is very important in the context of collection and retail mark-up. Collection for the over-the-counter

programme depends on pharmacist's skill how long an individual product will be in stock, i.e., for how long the working capital will be tied up, while collection of filled prescriptions and the mark-up in the form of pharmacy service depends on the CHIF. The prescription programme is regulated by an ordinance on charges for the drug dispensing service, and it can be roughly characterised as a mark-up for dispensing drugs, where all the coefficients are defined by the relevant Chamber. On the other hand, the Chamber also defines the retail differentiated mark-up depending on the product purchase price for the segment of over-the-counter products.

Distribution

Distribution represents the manner in which the product comes to the buyer. Types of distribution are wholesale, retail, direct sales, internet sales, and so on. In this case, we are dealing with a retail pharmacy unit, which is visited by buyers, who are most often also the final users of the products.

5.4. LOCATION

As the entrepreneur will soon change place of residence and move to the city of Rijeka, he has selected Primorje-Gorski Kotar County as the wide target area for deliberation about entrepreneurial activity. Analysis of the population census and the number of people with health insurance in cities and municipalities of Primorje-Gorski Kotar County has identified several micro-locations, i.e., municipalities where fulfilment of legal requirements for opening a pharmacy can be expected within a two-year period. The pharmacy will be located in one municipality of Primorje-Gorski Kotar County, where business premises with a minimum of 77 m^2 of functional space will be leased (Annex 3), which must have the following facilities[5]:

- Space for dispensing of drugs and medical products with at least 35 m^2 of floor space, with the condition that width or length of the room cannot be less than 5 m,
- Laboratory of at least 15 m^2, width or length of the room cannot be less than 3 m,
- Dishwashing room of at least 6 m^2, width or length of the room cannot be less than 2 m,

[5] Regulation on minimum standards of space, workers and medical-technical equipment in providing health services (National Gazette No. 90/04 and 38/08)

– Storage area of at least 15 m^2 with available access for delivery of goods,
– Room for the pharmacy manger and standby duty of at least 6 m^2,
– Space for the storage of narcotic drugs, that is, appropriate metal cabinet with key,
– Space for the storage of flammable substances,
– Sanitary facilities for employees.

5.5. EMPLOYEES AND FOUNDERS

Entrepreneur - founder

Company owner was born in 1984. He graduated from the Faculty of Medicine in Osijek in 2009. For the last two years he has been employed in a pharmaceutical company through whose work he built good business relationships with suppliers of drugs, pharmacists and doctors in Eastern Croatia. His involvement in the company will be related to its establishment and subsequent advisory services.

Two masters of pharmacy will be employed in the pharmacy, one as pharmacy manager, to whom the private pharmacy practice will be registered, and who will manage all the relevant segments of pharmacy operations. Since it is necessary to hire two masters of pharmacy for work in two shifts, the other one will carry out work in the opposite shift. The work of a master of pharmacy includes work on prescriptions (dispensing of drugs and other products in the pharmacy), with simultaneous preparation of simple pharmaceutical preparations that take place in the pharmacy laboratory. Masters of pharmacy also take care of the management of stock, i.e., ordering of all products that are sold by the pharmacy. One pharmaceutical technician will also be employed in the pharmacy, who will perform similar tasks as the master of pharmacy, but may not independently work in the pharmacy, because of insufficient level of education for licensed independent dispensing of drugs, and will therefore act as support to master of pharmacy in shifts when the extent of work requires involvement of two people in the pharmacy.

5.6. FINANCIAL DATA

The basis for the projections of the financial plan were current and past financial indicators of pharmacies operating in the environment, and which are direct competitors. Analysed were the key financial indicators relevant to the projection of the initial state when starting operations of a new pharmacy unit

in the same area, with an emphasis on the assessment of total revenue, market trends and liquidity assessment.

Special attention in the financial plan is paid to the cash flow, since ensuring liquidity is the most important, but also the most difficult task of any entrepreneur, especially in the pharmaceutical industry.

Entrepreneur-pharmacist plans to minimise the monthly fixed costs primarily through lease of business premises, and to optimise the variable materials costs with wise inventory management, thereby reducing the need for large working capital.

Sources and use of capital

The initial founder's investment has been estimated at HRK 500,000.00. Of this amount, HRK 300,000.00 will be spent for preliminary document preparation activities and other administrative costs to a lesser extent, while most of the rest of the amount will be spent on equipping the interior according to the rules of the trade, i.e., Regulation on minimum standards of space, workers and medical-technical equipment in providing health services (National Gazette No. 90/04 and 38/08). The amount of HRK 200,000.00 is planned for maintaining current liquidity. Total funding was provided in the entire amount by the founder.

List of equipment

Regulation on minimum standards of space, workers and medical-technical equipment in providing health services (National Gazette No. 90/04 and 38/08) prescribes the equipment that every pharmacy must have, as well as the appearance, size and arrangement of space.

Appropriate equipment[6] intended for pharmacies for storage of drugs, medicinal products and medicinal substances in the space for dispensing of drugs, laboratory and storage is defined according to the pharmacopoeia[7].

Estimate of revenue and expenditure

Estimate of revenue

The analysis of available data from 2011 and comparison of individual indicators on a representative sample of pharmacies in Primorje-Gorski Kotar

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6 Regulation on minimum standards of space, workers and medical-technical equipment in providing health services (National Gazette No. 90/04 and 38/08)

7 Pharmacopoeia - Official manual that describes therapeutic agents, auxiliary therapeutic agents, methods of their analysis and preparation, thus ensuring the quality of medicines

County, except for those in the city of Rijeka, 36 of which were analysed for the needs of this paper, resulted in certain findings, which were used for the projection of total annual revenue. In doing so, significant in the financial sense is the fact that the average revenue of the covered subjects in 2011 was HRK **7,300,000**, while the average share of sales of over-the-counter products in the total sales revenue, as the primary indicator of liquidity, as shown in later sections, was **40%**, compared with the average at the national level, which was around 30%. the difference at the regional level stems from the propensity of patients, as well as the financial situation, when patients from regions with higher purchasing power and standard often, in addition to drugs, spend more money on products that cannot be obtained free of charge on doctor's prescription, and are helping to improve the health condition. Also, there is a large proportion of foreign citizens in Primorje-Gorski Kotar County, tourists without Croatian health insurance, who, seeking to solve their health problems, bypass doctors and visit pharmacies to purchase products and drugs that can be obtained without a doctor's prescription.

Estimate of expenditure

The below table of expenditure shows an analysis of the share of costs of public pharmacies in 2010 and 2011. The table indicates that the cost structure has not changed significantly during one year. Looking at the two biggest costs, which together account for almost 80% of total costs, it can be seen that these are expenditures for employees, i.e., period expenses in a large proportion of salaries, and the purchase value of goods. There is a big difference between these two costs with regard to the current circumstances of maturity of payment. Namely, worker salaries in public pharmacies in Croatia are up to date without any significant monthly oscillations and delays, while payment of invoices for the goods sold and those in stock delivered by suppliers (pharmaceutical wholesalers) is subject to the payments by the Croatian Health Insurance Fund, which often have payment periods of up to 200 and more days. A fortunate circumstance in the whole chain of shaken liquidity is the patience of and non-restriction of deliveries by pharmaceutical wholesalers to pharmacies (until pharmacies are paid by the Fund).

Annual revenue of the pharmacy is based on 3 employees, 2 masters of pharmacy and 1 pharmaceutical technician.

Table 1 – *Expected annual revenues and expenses*

EXPECTED PROFIT AND LOSS STATEMENT in the first year of operations		
Operating revenue		**4,000,000.00 HRK**
CHIF – basic health care insurance		2,263,600.00 HRK
CHIF – additional health care insurance		24,400.00 HRK
Income from budget		80,000.00 HRK
Income from other users		1,120,000.00 HRK
Income from participation		112,000.00 HRK
Other and extraordinary income		400,000.00 HRK
Financial income		/
Extraordinary income		/
Operating expenditure		**3,600,000.00 HRK**
Material expenses		100,080.00 HRK
Compensation for employees		657,360.00 HRK
Expenses arising from loan repayment		720.00 HRK
Expenses for financing		1,440.00 HRK
Expenses for capital investments		7,560.00 HRK
Other and extraordinary expenses		36,000.00 HRK
Purchase value of goods sold		2,796,840.00 HRK

Source: Authors

As already mentioned and described in the table „Expected profit and loss statement in the first year of operations", in order to maintain liquidity, pharmacy must ensure monthly revenue from non-prescription services in the amount of HRK 1,500,000 for covering part of the purchase value of issued goods (assuming 30% of non-prescription items of the total products available in the pharmacy), material expenses and compensation for employees. That is exactly the amount of revenue planned from segments „Income from other users" and „Other and extraordinary income".

Planned cash flow statement

Cash flow statement provides an assessment of receipts and expenses, which is a direct indicator of the ability of a company to timely fulfil its obligations towards suppliers and other operating expenses.

Table 2 – *Cash flow forecast for the first year of operations*

Changes in cash balance	Amount (HRK)
Total receipts	3,500,000.00
Expenses from operating activities	3,550,000.00
Expenses from financial activities	10,000.00
Total expenditure	3,560,000.00
Net increase (decrease) in cash	(60,000.00)
Cash at beginning of year	200,000.00
Cash at end of year	140,000.00

Source: Authors

According to Table 2, total operating revenue of HRK 4,000,000 is expected, and total receipts in the same year are expected in the amount of HRK 3,500,000. The difference of HRK 500,000 arises from receivables from buyers, i.e., the CHIF and the time for collection of receivables for drugs from the main list of drugs that were dispensed to patients. Expenses from operating activities are expected in the amount of HRK 3,550,000, and the total planned expenditure is HRK 3,600,000. The difference of HRK 50,000 between expenses and expenditure will arise because of the increase in accounts payable to suppliers (pharmaceutical wholesalers). Total expected reduction of the amount of money in the first year is HRK 60,000, and despite the decrease of the amount of money at the end of the year, according to the foreseen working capital of HRK 200,000, liquidity will be maintained in the first year of operations.

Risk analysis

SWOT analysis was used for risk assessment. SWOT analysis was named after the initial letters of English words Strengths (advantages), Weaknesses, Opportunities and Threats. The results of application of the SWOT analysis are usually shown in the SWOT matrix, or matrix of opportunities / risks, with representation of both quantitative and qualitative dimensions.

Table 3 – *SWOT analysis*

Strengths - Competencies of the founding team - Self-financing of the entire project - Good knowledge of the activity - High barriers to entry in the industry – more difficult entry of competition	**W**eaknesses - Relatively high fixed costs - Founders' inexperience in running a business - Limited human resources (there is a deficit of masters of pharmacy in the labour market) - High barrier to entry into the industry – high initial investment
Opportunities - Possibility of expansion to a larger number of sales units by opening new pharmacies, which is easier considering the experience of opening the first pharmacy - resistance of the industry to economic trends, especially the negative ones	**T**hreats - Change of legislation that would favour the „big players " - Concentration of entities - Opening of the market after joining the EU - Constant number of people insured by the CHIF, which prevents an increase in the number of pharmacies in the network

Source: Authors

Risk management is the process of identifying potential risks, assessing their potential influence on the project, as well as developing and implementing plans to minimise any negative effects of risk events.

Based on these internal weaknesses and external threats in the SWOT matrix, entrepreneur believes that the greatest threat to the development of the project comes from the current limitation of the available human resources, i.e., non-financial resources. Namely, unemployed masters of pharmacy are very rare in the labour market. Fulfilment of demographic conditions for opening of a pharmacy is a *conditio sine qua non*. It is this condition that is identified as the greatest external threat, which cannot be directly influenced by the entrepreneur.

Neutralisation of the deficit of human resources can be implemented by granting scholarships to students in final years of study at the Faculty of Pharmacy and Biochemistry, who will be contractually obligated to work in the pharmacy after graduation. Another option is to develop incentives and working conditions that would be more appealing than those of pharmacies in the environment, and thus part of the staff would be complemented by transfers from other pharmacy units.

Neutralisation of the threat which is the result of failure to meet the demographic condition of the minimum number of insurance policyholders in a particular area is complex, since entrepreneur cannot directly influence the increase of the number of insurance policyholders in a certain city or municipality. What an entrepreneur can do is put the time of waiting for favourable conditions to good use, so as to be ready to quickly react at the right moment and start the process of opening a pharmacy. These activities include the preparation of premises, equipment, documents, maintaining contacts with local authorities in the area where opening of the pharmacy is planned, etc.

6. CONCLUSION AND RECOMMENDATIONS

Entrepreneurial process is the journey from idea to business venture. Entrepreneurial process begins with the decision of a person to become an entrepreneur. After reaching the decision on entering entrepreneurship, entrepreneur must successfully develop their business idea by recognizing opportunities, after which they should analyse their feasibility, make a business plan, analyse the economic sector and the competition, and then develop an efficient business model. This workflow of activities of the entrepreneurial process applies equally and is important for entrepreneurial ventures in all industries.

In a time of global insolvency, it is interesting to come across a business activity that, roughly speaking, generates an additional million kuna of income

per each newly employed person and in which the subject does not have to take short-term loans with unfavourable interest rate from business banks in order to maintain monthly liquidity and in which suppliers deliver goods despite previous uncollected receivables. Seemingly, an almost ideal industry. However, even in such an "ideal" industry, there are more and less successful business entities. To ensure a successful business and achieve competitive advantage, it is important to follow the aforementioned workflow of activities. It is important to seriously approach the planning of business activity, formation of the team, selection of the location, analysis of the environment (competition, buyers and suppliers), and building quality and long-term relationships with buyers. Neglecting any of these steps can lead to failure of an entrepreneurial venture even in such a profitable industry in which all the entities are apparently very successful. The objective of this paper was to show that on the way to success of any business venture there is a workflow of activities, which lead the entrepreneur from idea to successful venture, and which can help him examine all the aspects of future operations. Business plan is an important document for any entrepreneur and it represents a useful tool for both starting and running a business venture. On the concrete example of the business plan for starting a pharmacy, it was shown how much consideration and thinking about every part of the future business venture before it is started is important for the success of the venture, and how success of a venture does not depend on chance, but is the result of entrepreneurs' methodical work and deliberation.

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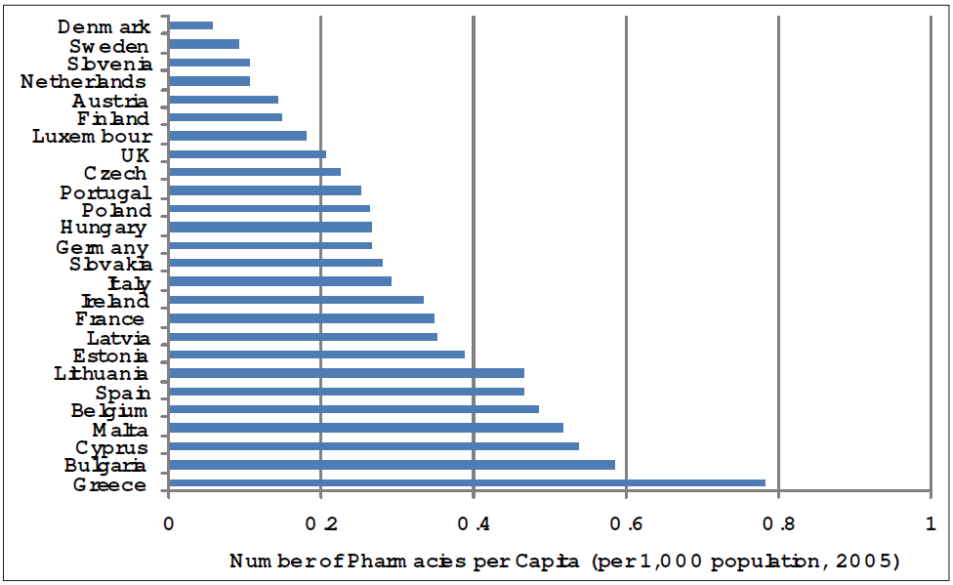
www.poslovna.hr, October 10, 2012

ADDITIONAL ELEMENTS OF THE BUSINESS PLAN – ANNEXES

ANNEX 1 - NUMBER OF PHARMACIES PER CAPITA IN EU-27 COUNTRIES



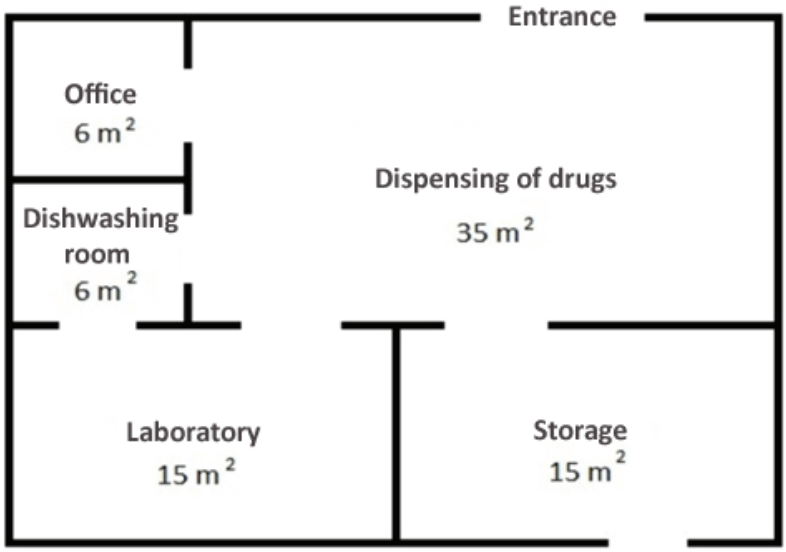
Source: PPRI Country Reports, ECORYS 2006 Report, GIRP 2007, OBIG 2007 Report

ANNEX 2 - OWNERSHIP ORGANISATIONAL STRUCTURE OF PUBLIC PHARMACIES IN THE REPUBLIC OF CROATIA

Form/ownership	Number of pharmacy units			
	1991	2005	2012	%
County institutions	361	202	205	19
Private institutions	-	404	585	54
Private practice (basic)	4	175	134	12,5
Private practice (lease)	-	144	129	12
Community health centres	31	22	27	2,5
TOTAL	396	947	1080	100

Source: Croatian Health Insurance Fund 2011 Annual Report, Croatian Health Insurance Fund, Margaretska 3, Zagreb

ANNEX 3 – FLOORPLAN OF A PHARMACY UNIT



Source: Authors

MICROFINANCE IN ROMANIA

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ABSTRACT

The current paper presents a comprehensive survey of the Romanian microfinance sector, including the early evolutions and the current developments. The research also includes the regional distribution of Romanian microfinance institutions in relation with the main goals of microfinance, poverty alleviation and support for individual and micro-enterprises. The research reveals that currently, due to the existing regulations, microfinance activity can be practiced only at authorised banks' level, while the non-banking financial institutions involved in microfinance can only provide micro-credits. Moreover, the territorial distribution of the Romanian microfinance institutions shows a high concentration within the more developed country regions than within the regions in need of microfinance support. While the demand for microfinance products given the important number of microenterprises at Romania's level exists, the Romanian microfinance sector remains marginal and blurry, included in commercial bank large offers, and hidden among various types of credits offered by a high number of non-bank financial institutions, credit unions and mutual aid houses.

Keywords: microfinance, outreach, mission drift, Romania.

1. INTRODUCTION AND LITERATURE REVIEW

The modern concept of microfinance, as introduced by Dr Muhammad Yunus with Grameen Bank, represents the provision of formal financial services to low-income households/ individuals and very small (or micro-) enterprises that were traditionally overlooked by the mainstream banking system due to their unreliable sources of revenues and the lack of assets that can be presented as collateral. Microfinance as a formal financial services concept includes tailored micro-savings, microloans, micro-insurance and micro-leasing (Kostov 2005, Ming-Yee 2007, Maas & Laemmermann 2012). As highlighted by Mersland and Stroem (2013), the word *formal* within this context is important since the low-income (poor) households and individuals and start-up enterprises have the tendency to rely and to use a diversity of informal credit sources, as shown by Collins et al. (2009). The core of microfinance is represented by microcredit, which, according to the European Commission, is a loan or a lease under EUR 25 000 (approximately USD 22 000) destined to support the development of self-employed and microenterprises (Bruhn-Leon et al., 2012).

Therefore, the main characteristic of modern microfinance is its aim to alleviate poverty through entrepreneurship, creating and expanding income-generating activities. This seems to differentiate it from many other initiatives and tailored banking services for poor people that have existed through history and presented by Hollis and Sweetman (1998) and Mersland et al.(2011), which rather concentrated on savings and small loans based on the respective savings.

According to Bruhn-Leon et al. (2012), the impact of microfinance was expected to be two-fold (or sometimes referred as *the two sides of microfinance coin*). Firstly, an *economic impact*, as it allows the creation of income-generating activities, and secondly, a *social impact,* as it contributes to the financial inclusion and therefore to the social inclusion of individuals. Currently, at international level, microfinance can be portrayed through the following features:

1. Group lending, which resulted in low levels of default (Gutierrez-Nieto et al.2007, Cull et al., 2009, Mersland & Stroem 2013); thus, a trend towards individual lending is emerging as more and more microfinance institutions (MFIs) tend to shift from group loans to individual loans following their clients' preferences (Mersland & Stroem 2009, Kodongo & Kendi 2013);

2. Provision of training programmes and counselling when required (Ghodsee 2003, Kraemer-Eis & Conforti 2009); and
3. 'Democratisation' of the credit market, which allowed the empowerment of all small borrowers, including women (Chordhury, 2009).

The development of the microfinance sector at international level and the results in alleviating poverty and the financial constraints for microbusiness are documented and discussed by Hartarska and Nadolnyak (2008a), Cull et al. (2009a), Kraemer-Eis and Conforti (2009), Mersland and Urgeghe (2011), Leikem (2012), Hartarska et al. (2013a), and Janda and Zetek (2014). As Cull et al. (2009a) consider, the greatest success of microfinance was to demonstrate that poor households can become reliable bank customers.

The international community recognised the microfinance impact of the microfinance industry by proclaiming 2005 as the International Year of Microcredit. In addition, in 2006, the Nobel Peace Prize was awarded to Dr M. Yunus as the founder of the first microfinance bank (Hartarska & Nadolnyak, 2008b). The growth of microfinance consequently triggered the transformation or conversion process of microfinance institutions (MFIs) from non-government organisations (NGOs) into regulated financial institutions (Kostov 2005, Ming-Yee 2007, Maksudova 2010). This process was induced by at least two factors, namely i) the donors' pressure toward financial sustainability (Mersland & Urgeghe 2011) and ii) the need for prudential regulations in order to facilitate an environment that allows MFIs to mobilise savings and reduce loan delinquency through access to information in the case of multiple borrowings (Arun, 2005). The transformation of MFIs into regulated institutions reached a turning point in April 2007 when Banco Comportamos of Mexico (a respected MFI founded in 1990) offered 30% of its existing authorised share capital to the public at approximately 12 times its book value, according to Rosenberg (2007). The controversial viewpoints in relation with this event are summarised by Cull et al. (2009a) and reignited the debate of the microfinance *mission drift*.

The concept of mission drift is represented by a shift in an MFI's priorities from social to financial performances (Mersland & Stroem 2010, Armendariz & Szafarz 2011) and is associated with a change in composition of MFI clients towards the less poor, indicated by an increase of the average loan per client and a preference for individual lending (Cull et al. 2007, Mersland & Stroem 2010). Often, this phenomenon is also called a trade-off between outreach (of a higher number of poor clients or social goal) and financial sustainability. A series

of recent studies argued i) that microfinance does not reach the poorest of the poor (Hermes & Lensink 2011, Leikem 2012) and ii) provides evidence that the trade-offs exist and the outreach is negatively related to MFI efficiency (Cull et al. 2007, Hermes et al. 2011, Lensink et al. 2010, Hartarska et al. 2013b, Janda & Zetek 2014).

With this controversial topic in mind, this paper investigates the state and development of microfinance in Romania as a European Union (EU) member country. The academic literature dedicated to this topic is scarce. Giurca Vasilescu and Grzinic (2011), and Pop and Bresfelean (2011) briefly discuss the impact of the financial crisis and the recovery of the microfinance sector in Romania, while Ghinaru and Mocanu (2005), Mihai et al. (2008), Doiciu and Bialus (2010), and Brown and Earle (2010) provide more detailed studies on the sector. Several studies include Romania among other countries from Central and Eastern Europe when focusing on microfinance; these are the studies of Kostov (2005), Szabo (2005), Kraemer-Eis and Conforti (2009), Szabo (2014), and Bendig et al. (2015) and complete up to a point the information from Romanian dedicated studies.

The present paper adds to the existing literature on Romanian microfinance by providing an updated and better structured survey of the sector and confirming the mission drift of Romanian microfinance institutions within the country-specific context. The remaining sections of the paper are structured as follows: the next section presents the evolution of the Romanian microfinance sector, which is followed by the empirical investigations, then by a discussion of the findings and some final concluding remarks.

2. ROMANIA: THE EVOLUTION OF THE MICROFINANCE SECTOR

Early days (1992 to June 2005)

The entry of microfinance services was triggered by the situation of the Romanian banking system, still influenced by the past communist period, featuring: state-owned banks, a poor level of bank territorial networks, and bank preferences to lend to state enterprises and government institutions via government bonds. Moreover, between 1993 and 2000, the inflation rate reached double and triple digits and the bank interest rates were prohibitive for many small economic entities. Furthermore, the lending at individual level was virtually ignored by banks until 2003/2004.

Within this period, the microfinance activity developed in the guise of microcredits offered by NGOs[1] supported mainly by international donor funding. The domestic resources to fund and support microfinance NGOs were scarce and very difficult to find. The banking sector regulations prohibited the microfinance involved NGOs to take deposits; therefore, there was not a clear specification that they cannot offer credit. Therefore, the activities of micro-lending were almost on the edge of questionable legality, based on the idea that if lending outside the banking system was not expressly prohibited by law, the respective activity was permitted (Ghinaru & Mocanu, 2005).

The microcredit providers targeted primarily micro- and small enterprises, family associations, and individual farmers. In providing microcredits, the involved NGOs used one of the features of micro-lending at international level, starting with small loans and, based on the success of repayment, the subsequent loan amounts could be higher. The maximum value for a microcredit was of EUR 25,000 (approximately USD 22,000). These loans were contracted on individual basis. Given the high risk associated with loan delinquency and default associated with almost no information available on formal sources of income, the individuals most exposed to poverty risk, such as the unemployed and the socially excluded, remained outside the reach of microcredits. Only the study by Doiciu and Bialus (2010) mentions micro-lending with group guarantee under a programme funded by an international donor (Annex 1).

The main progress registered during this period was related to i) the transformation of some of the microfinance involved NGOs in commercial entities; and ii) the launch of two domestic banks partly or entirely dedicated to microfinance. Libra Bank was the first bank dedicated to microfinance for liberal professions and was authorised by the Romanian National Bank (RNB) in 1997. In 2002, a second bank, MIRO Bank, primarily dedicated to serving micro- and small enterprises and individual farmers, was authorised by the RNB. MIRO Bank was later on taken over by ProCredit Group and became ProCredit Bank Romania at the end of 2004.

Notwithstanding these developments, at the level of 2004, Ghinaru and Mocanu (2005) considered microfinance as a closed world with loose links and concluded that its impact remained negligible. In fact, the majority of potential

[1] Annex 1 presents details on the beginning of the identified microfinance institutions (MFIs).

microfinance clients remained unaware of the existence of microfinance and microloan providers and the respective products.

July 2005 to April 2009

Following the suggestions and responding to the persisting demands of international donors, in July 2005, a law dedicated to the regulation of MFIs (Law no. 240/ 2005) was promulgated and the RNB was appointed as the supervising body of the MFIs. Through this regulation, the special status of microcredit activity was recognised. Moreover, it clearly specifies that no other entity outside banks and MFIs is allowed to offer credit. The promulgation of the law also imposed the transformation of NGOs involved in micro-lending in joint stock companies and imposed a minimum capital of EUR 200,000 (USD 175,400). Under this law, however, Romanian MFIs were not permitted to take deposits, although they could offer loans up to EUR 25,000 (USD 22,000) for a period of up to 60 months.

During this period, the majority of NGOs involved in microfinance acted in accordance with the law and became joint stock companies, continuing to rely heavily on international donors' contributions in order to meet the capital requirements. Given the new regulation, the microfinance/micro-lending activity moved into the realm of mainstream financial services and became more visible. Consequently, the visibility brought more competition from commercial banks, which became more aware of the opportunities represented by the largely untapped market represented by micro- and small enterprises, liberal professions and family associations. This resulted in the launch of various financial products more in line with microfinance, since they were allowed to take deposits and offer a wider array of services.

Despite the competition, several MFIs managed to strengthen their position by establishing their operations in geographical areas less covered by the banking network and/or by offering training and consultancy as complementary services, generally establishing a closer relationship with their clients than a bank.

The experience of this period has shown that in order to expand the provision of microcredits into the provision of microfinance, the MFIs would have benefited from having a commercial bank's status and the case of ProCredit Bank Romania

confirmed this situation[2]. However, no new bank dedicated to microfinance entered the market.

April 2009 to present

In April 2009, Law no. 93/2009 was enforced in order to enable the provision of a wider range of (micro-) lending activities such as consumer credit, the issuance of credit cards and leasing. Law no.93/ 2009 in fact upgraded Ordinance no. 28/2006, which regulated lending activities other than micro-lending. The entities partaking in the enlarged array of credit activities, including micro-lending, were defined as non-bank financial institutions (NBFIs) and, as in the case of MFIs under 2005 law, were required to register as joint stock companies and to have a minimum capital level of EUR 200 000 (USD 175 400). Law no.240/2005 was revoked and MFIs lost their distinct status; the provision of microfinance was included in a vast array of financial services.

Based on the RNB registers for NBFIs, as of December 2014, 73 institutions that listed micro-lending in their product portfolio were identified, and of these, only two institutions are dedicated only to micro-lending. The evolution of NBFIs, which included micro-lending in their portfolio, or dedicated exclusively their activity to micro-lending, is presented in Table 1, based on the year when they were authorised by the RNB. As can be seen, following Ordinance no. 28/2006, the highest number of NBFIs that ended up including micro-lending among their products were established in 2007, followed by 2008. During the financial crisis, the creation of such institutions remained at modest levels, while 2014 showed and increased interest toward this sector.

Table 1: Evolution of NBFIs with micro-lending in their product portfolio, end of the year

	2006	2007	2008	2009	2010	2011	2012	2013	2014
Registered with RNB	12	41	19	5	2	3	5	3	8
Cancelled authorisation	0	0	2	2	3	3	5	5	5
Active	12	53	70	73	72	72	72	70	73

Source: Authors' calculations based on the RNB data available at http://www.bnro.ro/Registrele-BNR-717.aspx

2 A case study dedicated to ProCredit Bank Romania can be found in McGlynn (2009).

3. EMPIRICAL INVESTIGATIONS ON ROMANIAN MFIS

In order to identify the NBFIs dedicated to microfinance, a brief analysis of the 73 active institutions was performed based on the activities mentioned in RNB registers and, where available, on their websites. The results of this brief analysis revealed the following: only two NBFIs concentrate their activity only on micro-lending; the remaining 71 NBFIs listed micro-lending among other credit products; and of these 71 NBFIs, 12 are part of large banking groups and their main focus is on leasing, 24 have no websites; the remaining 35 NBFIs were assessed in order to see whether they can be included within the MFI category. Ultimately, only 19 NBFIs were identified and could be considered as true MFIs; of these, only 14 are currently active, one of them being authorised by RNB only in 2014.

The evolution of identified MFIs is presented in Table 2 below. The identification was made taking into consideration the lending activities declared with RNB and the history of the respective MFI. The new MFIs of 2013 and 2014 were considered only if they targeted clearly micro-enterprises, independent entrepreneurs and farmers.

Table 2: Evolution of identified MFIs

	2006	2007	2008	2009	2010	2011	2012	2013	2014
Registered with RNB	2	11	2	1	1	0	1	0	1
Cancelled authorisation	0	0	1	0	1	1	1	1	0
Active	2	13	14	15	15	14	14	13	14

Source: Authors' calculations based on the RNB data available at http://www.bnro.ro/Registrele-BNR-717.aspx

The list with the identified active MFIs is presented in Table 3 below; the information was crossed with several previous studies of Romanian microfinance. Detailed information regarding the active MFIs and those with cancelled authorisations can be found in Annexes 1 and 2.

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3 The study of Doiciu and Bialus (2010) mentions also Pozitiv (Societate de Microfinantare) as MFI. However, the present investigations did not reveal the presence of this entity among MFIs in neither RNB registers. It is likely that the entity registered under 2005 law but failed to register with RNB under 2006 ordinance and therefore disappeared as NBFI.

4 Another NBFI that would have the profile of an MFI is Omega Top from Hundeoara County. Therefore, it was eliminated from the study based on media sources indicating that the entity is under investigation for involvement in criminal actions regarding their lending practices.

Table 3: Active MFIs

Identified MFIs based on previous studies[3]	Newly-identified MFIs[4]
Societatea de Finantare Rurala FAER	RoCredit
Societatea de Finantare Rurala LAM	BGA Microcredit
Societatea de Microfinantare Romcom	Creditul Fermierului
Opportunity Microcredit Romania	Brise Capital Group
Vitas (former Express Finance)	
Societatea de Microfinantare Aurora	
Imocredit/ Microimo	
Patria Credit (former CAPA Finance)	
Fair Credit House	
Good Bee Credit (former CDE)	

Sources: RNB registers http://www.bnro.ro/Registrele-BNR-717.aspx, Doiciu & Bialus (2010), Savescu (2012), Szabo (2014), Eurom Consultancy & Studies (2008, 2010), Mihai et al. (2008)

A further analysis takes into consideration only these 14 MFIs. The main hypothesis under investigation was: *the identified MFIs are rather for-profit and not social oriented entities.* This hypothesis is investigated based on the 14 MFIs' outreach and related activities captured through four features: equity capital, loan portfolio, estimated number of loans, and return on equity (ROE).

Annex 3 presents the situation of MFIs' outreach at county level. The unemployment rate and the percentage of rural population were taken into consideration to assess the poverty risk; these two measures were combined with the percentage of family enterprises and tourists that capture some of the economic potential of the respective county. These two measures were chosen due to the data availability at county level. The information provided by the four measures was crossed with the poverty risk rate available only since 2007.

The data in Annex 3 reveals that the 14 active MFIs have a poor coverage of the counties with high poverty risk; only four out of the nine high risk counties actually benefitted from the presence of MFIs. The remaining five counties were completely ignored by the MFIs under consideration. It may be argued that the number of MFIs increases as the poverty risk decreases. For the nine counties with high poverty risk, the average number of MFIs per county is one (only one of these counties could boast three MFIs). The 11 counties with moderate to high poverty risk have an average of two MFIs per county. The average of MFIs per county increases to three for the next 11 counties with moderate poverty

risk, while for the remaining counties with moderate to low and low poverty risk, the average is four MFIs per county. This simple analysis indicates the *for-profit* orientation of many MFIs.

In order to support this finding, further investigations were conducted. The level of MFIs outreach was converted into points taking into consideration the number of branches within a county and the location of respective branches/ headquarters. If a branch is located in a county residence, the number of points allocated was 1; if the branch was located in a town other than the county residence, it received two points; the location of branch within rural localities received three points. The reasoning behind this point allocation was that the population most exposed to poverty risk is located in smaller towns and rural localities and moreover for small farmers it is easier to have a finance institution close to their home. The outreach of MFIs increases as they are located closer to the population at risk; this category of population will seldom travel to county residences in order to search for a micro-loan. In the absence of MFIs, they would rather use informal sources of lending such as from friends and relatives or formal sources other than microfinance (such as provided by credit unions and cooperative banks), if available. The geographical proximity influence on the use of financial services by low income households was investigated and confirmed by Brown et al. (2013).

A multiple OLS regression was used to relate the MFIs' outreach level converted in points (dependent variable) to the first four measures (independent variables). The four independent variables (unemployment rate, percentage of rural population, percentage of family enterprises, and percentage of tourists) are generally uncorrelated. The only strong significant negative correlation appeared between rural population and percentage of tourists, indicating that the counties with high levels of rural populations are the least attractive for tourists, depriving the respective rural areas of an alternative income source and increasing the poverty risk. The general equation of multiple regressions used is:

$$\text{Outreach}_t = b_0 + b_1 U_t + b_2 RP_t + b_3 FE_t + b_4 T_t + \varepsilon_t$$

The regression results are presented in Table 4 below. These results confirm the idea that MFIs are commercial (for-profit) oriented, since the increase of outreach level is negatively correlated with the rural population and unemployment rate (however, only at 84% confidence level) and is positively correlated with the presence of family enterprises. The absence of tourists seems to increase the outreach.

However, it would be difficult to prove conclusively that MFIs try to encourage the development of small business to attract tourists. The model indicates a significant relationship that explains 39.45% of the outreach level variability.

Table 4: Multiple linear regression results for MFIs' outreach level

Parameters	Estimate	P-value	R-squared adjusted
Constant	12.2729	0.0006	-
U (unemployment rate)	-0.32231	0.1608	-
RP (rural population)	-0.15669	0.0006	-
FE (family enterprises)	1.28594	0.0007	-
T (tourists)	-0.41656	0.0691	-
Model	-	0.0001	39.4512

The results from multiple regressions were verified against the poverty risk rate. A simple linear regression between the MFIs' outreach level and the poverty risk rate was used. The results indicate a moderate negative correlation of -0.3711 (P-value 0.0156) between the MFIs' outreach level and the poverty risk rate, with an adjusted R-squared of 11.6132. These second results partly confirm the for-profit orientation of the 14 MFIs under scrutiny. Therefore, these results should be considered with care since they were adapted at county level as Note 5 of Annex 3 explains.

Furthermore, the activity of the 14 MFIs was placed under scrutiny through the four features mentioned above: equity capital, loan portfolio, estimated number of loans, and return on equity (ROE). These measures were chosen based on data availability; the simplified balance sheet available through the Ministry of Finance website not allowing for more in-depth calculations. The data are presented in Annex 4 and they are available only for 2008 to 2013. Since most MFIs registered as NBFIs in 2006 and 2007, earlier data would have not been concluded. Annex 4 data indicate that, in general, the MFIs under scrutiny exhibit positive ROE; only two MFIs consistently generated losses for the period 2008 to 2013, while a third managed to turn up to profit after four years of negative performance. The majority of MFIs are of small dimension, with an equity capital less than RON 10 million, a loan portfolio less than RON 25 million, and an estimated number of loans lower than 1 000 per annum. Therefore, they registered an increase in both equity capital and loan portfolio over the six-year span. The level of ROE indirectly indicates that the interest rates for the loans were high since with such a low nativity level the respective MFIs managed to be profitable over a period considered difficult for all, the crisis of 2007-2012. The Annex 4 data confirm the for-profit orientation of the 14 MFIs.

This information is combined with the lack of evidence regarding group lending. Only one entity (position 11 in Annex 1) practised group guarantees and only under an international funded programme as presented by Doiciu and Bialus (2010). The virtual absence of group lending, a feature of pro-poor-oriented MFIs, further enhances the commercial orientation of Romanian MFIs. Moreover, to this data the information from Annex 2 should be added. One of the very few MFIs considered to be socially oriented had to give up this status and be transformed into another entity, probably due to the impossibility to financially support its activity as socially-oriented MFI.

Considering all the above, the hypothesis that *the identified MFIs are rather for-profit and not socially-oriented entities is confirmed.*

The data in Annexes 5, 6 and 7 add to this confirmation by indicating that Romanian MFIs do not target women (empowering women being one of the social features of MFIs at international level), have a very low write-off ratio and a high average loan balance per borrower, almost six times the world average. The data from Annexes 5 and 6 should be considered with care, however, since not all the MFIs are reporting to MIX Market and for Europe only MFIs from three countries (Poland, Romania and Bulgaria) are reporting every year. Moreover, for Romania, the picture is further somewhat distorted since one of the reporting entities is a bank dedicated to microfinance. However, even with a partial picture, the Romanian microfinance sector emerged to be an important one at the level of Central and Eastern Europe despite its rather commercial orientation.

The main findings of the Central and Eastern Europe microfinance sector, based on the studies of Guichandut et al. (2007), Kraemer-Eis and Conforti (2009), Bruhn-Leon et al. (2012), D'Espallier et al. (2013), and Maas and Laemmermann (2012) include:

1. Microfinance operations began during the 1990s as private initiatives often backed by international donors/funders;
2. microfinance operations started in order to fill the gap of underdeveloped banking systems with low density;
3. microfinance was not seen as an alternative to alleviate poverty and exclusion (mainly in Bulgaria, Czech Republic, Romania and Slovakia);
4. a transformation process of MFIs from NGOs into more formal and regulated entities was observed;
5. the dominant feature is micro-lending and is focused on micro-enterprises;

6. MFIs are unsubsidised and find it more suitable to target less poor clients; this feature is also triggered by financially opaque households, without formal income sources and pledgeable assets, as documented by Beck and Brown (2012);
7. women are under-represented as MFI clients; and
8. MFIs are profitable and sustainable, and therefore they find it difficult to access stable external sources of funding.

The Romanian microfinance sector exhibits all these features: the sector was launched during the first half of the 1990s as private initiatives funded by international donors, as Annex 1 shows. Operations started to fill the gap of (then) state-owned banking system that almost completely ignored micro- and small enterprises. Therefore, the same banking sector is today a fierce competitor for NBFIs providing microloans. Micro-lending was never subsidised by Romanian government funds. The microfinance sector underwent the transformation from NGOs into NBFIs under regulations imposed between 2005 and 2009. The commercial orientation of Romanian identified MFIs was presented in the paragraphs above and it is confirmed by CSFI (2009), which cites Romania as one of the countries where social lending has almost disappeared, and by CSFI (2012), which mentions the over-commercialisation of the micro-lending sector. The difficulty to access external sources of funding is confirmed by CSFI (2014), which mentions that, since Romania became a member of the European Union, some international donors withdrew because they think microfinance is no longer needed.

4. DISCUSSION

The brief survey presented above indicates that Romanian MFIs drifted from the stated mission of modern microfinance to alleviate poverty through entrepreneurship. This drift has its roots in the beginning of modern microfinance in Romania, over two decades ago, and was rather related to fill a gap within the supply of domestic banking system. The social dimension remained as a secondary goal and this is confirmed by identified MFIs' outreach, performances, and the small number of old MFIs considered to be socially oriented.

The reasons for the commercially-oriented MFIs in Romania are numerous. The identification of poor or very poor clients willing to become entrepreneurs is difficult and tedious, while loan delinquency might be very high among such clients. Furthermore, the difficulty to perform wealth verification of poor

individual borrowers is confirmed by Aubert et al. (2009), while the level of risk associated with them is supported by Maas and Laemmermann (2012).

Moreover, Romanian MFIs are of small dimensions implying that the (human) resources allocated to identify clients are limited. Therefore, the focus toward micro- and small business in need of loans is easier and yields better results for the unsubsidised MFIs. Furthermore, the drift was induced by the regulation framework introduced since 2005. The RNB (Romanian National Bank) as regulatory body had as its principal goal to protect the investors' capital and to reduce as much as possible the criminal practices related to abusive lending activities, given the experiences of the 1990s. By including micro-lending, the competition level increased and social lending was left aside. Cull et al. (2011) confirm the idea of a trade-off between performance and outreach under the influence of prudential financial regulation.

The Romanian MFIs are also in competition with the domestic banks. All the 28 domestic banks registered with the RNB list among their products loans for micro- and small enterprises, family associations, and liberal professions. As banks, they can also offer saving products and other (needed) financial products. Three of these banks (Banca Transilvania, ProCredit Bank Romania, and Libra Internet Bank) are clearly dedicated to microfinance. Banca Transilvania is currently among the top three Romanian banks and has one of the best geographical coverage of all Romanian counties. The resources of these banks allow them to invest in marketing campaigns, internet banking services, and to allocate human resources to attract new clients. However, according to CSFI (2014), Romanian MFI executives consider the banks to be very aggressive with questionable ethics, especially in relation with micro-clients.

To the important competition represented by banks, however, two other groups of competitors must be added. In both cases, an extended territorial network exists, covering mainly small towns.

The first group is represented by the credit unions. Currently, 2 816 such entities are registered with RNB. They are associations of individuals that have in common the same or similar working place. These credit unions provide mutual financial aid exclusively to their members and most of the time they smooth consumptions; any loan amount is based on each member's contribution. It is estimated that 20 to 25% of the credit union loans are used to finance alternative independent activities or micro-enterprises. However, this estimation is difficult to prove given the level of

confidentiality. Therefore, it must be mentioned that several of these credit unions perceived the opportunity to extend their activity outside the inner circle of their members and became shareholders of one of the MFIs under scrutiny, Societatea de Microfinantare Aurora, one of the two MFIs dedicated only to micro lending and with an extended network in Hunedoara County.

The second group is represented by often overlooked cooperative banks. Currently, in Romania, 42 such entities, affiliated to a central house in Bucharest, are registered with RNB. Similar to credit unions, they provide financial support to their members based on their contributions and savings. These cooperative banks have a long history, existing at least since the beginning of the 20th century and they are well known among their members. Unfortunately, these cooperative banks were overlooked by academic studies and currently it is not clear how large their credit pool is or how their client profile is made up. Therefore, they represent important competitors for MFIs given their old roots.

Given this highly competitive environment and in the absence of direct subsidies offered by the Romanian government[5], MFIs choose the commercial orientation. This drift is common for pro-profit MFIs worldwide under the pressure of increased competition, as shown by Weiss and Montgomery (2005) and Cull et al. (2009b). Therefore, the 14 MFIs under scrutiny concentrate very little of the total lending, as Table 5 indicates. The competition is uneven since the dedicated microfinance banks, the credit unions, and the cooperative banks are typically better equipped to provide a wider range of microfinance products than the dedicated to micro-lending NBFIs and have a better geographical outreach.

Table 5: Percentage of MFIs under scrutiny loan portfolio in total domestic credit (%)

2008	2009	2010	2011	2012	2013
0.17	0.12	0.14	0.18	0.23	0.25

Simplified balance sheet data provided by Ministry of Finance available at http://www.mfinante.ro/agentinume.html?pagina=domenii (Romanian only), RNB data (www.bnro.ro), and authors' calculations

In order to differentiate themselves, the older MFIs (positions 1 to 6, 9 and 11 from Annex 1) attempt to develop a closer relationship with their clients.

5 According to Doiciu and Bialus (2010), several MFIs participated in the implementation of the Romanian Facility Micro Credit Scheme, a financial facility launched in 2006/2007 by European Bank for Reconstruction and Development. Other older programmes such as Rural Development Programme and The Micro credit programme for the unemployed were co-financed by the Romanian government in partnership with international financial institutions and donors.

Furthermore, two of these MFIs (position 2 and 6 from Annex 1) use social networks in order to reach their clients; in the case of position 2 (Societatea de Finantare Rurala LAM), the social network is related to the Protestant Church of Romania, while in the case of position 6 (Societatea de Microfinantare Aurora), the network is provided by the members of credit unions that are also the MFI's shareholders. The role of social networks in individuals' decision-making was suggested by Wydick et al. (2011). Therefore, while this provides a social component to respective MFIs' activities, the social lending remains marginal and based mainly on international donors/funders' contributions for most MFIs under scrutiny.

This commercial profile of Romanian MFIs is up to a point influenced by the whole domestic economic (mainly regulatory and fiscal) and social environment. As Ahlin et al. (2011) highlighted, the country context appears to be an important determinant of MFIs' performance and orientation toward social or commercial goal. Therefore, as the data show, Romanian MFIs are small and almost unknown outside relatively closed groups of clients. Most of the population is unaware that MFIs exist and what they offer[6]. The situation is similar to that presented by Ghinaru and Mocanu (2005) ten years ago.

The implementation of microfinance in Romania took place under the influence of international financial institutions at the beginning of the 1990s and ignored the existing institutions that could have enhanced the profile of microfinance in Romania. This situation is similar with that pointed out by Hulme and Mosley (1996), who consider that, ironically, the success of the 'first wave' of microfinance, particularly Grameen Bank, became the very obstacle to future experimentation; most designers and sponsors of new initiatives have abandoned innovation, and 'replication' is leading to a growing uniformity in financial interventions.

The success model of microfinance in one region cannot be copied with the same success in other regions. Domestic factors should be considered (e.g. in Romania women have equal rights and, in general, do not need empowerment to conduct business and run their own life) and innovation is needed to implement and adapt microfinance and MFIs to national social and cultural-specific features. This idea

6 Given their small dimensions, the 14 MFIs under scrutiny cannot afford marketing campaigns and probably rely on mouth to ear channels in most cases, along with the information available on their websites. No marketing campaign could be identified for any of these MFIs.

is supported by the findings of Mersland and Stroem (2009), suggesting that there is a need to better understand how MFIs can tap into local information networks.

5. CONCLUSIONS

The paper presents a structured survey of the Romanian microfinance sector and of its mission drift. The reasons for the low level of microfinance development and for its commercial orientation were discussed above. The situation is mainly due to the 'import' of modern microfinance concepts within a country that already had other financial institutions better equipped to provide financial services with a social component such as the credit unions and cooperative banks. Another important reason is provided by the prudential regulation that transformed micro-lending in just another credit product. Under such conditions, MFIs are small and their lending activity is negligible. They are virtually unknown outside (relatively) closed groups of clients.

The banks dedicated to microfinance and the cooperative banks are better situated to provide the entire range of microfinance products than the NBFIs (partly) dedicated to micro-lending. This idea suggests that the savings component should be considered, as shown by Cull et al. (2011), who consider that MFIs should broaden their services towards offering (more) deposits, in concordance with Leikem (2012), stating that savings are vital and more important to the poor than loans. Therefore, potential alliances are needed if microfinance is to emerge from its current shadow. This implies the inclusion of the country specifics into this sector's future development.

The paper provides only a partial picture of microfinance in Romania; as the research developed, it became clear that, in order to assess the entire microfinance sector, the dedicated banks, the credit unions and cooperative bank products should be included in a future, larger study.

The limits of this the present study comes from the use of secondary available data only. Therefore, the use of questionnaires was not taken into consideration due to previous trials with insignificant response rates and the reluctance of NBFIs to provide information due to confidentiality reasons. Despite these limitations, the paper adds to the existing literature by confirming Romanian microfinance's low profile and its stated unproved mission drift. Moreover, the main suggestion is that the microfinance sector in Romania should, finally, include the country specifics within its further developments.

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Annex 1: Active Romanian NBFIs focused on microlending

No.	General information and registered activities	Headquarter and branches[1]	Equity capital and shareholder structure as of December 2014	Other information
1	Societatea de Finantare Rurala FAER www.faer.ro (former Societatea de Microfinantare Rurala FAER) registered as NBFI in 2006 *consumer lending* *mortgage lending* *microlending*	***Reghin, Mures county*** branches in 2 other counties	RON 7,519,100 100% Romanian (2 Romanian foundations – majority and individual persons)	member of EMN (Belgium) *founded in 1992, having as main sponsor: the Organization to Help Evangelic Churches in Switzerland; considered to be social and commercial oriented MFI, having among the main clients small farmers (Doiciu & Bialus, 2010)*
2	Societatea de Finantare Rurala LAM www.lamilieni.ro registered as NBFI in 2007 *consumer lending* *mortgage lending* *microlending*	***Sf.Gheorghe, Covasna county*** branches in 4 other counties	RON 4,878,000 100% Romanian (a foundation, an economic entity and individual persons)	reporting to MIX rated by Microfinanza Rating *founded in 1992; having as main sponsor: the Organization to Help Evangelic Churches in Switzerland; social and commercial oriented MFI, having among the main clients small farmers (Doiciu & Bialus, 2010)*
3	Societatea de Microfinantare Romcom www.romcom.ro registered as NBFI in 2007 *microlending* *letters of guarantee*	***Oradea, Bihor county*** no other branches	RON 4,744,350 100% Romanian (a foundation as majority shareholder and individal persons)	reporting to MIX member of EMN (Belgium), MFC (Poland), Hope International (US) networks rated by Microfinanza Rating currently financed mainly by Oikocredit Netherlands *founded in 1992 as an iniative of Christliche Ostmission, Switzerland; social oriented MFI; offering a microentrepreneur club and training programs (Doiciu & Bialus, 2010)*

4	Opportunity Microcredit Romania www.opportunity.ro (former Societatea de Microfinantare OMRO[2]) registered as NBFI in 2007 *consumer lending, mortgage lending, microlending, commercial transactions financing, factoring, discounting of receivables, forfaiting, financial leasing, letters of guarantee*	***Tg.Mures, Mures county*** ***braches in 7 other counties***	RON 13,853,665 mix of foreign and Romanian shareholders (Opportunity USA, majority shareholder; Romanian foundation minority shareholder)	reporting to MIX member of MFC (Poland) and Opportunity Intl (USA) networks rated by Microfinanza Rating currently financed mainly by Oikocredit Netherlands and EFSE Luxembourg *established as Izvor Foundation in 1995 (non-for profit organization); the same year it became Banca Populara Izvor (similar to a cooperative bank); social and commercial oriented MFI; offering a microentrepreneur club and training programs (Doiciu & Bialus, 2010)*
5	Vitas www.vitasromania.ro (former Express Finance) registered as NBFI in 2007 *consumer lending* *mortgage lending* *microlending*	***Timisoara, Timis county*** braches in 8 other counties	RON 6,192,260 100% foreign (CHF International)	reporting to MIX member in networks: Global Communities (Swiss), MFC (Poland) currently financed mainly by Oikocredit Netherlands establihed initally as CHF Romania in 1997/1998; social and commercial oriented MFI; it targeted also former miners (Doiciu & Bialus, 2010)
6	Societatea de Microfinantare Aurora http://www.aurora.com.ro/ registered as NBFI in 2007 *microlending*	***Deva, Hunedoara county (7 branches within home county)*** braches in 4 other counties	RON 7,220,000 100% Romanian a mix of credit unions registered in Hunedoara county (majority) and individual persons	commercial oriented MFI (Doiciu & Bialus, 2010)

7	Imocredit/ Microimo (absorbed Mircoimo in 2012) www.imogrup.ro registered as NBFI in 2007 (Microimo) *consumer lending, mortgage lending, microlending, commercial transactions financing, factoring, discounting of receivables, forfaiting, financial leasing, letters of guarantee*	***Cluj-Napoca, Cluj county*** braches in 5 other counties	RON 26,456,485 100% Romanian a mix of economic entities (majority) and individual persons	
8	RoCredit www.rocredit-ifn.ro registered as NBFI in 2007 *consumer lending, microlending commercial transactions financing, discounting of receivables, letters of guarantee*	***Baia-Mare, Maramures county*** braches in 9 other counties	RON 23,940,150 100% Romanian individual persons	
9	Patria Credit3 www.patriacredit.ro (former Capa Finance between 2004 and 2008) registered as NBFI in 2008 *consumer lending, mortgage lending, microlending, commercial transactions financing, factoring, letters of guarantee*	***Voluntari, Ilfov county*** braches in 27 other counties	RON 65,579,614 99.7% foreign 0.30% Romanian	reporting to MIX member of EMN (Belgium), MFC (Poland), World Vison (USA) networks rated by MicroRate currently financed mainly by EFSE (Luxembourg), MicroVest (USA) innitially funded by World Vision and setup as CAPA Foundation; transformed in joint stock company in 2004; social and commercial oriented MFI (Doiciu & Bialus, 2010)

10	Fair Credit House4 NO WEBSITE registered as NBFI in 2008 *consumer lending, microlending commercial transactions financing, factoring, discounting of receivables, forfaiting*	***Bucharest*** no other branches	RON 834,000 100% Romanian a mix of economic entities (majority) and individual persons	
11	Good Bee Credit www.goodbeecredit.ro (former CDE or Fundatia Centrul pentru Dezvoltare Economica) registered as NBFI in 2009 *consumer lending, mortgage lending, microlending, commercial transactions financing, factoring, letters of guarantee*	***Bucharest*** braches in 17 other counties	RON 5,414,266 100% foreign (German)	CDE was sponsored by Open Society Foundation; CDE was member of Soros Open Network (Doiciu & Bialus, 2010) as long as CDE lasted as MFI it was considered a social oriented institution; CDE used individual lending with group guarantees within and World Bank funded program; CDE was involved in a project of economic development of Rroma (gypsy) communities (Doiciu & Bialus, 2010)
12	BGA Microcredit http://bga.sc16.co.uk/ registered as NBFI in 2010 *microlending*	***Oderheiul Secuiesc, Harghita county*** no other branches	RON 900,000 100% Romanian one foundation (majority) and one individual person	

13	Creditul Fermierului www.creditulfermierului.ro registered as NBFI in 2012 *consumer lending, mortgage lending, microlending, commercial transactions financing, factoring, discounting of receivables, forfaiting, financial leasing, letters of guarantee*	***Iasi, Iasi county*** no other branches	RON 9,010,000 100% Romanian a mix of economic entities and individual persons	
14	Brise Capital Group NO WEBSITE registered as NBFI in 2014 *consumer lending, mortgage lending, microlending, commercial transactions financing, factoring, discounting of receivables, forfaiting, financial leasing, letters of guarantee*	***Constanta, Constanta county*** no other branches	RON 1,000,000 100% Romanian one economic entity, one individual person	Member of Brise Group Romanian, one of the largest cereals trader within the country.

Sources: http://www.bnro.ro/Registrele-BNR-717.aspx, http://www.onrc.ro/index.php/ro/, www.mixmarket.org/mfi/country/Romania/organizations, Doiciu & Bialus (2010)

Note 1: for simplicity, Bucharest was asimilated to a county

Note 2: More details about OMRO transformations can be found in Kostov (2005

Note 3: Romanian media reported that Nextebank Romania announced during 2013 its intention to take over Patria Credit (http://www.bursa.ro/axxess-capital-vrea-ca-nextebank-sa-absoarba-patria-credit-213234&s=banci_asigurari&articol=213234.html). No other information regarding this intention could be found. Also it must be mentioned that Patri Credit applied to RNB for a bank authorization, but the application was rejected.

Note 4: This MFI was kept in the list without webside because it was identified by previous studies as MFI

Annex 2: NBFIs with canceled authorization that in the past qualified as MFIs

No.	General information	Headquarter	Comments
1	Integra Microfinantare registered as NBFI in 2007	Oradea, Bihor county	Authorization withdrew by RNB in 2008. Was transformed in the limited liability company Hiro Cons srl. Integra Microfinantare reported to MIX until its activity as NBFI ceased. *It was considered a social oriented MFI, supporting women entrepreneurs. As of 2006 it had a loan portfolio of EUR 313,222 and 135 active borrowers (Doiciu & Bialus, 2010)*
2	Ducat Societate de Microfinantare registered as NBFI in 2006	Bucharest	Authorization withdrew by RNB in 2010. Continues to exist as a limited liability company named Ducat srl.
3	Interomega (former Interomega Societate de Microfinantare) registered as NBFI in 2007	Galati, Galati county	Authorization withdrew by RNB in 2011. The company ceased its activity in 2012.
4	Societatea de Microfinantare Tomis registered as NBFI in 2007	Constanta, Constanta county	Authorization withdrew by RNB in 2012. Continues to exist as a limited liability company named Microfin Tomis srl
5	Grup Financiar registered as NBFI in 2007	Galati, Galati county	Authorization withdrew by RNB in 2013. Under criminal charges and investigation.

Sources: http://www.bnro.ro/Registrele-BNR-717.aspx, http://www.onrc.ro/index.php/ro/, www.mixmarket.org/mfi/country/Romania/organizations, Doiciu & Bialus (2010)

Annex 3: Poverty risk level by county and the presence of the active MFIs

County	Unemployment rate (%)1	Rural population (%)[1]	Family enterprises (%)[2]	Tourists (%)[2]	Poverty risk rate (%)[3]	Level of poverty risk[4]	Number of MFIs within the county	Points for MFIs outreach
Vaslui	13.64	57.85	1.90	0.52	32.8	high	0	0
Ialomita	9.92	56.93	1.67	0.63	22.9	high	1	1
Buzau	9.76	59.06	1.15	0.99	28.0	high	1	1
Mehedinti	9.17	51.46	1.16	0.79	32.9	high	1	1
Teleorman	9.12	66.06	2.05	0.24	22.9	high	0	0
Tulcea	8.96	51.04	0.87	1.03	28.0	high	0	0
Gorj	8.47	55.64	1.50	0.94	32.9	high	3	3
Calarasi	8.19	60.96	1.24	0.19	22.9	high	0	0
Giurgiu	7.22	69.23	0.60	0.31	22.9	high	0	0
Neamt	10.58	60.82	3.78	2.07	32.8	moderate-high	2	5
Galati	10.43	41.84	2.85	0.95	28.0	moderate-high	1	1
Botosani	10.20	59.77	2.32	0.52	32.8	moderate-high	1	1
Valcea	9.55	57.14	3.74	3.40	32.9	moderate-high	1	1
Braila	9.49	34.36	1.12	1.04	28.0	moderate-high	2	4
Dolj	9.36	48.05	2.26	0.97	32.9	moderate-high	2	4
Suceava	8.89	61.54	5.03	3.19	32.8	moderate-high	3	8
Iasi	8.80	51.55	3.58	2.45	32.8	moderate-high	3	5
Bacau	8.40	52.21	2.72	2.13	32.8	moderate-high	1	1
Olt	8.31	59.99	3.13	0.44	32.9	moderate-high	2	5
Vrancea	6.43	61.91	1.14	0.59	28.0	moderate-high	1	1
Hunedoara	10.88	23.58	3.24	1.62	17.5	moderate	3	19
Bistrita-Nasaud	9.14	63.09	2.61	1.12	17.9	moderate	4	4
Alba	9.12	42.01	2.01	1.12	18.4	moderate	6	6
Caras-Severin	8.89	43.51	2.59	1.83	17.5	moderate	2	2
Harghita	8.58	55.09	2.68	1.60	18.4	moderate	3	6
Covasna	8.58	48.73	0.90	1.10	18.4	moderate	1	3

Salaj	8.50	58.68	2.03	0.40	17.9	moderate	1	4
Prahova	8.29	48.67	2.33	6.00	22.9	moderate	2	2
Dambovita	8.21	69.05	4.02	1.01	22.9	moderate	1	3
Satu Mare	4.81	53.60	2.42	1.07	17.9	moderate	1	1
Arges	6.88	52.56	4.34	2.09	22.9	moderate	4	4
Maramures	6.17	44.47	6.03	1.63	17.9	moderate-low	4	10
Bihor	4.24	50.37	0.66	3.82	17.9	moderate-low	6	6
Ilfov	3.44	72.93	0.98	1.38	4.8	moderate-low	1	5
Brasov	7.70	25.00	0.92	7.47	18.4	low	5	5
Sibiu	7.37	32.35	1.89	3.57	18.4	low	4	6
Mures	7.36	48.39	3.66	3.28	18.4	low	5	8
Cluj	6.94	32.55	2.11	3.97	17.9	low	5	5
Constanta	6.77	28.39	3.14	13.93	28.0	low	3	5
Arad	5.35	46.67	3.55	2.60	17.5	low	3	7
Timis	4.04	38.24	0.85	3.51	17.5	low	3	5
Bucharest5	3.21	0.00	3.47	12.51	4.8	low	5	7
Average	8.08	49.89	2.39	2.38	23.5	-	2	-

Source: National Institute of Statistics (NIS) data and authors' calculations based on NIS data available at: http://statistici.insse.ro/shop/

Note 1: Average figures for the period 1993-2013

Note 2: Average figures for period 1993-2013. Data calculated as percentage of family enterprises, respective tourists of country total.

Note 3: Average figures for the period 2007-2013. This information was indtroduced by NIS only since 2007 and is available only at regional level; in order to obtain a series of data at county level, all the counties from the same region were considered to have the same poverty risk rate.

Note 4: Assesed by authors based on the first four columns crossed with the fifth column and compared with the country average.

Note 5: Two MFIs have 2 braches within the capital.

Annex 4: Romanian active MFIs dimension and performaces

	2008	2009	2010	2011	2012	2013	2008	2009	2010	2011	2012	2013
	Societatea de Finantare Rurala FAER						Societatea de Finantare Rurala LAM					
equity capital (RON million)	2.94	2.94	4.35	4.71	5.63	6.00	2.61	3.26	3.28	4.88	4.88	4.88
loan portfolio (RON million)	11.43	11.18	11.28	14.73	16.81	19.93	16.16	17.88	17.53	18.31	19.72	22.81
estimated number of loans1	645	523	523	590	837	617	912	836	747	733	982	706
ROE (%)	*0.89*	*16.24*	*8.85*	*20.80*	*19.24*	*17.04*	*12.93*	*20.24*	*27.89*	*23.05*	*18.86*	*12.95*
	Societatea de Microfinantare Romcom						Opportunity Microcredit Romania					
equity capital (RON million)	4.74	n/a	4.74	4.74	4.74	4.74	7.42	11.72	10.85	10.85	13.85	13.85
loan portfolio (RON million)	11.27	n/a	9.17	9.77	13.25	19.04	4.05	4.46	4.47	5.88	6.54	5.87
estimated number of loans	636	n/a	391	391	660	590	229	208	190	236	326	182
ROE (%)	*11.48*	*n/a*	*5.88*	*12.12*	*14.29*	*16.10*	*-35.95*	*-72.78*	*-35.97*	*-30.00*	*-7.08*	*-15.33*
	Vitas						Societatea de Microfinantare Aurora					
equity capital (RON million)	5.59	n/a	5.59	5.59	6.19	6.19	3.50	4.01	4.60	5.05	5.75	6.39
loan portfolio (RON million)	47.92	n/a	16.20	22.39	23.59	25.62	4.05	4.46	4.47	5.88	6.54	5.87
estimated number of loans	2,705	n/a	691	896	1,175	793	229	208	190	236	326	182
ROE (%)	*0.09*	*n/a*	*-16.94*	*13.62*	*17.86*	*13.18*	*5.48*	*12.03*	*7.67*	*9.23*	*7.43*	*8.81*
	Imocredit/ Microimo2						RoCredit					
equity capital (RON million)	1.47	1.47	1.48	1.48	25.68	25.68	15.64	19.62	21.24	22.22	23.07	23.94
loan portfolio (RON million)	1.94	1.44	1.29	1.03	44.18	41.71	31.93	35.41	29.54	39.76	51.02	59.71
estimated number of loans	110	67	55	41	2,201	1,291	1,802	1,656	1,259	1,592	2,541	1,849
ROE (%)	*0.57*	*-27.47*	*1.76*	*2.78*	*7.46*	*7.47*	*18.69*	*6.59*	*8.36*	*7.93*	*7.71*	*4.55*
	Patria Credit						Fair Credit House					
equity capital (RON million)	49.17	49.17	65.48	65.48	65.48	65.48	0.83	n/a	0.83	0.83	0.83	0.83
loan portfolio (RON million)	144.76	125.90	149.54	193.04	225.13	249.15	0.88	n/a	0.74	0.86	0.96	0.93
estimated number of loans	8,171	5,886	6,373	7,727	11,215	7,714	50	n/a	32	35	48	29
ROE (%)	*5.17*	*13.25*	*-7.98*	*5.26*	*13.67*	*14.12*	*4.08*	*n/a*	*-35.58*	*19.19*	*0.47*	*-2.24*

	Good Bee Credit (in activity since 2009)						BGA Microcredit (in activity since 2010)					
equity capital (RON million)	-	5.41	5.41	5.41	5.41	5.41	-	-	0.90	0.90	0.90	0.90
loan portfolio (RON million)	-	2.48	26.91	51.71	74.14	60.08	-	-	0.85	0.51	0.59	0.93
estimated number of loans	-	116	1,147	2,070	3,693	1,860	-	-	36	20	29	29
ROE (%)	-	*-38.96*	*-75.49*	*-52.98*	*-7.82*	*3.81*	-	-	*-4.96*	*-13.58*	*-22.23*	*-46.25*
	Creditul Fermierului (in activity since 2012)						Brise Capital Group (launched in 2014)					
equity capital (RON million)	-	-	-	-	4.51	9.01	-	-	-	-	-	-
loan portfolio (RON million)	-	-	-	-	3.04	7.92	-	-	-	-	-	-
estimated number of loans	-	-	-	-	151	245	-	-	-	-	-	-
ROE (%)	-	-	-	-	*1.24*	*5.86*	-	-	-	-	-	-

Source: Simplified balancesheet data provided by Ministry of Finance available at http://www.mfinante.ro/agentinume.html?pagina=domenii (Romanian only) and authors' calculations

Note 1: The estimated number of loans was calculated using the average loan reported to MIX Market by Romanian MFIs. This estimate is only and indicative one since only 6 MFIs of those investigated are reporting to MIX Market and the average loan is supossed to be higher since the 7th reporting MFI is a microfinace bank, Procredit Romania. Therefore, the real number of loans might be higher than that estimated in this annex.

Note 2: For the years 2008 – 2011 the data come from Microimo and continues with the data for Imocredit which absorbed Microimo.

Annex 5: Reporting MFIs at world, Europe and Romania's level

Year	Reporting MFIs			Gross loan portfolio (USD million)			Number of active borrowers (thousands)					
	World	EU member states*	Romania	World	EU member states*	Romania	World	% of women	EU member states*	% of women	Romania	% of women
1999	160	3	-	1,769.1	2.7	-	9.204	52.66	1	26.66	-	-
2000	238	5	-	2,174.6	5.2	-	10,893	52.20	2	25.71	-	-
2001	360	9	1	2,989.0	10.9	0.9	10,879	51.23	4	21.52	1	-
2002	551	11	3	4, 951.1	51.9	15.4	21,407	39.75	15	22.21	4	22.68
2003	825	18	7	8,483.3	170.4	40.3	27,116	38.52	45	36.04	10	18.40
2004	1,014	19	8	12,284.4	314.0	94.0	33,562	49.70	70	32.29	21	18.91
2005	1,217	33	7	18,243.9	439.5	132.2	49,257	48.57	96	31.13	34	14.72
2006	1,306	33	7	25,676.0	626.2	248.1	59,940	49.77	114	26.59	41	10.66
2007	1, 441	34	7	38,240.0	948.9	394.6	68,798	55.14	141	23.01	53	10.57
2008	1,474	31	6	44,690.6	1,084.5	401.5	84,566	49.12	146	18.34	57	7.62
2009	1,487	29	6	75,744.2	1,038.1	344.2	98,630	42.44	126	18.50	49	7.78
2010	1,466	23	6	91,018.8	1,053.6	317.6	102,639	55.71	98	16.81	43	6.14
2011	1,393	17	5	91,162.0	1,162.2	336.9	94,275	60.67	58	26.72	41	5.46
2012	1,120	12	4	99,789.2	644.2	369.4	94,532	57.40	39	27.69	15	8.98
2013	797	13	5	72,261.2	1,793.8	446.8	87,345	55.76	45	31.37	12	7.42

*The available data cover the period 1999 to 2013 for Bulgaria, 2000 to 2013 for Poland, 2001 to 2013 for Romania, 1999 to 2001for Slovakia, and 2003 to 2007 for Hungary.

Source: Based on Mix Market data available at http://reports.mixmarket.org/crossmarket accessed January 31st 2015

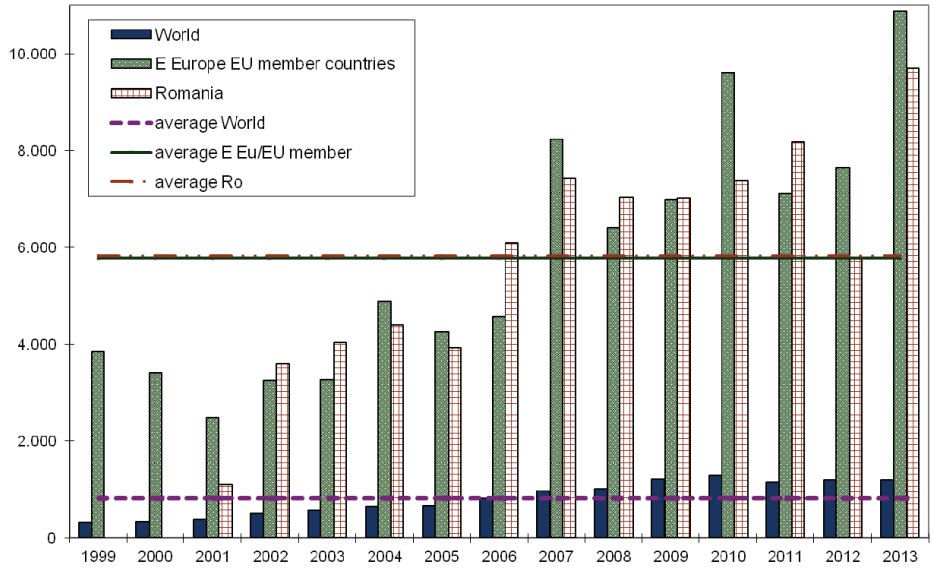
Annex 6: Performances of reporting MFIs at world, Europe and Romania's level

Year	Debt to equity ratio			Return on assets (%)			Return on equity (%)			Write-off ratio (%)		
	World	EU member states*	Romania	World	EU member states*	Romania	World	EU member states*	Romania	World	EU member states*	Romania
1999	1.82	0.56	-	1.94	0.22	-	5.29	0.22	-	1.23	-	-
2000	2.43	6.40	-	2.71	-10.09	-	8.51	-25.40	-	1.21	-	-
2001	3.16	16.33	0.53	3.36	-15.03	-	12.57	57.24	-	1.50	0.44	-
2002	3.46	21.28	0.87	3.43	2.51	5.05	12.83	162.88	9.09	1.02	0.55	-
2003	2.79	2.66	1.44	2.99	0.46	-1.44	11.46	13.35	-3.20	1.80	0.38	0.33
2004	2.94	2.01	3.30	2.14	-1.31	-0.58	8.45	0.03	-2.09	1.17	0.68	0.34
2005	3.47	3.29	6.03	2.03	0.58	1.23	8.42	4.10	7.02	1.25	0.50	0.61
2006	3.65	3.82	8.08	2.28	1.11	1.11	10.62	4.93	9.32	1.09	1.28	0.43
2007	4.07	4.52	8.59	2.49	0.47	0.33	11.78	2.78	3.15	1.03	0.68	0.34
2008	3.97	5.56	7.54	1.83	0.91	-0.64	9.61	3.99	-5.77	1.56	0.83	0.71
2009	4.07	5.13	7.97	1.58	-0.34	-2.43	8.10	-2.49	-21.24	2.09	1.36	1.33
2010	4.78	5.80	5.81	2.02	-8.26	-1.61	9.53	-31.73	-12.72	2.16	1.05	1.31
2011	4.79	7.65	6.25	1.58	-0.39	0.56	8.40	-3.32	3.93	2.21	3.55	0.86
2012	5.10	8.35	9.20	1.71	0.28	0.23	7.38	-5.76	2.36	1.87	3.85	0.10
2013	4.60	6.92	6.36	2.18	-0.95	0.35	11.07	0.10	3.52	1.19	0.77	0.08
Avg.	3.67	6.69	5.54	2.28	-1.99	0.18	9.60	12.06	-0.57	1.49	1.22	0.59

* The available data cover the period 1999 to 2013 for Bulgaria, 2000 to 2013 for Poland, 2001 to 2013 for Romania, 1999 to 2001for Slovakia, and 2003 to 2007 for Hungary.

Source: Based on Mix Market data available at http://reports.mixmarket.org/crossmarket accessed January 31st 2015

Annex 7: Average loan balance per borrower (USD)



Source: Based on Mix Market data available at http://reports.mixmarket.org/crossmarket accessed January 31st 2015

THE IMPACT OF INSURANCE LEGISLATION' LATEST CHANGES ON ROMANIAN INSURANCE MARKET

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ABSTRACT

The purpose of this paper is to analyze how the changing in Insurance legislation during 2014 will affect the insurance market in the following years. The most significant changes refers to motors' third party liability – price establishing and profitability of this type of insurance. We will analyze the reasons that determined Romanian Financial Supervising Authority (R.F.S.A.) to introduce these new requirements. There will be conducted also a study on insurance companies that are affected by these modifications, in order to emphasize the benefits of the new changes in insurance legislation. In conclusion part there will be pertinent solution for these companies, solution that may be taken into account in order to increase or maintain market share and profit.

Keywords: Motors Third Party Liability, Insurance, Legislation, Romania.

1. INTRODUCTION

Insurance industry in Romania is a very dynamic one as in all countries. Insurance companies make sustained efforts to remain in the market at the same levels of market shares or even to record a higher share than in previous years. In order to reach this important objective, many insurance companies used different strategies, strategies that in some cases were against insurance consumers/clients.

The most used strategies were related in Motors' Third Party Liability (M.T.P.L.) – a mandatory insurance for all registered vehicles in Romania. Based on figures available on Romanian Financial Supervisory Authority (R.F.S.A.) in the first semester of 2014 the level of M.T.P.L. subscription was of Mil. RON 1.393 (this represents and increasing with 8.69% from the same period of 2013, and a total of 43.61% from the Romanian non-life insurance market).

At the end of Q3 of 2014, M.T.P.L. reached the level of Mil. RON 1.944 – almost 11% increase than the last year similar period. This increase is not entirely caused by density of this mandatory insurance, but from the medium price increasing from RON 502 to RON 515 per M.T.P.L. contract (priced increased with 2.5%) - there were 5.3 million contracts (4% increasing compared to the same period of 2013).

2. PREMISES OF A CHANGE – MODIFICATION OF LEGISLATION

As mentioned, insurance companies in order to maintain the market share used a very risky strategy related to M.T.P.L. – a low price in order to have more clients. This strategy was used especially because the clients only searched for the lowest price for this insurance. In the most of clients' opinion the M.T.P.L. insurance is for other people and not for them. So, there is a lack of perception related to insurance role, insurance definition, insurance principle – insurance is a measure of protection. Different authors explain this affirmation:

> Based on Dorfman, Mark S *"People living in industrialized countries often fail to appreciate the importance of risk protection in their daily lives, but in fact products like insurance are crucial in stabilizing an economy. Many less developed economies offer few ways for individuals and firms to protect themselves from loss exposures because they have poorly developed risk and insurance infrastructures."*
>
> Also, Rausand, Marvin appreciates that *"During the last three to four decades, a number of major accidents have made the public increasingly aware of the risks posed by certain technical systems and activities. Many laws and regulations have emerged or been changed after major accidents, which have called for an increasingly structured approach to safety legislation."*
>
> Vaughan, Emmett J., and Therese M. Vaughan mention that *"There is no escape from the presence of risk, and humanity must seek ways of dealing with it. Some risks, generally of a fundamental nature, are met through the collective efforts of society and government. Although society and government can help alleviate the burden of risks in many areas, some risks are considered the responsibility of the individual."*

All these affirmations prove the fact that insurance must be seen as a measure of protection for the person or entities exposed to different types of risks.

Some insurance companies used lower prices than competitors in order to have more clients for M.T.P.L. – hoping that in the future they will be able to sell new

insurance products (life contracts, homeowners, travel and so on). Unfortunately for them, having clients with low financial resources, these insurance companies did not record the expected success – but a higher exposure on motors' insurance class. Inevitably, this higher exposure generated a higher level of loss files and the eligible amounts to pay at a higher level than expected. Having less financial resources to compensate the losses that insurance companies tried different "tricks" to delay, to decrease or to refuse the level of reimbursements/compensations.

Among the explanations given to the clients by representatives are: fraud analysis, lack of documents, bad communication with garages where the vehicles are repaired and may others. The clients that used M.T.P.L. insurance from such insurance companies were not satisfied having their vehicles retained by garages for long time period (garages did not released the repaired vehicles until insurance companies paid the costs). More, garages received only partial payments related to the loss and the clients were supposed to pay for difference in case they would like to have the repaired car.

Beneficiary of the M.T.P.L. insurance did not agreed the way that insurance companies decided to reimburse the losses. So, inevitably there were many sue in courts against insurance companies that did not paid. Unfortunately these juridical actions took a long time, so another option for the M.T.P.L. beneficiary is to sue in court the guilty drivers (the one that bought M.T.P.L. insurance and the client of the insurance company).

After a short period of trial, guilty drivers lost the trial and they were forced to pay the losses to the other part. In that moment, these clients realized the fact that they had a negative perception about M.T.P.L. insurance (as earlier mentioned) - so, insurance is for their own protection and not for a third party (indeed M.T.P.L. insurance covers the losses to a third party, but it protect the client from unexpected financial payments).

The clients that were not satisfied with the services offered by insurance companies (before sue in court) has an organizations that may help them - Romanian Financial Supervisory Authority has an internal department for complaints/petitions. Unfortunately there are many clients without education in M.T.P.L. insurance – they are simply accepting the refuse/lower level of compensations from the insurance companies and treat it as a simple matter of fact (this is also a strategy used by different insurance companies – they are getting advantages from the lack of information on clients' behalf). Beside this,

many clients do not know that there is in the market an entity that may help them.

Following this idea, based on an aggressive media activity from Romanian Financial Supervisory Authority, more insurance clients learn how to fight against improperly actions of insurance companies. Based on R.F.S.A. Normative 24/2014, published on Official Monitor, Part I, nr. 824 of 12 November 2014, following the existing measures on ISC Order 11/2012, published in Official Monitor, Part I, nr. 367 of 30 May 2012 – insurance companies must show on their official websites the number of petitions and also the way how these are solved (favorable or not favorable for the clients).

This changing in the legislation will give the chance to the clients of an insurance company to be better informed on the quality of services offered. In case the number of complains/petitions available on insurance companies website are at a high level, insurance clients may refuse to buy insurance.

Based on official figures presenting during European Conference on Consumer Protection in Financial Services – Bucharest March 3rd 2015 (Calin Rangu presentation) - in 2014, there were recorded 12,696 unique petitions, among them 8,990 for M.T.P.L. this representing 70.81% of total. If we analyze the number of M.T.P.L. contracts we have only 0.13% petitions and 3.31% pf the total loss files of 271,892.

Unfortunately, 58.26% of total petitions were recorded by Euroins SA (33.62%) and Astra SA (24.64%) – Astra was the leader of insurance market until end of 2013. Because of the numerous complaints against Astra and its incapacity to honor the eligible payments/debts in February 2014 there was opened official procedure of financial recovery administrated by K.P.M.G.

Following these negative influences on M.T.P.L. insurance market R.F.S.A. decided at the end of 2014 to change some insurance normative nr.23/2014, in order both to increase credibility for insurance companies and the satisfaction of the insurance clients.

In order to decrease the financial losses recorded on M.T.P.L. insurance this normative introduce the mention that insurance companies that sells this insurance must record profit from subscribing activity related to M.T.P.L. In order to realize this request, insurance must not affect the loss compensation and reimbursement process and to pay all losses to the clients. Beside this in order to have profit they have the next available choices:

- To decrease the percent of insurance commission applied to persons involved in M.T.P.L. selling process
- To increase the insurance premium for M.T.P.L. insurance
- Both of them

2.1 DECREASING INSURANCE COMMISSION

In the moment of introducing the new insurance normative related to M.T.P.L., the maximum commission for intermediation of this insurance was of 15%. Most insurance companies (11 insurance companies sell this type of insurance) used the 15% commission. They used this maximum level in order to motivate insurance agents to sell this insurance – hoping later to sell other insurance contracts (as already mentioned).

Also, when intermediation was done through an insurance broker – the commission was also 15%. It was impossible to offer a lower commission, because in this case insurance brokers would have sold M.T.P.L. insurance only from the insurance companies that offered 15% commission.

Based on the new normative, R.F.S.A. wanted to introduce a maximum level of commission of 10%. All intermediaries in the market took action and together with insurance companies succeeded in maintaining the level at 15%. Anyway, the normative included a paragraph that mentioned the possibility of R.F.S.A. to decrease the commission to 10% when it will be noticed that an insurance company faces profit problems related to M.T.P.L. insurance.

Another mention that was included in the new normative and is applying from the beginning of 2015 refers to the obligatory of included the level and amount of commission on M.T.P.L. printed insurance. For example if the insurance premium is RON 1,000 – on the insurance it will be mentioned: commission 15%, RON 150.

There were a lot of debates between R.F.S.A. and insurance companies/insurance brokers about this mention. Most of intermediation parts wanted that this level of commission not to be included on the printed insurance. The reason that they were relying on referred to the fact that the clients will be upset of the important amount of the commission. Following this point, intermediates of insurance were afraid not to lose the clients – clients being afraid of this commission will think that if they will go in insurance offices they will avoid this commission and the insurance will be cheaper. This mention did not stand, because based on the same

normative, insurance premiums for M.T.P.L. must be the same no matter the place where it is subscribed or who intermediates the contract.

The arguments of R.F.S.A. when decided to introduce this commission on the printed insurance was the transparency. Following directives in insurance from European Union, consumers of financial services need to be informed about the fees/costs related to these products. Similar, when a person gets a credit is informed about all costs that will increase the level of the interest. Also, when a person subscribe a life insurance contract for a medium-long term period, receives a detailed list of all costs related to that contract.

So, opinions related to this printed level of commission are still contradictory but beside this it remains on the contract.

Author opinion is that this mandatory mention is a very good one. This shows transparency in the system and there are at least two things that must be mentioned:

- Clients that will be surprised about the level of commission must know that this commission includes all taxes – for example if commission is of RON 150 (almost EUR 34), after taxes the level that insurance agent receive is of RON 102 (almost EUR 23) – so the real level is lower than expected
- Clients must know that they will pay the level of commission no matter where they will by insurance from – so, it is more efficient for them that insurance agents to visit them to sell the M.T.P.L. insurance (instead of going to insurance offices, to spend fuel for car, to lose time)
- In case the insurance distribution channel is relying on a multilevel marketing system (especially used by insurance brokers), even if the commission is of RON 150 in our example, this level will be split between all parts from that structure
- In case a client chooses to pay the insurance to an agent – we can talk about increasing the level of responsibility of the agent. For example, in case of a motor's accident the client may not know the procedure to be followed, in this case he can ask for an advice from the insurance agent that intermediated the contract (in case he will not receive proper advices, the client may say that he deserve to have it because this is why he paid commission for). Also, insurance agent will pay more attention towards clients because in case the clients will not be satisfied with the services they will choose to pay the contract to other insurance agent in the future

2.2 INCREASING INSURANCE PREMIUM

Another option available to insurance companies in order to have profit for M.T.P.L. insurance, may be the increasing of the level of these insurance premium.

The prices for this insurance, for a specific example, differ a lot from an insurance company to other. Sometime in the last two years, the prices were even double. This fact was generated by the following facts:

- Insurance companies that wanted to have more clients used a low pricing strategy (not founded on actuarial simulations)
- Insurance companies that used correctly actuarial simulations, and inevitably has higher prices (once the prices were split between many categories the differences were even more obvious)

Following the statistics of the drivers that generated most of the losses (frequency) and the most costly ones (severity) – there were made public the official results that teenagers up to 30 years old are the most risky persons for insurance companies. Based on affirmation from Romanian Police 37.4% of severe accidents in 2013 were caused by teenagers up to 30 years old, then 22% for segment of age 31-39 and 17.9% for ages between 40-49 years old.

Because clients up to 30 years old have less experience, the M.T.P.L. prices for this category simply doubled or tripled (insurance must have profit from M.T.P.L. insurance, this segment of age generate significant losses). In some cases, for vehicles older than 15 years the value of a car reaches a price of Eur 1,000 – price quite similar to M.T.P.L price.

There were recorded a lot of complains, official manifests on behalf of representatives of this groups. After 1 month of debates, early February 2015, R.F.S.A. asked insurance companies to find a modality to decrease the prices for this segment of clients (up to 30 years old). This requirement contradicts the normative from December 2014 where it is mentioned the fact that insurance companies are not allowed changing the M.T.P.L. prices during the year.

Anyway, the prices suffered modifications – for the beginning Allianz-Ţiriac, Astra, City Insurance, Euroins şi Generali all together with more than 50% market share, notified R.F.S.A. about decreasing the prices. They followed some similarities in Europe where the prices for young people are maximum 2.2 higher than an average (compared to 5 times higher in Romania for some classes).

The strategy that allowed these decreasing of the price for young people relied on increasing the prices for the rest of categories (small increasing applied). In this form, the eventually losses recorded from this segment are covered by the profit from the other clients.

2.3. PRICE SIMILARITIES

The practice in insurance field demonstrated the fact that the M.T.P.L. prices for a specific motor/driver, within the same insurance company, differed from a distribution channel to other.

This policy used by insurance companies was not a correct one – especially:

- Toward the client (even if the client is the one that might had benefits from a lower price) – because in case the client can buy the insurance from a distribution channel and then to find a lower price on other distribution channel, the client will feel himself cheated
- Toward insurance agents – most of the cases insurance agents that have access to online subscribing platforms have no option to use other price than the one program is calculating. As long as insurance agents represents in Romania the most used distribution channel for M.T.P.L. insurance it is not fair to offer lower prices to other channels

The distribution channel that offered a lower price could have been found on internet. There are insurance brokers that are very active online, offering discounts to the possible clients. This was possible because:

- Insurance companies offered them possibility to sell M.T.P.L. with discounts of 5-15% than the normal price
- Insurance brokers decrease their intermediation commission from 15% to 10%, offering in this way 5% discount to the clients (the reason was to sell more M.T.P.L. insurance)

Another distribution channel that used a lower M.T.P.L. price was insurance companies' own websites. There the insurance was sold with 5-10% lower than the prices available to insurance agents because:

- There were no commission to pay for this intermediation
- In order to get clients used with online insurance products

Having all these facts, R.F.S.A. considered that existing different prices within the same insurance company is not a fair attitude. So, it was decided that starting

from 2015 all M.T.P.L. prices are similar within the same insurance company, no matter the distribution channel.

3. CONCLUSION

Following the requirements of R.F.S.A. insurance companies took the needed modification. After the price was decreased for young drivers, some insurance companies decided to decrease also the level of M.T.P.L. commission from 15% to 10-12%. In this way expenses are lower for insurance companies, so this may be an opportunity to have profit (or to maintain the profit for this insurance at the level requested by shareholders).

About the existence of the same price for M.T.P.L. insurance (for any specific client) on all distribution channel of an insurance company, there are some notifiable consequences. The prices offered online by different brokers differs from the prices offered by insurance companies. Insurance brokers use a very simple trick: the data they require for online price simulations are not all needed data. So, they make a low price offer, and then when they send the insurance to the client the price is higher than initial (they explain to the client the fact that after it was introduced into program all details, the prices suffered modifications). R.F.S.A. took notice of these cases, but they cannot do too much about because those prices are not final based on those websites (so the clients do not read carefully all details). In the end, insurance brokers that will use this strategy will lose lot of clients on short time and the credibility will be affected. Beside this, insurance brokers that will act correctly are the ones to remain in the market.

Also, R.F.S.A. considered at the end of 2014 that the social capital of insurance brokers became too low compared to the level of intermediation and compared to the existed responsibility. They intended to introduce a minimum social capital of RON 150,000 (around EUR 34,000) entirely subscribed by the end of 2015. Initially the level was proposed to RON 250,000 but there were a lot of complains on behalf of insurance brokers. This approved level is following a normal trend, so it is very possible to see in the brokers' market mergers and acquisitions. This way, the small and inefficient insurance brokers will leave the market and the ones that remains will have a more concentrated business. In the end, this measure may be seen as an active one for the insurance clients, in this way their businesses, properties, life will be more protected by intermediaries' responsibility.

All these measures taken by R.F.S.A. in December 2014 and early months of 2015 must create the premises for an insurance market more disciplined and with higher ethical values. The next years will prove if this measures were correct or no.

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COMPETITION POLICY IN THE NEW EUROPEAN REGULATORY AND SUPERVISORY ARCHITECTURE OF THE FINANCIAL SYSTEM

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ABSTRACT

The necessity of maintaining the stability of the financial system is an indisputable paradigm. Competition is believed to be a desirable phenomenon leading to greater choice for consumers, motivating firms to innovate and improve efficiency thus leading to overall growth. Achievement of financial stability goal has been entrusted to central banks and/or special financial regulators. Competition policy is in the domain of competition agencies that in relation to financial regulators act ex post.

The financial crisis led to re-examination of relationship between competition and systemic stability and it remains to be seen what will be the dominant thesis in the post-crisis phase. The crisis has also put regulation and then present supervisory architecture into question. The massive public intervention to troubled banks revived the notion that banking is not like any other sectors. State aids and other forms of public intervention marked a return of too-big-to- fail paradigm.

It seems that the European Union has managed to solve the problem of too-big-to-fail as one of the central competition policy issues while simultaneously maintaining financial stability in troubled times. The answer was found in the creation of the Banking Union and establishment of single resolution mechanism as an integral part of it. It remains to practice to confirm the robustness of this new model.

Key words: banks, competence, regulation, competition policy, "too-big-to-fail" paradigm.

1. INTRODUCTION

The importance of the banking system and its role in the development and functioning of the economic mainstream is best summarized by the comparison with "financial bloodstream" of the country. The necessity of maintaining the stability of the financial system is an indisputable paradigm. The ways in which, due to the global financial crisis, different countries tried to accomplish this generally accepted universal objective pointed to the numerous differences between countries. The crisis also actualized the issue of the relationship between competition and stability and the role of the regulator in this interdependence. An efficient and effective system of regulation and supervision of the financial system must achieve a number of objectives: financial stability, freedom of competition, transparency of business participants, a framework for crisis management, a framework for change in the market structure and financial innovations, market integration and efficiency, and besides all that, be cost-effective. Achievement of these goals has been entrusted to central banks or special financial regulators. Competition policy is in the domain of other regulatory agencies (bodies) – competition agencies that are in relation to financial regulators acting ex post.[1] This paper especially considers the current coexistence of these policies.

Deregulation and financial innovation, last two decades prior to the global financial crisis in developed countries, have changed the business models of banks that were taking on more risk but have become exposed to new and, until then completely unknown forms of risk. At a time of intense global financial crisis spread to Europe from 2008 till today, mainly national rules of rescue measures for troubled banks with a minimum of rules and coordination mechanisms were represented in 28 regulatory and supervisory systems of the financial system. The existing legislative framework did not fit the systemic nature of today's financial crisis, which is best reflected through the decline of large, mostly cross-border active banks. As a consequence of the crisis some banking systems have lost international trust and increasingly depended on domestic sources of financing which preceded the abundant sources of state aid to banks.[2] These generous help

1 An exception is the area of merger control where competition agency operates ex ante, as well as financial regulator or supervisor who is considering the same transaction under the rules relating to the acquisition of qualifying holdings

2 The four countries that had assisted the most their banks during the period 2008 to 2013 are the United Kingdom (EUR 100 billion), Germany (EUR 64 billion), Ireland (EUR 63 billion), and Spain (EUR 62 billion). Banks that have received the most help are RBS (50 billion), Anglo Irish Bank (32 billion.), And Bankia (22 billion).

of the Member States to the troubled banks have actualized question of "too big to fail" paradigm as one of the central questions in the domain of competition policy. In fact, bearing in mind the destabilizing effect that the failure of one bank can have for the entire system, those banks that were considered to be systemic or "too big to fail" traditionally were provided implicit assistance by governments. This same help, however, may undermine the competitive process in the market putting ailing banks in a "privileged" position in relation to the stable. The aim is to clarify the issue of protecting the large banks from collapse from the aspect of competition protection and financial supervision in the context of the development of European banking union.

Allen and Gale (2004)[3] reviewed a number of cases including general equilibrium models of financial intermediaries and markets, agency models, "spatial competition" models, Schumpeterian competition and contagion and came to the conclusion that within the wide range of possibilities concerning the relationship between competition and financial stability, the issue of regulation and its effect on competition and financial stability is complex and multifaceted, and is therefore careful consideration of all the factors at work both at a theoretical and empirical level required for sound policy.

Furthermore, analyzing the relations of competition and financial stability, Beck, T. (2008)[4] tentatively concluded that competition per se is not detrimental for banking system stability in a market-based financial system with the necessary supporting institutional frameworks and therefore emphasizes the need to focus on a regulatory framework and financial safety net to support competitive and efficient financial markets, rather than restraining competition. Vives (2011) draws connections between regulation and competition policy, surveys and analyzes the role of competition policy in the banking sector in a financial crisis emphasizing that "*the crisis has put both regulation and competition policy in banking into question. The naive view that banking was like any other sector in the economy in regard to competition policy has been blown away by the massive public interventions involving considerable competitive distortion."* Analyzing the effects of the crisis, Vives documents that concentrated banking systems like those in Australia and Canada suffered less damage in the crisis than non nconcentrated systems like

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3 Allen, F. & Gale, D., (2004), *Competition and financial stability*, Journal of Money, Credit and Banking 36(3), Part 2

4 Beck, T., (2008), *Bank Competition and Financial Stability: Friends or Foes?*, The World Bank Policy Research Working Paper 5981

those in the US and Germany. However, countries with concentrated systems in retail banking, such as Belgium, the Netherlands and the United Kingdom, also ran into trouble. Departures from traditional banking have proved to be a source of increased risk and vulnerability. From the 72 largest commercial banks in OECD countries, those that are less dependent on the wholesale funding and who had higher capital cushions and liquidity ratios, fared better during the crisis (in terms of a smaller equity value decrease and less government intervention). It is not registered that certain types of institutions showed greater vulnerability then others: affected were specialized investment bank (all US ones), insurers (like AIG) and universal banks (UBS, Citigroup, German and UK banks).[5] Further explains that the introduction of competition in banking has been accompanied by policies to control risk taking. Capital requirements, adequate supervision and market discipline were considered key elements for maintaining a sound banking system. The 2008 crisis has revealed a massive regulatory failure. Therefore, Vives advocates regulatory reform to provide the correct incentives for banks but at the same time, draws attention to the limitations of regulatory schemes. The regulation can alleviate but not eliminate the competition - stability trade-off, which in one dimension does exist. In that case, a certain degree of market power may alleviate the externality problem of social cost of bank failures. It follows that the design of optimal regulation hast took into account the intensity of competition. Vives emphasizes that the coordination of prudential regulation and competition policy in banking is necessary and that better regulation could improve both stability and competition. Vives concludes that all this requires close cooperation of the regulator in charge of stability and prudential control and the competition authority.

Similarly, examining the relationship between bank competition and systemic stability Anginer, Demirguc-Kunt i Zhu (2012)[6] found that concentration and market power are associated with greater fragility of the system. Their results indicate that greater competition encourages banks to take on more diversified risk, making the banking system less fragile to shocks. Therefore, when competition and systemic stability are concerned, they do not observe a trade-off, which emphasizes the importance of ensuring a competitive environment in the banking. The results emphasize the importance of the underlying regulatory and institutional framework. Enabling entry (by rejecting fewer applications) reduces systemic

5 For a more detailed review, see: Vives, X. (2011a)

6 Anginer, D., Demirguc-Kunt, A., Zhu, M. (2012): „How Does Bank Competition Affect Systemic Stability?“, The World Bank, Policy Research Working Paper 5981.

fragility, but so do activity restrictions and diversification guidelines, especially in less competitive banking environments. The results also suggest that government ownership is directly associated with higher systemic fragility. Overall, their results support the view that fostering the appropriate incentive framework is important for ensuring systemic stability. These incentives are shaped by the design of entry and exit policies, existence and coverage of deposit insurance and safety net policies, good prudential regulation, and availability of information. They conclude that it is important for the regulatory framework to achieve the right balance between curbing excesses while avoiding potential anti-competitive effects. Information availability, prudent capital requirements and credit monitoring are the types of actions that would improve systemic stability without impairing competition. In contrast, increases in regulatory costs that raise entry barriers make markets less contestable, depriving countries of numerous benefits of an efficient and innovative banking system, as well as leading to greater fragility.

It is certain that regulation and the role of the regulator was set in focus by the crisis. Barth, Caprio, and Levine (2012a) advocate shifting the focus from regulation to better control of the regulators and the establishment of supervisory agency that would oversaw regulators on behalf of the taxpayer's interests. Similarly De Latorre and Ize (2011) advocate the establishment of a strong and independent supervisory agency, Enriques and Hertig (2010) propose the strengthening of the internal and external management of the supervisors, Weder di Mauro (2009) supports higher compensation levels for supervisors and the establishment of supervision at supranational levels (in Europe) to eliminate local industry capture (deriving from the captures theory).[7] Since the 2008 global financial crisis, which tested the international architecture developed to protect financial system, we are observing a trend of increased regulation. At European Union level it is accompanied by the birth of a completely new supervisory architecture finally shaped through the establishment of the Banking union.

7 Taken to: The World Bank, (2013), *Rethinking the Role of the State in Finance*, Global Financial Development Report, pp 69-70.

2. DEVELOPMENT AND REDESIGN OF COMPETITION POLICY DOCTRINES IN BANKING AND TREATMENT OF "TOO BIG TO FAIL" PARADIGM

There are many empirical and theoretical contributions from the field of industrial organization theory providing evidence that competition lowers prices and increases quality of products/services, encourages undertakings to creativity and innovation, contributing to consumer welfare who pay a lower price for a better product/service. Therefore, it's usually suggested that competition policy is in function of consumer protection. Undertakings and consequently the whole economy also benefit from (free) competition because of incentives to operate more efficiently. It is also considered that competition has a positive effect on competitiveness of the market and economic growth. Therefore, competition is considered desirable and acceptable phenomenon, and consequently legal systems of most modern countries (including the European Union and Croatia) have separate laws aiming to protect competition. In this context, it can be concluded that any contrary allegation certainly would be considered controversy if not heretical. The exception, however, still exists in relation to the banking system in terms of the influence of competition on the financial stability. There is a continuous debate between the academic community and policy about this topic.

Historically, banks had different treatment in comparison to all other businesses. White (1996)[8] points out that "*the United States has a 200-year history of treating banks specially with respect to competition policy*". Banks were regarded as a specific industry, and "*were exempted from the application of some laws, but in other respects have also had special legislation and special burdens placed on them*". In terms of "*formal antitrust actions banking was considered to be exempted from the reach of the federal governments' antitrust laws (the Sherman and Clayton Acts) until 1944. It was only in that year, in the Supreme Court's South-Eastern Underwriters Association decision, that insurance – and, by implication, banking – became subject to the Sherman Act. Furthermore, until the early 1960s bank mergers were considered to be exempted from the reach of the Clayton Act. The US Congress, however, was creating separate and specific competition policy for banks."* Like in the US practice, European Commission - the body that is in charge of protection of competition at European Union level, has long argued that Article 81 and 82 of the Amsterdam Treaty (former Article 85 and 86 of the Treaty of Rome, now Articles 101 and

8 White, L. J. (1996): „Banking mergers, and antitrust: historical perspectives, and the research tasks ahead", The Antitrust Bulletin, page 324-331. Vol. XLI, NO 2/summer1996

102 of the Treaty on the functioning of the European Union) are fully applicable to the banking and insurance system.

It was finally confirmed during the1980s by the Court of Justice: in the Züchner[9] case the Court rejected the complaint that the provisions of Articles 81 and 82 do not apply to banks[10].

Reasons for this historically different treatment of banks (compared to all other sectors) are numerous, and arise from the nature of banking business, its natural characteristics (oligopolistic nature, information asymmetry, moral hazard, the value of the franchise) and the influence that banking system therefore has to all other businesses and the economy as a whole (financial crisis that began in the US in 2007 shows clearly the extent of this influence). The bank is a "public good" and its failure has far-reaching consequences not only to its shareholders, but also to society as a whole.

As a result shift of cycles of increased regulation and deregulation (liberalization) with the occasional occurrence of banking crises both local and those of larger scale can be observed. Most academics and researchers would agree that competition in banking sector, due to solvency issues and systemic risk, differentiate in some important aspects from the competition in other sectors[11]. This approach is created over time by development of the economic theory and as a result of empirical studies that showed that connections between the standard variables are not as clear and predictable as in other sectors. There is no doubt that increased competition in the banking system leads to increased efficiency and innovation, but with conflicted theoretical predictions and mixed empirical results there is still no academic consensus on whether this competition also leads to greater fragility[12].

Regarding the influence of banking structure on financial stability, economic literature is diverse and conflicting. Empirical literature also provides conflicting

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9 Case 172/80 Züchner against BayerischeVereinsbank AG (1981)

10 In 1984 the European Commission adopted its first decision in the insurance sector: an exception in the case of Nuovo CEGAM and prohibition in the case Fire Insurance, v. Nuovo CEGAM (1984) and Fire Insurance (1985), Carletti and Vives (2009)

11 For an excellent overview of the development of the theory of industrial organization; see Kraft, E. (2007): "What is the competition in the Croatian banking sector?"; Research of Croatian National Bank, May 2007, Zagreb, www.hnb.hr

12 For literature overview see eg. Carletti (2008), Degryse and Ongena (2008)

conclusions[13]. Synthesizing the literature on the relationship between competition and stability in the financial system, Anginer, Demirguc-Kunt and Zhu (2012)[14] point out that on the one hand, *"the charter value view of competition suggests there could be significant stability cost of competition, since too much competition may lead to excessive risk taking as it reduces margins (Marcus, 1984, Keeley, 1990, Allen and Gale, 2004). Proponents of this view argue that in an environment with greater competition, the pressure on profits will make banks choose riskier portfolios, leading to greater fragility (Hellman, Murdoch and Stiglitz, 2000). Others argue that in a more competitive environment, banks earn lower rents which also reduces the incentives for monitoring (Boot and Thakor, 1993, Allen and Gale 2000). Large banks can also diversify better, so that banking systems dominated with a few large banks are likely to be less fragile than banking systems with many small banks (Allen and Gale, 2004)."* Furthermore, it's easier to monitor and supervise systems with several large banks than systems with a large number of small banks. All these arguments are consistent with the view that competition leads to greater fragility of the system. On the other hand, Anginer, Demirguc-Kunt and Zhu explain that lack of competition may exacerbate bank fragility. Banks with greater market power tend to charge higher interest rates to firms, leading them to take on greater risks and, consequently increasing the fragility of the financial system (Boyd and De Nicolo, 2005). Furthermore, large banks usually receive "too-big-to-fail" subsidies from safety net policies, which distort their risk taking incentives and destabilize the entire financial system (Anginer and Warburton 2011, Kane 1989). Finally, it's more difficult to supervise large banks due to their complexity and ability to "capture" their supervisors (Johnson and Kwak, 2010).

Through history, economic theory has had a great practical importance in formulating policymaker's attitudes. In that way during the period from the crisis in 30s to the 70s of the 20th century most of developed countries applied the view that competition in banking is not a desirable phenomenon. The base for this view was found in arguments of asymmetric information and franchise value which showed that greater competition may be associated with increased risk portfolio and potential instability (it was thought that competition

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13 See: Claessens, S. and Laeven, L. (2005): Financial Dependence, Banking Sector Competition and Economic Growth, Policy Research, Working Paper 3481, The World Bank; January Claessens, S. and Laeven, L. (2004): What Drives Bank Competition? Some International Evidence, Journal of Money, Credit and Banking, 36

14 Anginer, D., Demirguc-Kunt, A., Zhu, M. (2012): "How Does Bank Competition Affect Systemic Stability?" Policy Research Working Paper 5981, World Bank, February 2012

harms stability). The process of liberalization and deregulation in the banking industry began in the 70s of the 20th century and was accompanied by a strong development of information technology that enabled faster transactions processing, introduction of new distribution channels (ATM, Internet Banking), accelerated development of new products and services and advanced risk management techniques development. Banking has evolved from traditional activities of collecting deposits and issuing loans to more complex services for investors (consulting and insurance, asset management) and corporate clients (consulting, mergers and acquisitions, underwriting of equity and debt issues, , securitization), and to proprietary trading. At that time the idea that competition is good for stability gained ground. Financial globalization has been an integral part of that process.

Global financial crisis began in 2007 with subprime mortgages in the United States, and became systemic after the collapse of Lehman Brothers in September 2008. During the period of crisis, as a dominant form of revitalization of the system, state aids and various other forms of state assistance to troubled banks in the US, EU and individual Member States overshadowed the objectives of competition policy by distorting the competitive market structure[15]. Troubled banks were saved through mergers with "healthy" banks which also distorted the competitive environment and increased the degree of concentration. Besides forced mergers, asset purchases and guarantee schemes, capital injections, nationalization were used as instruments to stabilize the system. As Vives (2012) explains all this represented "*a tremendous distortion in terms of moral hazard, long term effects in market structure, protection of inefficient incumbents, and creation of an uneven playing field*."[16]

The problem that was especially actualized was too-big- to-fail resolutions in banking. There is also a difference between state aids to banking compared to other sectors: providing aid to one bank usually represents a positive externality to other banks because it limits the spread of the crisis and by avoiding contagion, it protects the system. If it is liquidity help, it does not distort competition but allows a sound bank to avoid contamination and ride the crisis. However, if a bank has solvency problems, it should be restructured and help should be

15 For more about the extent and forms of state assistance to banks in the European Union, see: http://ec.europa.eu/competition/state_aid/scoreboard/financial_economic_crisis_aid_en.html#tables and Beck et al (2010) for a detailed analysis of bank rescuing in Europe during the crisis

16 Vives, Xavier (2012): „Competition Policy in Banking", Oxford University Press.

linked to commitments (structural ones and those relating to the behavior) so that competition is not distorted. The bank should end up the restructuring process as a "viable competitor"[17]. At EU level, as Vives (2012) explains the European Commission has played an active role in controlling the distortions due to public assistance to troubled banks. This was possible thanks to the exclusive jurisdiction the Commission has over state aid control in the European Union. All cases where banks were saved by the Member States confirmed the need for coordination between regulator and competition authority which should preserve competition, not limit moral hazard, which is the role of the regulator. Vives (2012) finds that "*the important side benefit of state aid control in the EU is that it limits the incentives of bankers to take excessive risk in the expectation of a bailout if things go wrong. That is, it addresses the too-big-to-fail issue*." Same thing that Commission tried to accomplish with state aid control, the US tried to accomplish by regulation following the advice of Paul Volcker who advocated limits on size and scope of banks. The US position is that too-big-to-fail paradigm is explicitly not an antitrust problem, but, as explained by White (2014)[18], fundamentally the problem of subsidies and negative externalities.[19].

Before moving to US regulatory solution we will point to the core stones of White's position that we find interesting in the context of this paper.[20] White explains the key features of the too-big-to-fail as: 1) a large financial institution; 2) creditors that can run – a financial institution which short-term debts exceed its holdings of liquid assets; 3) creditors that are imperfectly informed as to the financial institution's solvency – the fears and uncertainties of the short-term creditors about the financial institution's solvency drive a run and the uncertainties are created by the absence of real-time market-value information, 4) the financial institution's solvency is substantially at risk. Furthermore, White stresses out

17 See Vives (2012) for more detail.

18 White, L. J. (2014): Antitrust and the Financial Sector – with Special Attention to "Too Big To Fail", presented on November 15, 2013 at a conference on the occasion of the fiftieth anniversary of United States v. Philadelphia National Bank, revised on March 27, 2014, NYU Working paper No . 2451/33582.

19 Emergency Economic Stabilization Act from 2008 colloquially known as "bailout" of the American financial system is an act that approved a program to rescue the financial system worth 700 billion $

20 As stated by Kaufman (2013): „Despite the recent sharp explosion in interest, „too-big-to-fail" in banking remains a vague and fuzzy concept." For more see: Kaufman, G. (2013): „Too Big To Fail In Banking: What Does It Mean'", LSE Financial Markets Group Special Paper Series, Special Paper 222, ISSN 1359-9151-222, June 2013.

that "*it is not the presence of market power that makes a financial institution too-big-to-fail*" and further explains "*Although the too-big-to-fail financial institution's activities involve a distortion in the use of society's resources, that distortion is neither a consequence of nor an expression of market power. And, consequently, antitrust has little relevance for addressing too-big-to-fail issues*."

Vives (2012) explains that the Dodd-Frank Act from 2010 introduced a mild version of the limits on proprietary trading and strengthened some limits on size (extending Riegle-Neal's law from 1994, which prohibits a merger or acquisition which results in the combined entity controlling more than 10% of domestic deposits at the national level to all types of depository institutions and introduces a concentration limit on any consolidation of financial companies at 10% of financial industry liabilities). Vives explains that the deposit "cap" can be outperformed by organic growth and that national "cap" of the market share per deposits is not relevant, according to antitrust perspective, because the relevant market in retail banking (also including banking for small and medium-sized enterprises) is the local market. As a better approach to "too big to fail" problem White advocates effective resolution procedures and higher capital requirements for systemically important institutions. Dealing with the same issue, Kaufman (2013) asks for the differentiation of proposals to end too-big-to-fail regimes by modifying the resolution regime from proposals to prevent large banks from failing "*through requiring higher capital and liquidity requirements, strengthening prompt correction action provisions, and imposing limitations on size by legislation, such as Dodd-Franck Act, or by regulation, such as by the Basel Committee...*" All of these measures are ex-ante aimed to reduce the probability of failure. The opposite, modifying the resolution regime assumes failure and is ex-post. It aimed to reduce and/or reallocate the loss given failure.

The review of the institutional framework is found even before 2008 and very often in the context of a discussion about the relationship between stability and competition. So Cetorelli, N. (2001)[21] warns that contrary to popular perception that competition in banking industry is necessary welfare-enhancing, there are channels through which bank competition can generate negative economic effects. He notes that none of extremes - monopoly or perfect competition – may be the most desirable market structure for banking sector and suggests a broader approach when analyzing the role of bank competition. That broader

21 Cetorelli, N. (2001): Competition among banks: Good or Bad?, Federal Reserve Bank of Chicago Economic Perspectives, 2Q/2001

approach should take into account the fact that specific characteristics of banking industry, also affect different dimensions of other sectors of the economy. Ward, J. (2002),[22] in a critique of Cruickshank's report from 2000 about innovation, competition and efficiency in retail banking in the UK[23] and radical proposal of the Competition Commission after the sector inquiry about retail banking[24], updates the thesis that there could be too much competition in banking system (with simultaneous reservation relating to actual situation in practice). Ward starts from the fact that in reality, and especially in the banking market the "the invisible hand" assumptions are often violated (this is known as market failure), and in such a situation, more competition will not always lead to lower prices and increased choice[25]. Ward points that competition can lead to excessive choice, and that there is no general theorem about that competition facilitates innovation. He considers that the analysis of competition between banks must recognize the special features of banks and banking market which is characterized by increasing returns to scale ("*so it pays to be bigger*"), asymmetry of information and the fact that the whole system is implicitly underwritten by the state. That general form of state intervention known as "prudential regulation/supervision" is aimed at avoiding catastrophic economic and social costs associated with large-scale banking failures. Ward concludes suggesting the changes of institutional framework in relation to the functioning of the Financial Services Authority and Competition Commission.

Analyzing relations between competition and stability, Carletti, E. Hartman, P. (2002)[26] start from generally accepted understanding of particularities of banking system in terms of financial stability. Analyzing the role of supervisors and competition authorities in the assessment of bank concentration in the G-7 countries and the EU, they found large differences in national approaches. Looking for an explanation for such differences in institutional structures, Carletti and Hartman analyzed theoretical and empirical literature on the link between bank competition and bank stability. The authors found the idea that

22 Ward, J (2002): „What's so great about competition in banking?"

23 Cruickshank, D (2000): Competition in UK banking, March, http://www.hm-treasury.gov.uk

24 CompetitionCommission (2002): Supply of Banking Services to SMEs, March, http://www.competition-commission.org.uk;

25 The base for this attitude we see at the beginnings of the crisis of subprime mortgages in the United States in 2007

26 Carletti, E. and Hartmann, P. (2002): Competition and Stability: What's special about banking?, Working paper No. 146, European Central Bank, May

competition was something dangerous in the banking sector could be dismissed but they also pointed that competition aspects of in banking should be carefully considered. In that sense, one of their proposals is that there should be well-defined arrangements about the relative roles of supervisors and competition authorities. They also warn that the bank merger reviews should not neglect competition concerns. "*However, beyond this it is very hard to draw any strong conclusions, because both the theoretical and the empirical literature suggests that the stability effects of changes in market structures and competition are extremely case-dependent.*"

3. FINANCIAL SECTOR REGULATORY AND SUPERVISORY FRAME IN EUROPEAN UNION

The difficulties to rescue "distressed" banks, systemic risk in some systems, undermined financial stability, and regulatory arbitrage of some bank managers and a multitude of national discretions are substantially consequences of still significant regulatory fragmentation in national financial systems in Europe. Listed side effects will be prevented in the future trough supranational supervisory mechanism of the financial sector made up of: the Single Rulebook, the Single Supervisory Mechanism, the Single resolution fund and the Deposit guarantee scheme, colloquial called banking union. In a broader context, the establishment of full banking union is important economic, legal, institutional and political issue and given the diverse national interests, the duration of union establishment is slower than expected (Pavković, 2013.).

In recent decades, the border between the segments of the financial markets has become weaker in most countries, which led to the establishment of a single cross-sectoral supervisory authority in some countries under the principle of "same business, same risks, and same rules". Current discussions show that integrated supervision has no longer the primacy in the European Union which can be supported by the fact that most Member States at the moment do not have an integrated supervision at the national level.

European trilogy (Commission, Council and Parliament) through regulation, directives and other acts have significantly re-regulated the banking sector of the European Union in recent years and the gradual implementation of rules is expected in the coming years. There are still many questions about areas of re-regulation of the financial sector and its adoption is still expected. The new capital requirements for banks, applied in early 2014 in about 100 countries in

the world, are the backbone of these reforms. The new regulatory framework will leave a certain degree of national flexibility in activating macro prudential tools for non-compliance of national credit and economic cycles. Currently, the European banking regulatory framework is based on the guideline which leaves room for significant differences in national rules and still generates regulatory arbitrage, legal uncertainty, allowing institutions to take advantage of regulatory gaps and distort competition.

Finally in 2012 the European Commission is obligated to present the proposal of establishing the Single Supervisory Mechanism as a backbone of bank Union on the basis of Article 127 (6) of the Treaty establishing the European Union. Based on negotiations of the trilogy in March 2013, an agreement was reached which defines the basic guidelines. Negotiations were followed by a legislative proposal according to which the European Parliament authorized the European Central Bank to supervise banks in the euro area within the Single Supervisory Mechanism. The Single Supervisory Mechanism since its application in November 2014 is complementary to institutional framework of the European Monetary Union that will allow uniform standards of supervision in the euro area. The Single Supervisory Mechanism will autonomously and independently relate to banking systems and individual banks where domestic factors will not be crucial in supervisory decisions. The intermediate goal is to restore confidence in the banking system and the good functioning of the interbank market. In this system, supervision of credit institutions established in the euro area (about 6000 of them) is in the responsibility of the European Central Bank through a unique supervisory mechanism which consists of the European Central Bank and the national supervisory authorities. The Single Supervisory Mechanism applies to the euro area but is open to other Member States where it is necessary to immediately include national supervisors in The Single Supervisory Mechanism under the auspices of the European Central Bank. The European Central Bank directly supervises banks with assets of more than EUR 30 million, banks that participate with at least 20% of the national GDP in and banks that have sought or received direct financial assistance from the European Financial Stability Facility or ESM. The European Central Bank monitors the supervision of less important banks by national supervisors and at any moment can take control of them. The Single Supervisory Mechanism is active from 4 November 2014 and has since then directly supervised 123 banks.

The European Central Bank through the Single Supervisory Mechanism should not jeopardize existing reputation, and it must remain independent in achieving its objectives therefore the strict separation of supervisory activities and tasks of monetary policy should be maintained. In addition, the European Central Bank must have available: the knowledge, expertise and operating resources of national supervisory authorities. The Single Supervisory Mechanism must operate according to the principles of the single market of financial services and in this sense it is desirable that the countries outside the euro area are involved in the Single Supervisory Mechanism that will facilitate the harmonization of supervisory practices. The proposed model of the Single Supervisory Mechanism will also include macro prudential instruments defined by legislation of the European Union, including counter-cyclical shock absorbers and other tools aimed at systemic or other macro prudential risks (liquidity risk or leverage requirements) to the national macro prudential authority or the European Central Bank.

The Single Rulebook as an element of banking union can be most easily achieved because the European Union has already significantly improved framework for bank regulation. In June 2009, the European Council proposed uniform rules applicable to all financial institutions and their products. The purpose of the Single Rulebook is stricter prudential regulation of banks. European supervisory authority for banks will continue to develop the Single Rulebook in the 28 Member States. To achieve mentioned aim, the Single Supervisory Manual will be developed. Likewise, the regularity of stress tests and the survival of European banks will be tested. The effect of European Banking Supervisors in the aspect of regulation is seen through contribution to the elaboration of the Uniform European rules in the banking sector, whose task is to ensure uniform and harmonized rules for banks in the European Union and help in market competition, and all because of raising the quality of regulation and the overall quality of the single market. The Single Rulebook will ensure that credit protection measures, whenever possible, are applied across the European Union and not just in some individual member states, because the crisis has highlighted the extent to which the economies of some states are interrelated. The Single Rulebook will ensure that the financial situation of individual institutions are more transparent and figures comparable to supervisory institutions, depositors and investors in the European Union. Since this issue is already addressed the soon completion of rules is expected. Lack of transparency is an obstacle to effective supervision as well as the market and the

investment trust. A more efficient banking sector will be accomplished through the possibility that institutions do not have to coordinate with 28 different sets of rules. European bank supervisor is also responsible for making a number of related technical standards for the implementation of the CRD IV package. It is used to specify certain aspects of the regulation of the European Union (Directive or Regulation) in order to ensure consistent harmonization of certain areas. Finally they are approved by the Commission and will be legally binding and directly applicable in all Member States. On the day of their entry into force it will become the part of the international law of the Member States and their implementation into national law is unnecessary and prohibited. Also The Single Rulebook will include reformed rules on: hedge funds, short selling and credit default swaps, derivatives, high quality credit ratings, the audit sector, criminal sanctions for market abuse, current rules on markets in financial instruments and investment funds, including money shadow banking market funds and securities law, governance of market benchmarks such as Libor. Reform of the framework for market abuse is already adopted.

Deposit guarantee scheme is an important element of depositor confidence in the banking system stability. The system proved to be more efficient in the case of smaller banks when there are several options available and not only so-called "ATM" arrangement or mechanism of payment of insured savings. More harmonized schemes also contribute to the banking community. Under current circumstances, the national agencies, responsible for deposit insurance scheme are trying to find cheaper long-term sources of funding rather than use emergency rescue ventures. All bank deposits in member countries of the European Union are insured up to € 100,000 per depositor if the bank fails and payments are accelerated from the earlier 20 working days to 7 calendar days through empowerment of financing through ex-ante funding (target level of 1.5% of deposits that should be covered within 10 years). Consultations for a uniform system of deposit insurance are still under way. The planned joint deposit insurance system would require each member country a separate deposit insurance fund that would be financed ex-ante in the 75% amount and ex-post in the 25% amount. It is expected that this system improves the resilience of the European financial system in cases of "stampede" of depositors on banks caused by panic.

The Single Resolution Mechanism is also an essential element of the full banking union. Mode of rescue troubled banks from the planned fund aims to avoid bank failures or makes them the least harmful to the economy and to

transfer the costs of their deterioration to the owners and creditors and not on taxpayers and depositors as before. Still the majority of Member States has no adequate legislative framework of prompt and effective bank resolution as well as any available, prepaid funds on disposal. Policy-makers have always, and especially during this crisis, doubted about letting institutions fail and undermine financial stability or to save the institution of taxpayers' money and cause moral hazard and distortion in the competitive process. The problem is even more pronounced for internationally active banks where several institutions are involved under different regulatory framework and all fight for national interests which can make rescue system more expensive and less effective.

Commission proposal for saving the banks, in the crisis of 6 June 2012 is part of the G-20 plan on the resolution of issue "too big to fail" and is an integral part of Basel III. This was followed by the establishment of the Financial Stability Board, whose recommendations on key attributes of effective-resolution regimes for financial institutions from October 2011 determined the key elements that resolution framework must have to enable the rescue of financial institutions so as to maintain the continuity of their vital functions to the prevention of spillover costs of government assistance to taxpayers. The planned implementation start is 2015. There are still open questions: about contribution payers (banks and investment firms or all financial institutions), what will be the base and at what rate will be the target volume, in which assets fund will may invest, what will be alternative options of fund using (bridge bank, purchase of assets, recapitalization), whether in the case of the system of supervision at the EU level and the national level, whether large banks will be able to opt out of national schemes and engage only in supranational and similar questions. The Commission's proposal to rescue banks and investment firms is the first step towards an independent European resolution institution that would be common, independent of the influence of the states and that would have the instruments to preventively discover banking crisis by increasing security of the financial system and minimizing the risk exposure of taxpayers. The application of homogeneous tools, principles and procedures that should be implemented in all the banks and the countries under its jurisdiction is expected. A common system of bank bailouts should be agreed by the trilogy by the end of mandate of Parliament in 2014, and is planned that, participants of the Single Supervisory Mechanism become also and the participants of the joint resolution mechanism. The European Commission in June 2012 published a Proposal for a Directive to establish a framework to

recovery and resolution of credit institutions and investment firms, and the main elements are: preparation and prevention, early intervention, unique instruments and powers for bank resolution, rules of cooperation between national authorities and funding operations. The agreement of the European Council and the European Commission on the Single Resolution Mechanism was reached in March 2014. The agreement contains creation of Single Resolution Fund that is financed through the bank levies and initially contains national compartments which will be gradually connected through 8 years.

The Single Resolution Mechanism is built around a strong Single Resolution Board and will involve permanent members as well as the Commission, the Council, the ECB and the national resolution authorities. The decision-making procedures have been carefully calibrated between different actors so that it will be possible to decide on a resolution case over a week-end. To avoid taxpayers being called upon, all banks in the EU will need to pay towards a fund to aid smooth resolution. In the banking union, those funds are pooled together gradually. It means that if additional resources are needed to make medium-term funding available to the bank to enable it to continue to operate while being restructured, these would be taken from the Single Resolution Fund. All banks in the banking union countries will contribute to the Single Resolution Fund as of 2016 and it will amount to €55 billion by 2024. If a bank needs to resort to bail-in, authorities would first write down all shareholders and would then follow a pre-determined order in bailing in other liabilities. Shareholders and other holders of instruments such as convertible bonds and junior bonds would bear losses first.

Like in the USA, as a crisis consequence and the result of G-20 Agenda in Europe four European supervisory authorities (ESAs) were established on 1 January 2011 to introduce a supervisory architecture: A European Systemic Risk Board, The European Banking Authority (EBA), The European Securities and Markets Authority (ESMA), The European Insurance and Occupational Pensions Authority (EIOPA). The 28 national supervisors are represented in all three supervising authorities.

Review: European system of financial system supervisors

A European Systemic Risk Board (ESRB) was established to monitor and assess potential threats to financial stability that arise from macro-economic developments and from developments within the financial system as a whole ("macro-prudential supervision"). To this end, the ESRB provides an early warning of system-wide risks that may be building

up and, where necessary, issues recommendations for action to deal with these risks.

European Banking Authority is an independent body of the European Union whose work provides effective and consistent prudential regulation and supervision of the banking system of the European Union with headquarters in London, United Kingdom. Regulation, supervision and consumer protection are the three main areas of activity of the Agency. Within the framework of consumer protection action is manifested through the provision of maximum protection of customers and the promotion of transparent, simple and fair conditions for consumers of financial products and services in the Single Market. The agency also has an important role in promoting the convergence of supervisory practices and awareness of the risks and possible irregularities in the banking system of the European Union. The agency is authorized to issue a certain number of regulatory and non-regulatory documents such as instructions, opinions, recommendations, technical standards, ad-hoc or regular documents. In 2012 EBA issued: six guides, four discussion paper, 14 consultative documents, and 23 draft technical standards have been put to a public hearing to incorporate the CRD IV. European Insurance and Occupational Pensions Authority is an independent advisory body of the European Parliament, the Council of the European Union and the European Commission with its headquarters in Frankfurt am Main, Germany, and as a result of reforms to the structure of supervision of the financial sector of the European Union, and was initiated by the European Commission, with the support of the Council Europe and the European Parliament. The main areas of activity of the Agency are: insurance, occupational pension schemes, consumer protection and financial innovation, and prevention of financial crises. The main responsibility of the Agency is to support the stability of the financial system, the transparency of financial markets and products as well as the protection of the insured, the pension system and user security. It is responsible for monitoring and identifying trends, potential risks and irregularities arising from micro-prudential, inter-state and inter-sectoral levels. European Securities and Markets Authority is an independent body of the European Union which is responsible for ensuring the stability of the European financial system by ensuring the integrity, transparency, efficiency and orderly operations of the securities market, as well as the protection of investors based in Paris, France. It is responsible to: the European Parliament, the Council of the European Union and the European Commission. The jurisdiction of the Agency in the field of legislation securities market contributes to the development of the Single European Rulebook. This ensures equal treatment of investors in the European Union and provides an adequate level of protection for investors through effective regulation and supervision, as well as promotes equal conditions of service for providers of financial services and ensures the effectiveness of supervision for supervised institutions. With the standard role of reducing regulatory arbitrage, ESMA also aims to strengthen international cooperation in the field of supervision, financial stability contributes to the EU in the short, medium and long term, and all through cooperation with the European Committee for systemic risk.

Source: According to EBA, ESMA; EIOPA i ESRB official data, 2015.

According to mentioned regulatory infrastructure reform have complementary wider goals (European Commission, Memo, 2015):

1) Future crisis prevention and more efficient crisis management;
2) Stronger and supranational supervisor which permit integrative rules application;
3) Rules which would be implemented successive from 2014 to 2019, that will ensure enough quality and quantity capital for banks (CRD IV package or Basel III framework),
4) Agenda, techniques and procedures for problematic banks (activity planning, recovery plans, resolution plans, Single Resolution Board and national independent comparable authorities, instruments, etc.).

According to European Commission the approved state aid measures between October 2008 and December 2012 amount to €591.9 billion or 4.6% of EU 2012 GDP. Including guarantees, this figure would amount to €1.6 trillion or 13% of EU GDP for the period 2008-2010 only. In wider sense these costs directly increased public and taxpayers debts.

4. CONCLUDING REMARKS

Recent financial crisis led to re-examination of relationship between competition and financial stability in the banking system. The massive public intervention to troubled banks revived the notion that banking is not like any other sectors. State aids and other forms of public intervention have put too-big-to-fail concept into question.

Highlighting the serious flaws in the hitherto existing system of European financial supervision, the same crisis has put into focus the role of regulators and regulation. Due to these circumstances and as a response to the crisis in the European Union a completely new European supervisory architecture (regulation) began emerging in September 2009. It assumed its final form by the establishing of the Banking union. It is strongly believed that the Banking union will create a safer banking sector in the euro area: all banks would be safer in the first place by crisis prevention instruments, supervisors should intervene early to manage the problems and there are tolls to manage crisis effectively (bank resolution).

The new financial system regulatory environment (especially the new rules of liquidity and capital) will significantly shape the future business models of banks

which will directly and indirectly affect competition in the banking market. Given the slow pace of negotiations and the procedures of implementation of agreed regulatory measures in the banking industry, and still significant differences in national supervisory practices, (national discretions, treatment of complementary financial products, etc.) questions remains whether a layered system of supervision will increase regulatory costs having stronger impact on small and weak banks and favoring large cross-border banks and what will be its final effect on competition in the banking and broader financial system. Agreed elements of banking union, together with those who are still negotiating, will definitely enhance the financial stability or the possible indirect spillover cost of maintaining financial stability at the back of the user. In any case, the benefits of a new, wider and complicated process of regulation and supervision should surpass the potential damage from all the longer, wider and faster crisis.

Due to the effects of the crisis (on monetary and fiscal stability) the future requires uniform standards of supervision in the entire euro area and the efficient management of systemic risk and economic cycles. The Single Rulebook, as a necessary precondition, will be implemented through a unique supervisory mechanism in the euro area and across national supervisors in other countries and the process will be overseen by the European Central Bank. Harmonization of a single bank restructuring and bank bailouts, and deposit insurance system will end and complete banking union. Planned resolution directives should be provided through the application of tools to ensure efficient rescue "troubled" banks with a minimum commitment of taxpayers' money. A key tool for this is a system of debt relief, according to a predefined hierarchy, conversion of debt into equity and establishment-resolution fund payments through banks. Using this instrument the lowest share in the bail-out cost would be borne by taxpayers

In this way, a common European Resolution mechanism while preserving financial stability should solve the problems related to the paradigm of "too-big-to fail" as one of the central issues in the field of competition policy. In theory, this concept meets the requirements of banking supervisors and requirements of the competition authority, but it remains on practice to confirm the robustness of this new model.

In the Banking Union era which creation included the establishment of the Single Resolution Mechanism it remains to be seen what will be the dominant thesis about the relationship between systemic stability and competition in banking.

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THE RESULTS OF EXAMINATIONS OF CORRELATION COEFFICIENTS FOR HEDGE FUND ASSETS RATES OF RETURN

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ABSTRACT

The paper presents the research on correlation coefficients between hedge fund assets rates of return for different strategies used by these vehicles. The examination period was from January 1990 up to march 2011. The monthly index data for 2200 hedge funds were considered. The results show that the correlation between hedge fund assets rates of return for various investment strategies, increased in 1990 – 2011. It means that hedge funds generate higher and higher systemic risk.

For the purpose of the study, hedge funds were divided into 9 groups, that is *Merger Arbitrage*, *Short Bias*, *Emerging Markets*, *Event Driven*, *Macro*, *Relative Value*, *Fixed Income Convertible Arbitrage*, *Multistrategy*, *Long/Short Equity*.

Key words: hedge funds, investments, rate of returns.

1. THE INTRODUCTION AND SCOPE OF EXAMINATIONS

The purpose of the paper is to bring to the public examinations of correlation coefficients of hedge fund assets rates of return and their fluctuations during the analyzed period. The analysis of hedge funds should be conducted after having divided them into groups depending on the strategies used. This is why the author analyzed 9 different groups of hedge funds, that is: *Merger Arbitrage*, *Short Bias*, *Emerging Markets*, *Event Driven*, *Macro*, *Relative Value*, *Fixed Income Convertible Arbitrage*, *Multistrategy*, *Long/Short Equity* index rates of return for each strategy applied by hedge funds were calculated. The examination period was from January 1990 up to march 2011. The monthly data for 2200 hedge funds were considered. The results show that the correlation between hedge fund assets rates of return for various investment strategies, increased in 1990 – 2011. It means that hedge funds generate higher and higher systemic risk.

2. THE CORE OF HEDGE FUNDS ACTIVITY ON FINANCIAL MARKETS

In 1949 Alfred Winslow Jones created the first hedge fund to take advantage of market fluctuations, both up and down, to generate the attractive rates of return and risk profile. To establish this hedge fund, Jones gathered 20000 USDs from investors and used 40000 USDs of his own money, which let him pool the capital of 60000 USDs. Next he was using sophisticated strategies he thought would deliver returns during both up and down markets fluctuations. The two main investment strategies he employed in his hedge funds were: short sale of assets and the financial leverage. These are the most typical two strategies that many hedge funds managers apply nowadays.[1] Also T. Caldwell reports that the first hedge fund was brought to life by Albert Winslow Jones in 1949. [2] During the early years of the hedge fund industry development (1950s – 1970s), the name hedge fund was used in order to reflect the hedging strategy applied by managers at that time. [3] However, the term evolved and now is used in a different context, meaning also arbitrage and speculative strategies which generate high risk levels. Hedging is also applied by hedge funds, however it is not the core of their investments.

These are mostly institutional investors, including endowments and foundations and pension funds as well as for wealthy individuals, particularly among the advanced economies, which hedge funds were designed for. Their main reason for making investments in hedge funds is that they generate absolute returns and very low correlations with traditional asset classes, like equities and bonds. This risk – return profile, to some extent, results from unregulated and various investment strategies used by them. [4] Although during the last years a lot was done to regulate hedge funds in the USA and in Europe, hedge managers try to avoid regulations by taking their capital from Europe and USA to Asia where hedge funds have not been regulated so far. This is why Asian fund assets have grown gradually since the end of 2013, following the strict Europe regulations on these investment vehicles.

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1 S. Frush, Understanding Hedge Funds, McGraw-Hill Professional, United States 2007, p. 32.

2 T. Caldwell, Introduction: The Model for Superior Performance, in: Lederman, Jess and Robert A. Klein (ed.), Hedge Funds, New York: Irwin Professional Publishing, p. 1 – 17.

3 Vault Career Guide to Hedge Funds, Vault Career Library, p. 2, see: www.vault.com.

4 N. Baba, H. Goko, Survival Analysis of Hedge Funds, Bank of Japan Working Paper Series, Bank of Japan, March 2006, p. 1.

The purpose of the alternative investment sector is to generate absolute rates of return, not relative ones. Contrary to traditional investment managers treating indexes as benchmarks, alternative investment managers invest for absolute returns, not returns dependable on the broad market. The majority of the rates of return from alternative investment strategies derive from the unique skill of the manager rather than the returns of an asset class.[5]

Hedge funds industry is one of the fastest developing parts of the financial market in the world. Their number has increased rapidly in the last years. They still have good perspectives for the future, which lets assume that their dynamic development will be continued. The number of assets gathered in these institutions has also been growing fast making them important players in the global economy.

Although hedge funds are very much associated with the negative events of the LTCM bankruptcy, it is important to understand that they have various positive effects on the financial system: they contribute to market liquidity, play an important role in the price discovery process, contribute to the elimination of market inefficiencies, and offer diversification benefits to investors. [6] For example, the study of the markets in U.S. dollar interest rate options indicated that market participants treated hedge funds as a significant stabilizing tool.[7] In particular, as the Federal Reserve Board stresses, when the options and other fixed income markets were extremely volatile in the summer of 2003, the willingness of hedge funds to sell option contracts after a spike in options prices helped create market liquidity and limit losses to many market participants, such as derivatives dealers and investors in fixed-rate mortgages and mortgage-backed securities. [8]

All in all, hedge funds are considered alternative assets. They not only invest in traditional long positions in public securities, but also in other asset classes. Examples of alternative investments include private equity market; inflation hedges such as timber and real estate and of course, other hedge funds (such

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5 J.R. Hedges IV, Hedges on Hedge Funds. How to Successfully analyze and select an Investment, John Wiley & Sons, Hoboken 2005, s. 5.

6 T. Garbaravicius, F. Dierick, Hedge funds and their implications for financial stability, Occasional paper series, no, 34, August 2005, European Central Bank, p. 55.

7 The Role of Hedge Funds in the Capital Market, Testimony of Patrick M. Parkinson, May 16, 2006, www.federalreserve.gov, 5 January 2008.

8 Concentration and Risk in the OTC Markets for U.S. Dollar Interest Rate Options, Federal Reserve Board 2005, www.federalreserve.gov, 5 January 2008.

hedge funds which invest in other hedge funds are called funds of funds). The main difference between hedge funds and other alternative investments is that hedge funds mostly invest in publicly traded stocks of companies or bonds, although some that call themselves hedge funds invest in private transactions such as private investments in public entities (PIPE). Some other hedge funds engage in highly illiquid securities.[9] Investment strategies applied by hedge funds use financial leverage, which means that from one point of view, they may generate higher rates of return, but on the other side, they put investors into higher level of risk. Besides, they exhibit other features which differ them from investment funds. They are summarized in Table A.

Table A. Traditional versus Hedge Funds.

	Traditional funds	Hedge funds
Performance objectives	Relative rates of return	Absolute rates of return
Investment vehicles	Stocks, bonds, cash	All asset classes/vehicles
Investment strategies	Limited	Unlimited
Regulation structure	Regulated	Largely unregulated apart from Europe and USA
Performance drivers	Asset class and market correlation	Fund manager skill
Fees	Management fee only, rarely performance incentive	Management fee plus performance incentive fee if the realized profit is higher than the agreed water-mark level
Liquidity	Unrestricted, often daily	Restricted and depends on the strategy used

Source: J.R. Hedges IV, Hedges on Hedge Funds. How to Successfully analyze and select an Investment, John Wiley & Sons, Hoboken 2005, p. 3.

According to W. Fung and D. Hsieh, while investment funds returns have high and positive correlation with traditional assets rates of return, hedge funds returns have low and sometimes negative correlation with the same assets rates of return. They achieve it thanks to the often use of leverage and changes in asset exposure.[10]

9 V.Q. Tran, Evaluating Hedge Fund Performance, John Wiley & Sons, inc., New Jersey 2006, p. 48.

10 W. Fung, D. Hsieh, Empirical characteristics of dynamic trading strategies: the case of hedge funds, Review of Financial Studies, 10(2), p. 275 – 302.

3. THE RESEARCH RESULTS

The beneath-presented examinations[11] were conducted in order to check in what directions correlation coefficients fluctuate during the analyzed years, that is from 1990 – 2011.

Data presented in Table 1 and Table 2 show high diversification of rates of return statistics for different investment strategies applied by hedge funds. It is worth emphasizing that average rates of return generated in the examined period are positive for all strategies. Medians are also positive apart from Short bias strategy. At the same time absolute values of minimum rates of return are on average higher than absolute values of maximum rates of return generated in the examined period. It shows a relatively high down fluctuations which cannot be captured by the traditional risk measure – standard deviation, because it takes into consideration both up and down fluctuations at the same time. Besides low values of standard deviations prove that on average fluctuations are not high, however if they appear, they generate big losses, which is confirmed by data concerning minimal values of rates of return. Moreover, the majority of the examined rates of return have negative skewness coefficients (except from Short bias and Macro) that have average values and high levels of kurtosis that indicate the presence of fat tails of the distribution. Furthermore, there is a statistically significant low, medium and high correlation between the analyzed strategies (except from correlation coefficient between the Short bias and Equity market neutral strategy).

[11] Examinations presented in the paper were also published in Polish in: I. Pruchnicka-Grabias, Fundusze hedgingowe. Teoria i praktyka, Wydawnictwa fachowe CeDeWu, Warszawa 2013.

Table 1.

Correlation coefficients between rates of return for different hedge fund investment strategies. The examined period is between 1990 and 2011. Underlined correlations are statistically significant for $p<0,05000$.

Strategy	Merger Arbitrage	Equity Market Neutral	Short Bias	Emerging Markets	Equity Hedge	Event Driven	Macro	Relative Value	Fixed Income Convertible Arbitrage	Multi-strategy
Merger Arbitrage	1	0,31	-0,40	0,51	0,58	0,75	0,33	0,54	0,46	0,46
Equity Market Neutral	0,31	1	-0,11	0,21	0,45	0,35	0,32	0,36	0,26	0,34
Short Bias	-0,40	-0,11	1	-0,58	-0,74	-0,62	-0,35	-0,38	-0,31	-0,44
Emerging Markets	0,51	0,21	-0,58	1	0,72	0,74	0,57	0,59	0,50	0,65
Equity Hedge	0,58	0,45	-0,74	0,72	1	0,83	0,56	0,66	0,57	0,66
Event Driven	0,75	0,35	-0,62	0,74	0,83	1	0,51	0,74	0,63	0,74
Macro	0,33	0,32	-0,35	0,57	0,56	0,51	1	0,33	0,23	0,41
Relative Value	0,54	0,36	-0,38	0,59	0,66	0,74	0,33	1	0,79	0,79
Fixed Income Convertible Arbitrage	0,46	0,26	-0,31	0,50	0,57	0,63	0,23	0,79	1	0,77
Multi-strategy	0,46	0,34	-0,44	0,65	0,66	0,74	0,41	0,79	0,77	1

Source: author's own calculations based on Hedge Fund Research monthly data.

Table 2

Basic statistics on rates of return for hedge fund strategies applied by hedge funds. The examined period is between 1990 and 2011.

Strategy	Average value	Median	Minimal value	Maximal value	Variance	Odchylenie standardowe	Standard error for the standard deviation	Skewness	Kurtosis
Merger Arbitrage	0,74	0,90	-6,46	3,12	1,43	1,19	0,07	-2,21	9,17
Equity Market Neutral	0,60	0,58	-2,87	3,59	0,84	0,92	0,06	-0,12	1,26
Short Bias	0,14	-0,21	-21,21	22,84	30,81	5,55	0,35	0,20	2,03
Emerging Markets	1,18	1,59	-21,02	14,80	17,18	4,14	0,26	-0,90	3,89
Equity Hedge	1,13	1,28	-9,46	10,88	6,95	2,64	0,16	-0,24	1,99
Event Driven	1,00	1,28	-8,90	5,13	3,91	1,98	0,12	-1,38	4,44
Macro	1,08	0,81	-6,40	7,88	4,91	2,22	0,14	0,46	0,88
Relative Value	0,86	0,93	-8,03	5,72	1,63	1,28	0,08	-2,26	14,58
Fixed Income Convertible Arbitrage	0,76	0,99	-16,01	9,74	3,72	1,93	0,12	-3,23	30,42
Multi-strategy	0,723	0,88	-8,40	5,34	1,65	1,28	0,08	-2,20	14,00

Source: author's own calculations based on Hedge Fund Research monthly data.

Data presented in Table 3, Table 4, Table 5 and Table 6, show the results of examinations conducted for a few-year periods in order to verify the thesis regarding the increase of correlation coefficients of hedge fund assets rates of return for different investment strategies applied by hedge funds.

The comparison between correlation coefficients from 1995 – 1999 with correlation coefficients from 1990 – 1994, the increase of correlation between hedge fund assets rates of return can be noticed for the majority of investment strategies. There are only 3 exceptions out of 45. These are: the correlation coefficient between the Macro strategy and *Emerging Markets* strategy, the correlation coefficient between the *Multistrategy* and *Short bias* strategy, well as the correlation coefficient between the *Fixed Income Convertible arbitrage* strategy

and *Macro* strategy. Besides, in 1990 – 1994, many correlation coefficients were statistically insignificant.

If one compares the years 2000 – 2004 with 1995 – 1999, it turns out that for the majority of investment strategies, correlation coefficients between hedge fund assets rates of return, decreased and additionally plenty of them started to be statistically insignificant. For 10 cases out of 45, the correlation grew up.

Making a comparison between correlation coefficients from 2005 – 2011 with the period of 2000 – 2004, shows again the increase of correlation between hedge fund assets rates of return for the majority of investment strategies. For 7 cases only out of 45, the decrease of correlation can be noticed. It concerns the following strategies: *Emerging markets* and *Short bias*, *Equity hedge* and *Short bias*, *Macro* and *Short bias*, *Macro* and *Emerging markets*, *Equity hedge* and *Macro*, *Event driven* and *Macro*, *Multistrategy* and *Macro*. Moreover, in 2005 – 2011 all correlation coefficients are statistically significant, contrary to the period of 2000 – 2004.

The comparison between correlation coefficients from 2005 – 2011 with the period of 1990 – 2004, indicates again the rise of correlation coefficients between hedge fund assets rates of return for various strategies. For 7 cases out of 45, they diminished. It concerns correlation coefficients between the following strategies: *Macro* and *Short bias*, *Macro* and *Emerging markets*, *Macro* and *Equity hedge*, *Macro* and *Event driven*, *Macro* and *Relative value*, *Macro* and *Fixed Income Convertible Arbitrage*, *Macro* and *Multistrategy*. All mentioned exceptions refer to the inflation of correlation coefficients of *Macro* strategy with other strategies.

The research presented in the paper prove that in the long time, the relations force between hedge fund assets rates of return for different investment strategies, augmented.

Table 3

Correlation table for the period 1990 – 1994. Underlined correlation coefficients are statistically significant for p<0,05000.

Strategy	Merger Arbitrage	Equity Market Neutral	Short Bias	Emerging Markets	Equity Hedge	Event Driven	Macro	Relative Value	Fixed Income Convertible Arbitrage	Multi-strategy
Merger Arbitrage	1	-0,05	-0,37	0,43	0,35	0,74	0,31	0,18	0,38	0,33
Equity Market Neutral	-0,05	1	-0,04	-0,02	0,37	0,04	0,14	0,11	0,01	0,09
Short Bias	-0,37	-0,04	1	-0,51	-0,58	-0,54	-0,36	-0,31	-0,34	-0,56
Emerging Markets	0,43	-0,02	-0,51	1	0,53	0,62	0,65	0,36	0,48	0,56
Equity Hedge	0,35	0,37	-0,58	0,53	1	0,66	0,60	0,42	0,46	0,51
Event Driven	0,74	0,04	-0,54	0,62	0,66	1	0,54	0,51	0,61	0,63
Macro	0,31	0,14	-0,36	0,65	0,60	0,54	1	0,32	0,51	0,42
Relative Value	0,18	0,11	-0,31	0,36	0,42	0,51	0,32	1	0,42	0,48
Fixed Income Convertible Arbitrage	0,38	0,01	-0,34	0,48	0,46	0,61	0,51	0,42	1	0,48
Multi-strategy	0,33	0,09	-0,56	0,56	0,51	0,63	0,42	0,48	0,48	1

Source: author's own calculations based on Hedge Fund Research monthly data.

Table 4

Correlation table for the period 1995 – 1999. Underlined correlation coefficients are statistically significant for p<0,05000.

Strategia	Merger Arbitrage	Equity Market Neutral	Short Bias	Emerging Markets	Equity Hedge	Event Driven	Macro	Relative Value	Fixed Income Convertible Arbitrage	Multi-strategy
Merger Arbitrage	1	0,41	-0,60	0,53	0,60	0,79	0,35	0,73	0,62	0,41
Equity Market Neutral	0,41	1	-0,28	0,24	0,42	0,40	0,40	0,34	0,35	0,40
Short Bias	-0,60	-0,28	1	-0,56	-0,86	-0,67	-0,45	-0,58	-0,53	-0,37
Emerging Markets	0,53	0,24	-0,56	1	0,67	0,72	0,59	0,59	0,56	0,62
Equity Hedge	0,60	0,42	-0,86	0,67	1	0,77	0,64	0,64	0,60	0,56
Event Driven	0,79	0,40	-0,67	0,72	0,77	1	0,64	0,82	0,73	0,69
Macro	0,35	0,40	-0,45	0,59	0,64	0,64	1	0,45	0,50	0,62
Relative Value	0,73	0,34	-0,58	0,59	0,64	0,82	0,45	1	0,79	0,69
Fixed Income Convertible Arbitrage	0,62	0,35	-0,53	0,56	0,60	0,73	0,50	0,79	1	0,74
Multi-strategy	0,41	0,40	-0,37	0,62	0,56	0,69	0,62	0,69	0,74	1

Source: author's own calculations based on Hedge Fund Research monthly data.

Table 5

Correlation table for the period 2000 – 2004. Underlined correlation coefficients are statistically significant for p<0,05000.

Strategia	Merger Arbitrage	Equity Market Neutral	Short Bias	Emerging Markets	Equity Hedge	Event Driven	Macro	Relative Value	Fixed Income Convertible Arbitrage	Multi-strategy
Merger Arbitrage	1	0,27	-0,17	0,33	0,48	0,62	0,16	0,62	0,33	0,30
Equity Market Neutral	0,27	1	0,06	-0,13	0,14	0,04	0,11	0,20	0,13	0,02
Short Bias	-0,17	0,06	1	-0,78	-0,90	-0,68	-0,47	-0,28	-0,08	-0,54
Emerging Markets	0,33	-0,13	-0,78	1	0,81	0,80	0,51	0,42	0,12	0,69
Equity Hedge	0,48	0,14	-0,90	0,81	1	0,84	0,54	0,48	0,21	0,60
Event Driven	0,62	0,04	-0,68	0,80	0,83	1	0,48	0,55	0,28	0,68
Macro	0,16	0,11	-0,47	0,51	0,54	0,48	1	0,19	0,09	0,58
Relative Value	0,62	0,20	-0,28	0,42	0,48	0,55	0,19	1	0,72	0,45
Fixed Income Convertible Arbitrage	0,33	0,13	-0,08	0,12	0,21	0,28	0,09	0,72	1	0,23
Multi-strategy	0,30	0,02	-0,54	0,69	0,60	0,68	0,58	0,45	0,23	1

Source: author's own calculations based on Hedge Fund Research monthly data.

Table 6

Correlation table for the period 2005 – 2011. Underlined correlation coefficients are statistically significant for p<0,05000.

Strategia	Merger Arbitrage	Equity Market Neutral	Short Bias	Emerging Markets	Equity Hedge	Event Driven	Macro	Relative Value	Fixed Income Convertible Arbitrage	Multi-strategy
Merger Arbitrage	1	0,54	-0,63	0,76	0,81	0,82	0,38	0,75	0,66	0,68
Equity Market Neutral	0,54	1	-0,30	0,62	0,65	0,65	0,52	0,54	0,40	0,52
Short Bias	-0,63	-0,30	1	-0,65	-0,78	-0,76	-0,18	-0,64	-0,60	-0,65
Emerging Markets	0,76	0,62	-0,65	1	0,95	0,89	0,49	0,86	0,80	0,82
Equity Hedge	0,81	0,65	-0,78	0,95	1	0,94	0,50	0,87	0,81	0,84
Event Driven	0,82	0,65	-0,76	0,89	0,94	1	0,39	0,93	0,84	0,89
Macro	0,38	0,52	-0,18	0,49	0,50	0,39	1	0,26	0,20	0,24
Relative Value	0,75	0,54	-0,64	0,86	0,87	0,93	0,26	1	0,94	0,96
Fixed Income Convertible Arbitrage	0,66	0,40	-0,60	0,80	0,81	0,84	0,20	0,94	1	0,94
Multi-strategy	0,68	0,52	-0,65	0,82	0,84	0,89	0,24	0,96	0,94	1,000000

Source: author's own calculations based on Hedge Fund Research monthly data.

Furthermore, data depicted in Table 7, Table 8, Table 9 and Table 10, verify the hypothesis that hedge fund assets rates of return are diversified, both for different strategies and for different examination periods.

Table 7

Basic statistics concerning hedge fund assets rates of return for different investment strategies. The examined period is from 1990 – 1994.

Strategy	Average value	Median	Minimal value	Maximal value	Variance	Standard deviation	Skewness	Kurtosis
Merger Arbitrage	0,87	1,21	-6,46	2,90	2,30	1,52	-2,81	10,78
Equity Market Neutral	0,85	0,80	-1,45	2,70	0,76	0,87	0,04	0,05
Short Bias	0,68	0,47	-16,24	12,04	31,85	5,64	-0,18	0,31
Emerging Markets	2,06	2,27	-12,07	12,27	17,10	4,13	-0,45	1,55
Equity Hedge	1,60	1,53	-3,34	7,22	4,98	2,23	0,13	-0,20
Event Driven	1,23	1,36	-5,69	4,92	3,56	1,89	-1,21	3,27
Macro	1,93	1,71	-6,40	7,88	8,58	2,93	-0,02	0,23
Relative Value	1,24	1,21	-1,19	5,72	1,50	1,22	0,69	1,73
Fixed Income Convertible Arbitrage	0,74	1,01	-2,79	2,19	1,15	1,07	-1,36	1,63
Multi-strategy	1,18	1,12	-1,86	5,34	1,08	1,04	0,90	4,86

Source: author's own calculations based on Hedge Fund Research monthly data.

Table 8.

Basic statistics concerning hedge fund assets rates of return for different investment strategies. The examined period is from 1995 – 1999.

Strategy	Average value	Median	Minimal value	Maximal value	Variance	Standard deviation	Skewness	Kurtosis
Merger Arbitrage	1,14	1,33	-5,69	2,47	1,27	1,13	-3,93	22,39
Equity Market Neutral	0,94	0,89	-1,67	3,59	0,86	0,93	-0,23	1,08
Short Bias	-0,63	-0,56	-14,60	19,40	33,34	5,77	0,48	1,64
Emerging Markets	0,88	1,32	-21,02	14,80	27,60	5,25	-0,99	4,53
Equity Hedge	2,04	2,03	-7,65	10,88	7,58	2,75	-0,20	2,73
Event Driven	1,48	1,81	-8,90	5,13	3,97	1,99	-2,28	11,54
Macro	1,27	0,94	-3,77	6,82	5,57	2,36	0,22	-0,22
Relative Value	1,00	1,23	-5,80	2,80	1,32	1,15	-3,61	20,23
Fixed Income Convertible Arbitrage	1,09	1,18	-3,19	3,33	0,88	0,94	-1,63	6,85
Multi-strategy	0,76	0,99	-3,27	2,35	1,11	1,05	-1,95	5,48

Source: author's own calculations based on Hedge Fund Research monthly data.

Table 9.

Basic statistics concerning hedge fund assets rates of return for different investment strategies. The examined period is from 2000 – 2004.

Strategy	Average value	Median	Minimal value	Maximal value	Variance	Standard deviation	Skewness	Kurtosis
Merger Arbitrage	0,50	0,59	-2,72	2,47	0,84	0,92	-0,96	2,04
Equity Market Neutral	0,46	0,35	-1,57	3,06	0,81	0,90	0,73	1,16
Short Bias	0,84	0,10	-21,21	22,84	50,48	7,10	0,07	1,89
Emerging Markets	0,93	1,68	-6,59	6,61	10,77	3,28	-0,69	-0,42
Equity Hedge	0,54	0,42	-4,30	10,00	6,39	2,53	0,67	2,21
Event Driven	0,86	1,16	-4,35	4,59	3,37	1,83	-0,57	0,73
Macro	0,68	0,63	-3,68	5,66	3,08	1,75	0,13	0,72
Relative Value	0,69	0,69	-0,50	2,18	0,33	0,58	0,25	0,30
Fixed Income Convertible Arbitrage	0,76	0,79	-1,28	2,73	0,80	0,90	-0,29	-0,15
Multi-strategy	0,64	0,73	-1,72	3,28	0,66	0,81	-0,11	1,66

Source: author's own calculations based on Hedge Fund Research monthly data.

Table 10.

Basic statistics concerning hedge fund assets rates of return for different investment strategies. The examined period is from 2005 – 2011.

Strategy	Average value	Median	Minimal value	Maximal value	Variance	Standard deviation	Skewness	Kurtosis
Merger Arbitrage	0,51	0,71	-2,90	3,12	1,13	1,06	-0,90	1,38
Equity Market Neutral	0,24	0,41	-2,87	1,45	0,66	0,81	-1,44	3,17
Short Bias	-0,22	-0,41	-10,09	9,58	12,52	3,54	0,04	0,24
Emerging Markets	0,91	1,53	-14,45	9,62	13,96	3,74	-1,25	3,61
Equity Hedge	0,50	1,02	-9,46	6,37	7,20	2,68	-1,09	2,56
Event Driven	0,57	1,04	-8,19	4,74	4,29	2,07	-1,49	4,12
Macro	0,59	0,61	-2,62	4,22	2,16	1,47	0,21	-0,45
Relative Value	0,58	0,81	-8,03	3,93	2,82	1,68	-2,59	10,91
Fixed Income Convertible Arbitrage	0,52	0,78	-16,01	9,74	10,29	3,21	-2,15	11,81
Multi-strategy	0,41	0,68	-8,40	3,88	3,08	1,75	-2,45	10,27

Source: author's own calculations based on Hedge Fund Research monthly data.

4. DISCUSSION

The results of the study show that the correlation between hedge fund assets rates of return for various investment strategies, augmented in the analyzed period. It means that hedge funds generate higher and higher systemic risk. This in turn means that some steps should be taken to introduce regulations of hedge funds to the financial markets. Although in 2013 regulations in Europe were launched, and during the last years regulations in the USA improved as well, it is not enough. Other markets (like those in Asia) are still unregulated. Hedge fund managers take their assets and move hedge funds to less regulated markets. Thus,

if this industry is not regulated globally, which is impossible at the moment, financial markets stability will be more and more endangered by them.

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IS THE LEGAL FRAMEWORK OF TOURISM A SUPPORTING OR A HINDERING FACTOR IN THE CASE OF ROMANIA?

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ABSTRACT

Although Romania enjoys a great tourism potential, unfortunately, it is still underdeveloped and underexploited; legal aspects seem to have a great influence upon this situation. This paper is dedicated to analyzing weather the Romanian legislation is appropriate and supportive for the development of the country's tourism sector. The fundamental principle of tourism legislation is to grant tourists' rights and to ensure their tourist interests; moreover, legal policies and regulations should provide a framework able to support, ensure, and stimulate a high level of the services' quality.

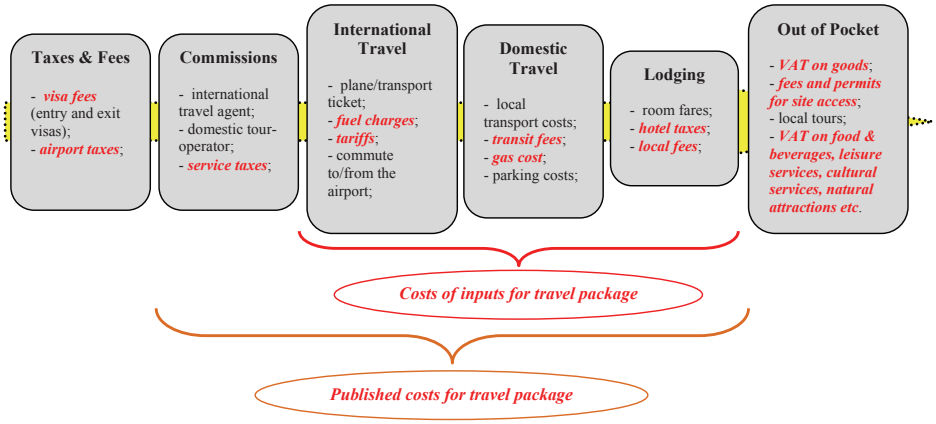
It is assumed that there is a need for strong government leadership in developing tourism. Issues discussed include: tourism legislation; policy implementation structures; financial and tax incentives from governments, as well as also the benefits received by governments from such schemes; and, last but not least, the governments' role in destination marketing policies and implementation. The development of Romania's tourism industry is analyzed by reporting it to the World Economic Forum's Global Economic and Tourism Competitiveness Reports. Further, the evolution of Romanian tourism is going to be compared to that of other former communist countries, and not only. VAT issues are also going to be pointed out; again, a comparison between Romania's and other countries' policies referring to the fiscal facilities applied to tourism is going to be made. In the end, a few suggestions for the improvement of some legal aspects are going to be formulated with the purpose of contributing to the development of this sector.

Key words: tourism development, shadow hospitality, government policies, legal framework, regulations, VAT and fiscal policies, competitiveness, Romania.

1. INTRODUCTION

For the tourist industry, a healthy investment climate, supported by a sound tax regime, plays a key part in any government's strategy for growth and development. Still, many countries implement in the case of the tourist sector tax systems that are rather complicated and which generate low revenues but burden businesses. A brief presentation of the various taxes that come along with a tourist package is represented below (Figure N° 1):

Figure N° 1. *Total Tourist Expenditures*



[Source: based on: FIAS, 2007 in Corthay; Loeprick, 2011: 2]

Legal issues and fiscal policies are most certainly connected in any field of activity. Obviously, the development of tourist destinations is closely dependent upon these two major interdependent factors. The regulatory framework of tourism activities implies laws and regulations concerning both sides, the suppliers (including the intermediaries) and the clients, by:

- developing the national, regional and local management structures of national, regional and local tourist destinations;
- creating the appropriate conditions for the development of destinations;
- creating the appropriate conditions for the development of tourist attractions;
- defining and establishing the functioning conditions of the hospitality services' providers, respectively by clearly stating their rights, as well as their obligations;
- making sure that established qualitative standards of the hospitality services, respectively of the ancillary ones, are respected and met by the specific providers;

- defining and establishing how distribution and intermediation can be realized;
- raising and allotting financial support for the development of destinations, including the development of appropriate technical and tourist infrastructures;
- raising and allotting financial support for the branding, marketing and promotion of national, regional and local destinations;
- establishing taxation strategies and policies in order to support and encourage the development of certain destinations, respectively types of tourism, or, on the contrary, aiming at diminishing demand and tourist consumption in certain areas;
- establishing rules and regulations regarding the rights and obligations of national and international tourists.

Of course, the above listed elements constitute only a few of the contributions and implications of legal provisions. Coherent strategies for the development of tourism can only be elaborated based on clear and stable regulatory frameworks. Unless this condition is fulfilled, no one is entitled to expect positive results in terms of tourist attractiveness (growth of numbers of tourists, increased average durations of stay and, consequently, high occupancy rates, respectively more revenues and higher profits). Moreover, despite the fact that tourists seek more and more authentic, unique and outstanding destinations, regarding their expectations in terms of provided services, standardization seems to be quite often the concept that best describes them. Unfortunately, Romanian authorities do not seem to have perceived, nor understood such a simple reality. At the same time, as the sections below reveal, matters resemble this situation to a certain extent throughout the entire European Union.

2. RESEARCH METHODOLOGY

A complex research has been carried out with the purpose of establishing how the legal framework influences the Romanian tourist activity. In this respect, the following research techniques have been combined:

- document analyses: the European hospitality sector has been described based on the legal and fiscal issues covered by several documents of organizations such as the European Commission, of HOTREC, of Ernst & Young;
- statistical data processing: figures, facts and data have been collected and processed from international publications such as the *Global Competitiveness*

Report (2007-2014 collection) and the *Travel & Tourism Competitiveness Index* (2007-2013 collection), issued by *The World Economic Forum*, respectively from national institutions, namely the *National Institute of Statistics (NIS)*; relying on these sources, Romania's position in terms of economic and tourism competitiveness was established. Further, the role of the legal issues in Romania's tourist performance compared to that of its main competitors, were researched; the picture was completed by processing statistical data provided by the UNWTO regarding international tourist arrivals and receipts of Romania and of its main competitors; researches continued based on the figures offered by NIS concerning VAT and enterprise life in Romania;

- legal database analysis passed on *Legis*: a list of all legal documents that have been issued beginning with 1949 and until April 2015 was developed with the purpose of identifying the categories of legal documents and of their impact; statistical processing was also applied in this case.

3. THE EUROPEAN PERSPECTIVE. THE NEED FOR A SET OF COMMON RULES AND REGULATIONS

Today almost everyone admits that hospitality is a central pillar of tourism, the third largest socio-economic activity in the EU. Obviously, the overall economic impact of tourism (through expenditures related to: accommodation services, food and beverage services, transport, leisure, entertainment and amusement services, cultural services, shopping, etc.) is considerable. A loose and too flexible legal framework that allows or tolerates shadow hospitality across Europe does not only lead to the decrease of the industry's contribution to employment and job-creation growth throughout the European states but, most certainly, negatively affects the quality of the overall tourist experience of the consumer. Moreover, such an attitude may directly impact other tourism and hospitality sub-sectors. [HOTREC, 2014]

HOTREC [HOTREC, 2015][1], a business association representing and monitoring the hospitality industry throughout Europe, expresses its concerns

[1] HOTREC represents the hotel, restaurant and café industry at European level, having 42 member associations from 28 European countries. Some countries among which there are: Romania, Bulgaria, the UK and Iceland have not yet become members. The European hospitality sector employs some 9.5 million workers (some 71 % are under full-time contracts) and counts in total around 1.7 million enterprises, 99.5 % being small and medium sized enterprises; of these 92 % are, in fact, micro enterprises). These businesses

regarding the rapid emergence of the shadow hospitality economy, which is often developing in an unregulated way. According to HOTREC [2015], at European level, the black hospitality market already accounts for far more than the double of the existing number of hotels and similar establishments, as it results from a simple cross-check of the lodgings officially listed by national authorities with the ones available and promoted by the means of various websites, especially by some of the most influential ones. This uncontrolled and unregulated growth has generated many concerns among the actors of the hospitality industry, especially in relation with the need of equal and fair conditions of competition amongst the various enterprises that operate on the hospitality market, respectively in the tourist accommodation sector. HOTREC [2015] also points out that the quality of the services provided by shadow hospitality enterprises are most often not regulated, and consequently present high risks for the clients, for the residents and for the other actors of the tourism sector, who might end up being unable to properly exercise their rights.

Fair competition is a key condition of success in any field of activity. Obviously, to ensure a loyal competitive environment for the players present on the European tourism market is a must. Moreover, tourists and any other guests of the hospitality facilities must be granted at least a minimum level of protection, no matter what type of tourist accommodation they choose. At the same time, it is compulsory to make sure that all types of accommodation establishments are measured and assessed based on similar criteria on the entire European market. Given all of these musts, HOTREC [2015] considers that a set of requirements must be fulfilled by all providers of accommodation cervices; these include exiting the shadow by adopting measures such as:

- the registration of the business activity, with the fulfillment of all legal national, regional and local requirements;
- the provision of reliable statistics regarding the economic activity and the performance of any type of lodging facility;
- the requirement of similar conditions and the implementation of similar restrictions when it comes to the development of tourist accommodation facilities (authorizations for operating in certain areas from residential

generate nearly 60% of the value added. The sector is the 3rd largest industry in Europe, accounting for around 4.4 % of all EU jobs and for some 8 % of all EU enterprises. Europe attracts around a half of all international tourist arrivals worldwide (nearly half a billion) and registers over 1.5 billion nights. [HOTREC, 2015]

areas to natural parks/reservations, building authorizations and limitations regarding the quota building/green area);
- the guarantee that the rights of the neighbors are not infringed;
- the adoption and implementation of hygiene, cleanliness and tidiness norms, according to national, regional and local regulations;
- the ensuring of health and safety conditions for both customers and employees, adapted to each type of accommodation facility; fire safety certifications should be a prerequisite for all types of lodgings;
- the provision of food and beverages under similar hygiene conditions throughout the entire hospitality market; all such suppliers must fulfill and respect all functioning regulations;
- the fulfillment of all fiscal obligations at national, regional and local levels (VAT, profit/turnover tax, etc); further, if other taxes are applied (city/resort tax, bed tax, etc) all suppliers of accommodation services should be subject to them;
- the internet platforms and websites that provide information and promote accommodation facilities should be considered similar to any online travel agency; moreover, they ought to respect the European and national regulations, respectively to make use of fair practices in online distribution;
- the provision of information concerning lodging facilities must comply to the previous point; moreover, on the distributors' or intermediaries' websites there ought to appear clear distinctions between authorized and regulated facilities and shadow hospitality suppliers, with objective explanations concerning the differences between the two categories and with highlights of the risks and responsibilities associated to the choices of the consumers;
- the protection of the environment and the development of environmentally friendly tourism and hospitality businesses constitutes another must; moreover, regulations in this respect must be applied with consequence in the case of all suppliers;
- the guarantee of respecting the rights of the consumers, as stipulated by European directives and by national laws, must be ensured within all cases (business to consumer, business to business and consumer to consumer);
- the application of all obligations regarding accessibility issues, in all specific cases;
- the implementation of collective agreements should be done by all suppliers of hospitality services;

- the registration of all accommodated guests is another compulsory aspect of the activity of any supplier of tourist accommodation services; it is closely linked to fiscal issues and to international travel regulations;
- the fulfillment of copyright-related obligations is another must of all hospitality services suppliers;
- the official controls are to be carried out in all types of accommodation facilities and of other hospitality businesses with the purpose of securing the adequate implementation of all applicable provisions.

The Directive on a common system for the VAT proposed by the European Council is discussed by HOTREC [2011]. Some of the organization's main conclusions concerning the policies presented in this document are presented below. The core objective of the Directive is that of setting up a common (single) system of VAT to be applied to the production and distribution of goods and to the provision of services consumed across the entire EU. HOTREC clearly highlights the direct effect of VAT rules upon the competitiveness on the hospitality sector and upon the industry's employment level. Obviously, VAT rates have a direct impact on the final price of the provided tourism and hospitality services. Throughout the EU, **accommodation** services may be subject to **reduced VAT rates since 1992**, while **restaurants** can benefit from a lower rate only since the **1st of June 2009**; if any Member State wishes so, alcoholic and/or non-alcoholic drinks may be included in the food-services with a reduced VAT rate. In 2011 a large majority of the EU members applied reduced VAT rates for accommodation services, while only around a half of them extended the policy to restaurants. [HOTREC, 2011] Although other tourism and hospitality related services, such as: cultural activities, amusement parks, sportive events, entertainment, souvenir shops, etc may also be subject to diminished VAT rates, no clear positions have been identified in this respect.

A research study run by Copenhagen Economics [Copenhagen Economics, 2007: 33] on the reduced VAT rates applied to goods and services among the Member States of the EU led to the following conclusions regarding the impact of lower rates upon tourism. Thus, lower prices, more production and more jobs are generated by the application of diminished VAT rates upon the following tourism and hospitality related services: hotels, restaurants, and food and non-alcoholic beverages. As the Brewers of Europe [2013: 5] point out, the Copenhagen Economics final report revealed that the use of reduced rates in some sectors is not only legitimate, but desirable, specifically in the case of

the hospitality industry where: "there is a convincing theoretical and empirical argument for extending reduced VAT rates (or other subsidies) to sectors whose services are easily substituted for do-it-yourself or underground work, e.g. locally supplied services and some parts of the hospitality sector.". Moreover, the same report [The Brewers of Europe, 2013: 5] explained that "there is a theoretical /…/ argument for extending reduced VAT rates to sectors employing many low skill workers in order to boost low skill demand, e.g. hotels, restaurants and locally supplied services".

Generally, indirect taxes (such as VAT) are broadly recognized to be more efficient than direct taxes (like those applied to income or earnings), as consumers can, at least theoretically, opt whether or not to pay them through their consumption choices. Several countries try to aid the hospitality sector, by favoring it over the general economy given its contribution to skills and employment and because it competes with lower value-added substitutes (like take-away food or stay at-home vacations/meals). Consequently, a reduced VAT rate is one of the mechanisms commonly used and, obviously, a preferred choice for many Member States [The Brewers of Europe, 2013: 8]. Further, according to the data collected and processed by the Copenhagen Economics [The Brewers of Europe, 2013: 11-14] led to the following findings:

- in the cases of most of the countries applying reduced VAT rates, the growth of the hospitality sector outperformed the increase in the wider economy, as reflected by the development of the GDP; the conclusion is valid even for the years of economic crisis, when the contraction of the hospitality sector, although significant, was less dramatic compared to that of other sectors; the pattern can be observed in countries such as: Austria, Bulgaria, Estonia, France and Portugal; the situation is exactly opposed in the UK, which does not apply a reduced VAT rate; there the hospitality sector is much closer linked to the evolution of the whole economy;
- the same countries (Austria, Bulgaria, Estonia, France and Portugal) registered better results in terms of labor market performance, the employment in the hospitality sector outstripping their average national employment, due to the same reduced VAT rates for this sector; positive effects are visible even in the early stages of the VAT quota reduction, as the Bulgarian case reveals; once again, the UK proved to underperform in the hospitality sector employment, because of not practicing reduced VAT rates;

- reduced VAT rates are most often reflected in the pricing policies of the providers and, consequently, in the decision-making process of the consumers;
- moreover, in the countries practicing reduced VAT rates, negative effects of independent phenomena (such as the global economic crisis) which determine the diminishing of disposable incomes, the hospitality sector tends to be privileged, becoming a somewhat more attractive option compared to other areas of consumption, tending to be somehow assimilated to "necessities".

The table below contains information regarding the levels of VAT applied to tourism across Europe, respectively the existence or absence of any special taxes related to tourism and hospitality activities. Romania's main competitors are highlighted. The main findings are presented briefly below:

- a number of 18 (nearly 65 %) from the EU-28 Members States apply various types of tourism taxes, starting with the most frequent bed taxes and sojourn taxes, completed with annual property related-taxes, and ending with the less common eco-environmental taxes, etc;
- 24 of the EU-28 Member States (some 86 %) apply reduces VAT rates for tourist accommodation services; in most of the cases the same rate applies to breakfast if supplied together with the room; the average VAT reduced rate for accommodation services is of 10.64 % across EU-28, compared to the average standard VAT rate (21.61 %); the difference of nearly 11 % is significant and proves a real interest of the Member States towards diminishing some of the fiscal pressure faced by the lodging owners; still, as already pointed out other taxes are used; in fact, 18 of the EU-28 Member States (a little over 64 %) that apply reduced VAT rates for accommodation make use of other taxes to raise money from this sector; two countries (Lithuania and Slovakia) do not use diminished VAT rates for lodging services, applying standard rates but they do not put any extra fiscal pressure upon the business in this sector; finally, nearly 30 % or 8 countries (Cyprus, Estonia, Finland, Greece, Ireland, Latvia, Luxembourg, and Sweden) have diminished the VAT rates and, with the clear purpose of supporting the sector, have opted not to introduce other taxes;
- the food-service sector enjoys less support in terms of diminished VAT rates, as only 15 of the EU-28 Member States (meaning 54 %) have implemented

such policies; the average value of the reduced VAT rate at the level of EU-28 is 15.48 %, obviously higher than that of the accommodation sector but suggesting an increasing interest towards diminishing this burden (Romania is an example in this respect, as the government intends to reduce the rate to 9 %); 13 states of the EU-28 (some 46 %) have diminished the VAT quota for food-services but have also implemented other taxes to compensate; other 9 countries (32 % of the EU-28) have not opted for the decrease of VAT, applying a standard rate for food-services and also implement other taxes, putting more pressure on the hospitality sector; finally, only 6 states (Cyprus, Finland, Greece, Ireland, Luxembourg, and Sweden) apply lower VAT rates for food-services and do not increase the fiscal burden with other taxes in the field of hospitality.

Table N° 1. *Tourism Related Taxation in EU-28 Member States, on the 1st of January 2015*

Country	Tourism Tax	Tourism Tax	Reduced VAT Rate (Accommodation)		Reduced VAT Rate (Restoration)		Standard VAT Rate
		1 = YES, 0 = NO	Value	1 = YES, 0 = NO	Value	1 = YES, 0 = NO	
Austria	all lodgings 0,15-2,18 €/pers./night; VAT rates: 10% on food, 10% on milk and chocolate, 20% on coffee, tea and other alcoholic or not alcoholic beverages	1	10	1	10	1	20
Belgium	city tax; approx. 10% of room rate, paid on a yearly basis depending on the hotel size and classification; all beverages excluded from reduced VAT	1	6	1	12	1	21
Bulgaria	lodging tax per overnight stays 0,5-1,5 € depending on the type of establishment; seaside resort tax 8 €/stay; annual license up to 250 €/year	1	9	1	20	0	20
Croatia	sojourn tax 0,25-1 € depending on the category of establishment and season	1	13	1	13	1	25
Cyprus	None	0	9	1	9	1	19
Czech Rep.	1 €/night	1	15	1	21	0	21
Denmark	None	0	25	0	25	0	25
Estonia	None	0	9	1	20	0	20

Country	Tourism Tax	Tourism Tax	Reduced VAT Rate (Accommodation)		Reduced VAT Rate (Restoration)		Standard VAT Rate
		1 = YES, 0 = NO	Value	1 = YES, 0 = NO	Value	1 = YES, 0 = NO	
Finland	None	0	10	1	14	1	24
France	0,2 € (camping sites and 1* hotels); 1,5 € for 4-5* hotels; all beverages excluded from reduced VAT	1	10	1	10	1	20
Germany	bed tax in certain cities; 0,25-5 € or 5% of the bill depending on the type of lodging, room rate and location	1	7	1	19	0	19
Greece	None	0	6,5	1	13	1	23
Hungary	approximately 1,5 €/night depending on the region; lodging owners are subject to tax proportionally to the size of the hotel; in Budapest 4% of the room rate in 2014, compared to 2% in 2000	1	18	1	27	0	27
Ireland	none; all beverages excluded from reduced VAT	0	9	1	9	1	23
Italy	sojourn tax 0,35-5 €/night depending on the region; based on the star rating levied on a set number of nights	1	10	1	10	1	22
Latvia	None	0	12	1	21	0	21
Lithuania	applied only to 2 resorts; hotels and apartments 0,3-0,6 €	1	9	0	21	0	21
Luxembourg	none; super reduced VAT rates for hospitality services; alcoholic beverages are subject to the standard VAT rate	0	3	1	3	1	17
Malta	none but a tax of 0,5 €/ pers./night was proposed; since 2010 - eco-contribution tax of 0,5 €/tourist payable upon arrival; a permit is required for putting tables and chair on public domain	1	7	1	18	0	18

Country	Tourism Tax	Tourism Tax	Reduced VAT Rate (Accommodation)		Reduced VAT Rate (Restoration)		Standard VAT Rate
		1 = YES, 0 = NO	Value	1 = YES, 0 = NO	Value	1 = YES, 0 = NO	
Netherlands	fixed amount depending on the ranking and type of accommodation in most municipalities; some municipalities charge a % on hotel charges sometimes variable by rank and type of lodging; 0,55-4,76 €/ pers./night; alcoholic beverages are subject to the standard VAT rate	1	6	1	6	1	21
Poland	none; alcoholic beverages are subject to the standard VAT rate	1	8	1	8	1	23
Portugal	None	1	6	1	23	0	23
Romania	sojourn tax 0,5%-5% in each municipality regardless of ranking, changed to 1% since 2012; city tax - charged per person, per night; resort tax - charged on the first night only; all visitors 18+ years; VAT for food-services is expected to be reduced in June 2015 to 9%	1	9	1	24	0	24
Slovakia	city tax applied on hotels; 0,5-1,65 €/pers./ night depending on the municipality regulations	1	20	0	20	0	20
Slovenia	0,6-1,25 €/person/ night, varies by location and hotel ranking; some reductions/exemptions apply for children but vary according to the location; VAT rate of 9,5% applies to the preparation of meals	1	9,5	1	22 & 9,5	1	22
Spain	only in Catalonia - 0,75-2,5 €/pers./night depending on the location and ranking, for stays of up to 7 nights; children under 16 are exempt	1	10	1	10	1	21
Sweden	None	0	12	1	12	1	25
UK	none; a license is required to sell alcohol	0	20	0	20	0	20
EU - 28		18	10,64	24	15,48	15	21,61

[Sources: EC, 2015: 4-8; Ranson, 2014: 7-8; Brewers of Europe, 2013; Ernst & Young, 2013; HOTREC, 2011.]

4. A BRIEF ANALYSIS OF ROMANIA AS A TOURIST DESTINATION IN THE EUROPEAN CONTEXT

When referring to Romania's tourism, a significant number of papers (official strategic writings, as well as also books and academic articles) state at some point the fact that "Romania used to be an attractive tourist destination". This phrase seems to be the curse of the past more than 20 years. The fall of communism has, on one hand, brought along the much desired democratization of the country but, on the other hand, it has led to its economic destabilization. Romania's closed economy was neither ready, nor able to face the challenges of free markets. Obviously, once the borders opened, the residents of the former communist bloc were drawn towards tourist destinations that they had not been able to visit in the past. Moreover, relatively quickly after their first visits abroad in Occidental destinations, these tourists became familiar with better accommodation services and with a more diversified offer of food-services, respectively of leisure services. Consequently, they became more and more attracted by those destinations. At first, more developed tourist destinations became the main attractions. Today, consumer trends also reveal an orientation towards emerging destinations, which are less frequented and thus, not crowded. Unfortunately, it looks like Romania is still unable to capitalize on either of the tourists' preferences.

One of the most relevant tools for the comparison of tourist destinations' competitiveness is provided by *The Travel & Tourism Competitiveness Report* published every second year by the World Economic Forum (WEF). The most recent edition is that of 2013 [Blanke; Chiesa (eds.), 2013]. Although a European country, Romania does not manage to capitalize of the continent's leading position. In order to be able to better understand some of the causes of Romania's poor performance in terms of tourist arrivals and revenues, respectively in those of tourism competitiveness, the top positions are highlighted; among these, there are some of Romania's international competitors, especially in what concerns outgoing tourist activities. As previous studies [Coroş, 2007; Vorzsák; Coroş, 2008; Coroş; Negruşa, 2014] have revealed, after 1989 Romania seized to be attractive to its former target markets (the ones developed under communism) and to its Romanian clients, who have shifted towards external destinations; moreover, despite its rich and generous tourist potential, the country has not managed to attract significant numbers of international visitors from former and new target- and opportunity-markets.

According to the most recent report on tourism issued by WEF [Blanke; Chiesa (eds.), 2013: XVII-XIX]: Europe remains the leading region in terms of travel and tourism competitiveness, the top 5 positions of the general hierarchy of 140 countries being taken by European countries (Switzerland, Germany, Austria, Spain and the United Kingdom); Romania only managed to occupy the 68th place (obviously at the end of the first half), being outrun by some of its most important competitors (France (7th position), Italy (26th place), the Czech Republic (31st position), Greece (32nd place), Croatia (35th position), Slovenia (36th place), Hungary (39th position), Montenegro (40th place), Poland (42nd position), Turkey (46th place), Bulgaria (50th position), and Slovakia (54th place)); Romania manages to rank better only compared to four of its competitors: Ukraine (76th position), Albania (77th place), Serbia (89th position), and Moldova (102nd place). Switzerland continues to rank 1st out of all countries in this TTCI (2013), too; in fact, it has continuously held this position ever since the first edition of the TTCI (2007). Countries, such as: Germany, Austria, Spain, and the United Kingdom complete the top five, while France (the world's Number One Destination) and Sweden are among the top 10 overall. What makes Swiss tourism the most competitive one of the world? Except for price competitiveness, where it ranks 139 of 140 and for a somewhat restrained visa policy (58th place), Switzerland [Blanke; Chiesa (eds.), 2013: XVII] performs excellently under most analyzed aspects. In fact, Switzerland has an excellent infrastructure, with an outstanding ground transport infrastructure (3rd place worldwide, outrun only by Hong Kong and Singapore). It enjoys a very good hospitality infrastructure; its hotels are highly appreciated and recognized in terms of quality; its staff is highly appreciated due to the renowned Swiss hospitality and hotel management schools, the country ranks 2nd for the availability qualified labor force. Swiss tourism attracts tourists because of its rich and well-managed natural resources, as a significant quota of the country's surface being protected; in fact, the Swiss environmental regulatory framework is one of the most stringent ones worldwide (ranking 3rd), while the tourist industry registers a sustainable development (7th place worldwide). The destination ensures high safety and security to its citizens and tourists as well (2nd position). Switzerland has a highly competitive tourist industry with strong leisure tourism and business tourism infrastructure due to the fact that the country is an important business travel hub, hosting yearly numerous international fairs and exhibitions; the increased tourist flows generated by business tourism, which, as shown, develops along-side with leisure

tourism, reflects in the capitalization on the Swiss cultural resources pillar (6th place); creative industries are another strength of the Swiss.

Just like at global level, at European level, too Germany ranks 2nd. Similar to Switzerland, Germany's infrastructure is among the most developed ones worldwide (6th place for ground transport infrastructure and 7th position for air transport infrastructure, facilitating national and international connections). The German cultural heritage ranks 5th for the numerous UNESCO World Heritage Sites it possesses. At the same time, Germany occupies the 2nd best position in the global top, hosting annually over 600 international fairs and exhibitions. In terms of price competitiveness, the destination is relatively well positioned (55th place). Germany's attractiveness as a tourist destination is closely linked to its great efforts to develop in a sustainable way (4th), having adopted the most stringent environmental regulations worldwide (1st place), being the 3rd at global level in terms of enforcement of environmental regulations, and ranking 1st for the ratification of many international environmental treaties.

The 3rd most competitive global tourist destination is Austria. This country's performance derives from various factors. Among these, the tourist infrastructure places Austria together with Italy on the 1st position. Further, Austrians are recognized to be friendly people, the country ranking 5th at global level for its attitude towards foreign visitors. Moreover, the destination is a very safe one (7th position worldwide). It ranks 1st for the quality of the natural environment, respectively it is highly appreciated for its cultural resources (12th position), being host to a number of nine UNESCO World Heritage cultural sites. Austria has a well-developed creative industry. A well-developed business tourism infrastructure, attracts many participants at yearly fairs and exhibits. Tourism develops sustainably (10th position at global level), having some of the most restrictive (4th position) and well-enforced (7th place) environmental regulations worldwide, which place the destination on the 6th position in terms of environmental sustainability.

The remainder of the most competitive destinations of the globe are presented in se synthesized manner in the following lines. Despite its economic problems, derived from the global crisis, Spain occupies the 4th position in the competitiveness ranking. Spain is the global leader in terms of cultural resources, ranking 1st for this pillar, due to the fact that it possesses some of the most numerous UNESCO World Heritage cultural sites (2nd place worldwide). Business tourism is an important component of its T & T industry; Spain hosts very many international fairs and exhibitions (3rd position). Moreover, sportive-

events tourism occupies plays a significant part in the country's T & T industry, as it has a well-developed sportive infrastructure. Tourism infrastructure places Spain on a leading position, too. Moreover, creative industries also have a positive impact on the competitiveness of Spanish tourism. The effectiveness of tourism marketing places Spain on the 4th place worldwide, being relevant for the prioritization of the country's T & T. This is a great success, especially under the less favorable economic conditions of the country.

The United Kingdom in another one of the most expensive worldwide destinations, ranking 138th, due to the high taxes it applies (VAT rates, airport taxes etc). Still despite this fact, it is the 5th country in terms of tourism competitiveness. This position is ensured by outstanding cultural resources (3rd place at global level), enriched by numerous UNESCO World Heritage cultural sites, doubled by a strong and attractive creative industry. The UK is also among the top organizers of international fairs and exhibitions. Two major events of 2012 (the Summer Olympic Games and the Diamond Jubilee of Queen Elizabeth II) prove the high importance granted to the prioritization of T & T, respectively the effectiveness of the marketing activities. The UK rank high for ICT infrastructure (10th place) and for air transport infrastructure (5th position). The development of the T & T industry is supported and encouraged by an appropriate policy environment (ranking 8th worldwide); the sector also benefits from an excellent human capital (6th place).

Number one destination of the world, France, ranks 7th in the T & T competitiveness index. France abounds in cultural heritage sites (ranking 4th in terms of UNESCO World Heritage cultural sites) and a well-developed creative industry (8th position worldwide). From the perspective of the business tourism infrastructure, France does very well, ranking 5th for international fairs and exhibitions. The French have an excellent ground transport infrastructure (5th place worldwide): the roads and railroads are excellent; the country's air transport infrastructure is also very good (8th position). A series of hindering factors for the development of French tourism can be found in a regulatory framework that is not supportive enough and in the declining interest for the prioritization of T & T (only 35th place worldwide). France also seems to face to a certain extent a decrease in what concerns the quality and the availability of the qualified labor force in the field of hospitality.

Italy is a quite competitive destination, ranking 26th worldwide and 18th in Europe. The Italian tourist industry enjoys an excellent specific infrastructure

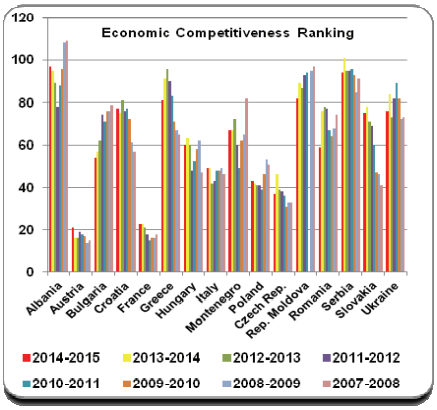
(equaling Austria on the 1st global position). This infrastructure enables the destination to capitalize on its cultural richness (with many cultural sites listed in the UNESCO World Heritage), on the attractiveness of its business-related infrastructure (numerous international fairs and exhibitions), and on its rich creative industries. All of these are covered by a relatively good air transport infrastructure (24th position). The factors that draw Italy downwards in the overall top include: an unsupportive regulatory framework (100th global position) and the poor price competitiveness (ranking 134th).

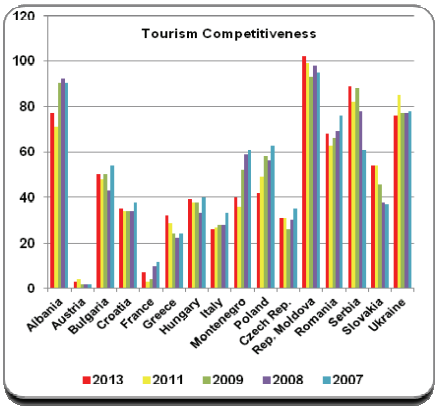
Proving that the global economic crisis and the economic difficulties faced by some destinations do not necessarily have to affect their tourist industry but, on the contrary, the latter can contribute to the diminishing of their negative effects, Greece ranks 32nd in the overall top but on a declining trend. Despite its problems, it still enjoys the 3rd best tourism infrastructure worldwide and it ranks 25th in terms of cultural resources. Health and hygiene also place Greece among the leading destinations (13th place). Its air transport infrastructure is also appreciated (20th position). The people are nice and friendly, proving a higher national affinity for tourism, compared to that of other European nations; they usually have an open and positive attitude towards foreign visitors. The main drawbacks of Greece include: a worsening of the political environment and, consequently, of the policy-making process and a lower prioritization of T & T.

Finally, Turkey occupies the 46th place, registering an increasing trend. It also has rich cultural resources (19th position overall), listing 20 UNESCO World Heritage cultural sites. The market enjoys the development of a business-friendly destination, hosting an increasing number of international fairs and exhibitions. Creative industries are also a powerful sector. The destination's overall capacity registers and increasing trend, responding to the significant increase in international demand. Moreover, its legal framework is a supportive one, ensuring the destination's progress. Both the air transport infrastructure (ranking 29th) and the tourism infrastructure (45th position) register improvements. Some of Turkey's challenges are related to: the safety and security of tourists (79th place); the poor quality of the ground transport infrastructure, especially railroads and ports; the poor ICT infrastructure (71st position). Environmental policies and their implementation are far from being an asset (ranking 95th).

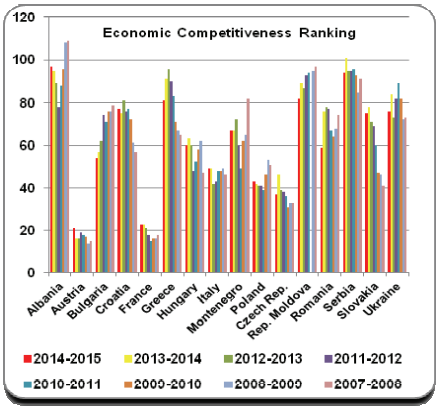
A brief analysis of the two sets of charts below, leads to several conclusions regarding Romania's competitiveness in terms of tourism.

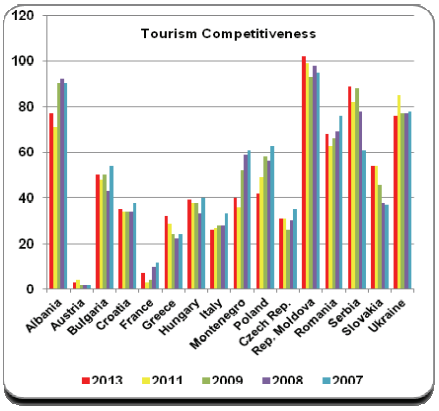
Charts Nos 1. a and b. *Romania's Economic and Tourism Competitiveness Compared to Its Main Competitors**

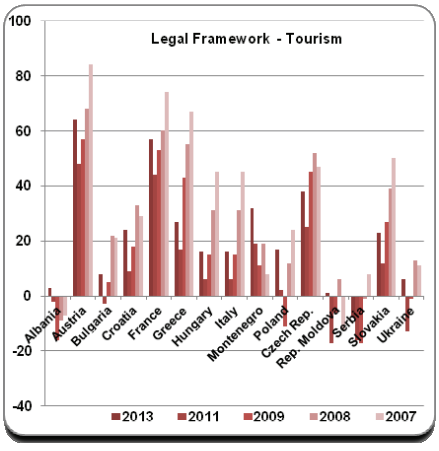


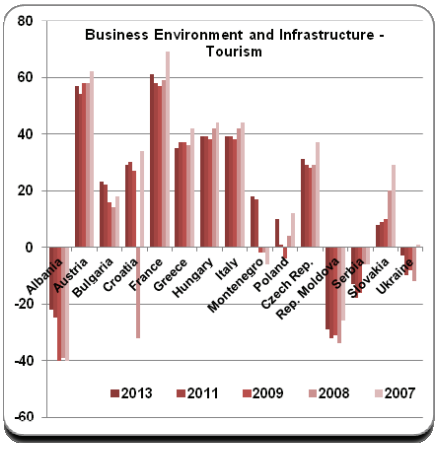


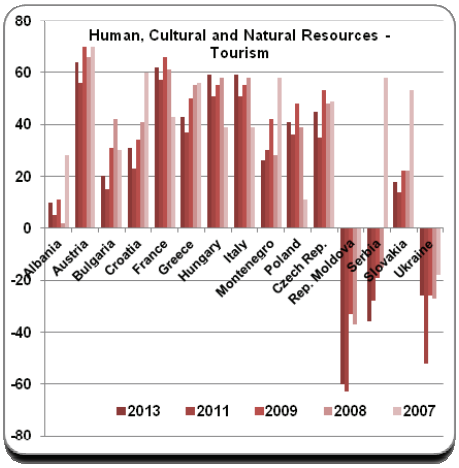
*Positions in the overall rankings, where: 1 corresponds to the best score and 144 represents the worst result. [Source: own calculations based on Blanke; Chiesa (eds.), 2007-2013; Schwab (ed.), 2007-2014.]











Charts Nos 2. a-e. *Romania's Competitiveness Compared to Its Main Competitors (Differences*)*

*Differences between Romania's and its competitors' positions in the overall rankings, where NEGATIVE results reflect Romania's advantages

[Source: own calculations based on Blanke; Chiesa (eds.), 2007-2013; Schwab (ed.), 2007-2014.]

From the point of view of its general economic competitiveness at global level, Romania is still far from a comfortable position, ranking close to the bottom of the first half of the overall top (59th position of 144 analyzed) and managing to outperform only few of its main competitors, namely Albania, Croatia, Greece, the Republic of Moldova, Serbia and Ukraine. Unfortunately, the country's poor economic performance occurs in all fields of activity and is also significantly reflected by its tourism industry. Once again, Romania ranks in the grey area of the overall index, a little above its middle. Obviously, if appropriately managed, tourism can become "an engine" of Romania's economy, respectively it can constitute a source of economic prosperity, for any of its competitors (for some cases, this has turned into reality a long time ago, e.g. Austria).

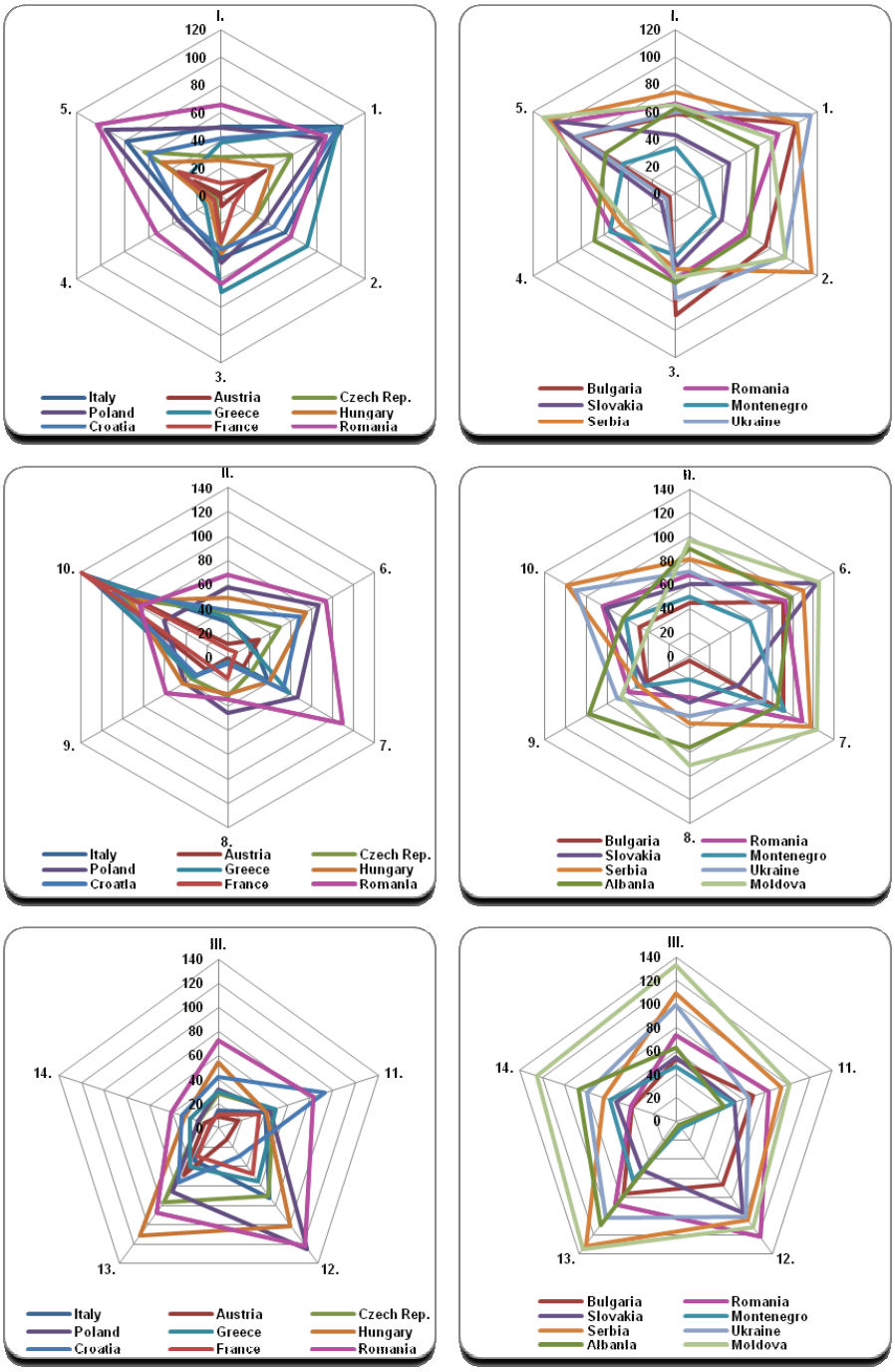
The sad reality is easy to not: Romania occupies poor (even very poor) positions in compared to those of its competitors. For the time being it only manages to outrun some emerging destinations, which, on the other hand have good perspectives of occupying in the future a comfortable place on the tourism market (it is mainly the case of Albania, a destination that grows on a constant basis on the seaside market, and, if peace reestablishes, Ukraine for winter sports and mountain tourism). An interesting observation is that, from the perspective of tourism, Romania still holds competitive advantages compared to: Albania, Republic of Moldova, Serbia and Ukraine, while all other destinations clearly outperform it.

The Travel & Tourism Competitiveness Index consists of a complex set of explicit items, detailed in Appendix N° 1. Regrettably, Romania does not register outstanding performance in any of the included variables. The only aspect worth to be mentioned is that Romania has had a positive evolution, moving upwards in the first half of the overall rankings (from the 76th place of 124 in 2007, reaching the 69th position of 130 countries in 2008, respectively the 66th place of 133 in 2009-2010, to the 63rd position of 139 in 2011) Moreover, instead of continuing its positive development, it falls back on the 68th place of 140 in 2012-2013.

Aiming at sketching a clearer image of Romania's competitiveness on the international tourism market, a number of 15 European countries, identified as Romania's main competitors, were selected, as shown in the two sets of charts above. Throughout the period analyzed in the five editions of the *T & T Competitiveness Index* [Blanke; Chiesa (eds.), 2007-2013] no significant changes have occurred neither at global level, nor in Romania's case. Therefore, it is considered that a deeper analysis relying only on the most recent report [Blanke; Chiesa (eds.), 2013] is reliable and appropriate.

The first sets of six charts illustrate Romania's overall performance compared to that of its competitors for the 14 pillars considered by the World Economic Forum (Appendix N° 1):

Charts N^{os} 3. a-f. *Romania Compared to Its Main Competitors (14 Pillars – detailed in Appendix N^{o} 1)*



[Source: own calculations based on Blanke; Chiesa (eds.), 2013.]

The three main pillars are numbered in Roman figures, while de 14 smaller/component pillars are numbered in Arab style (as done in Appendix Nº 1). The enumerations of the most competitive states begins with the first one in terms of performance and is done decreasingly, until Romania is reached; similarly, the less competitive states are mentioned beginning with the first one that follows Romania and ending with the least competitive one. The analysis of the six charts above leads to the following conclusions concerning Romania's competitiveness.

Thus, in the case of the first pillar, ***Pillar I. T & T Regulatory Framework***, Romania has a better position only compared to Serbia; all other countries outrun it (Austria, being in the most competitive position, followed by France, Hungary, the Czech Republic, Montenegro, Greece, Croatia, Slovakia, and Poland; at the same time, Bulgaria, Ukraine, Albania, and Moldova do not do much better, in reality occupying positions close to that of Romania). Regarding the legal framework of T & T (1), Romania is outrun by: France, Austria, Montenegro, Hungary, Slovakia, the Czech Republic, Albania, Moldova, and Poland, while it performs better compared to: Croatia, Greece, Italy, Bulgaria, Serbia, and Ukraine. The environment (2) is considered to be better protected in the cases of: Austria, France, Hungary, Czech Republic, Montenegro, Poland, Slovakia, Croatia, and Italy; the natural environment appears to be less sustainable in: Albania, Greece, Bulgaria, Ukraine, Moldova and Serbia. The following destinations: Austria, France, Croatia, Hungary, Italy, Montenegro, Poland, and Slovakia are safer destinations (3) compared to Romania, which still has some competitive advantages from this point of view compared to: Albania, Greece, Ukraine, Serbia, and Bulgaria. Health and hygiene (4) constitute another weak point of Romania compared to most of its competitors: Austria, Czech Republic, France, Bulgaria, Ukraine, Hungary, Slovakia, Greece, Italy, Croatia, Poland, Moldova and Serbia; only Montenegro and Albania are a little outperformed by Romania. As expected, Austria, Greece, France, Montenegro, Hungary, Albania, Croatia, Czech Republic, Italy, Bulgaria, Ukraine, and Poland have better prioritized T & T (5), fact which is also reflected by their revenues from their international tourist activity; a worse prioritization of tourism occurs only in: Slovakia, Serbia, and Moldova.

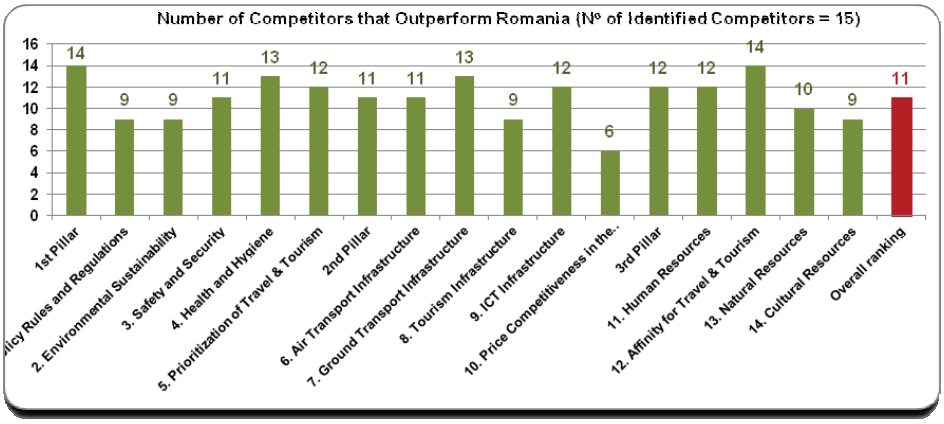
The second pillar, ***Pillar II. Business Environment and Infrastructure***, does not bring any good news for Romania, which is in an obvious disadvantage compared to: France, Austria and Italy, being also outperformed by Greece, Czech Republic, Croatia, Bulgaria, Hungary, Montenegro, Poland, and Slovakia;

the only countries that are less competitive in this respect are: Ukraine, Serbia, Albania, and Moldova. A disadvantage of Romania resides in its air transport infrastructure (6); the better developed countries are: France, Greece, Italy, Austria, Czech Republic, Montenegro, Croatia, Hungary, Ukraine, Poland, and Bulgaria; Romania only outruns: Albania, Serbia, Slovakia and Moldova. Widely criticized and not without any reason, the ground transport infrastructure (7) places Romania in the last third of the overall rankings. Only two destinations have a worse terrestrial infrastructure; Serbia (which has experienced a war in the relatively recent past) and Moldova; all other countries enjoy clear competitive advantages under this aspect: France, Austria, Czech Republic, Italy, Hungary, Slovakia, Croatia, Greece, Poland, Albania, Bulgaria, and Montenegro. These countries have obviously acknowledged that tourism cannot be developed unless there are terrestrial networks that enable access to destinations and attractions. Moreover, these countries do not seem to have problems in understanding the importance of tourism prioritization, either. Tourism infrastructure (8) is the only indicator that places Romania in the first quarter of the global rankings. In this respect, Austria, Italy, Greece, Bulgaria, Croatia, and France present clear competitive advantages compared to Romania; perhaps, Bulgaria and Croatia have gained this advantage with German support and investments; more competitive are also Montenegro, Hungary and Czech Republic, while a less developed tourism infrastructure can be found in: Slovakia, Poland, Ukraine, Serbia, Albania and Moldova. Further, IT & C (9) does not provide an advantage for Romania when compared to: France, Austria, Croatia, Italy, Greece, Czech Republic, Poland, Bulgaria, Hungary, Slovakia, Serbia, and Montenegro but this sector places it on a better position compared to: Moldova, Ukraine, and Albania. Although the indicator measuring the price competitiveness of T & T (10) places Romania in the second half of the global top, compared to the destinations that have until now registered better performance than Romania (Hungary, Czech Republic, Croatia, Ukraine, Serbia, Greece, Austria, Italy, and France), our country finally outperforms them; still, Romania is less competitive in terms of prices than: Moldova, Bulgaria, Poland, Montenegro, Albania and Slovakia. On the other hand, better prices, without an adequate transport infrastructure cannot generate any significant positive effects upon the destination's tourism industry.

The third pillar, ***Pillar III. T & T Human, Cultural and Natural Resources***, places Romania right below the half of the overall ranking, on a disadvantaged

position relative to that of most of its competing destinations: Austria, France, Italy, Czech Republic, Greece, Poland, Croatia, Montenegro, Bulgaria, Hungary, Slovakia, and Albania; only three countries: Ukraine, Serbia, and Moldova are outrun by Romania. Human resources in tourism and hospitality (11) represent another weakness of Romania comparatively to most of its competitors: France, Austria, Italy, Hungary, Albania, Poland, Czech Republic, Montenegro, Slovakia, Ukraine, and Bulgaria. In terms of human capital, the only less competitive destinations are: Croatia, Serbia, and Moldova. It is interesting to note that a significant number of Romanian citizens are employed in hospitality in Italy and in other EU countries, proving the appreciation of the labor force high quality. Consequently, one cannot but wonder if the poor rating of the Romanian human resources for T & T is not mainly due to their poor stimulation provided by the local industry. Further, despite the much claimed friendliness of Romanians, this destination occupies a very poor position (122nd place of 140 available). This is mainly generated by: Romania's low tourism openness, reflected by the poor contribution of this industry in Romania's GDP (116th place); the Romanian's attitude towards foreign visitors (122nd position worldwide); and to the poor degree of customer orientation (114th place). Only Poland does worse compared to Romania, while all other destinations outperform it: Albania, Montenegro, Austria, Croatia, France, Greece, Bulgaria, Czech Republic, Italy, Slovakia, Ukraine, Hungary, Serbia, and Moldova. Despite the fact that the general impression is that Romania's nature is a source of competitive advantages, reason why the promotion strategy is built around the richness of its natural tourism resources (13), the destination does not manage to reach the first half of the global hierarchy, being less competitive than: France, Italy, Greece, Austria, Slovakia, Croatia, Montenegro, Poland, Bulgaria, and Czech Republic. Having in mind that, except for Bulgaria and Greece, the same countries outperform Romania in terms of environmental sustainability (2) one cannot but point out that Romania's ecotourism faces serious challenges. Still, regarding its natural capital, Romania is better positioned than: Ukraine, Albania, Hungary, Serbia, and Moldova. With a valuable but not very rich cultural heritage (14), Romania reaches the first quarter of the worldwide hierarchy, being outperformed by: Italy, France, Austria, Czech Republic, Greece, Hungary, Croatia, and Bulgaria. It occupies a better position compared to the following states: Slovakia, Montenegro, Serbia, Ukraine, Albania and Moldova.

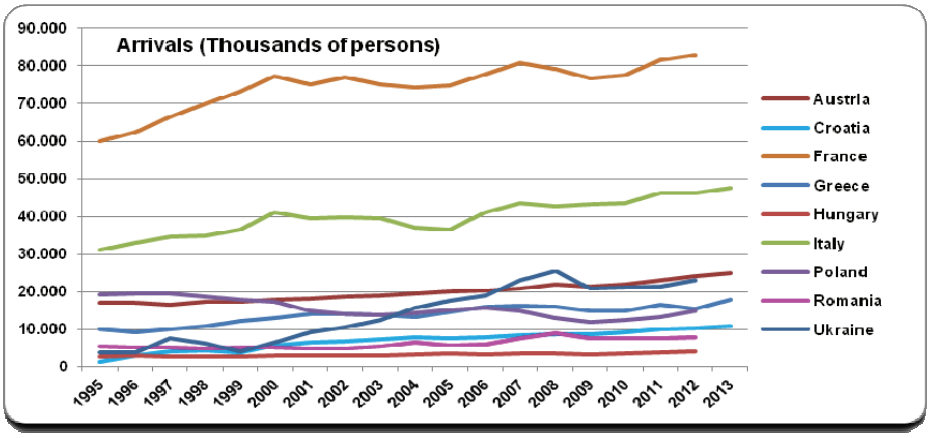
Chart N° 4. *Number of Competitors Outrunning Romania for Each Pillar*



[Source: own calculations based on Blanke; Chiesa (eds.), 2013.]

A synthetic presentation of Romania's competitiveness is presented above. One may easily observe that with very few exceptions, this destination is rather disadvantaged, being overall outrun by 11 of the 15 identified competitors. Obviously, many of its problems are complex and not easy to solve. They are linked to each other and interdependent. Clearly, some of the most important challenges start from the prioritization of the tourism sector, which is reflected by the sector's poor contribution to the GDP, and also in the lack of development of the transport infrastructure. As the figures below reveal, tourist arrivals and international receipts are still expected to increase, being rather below the level of the destination's main competitors.

Charts N^os^ 5. a-d. *Romania's International Arrivals and Revenues Compared to Those of Its Competitors*



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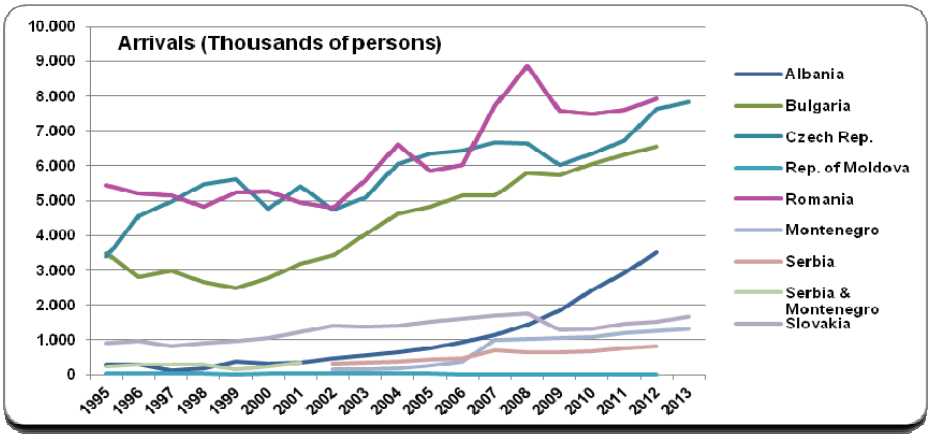
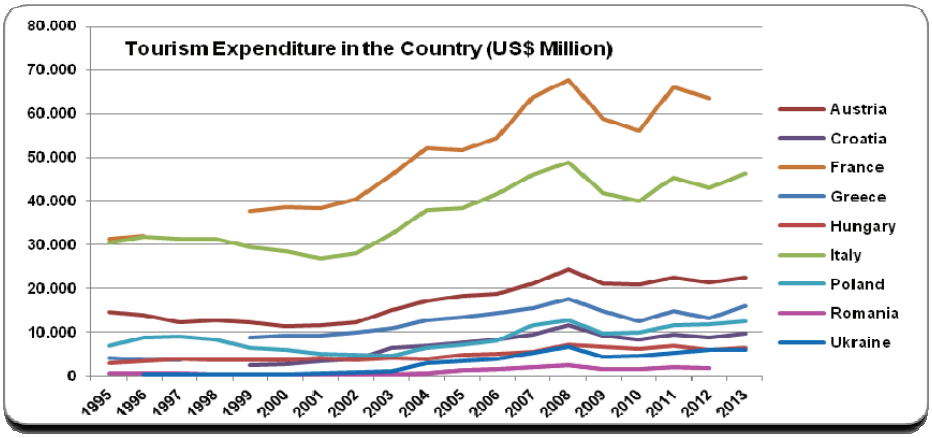
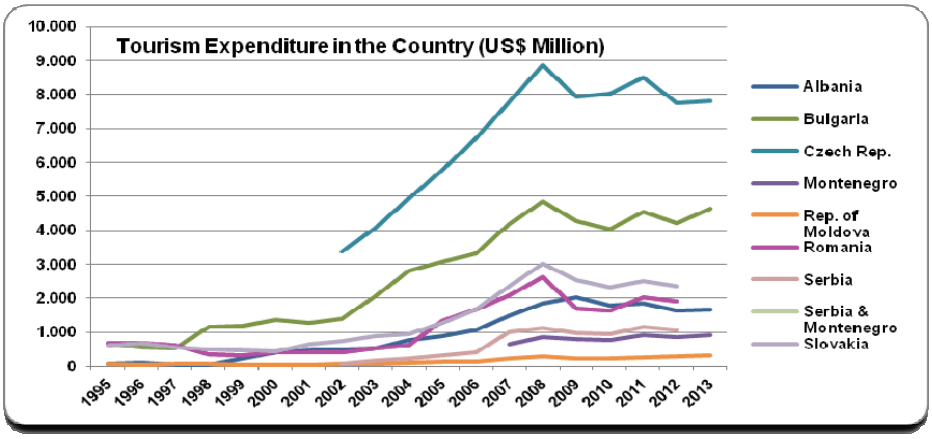






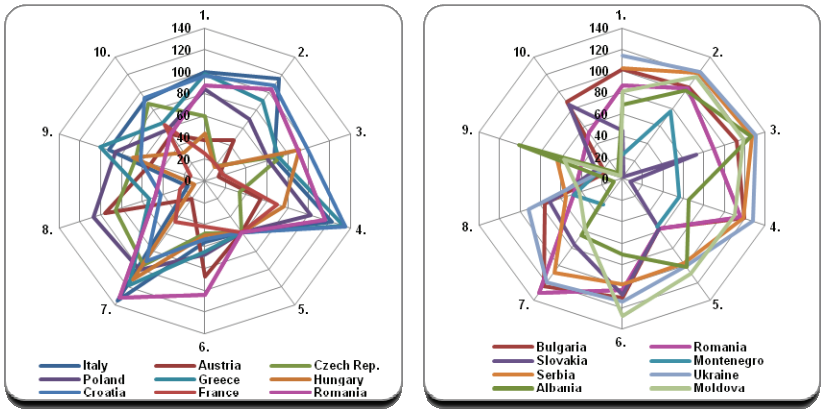
Source: own calculations based on UNWTO Data (2015).]

The data contained in the by four charts above can only confirm that, although Romania struggles without significant positive effects to attract more international visitors and to increase its revenues, results are still to be expected. Obviously, no positive trend can occur unless coherent strategies are adopted and unless the needed measures are implemented, at least in fields such as infrastructure development and environmental sustainability. Moreover, one cannot but wonder how come today's government still does not acknowledge the fact that hospitality is a complex economic sector. In fact, one of the most recent governmental strategies for the development of entrepreneurship [Ro. Gov., 33.019/2014], splits up the sector, spreading its components into no more than three different categories, that even ignore the structure provided by the National Classification of Occupations in Romania. Thus, under tourism and ecotourism there are: hotels and similar accommodation facilities; lodging services for vacations and short term stays; caravan parks, camping sites and camps; other accommodation services; activities of travel agencies; activities of tour-operators; and other reservation and tourist assistance services. Further, creative industries include: fairs/markets and amusement parks; other recreational and leisure activities. Finally, restaurants; catering and food-services for events; respectively other food-services are included in the category of food and beverages processing.

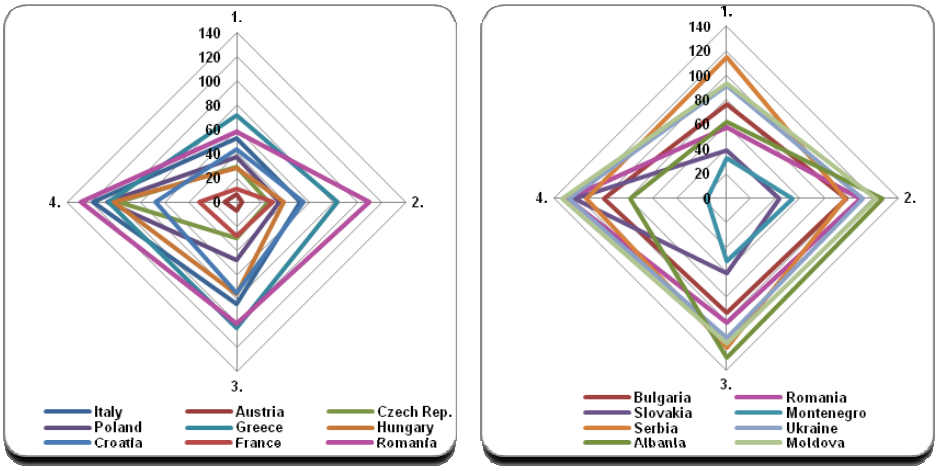
5. ROMANIA'S COMPETITIVENESS IN TERMS OF LEGAL ASPECTS

Similar to the analyses dedicated to Romania's overall tourist competitiveness, its position in terms of legal framework has also been investigated. The six sets of charts below illustrate this situation. For each pair of charts an explanatory legend is included below.

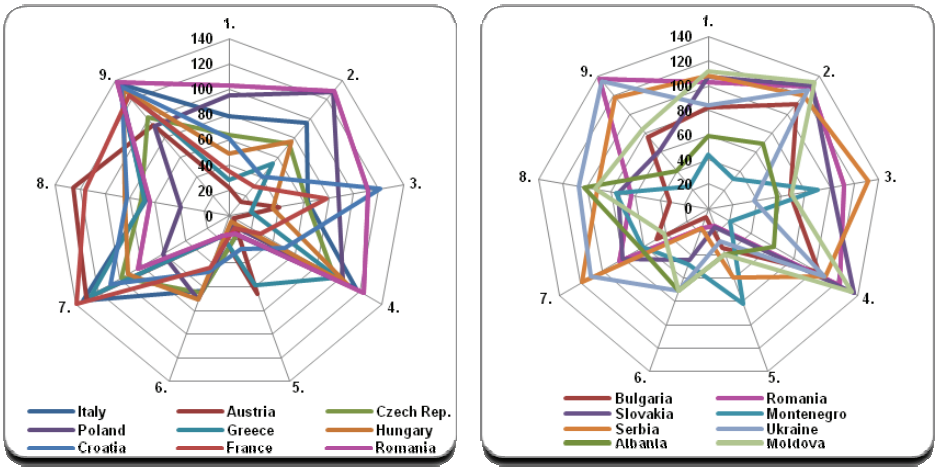
Charts Nos 6. a-f. *Romania's Competitiveness under Legal Aspects*



1. Policy Rules & Reg.; 2. Prevalence of Foreign Ownership; 3. Property Rights; 4. Business Impact of Rules on FDI; 5. Visa Requirements (all EU Member States apply the same policy); 6. Openness Bilateral Air Service Agreements; 7. Transparency of Gov't Policymaking; 8. Nº of Days to Start a Business; 9. Cost to Start a Business (% GNI/capita); 10. GATS Commitment Restrictiveness.



1. Environmental Sustainability; 2. Stringency of Environmental Regulations; 3. Enforcement of Environmental Regulations; 4. Sustainability of T&T Industry Development

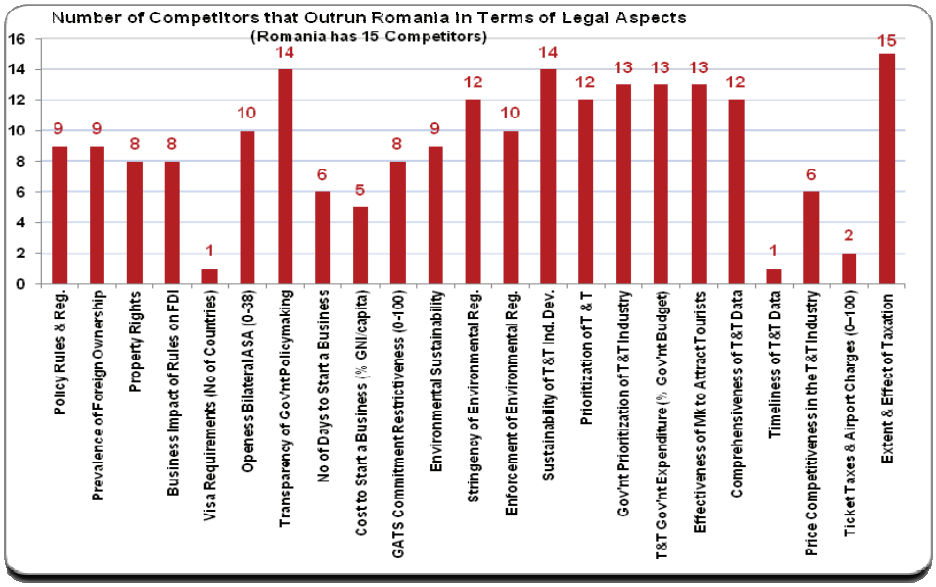


1. Prioritization of T & T; 2. Gov'nt Prioritization of T&T Industry; 3. T&T Gov'nt Expenditure (% Gov'nt Budget); 4. Effectiveness of Mk to Attract Tourists; 5. Comprehensiveness of T&T Data; 6. Timeliness of T&T Data; 7. Price Competitiveness in the T&T Industry; 8. Ticket Taxes & Airport Charges; 9. Extent & Effect of Taxation.

[Source: own calculations based on Blanke; Chiesa (eds.), 2013.]

A rapid analysis of the data contained by the charts above cannot but confirm the reality of the Romanian Travel and Tourism Industry. For most of the analyzed pillars Romania registers some of the poorest results in terms of competitiveness. A clearer situation of how many of its competitors outrun the destination is reflected by the chart below.

Chart N° 7. *The Number of Competitors that Outperform Romania under Legal Aspects*

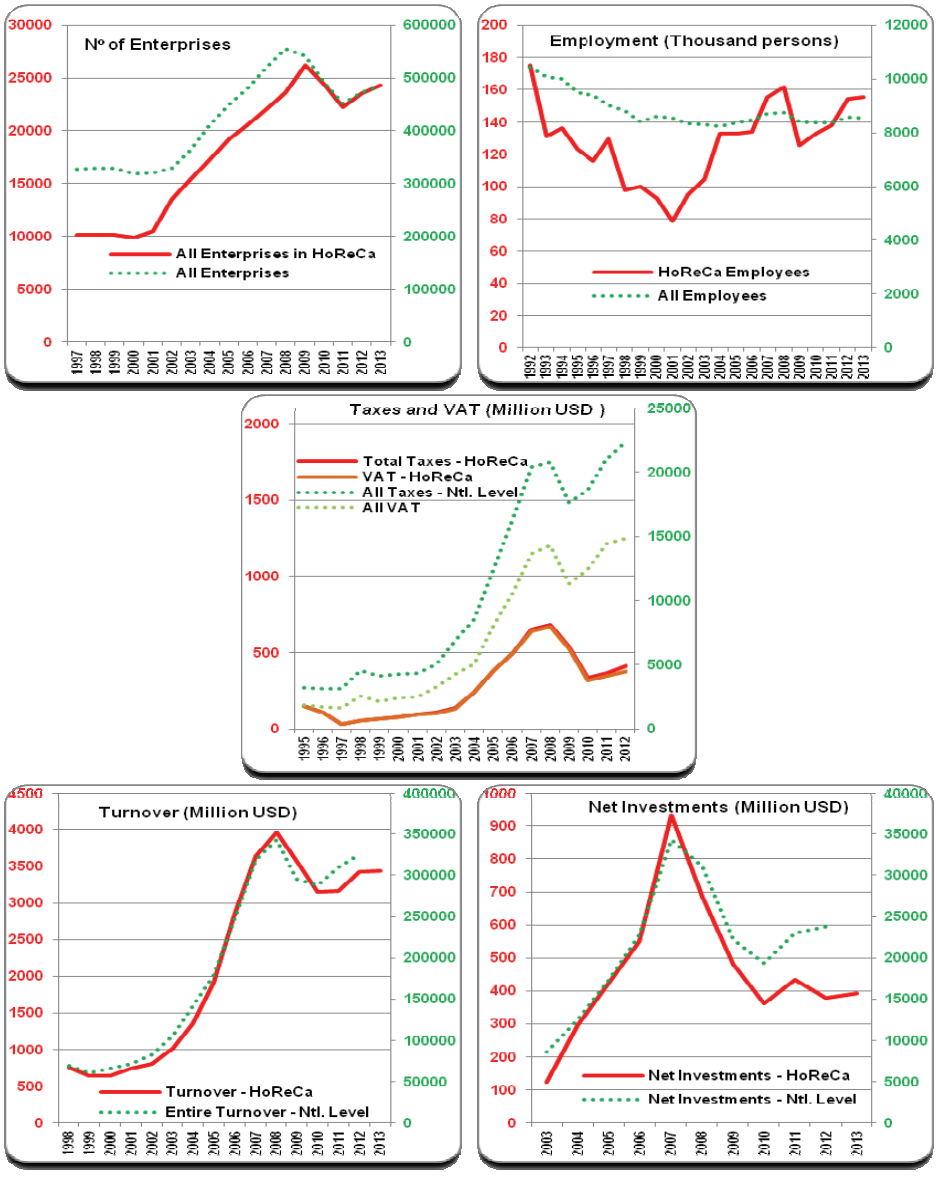


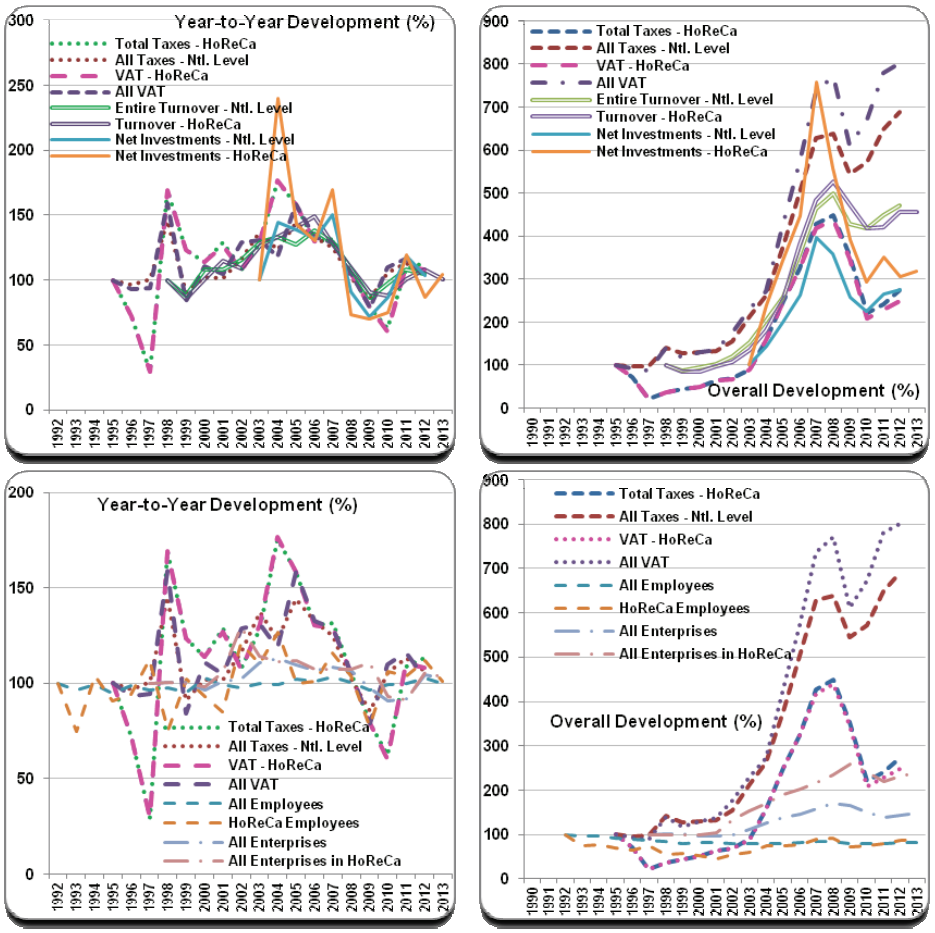
[Source: own calculations based on Blanke; Chiesa (eds.), 2013.]

It becomes obvious that the legal framework of T & T represents for Romania's case one of the most important hindering factors in the development of this industry. Moreover, as Appendix N° 2 reveals, during the almost 50 years covered in the analysis, some peculiarities can be noticed. Thus, after its official establishment in 1967, during the communist ruling, the Romanian tourist industry was affected by a single structural change, respectively had only two ministers; a number of other 8 persons were involved in the coordination of the sector. All in all, the political environment was a stable and supportive one (under the limits of the policies promoted by the communist ruling). On the other hand, the instauration of democracy brought along plenty of instability: at least 15 major structural changes of the ruling authority/minister for tourism, and at least 38 responsible persons, in charge of the sector for rather short, if not very short periods of time. All of these cvasi-permanent changes can, up to an extent, provide reasonable explanations for the fragility and lack of competitiveness of Romania's

tourism-related legal framework. Moreover, they can also be one of the causes of the very flaws in the appropriate registration of accommodation and food-services facilities [Cojocea; Coroş, 2013; Pop, 2014; Coroş; Negruşa, 2014], respectively of the significant shadow-hospitality market that prospers in Romania.

Charts Nos 8. a-h. *The Relation between the Development of Taxes and the Hospitality Sector in Romania (Values and Indices)*





[Source: own calculations based on NIS, TempoOnline, 2015.]

Figures gathered from the Romanian National Institute of Statistics have been processed in order to generate the four charts above. The aim of the calculations was that of trying to establish if Romanian hospitality enterprises have developed alongside with the applied taxes or if the financial burden has increased on behalf of the sector. The numeric development of the hospitality enterprises follows and respects the national trend, after the stagnation of the last years of the '90s, registering a steady growth until the 2008, diminishing due to the crisis and returning on an ascending trend after 2011. During the past years it seems that the hospitality providers follow the numeric increases of Romania's enterprises. Despite the positive development of the enterprises in general, hospitality

employment has registered a significant and constant decrease starting with 1992 and until 2001; afterwards it began to grow until 2008; the development during the most recent years being similar to that of the enterprises. The turnover of the sector respects the trend of the overall turnover.

The financial development of the Romanian hospitality sector reveals once again that Romania has not managed to properly benefit from its hospitality sector. Some of its main competitors (namely Austria, Bulgaria, and France) proved to have a stronger hospitality sector that, during the crisis, increased a faster pace compared to that of this destination, generating more workplaces and providing an alternative for the sectors, which were affected harsher by the crisis [The Brewers of Europe, 2013]. Further, while on the European market the development of the hospitality sector was under no doubt positively affected by the diminishing of the VAT rates, in Romania things are not necessarily the same. First of all, the VAT has the largest quota in the taxes raised from the hospitality sector. The hospitality sector turnover copies the national trend. The investments have a much steeper development, with a significant decrease during the crisis years, despite the less visible decrease in the sector's revenues. One of the reasons may be associated to the increase of the fiscal pressure.

In terms of indices, the year-to-year development of all analyzed items reveals many irregular oscillations and downturns during the most recent years. The charts containing the overall development reveal a much faster pace in the development of taxes in general compared to all other analyzed items. The VAT has obviously decreased due to the adoption of a reduced quota but unlike in other, more developed competing destinations, the diminishment has not been able to stimulate the sector's growth significantly. Once again it becomes clear that for the hospitality sector to truly develop, the specific legal framework must be reformed and stabilized.

Table N° 2. *Romania's VAT Policy Compared to that of the EU-28 and of Its EU Competitors*

	Tourism Tax is Higher	Romania's Reduced VAT Rate (Accommodation) is Higher		Romania's Reduced VAT Rate (Restoration) is Higher		Romania's Standard VAT Rate is Higher		Destination Outruns Romania
	1 = YES, 0 = NO	Value	1 = YES, 0 = NO	Value	1 = YES, 0 = NO	Value	1 = YES, 0 = NO	
Austria	0	-1	0	14	1	4	0	yes
Bulgaria	1	0	0	4	1	4	1	yes
Croatia	1	-4	0	11	1	-1	1	yes
Czech Rep.	0	-6	0	3	1	3	1	yes
France	1	-1	0	14	1	4	1	yes
Greece	1	2,5	1	11	1	1	1	yes
Hungary	0	-9	0	-3	0	-3	0	yes
Italy	0	-1	0	14	1	2	1	yes
Poland	1	1	1	16	1	1	1	yes
Slovakia	0	-11	0	4	1	4	1	yes
EU - 28	-	-1,64	1	8,52	0	2,39	0	-
Romania's Position	**5**	**-**	**2**	**-**	**9**	**-**	**8**	

[Source: own calculations based on Table N° 1 of the present chapter and on Blanke; Chiesa (eds.), 2013.]

Moreover, as the data above reveal, Romania's poor competitiveness compared to its main EU-28 competitors may be up to a certain extent attributed to its unsupportive fiscal policies.

6. A CLOSER LOOK AT ROMANIA'S TOURISM AND HOSPITALITY LEGAL FRAMEWORK

Making use of *Legis*, an official database of legal documents, 541 legal documents concerning tourism were identified (at the level of April 19th, 2015). These were issued/modified/repealed beginning with 1949 and up to today. The initial searches included more keywords (all inclusive, touristic structures, accommodation, touristic services, tourism promotion, tourism, touristic, hospitality, classification criteria) of which only two generated relevant results:

Table N° 3. *Romania's Normative Acts that Comprise the Terms turism and turistic*

Keyword	Until 1989	Beginning with 1990	Total
turism	19	272	**291**
turistic	14	444	**458**

[Source: own calculations based on *Legis*, 2015.]

The lists were merged and after several double crosses all duplicates were removed. The final list includes a total number of 541 legal documents that regulate Romania's tourism. In order to better understand the implications of the legal framework upon the development of the destination's national and international tourism, the identified documents are categorized and analyzed according to the following criteria:

- the year of adoption;
- the type of legal document;
- the problem it regulates, 14 categories were established, admitting that one legal document can address more than a single topic:

(1) classification criteria of tourist reception facilities (accommodation and restoration units);
(2) measures regarding the development of the offer of accommodation facilities;
(3) criteria for granting Tourist Licenses for individuals (*Brevet de turism*), respectively Tourist Licenses for enterprises (*Licenţă de turism*);
(4) issues concerning travel agencies, tourist guides, transport services, safety issues of tourists, rescue systems;
(5) measures concerning promotional activities, (multi)annual marketing programs, (multi)annual programs for the development of tourist products;
(6) issues concerning the organization of the tourist activity (office, ministry, authority, etc);
(7) financial policies (establishment of tariffs, taxes and fees, VAT, fiscal facilities, etc);
(8) matters concerning tourist destinations and resorts;
(9) statistical methodology;
(10) measures concerning financing sources, European financing programs (e.g. POR 2007-2013), Governmental investment programs (*Investiţii în turism*);
(11) issues concerning enterprises, state owned enterprises, enterprises with state participation, privatization;
(12) problems related to the foreign citizens' circulation on Romania's territory and to the international travels of the Romanians;
(13) measures concerning the development of the tourism and hospitality educational system, the development of human resources; and

(14) other problems;

- the type of intervention:

(1) legislating document: it enacts/establishes something;

(2) approval document: it is issued for the approval of a certain measure, norm, ordinance, etc;

(3) modification document: it is issued in order to communicate certain changes suffered by another legal document;

(4) rejection document: it rejects the approval of a certain document;

(5) repealed document: it is issued with the purpose of repealing a certain legal document;

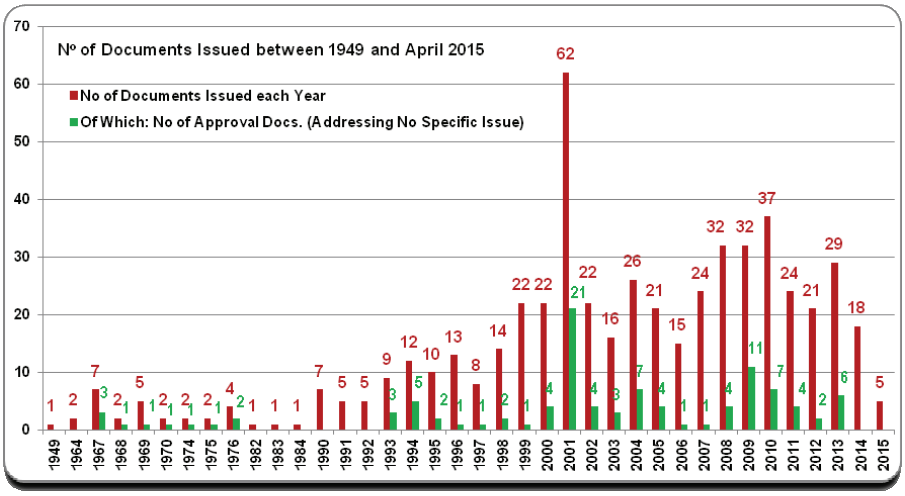
(6) other: documents issued by the Constitutional Court of Justice;

- the institution issuing the document.

Of the 541 identified legal documents, a number of 104 documents do not appear among the ones covering certain specific problems; in fact, they are legal documents that approve other ones.

According to the year of their issue, the identified documents are distributes as illustrated in the chart below:

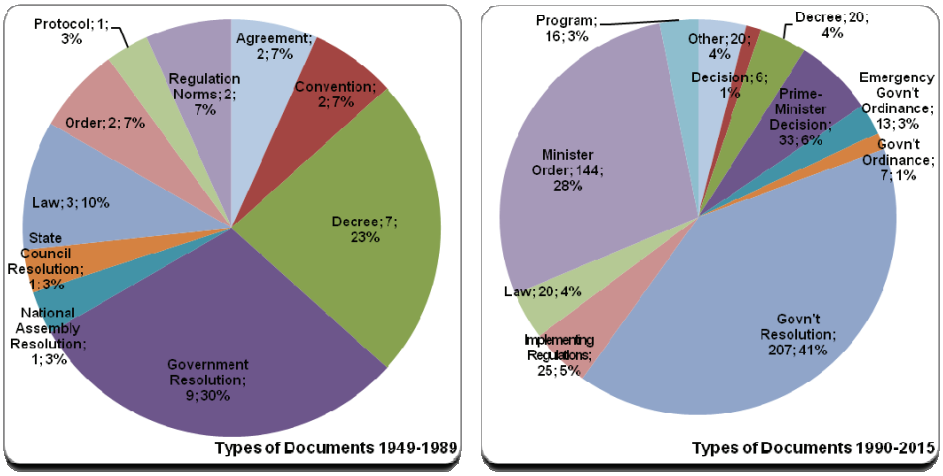
Chart N° 9. *The Distribution of the Legal Documents Issued between 1949 and April 2015*



[Source: own calculations based on *Legis*, 2015.]

Although it is highly possible that not all documents issued during the years of communist ruling are indexed by *Legis* today, the reality remains unchanged: compared to the previous period, the many democratic governments of contemporary Romania have produced an excessive amount of legal documents (511).

Charts Nos 10. a and b. *The Distribution of the Legal Documents Issued between 1949 and April 2015*



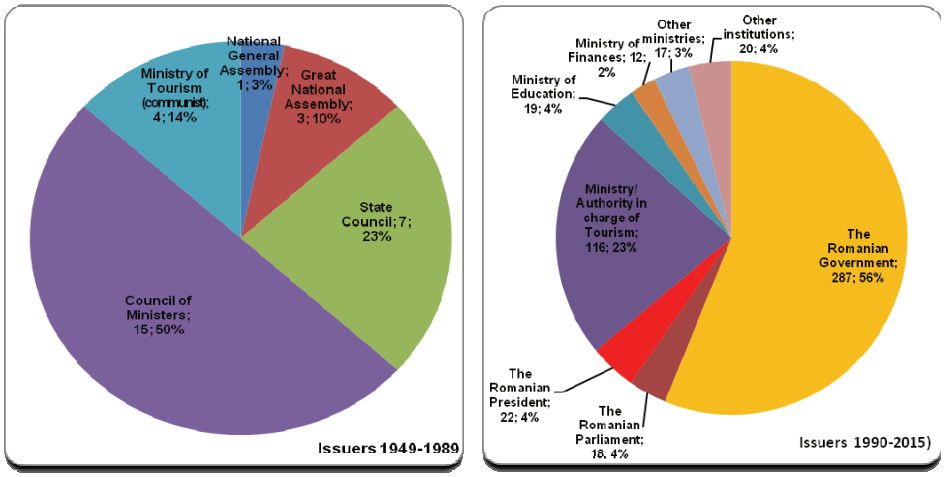
[Source: own calculations based on *Legis*, 2015.]

Another interesting aspect is represented by the distribution of the identified by types of legal documents. For a more accurate illustration of the way in which tourism decisions have been adopted in what concerns tourism, the analysis is done independently, as the two charts above reveal, for each of the two time-spans 1949-1989 and 1990-2015. One cannot but notice the fact that a large majority of the documents are Government Resolutions, Minister Orders, Implementing Regulations, Government Emergency Ordinances, and Government Ordinances, which, cumulated reach 84 %. Laws only occur as a regulating tool in the case of 4 % of the analyzed documents. The category *Other* includes: an agreement, an appendix, two by-laws; an Instruction list; two international memorandums; two procedures; a protocol; a set of regulations; a scheme; six statistical methodologies; a stipulation; and a strategy.

The issuers of legal acts are key actors of the managing process. In any democratic and civilized country, the Parliament is the regulator or the issuer of laws. Obviously, any Government's role is that of establishing its strategy for the years in office and to implement it. The executive power may get involved in the development of the legal framework by the means of its members of the parliament, who ensure the governing majority, as well as, by issuing those legal documents that are needed for the implementation of laws. Romania's democratic governments have been and still are criticized for their practice of abusing the law and of governing by the means of government emergency ordinances, respectively by government ordinances and resolutions. This unhealthy practice

of substituting the legislative power is easily observable in the charts above, respectively in the ones that follow.

Charts Nos 11. a and b. *The Distribution of the Legislators between 1949 and April 2015*



[Source: own calculations based on *Legis*, 2015.]

The following issuers of legal documents have been identified for the 1990-2015 time-span:

Table No 4. *Details Concerning Romania's Issuers of Legal Documents (1990-April 2015)*

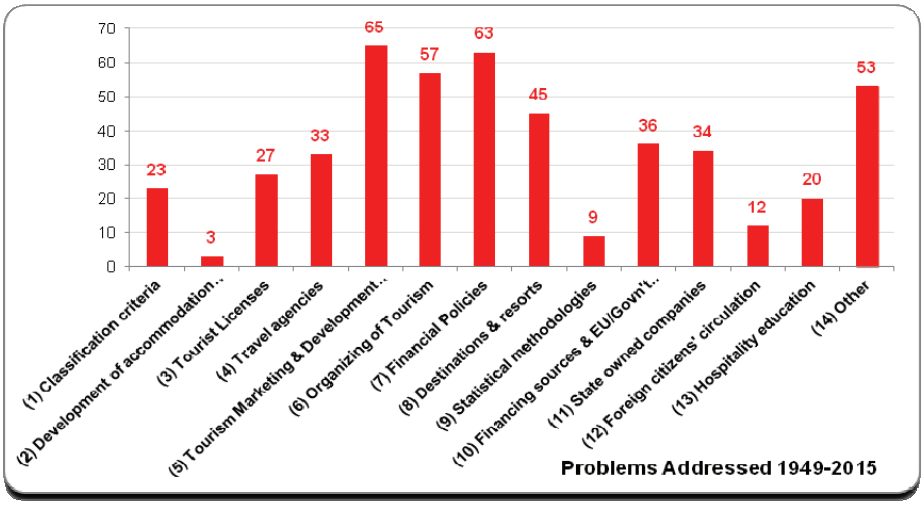
Issuer		No of Docs. Issued (1990-Apr. 2015)
The Romanian Government	Government – The Prime Minister	33
	The Romanian Government	254
The Romanian Parliament	The Romanian Parliament	18
The Romanian President	The Romanian President	22
Ministry/Authority in charge of Tourism	The Department of SMES, Business Environment, and Tourism	1
	National Authority for Tourism	14
	Ministry of Regional Development and Tourism	24
	Ministry of Small and Medium-sized Enterprises, Commerce, Tourism and Liberal Professions	11
	Ministry of Regional Development and Dwellings	2
	Ministry of Development, Public Works and Dwellings	4
	Ministry of Transports, Constructions and Tourism	10
	Ministry of Tourism	50

Issuer		No of Docs. Issued (1990-Apr. 2015)
Ministry of Education	Ministry of Education and Scientific Research	2
	Ministry of Education, Research and Sport	11
	Ministry of National Education	6
Ministry of Finances	Ministry of Economy and Finances	3
	Ministry of Public Finances	9
Other ministries	Ministry of European Integration	5
	Ministry of Transports	1
	Ministry of Public Administration	2
	Ministry of External Affairs	1
	Ministry of Waters and of Environmental Protection	2
	Ministry of Regional Development and Public Administration	2
	Ministry of Administration and Internal Affairs	1
	Ministry of Labor and Social Protection	1
	Ministry of Health and Family	2
Other institutions	The Constitutional Court	6
	National Institute of Statistics	12
	International Document	2

[Source: own calculations based on *Legis*, 2015.]

For the above-mentioned 14 types of problems, the distribution is presented in the following chart:

Chart N° 12. *The Distribution of the Problems Covered by the Legal Framework between 1949 and April 2015*



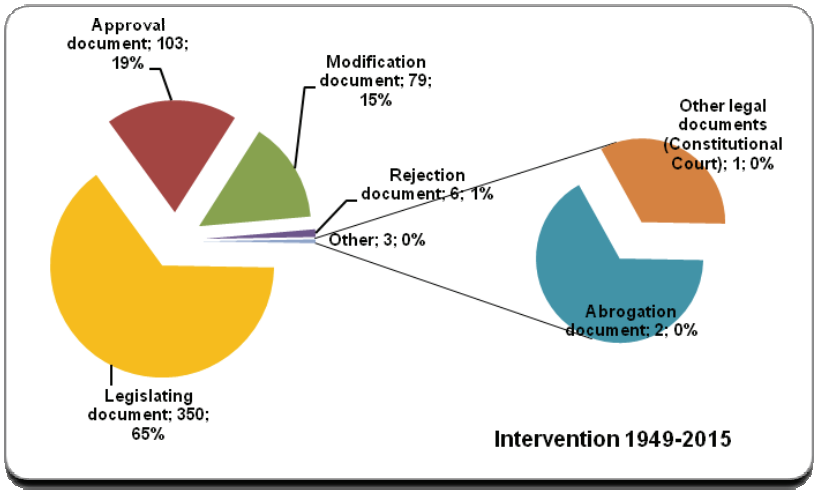
[Source: own calculations based on *Legis*, 2015.]

Two types of cases can be identified. First of all, there are quite many categories of problems that have a much too high frequency of change; among

these one can mention: the classification criteria of tourist reception facilities (accommodation and restoration units); criteria for granting Tourist Licenses for individuals (*Brevet de turism*), respectively Tourist Licenses for enterprises (*Licenţă de turism*); issues concerning travel agencies, tourist guides, transport services, safety issues of tourists, rescue systems; matters concerning the development of tourist resorts and destinations; issues concerning the organization of the tourist activity (office, ministry, authority, etc) – as Appendix N° 2 reveals, this issue is beyond any reasonable understanding; the absurd way of continuously shifting the responsibility for the development of tourism in Romania has nothing whatsoever in common with strategic planning and coherence. In fact, this lack of professionalism is clearly proven by the poor performance of the Romanian tourist industry. Some of the rather positive occurrences of problems addressed regard the abolishment of the communist discriminating tariffs for foreign tourists, the elimination or the loosening of visa policies, respectively some measures adopted for the support of governmental investments and for the absorption of EU funds. The further development of hospitality education needs more attention.

Concerning their intervention, the legal documents are distributed as below:

Charts N° 13. *The Distribution of the Legal Documents According to their Intervention between 1949 and April 2015*



[Source: own calculations based on *Legis*, 2015.]

The fact that most of the documents issued are legislating documents correlated with the great majority of documents issued by the Government, confirms once again the fact that the executive substitutes the legislative.

The results above clearly prove that, in Romania, and especially in the tourism activity, the enacting process does not respect the Constitutional provision; moreover, due to the number and level of normative power of the acts that were adopted, the tourism industry legislation lacks the clarity and stability that are essential for an appropriate development of the sector.

The Romanian legal system belongs to the civil law legal system under which only the Constitution and other statutory legislation constitute a legitimate source of legal rules, therefore the enacting process being of great importance. For the functioning of a democratic state and the development of all sectors, the rule of law is a vital indicator.

According to the European Commission, the principle of the rule of law has progressively become a dominant organizational model of modern constitutional law, and international organizations (including the United Nations and the Council of Europe) to regulate the exercise of public powers. It makes sure that all public powers act within the constraints set out by law, in accordance with the values of democracy and fundamental rights, and under the control of independent and impartial courts. The principles include legality, which implies a transparent, accountable, democratic and pluralistic process for enacting laws; legal certainty; prohibition of arbitrariness of the executive powers; independent and impartial courts; effective judicial review including respect for fundamental rights; and equality before the law [EC, 2014: 2-4]. In Romania's tourist industry, the lack of legal certainty is very obvious, as it can be seen in the data analyses listed above.

The World Justice Project analyzes the rule of law based of four principles: 1.The Government and its officials and agents as well as individuals and private entities are accountable under the law. 2. The laws are clear, publicized, stable, and just; are applied evenly; and protect fundamental rights, including the security of persons and property; 3. The process by which the laws are enacted, administered, and enforced is accessible, fair, and efficient; 4. Justice is delivered timely by competent, ethical, and independent representatives and neutrals who are of sufficient number , have adequate resources, and reflect the makeup of the communities they serve [WJP, 2014: p.4].

The WJP analyzes 99 countries, based on several factors. According to this organization, Romania is ranked 33rd overall, trailing its EU peers but outperforming most upper-middle income countries. The country performs relatively well in the

dimensions of: security (ranking 31st overall), respect for fundamental rights (ranking 25th globally, and 2nd among upper-middle income countries), and criminal justice (ranking 3rd among its income peers, and 29th overall). However, the country does less well on administrative and judicial efficiency. While administrative agencies perform on par with those in other upper-middle income countries, they rank worse than those of other countries of the region. Corruption is still an area in need of attention, (ranking 41st globally, and second to last in the region), particularly in the legislature, like the difficulties in petitioning the government and accessing official information [WJP, 2014: p.55].

As the results of the report show, Romania has a lower position in the fields related to administrative and judicial efficiency, and does worst, as compared to itself, on the 1st factor, "Constraint on Government powers"[2], ranking 43rd, and on factor number 3 "Open Government"[3], ranking 47th, which, for the present analyses is the most important factor.

Unfortunately, the analyses on the Romanian legislation presented above, confirm the fact that problems related to the enacting process, as well as the lack of clarity, stability and certainty of normative acts, together with the replacement of the legislative power with the executive power, are clearly a hindering factor in the development of the tourism industry, as can be observed in the sections above.

In order to have a good understanding of the enacting process in Romania, it is considered that the presentation of the provision of the Romanian Constitution related to the legislative and executive powers is mandatory.

According to the Romanian Constitution, the enacting power is represented by the Romanian Parliament. Article number 73 establishes that the Parliament

---

2 Assesses the effectiveness of the institutional checks on government power by looking at the effectiveness of legislative and judicial oversight, and independent auditing and review agencies, as well as non-governmental oversight by the media and civil society. It also examines the extent to which transitions of power occur in accordance with the law, and if minister official are held liable for their misconduct

3 Assesses the extent to which the society has clear, publicized, accessible, and stable laws; whether proceedings are open to public participation; and whether official information, including drafts of laws and regulations, is available to the public. Clear, stable, and publicized laws allow the public to know what the law is and what conduct is permitted and prohibited. Public participation provides citizens with a voice in decision-making processes that may impact their lives. Finally, access to information provides citizens with knowledge to address public issues, scrutinize the government, and demand accountability

passes constitutional, organic and ordinary laws, this also being the scale of importance. The Parliament is constitutionally entitled to adopt organic laws in the following domains:

a) the electoral system; the organization and functioning of the Permanent Electoral Authority;
b) the organization, functioning, and financing of political parties;
c) the statute of Deputies and Senators, the establishment of their emoluments and other rights;
d) the organization and holding of referendum;
e) the organization of the Government and of the Supreme Council of National Defense;
f) the state of partial or total mobilization of the armed forces and the state of war;
g) the state of siege and emergency;
h) criminal offences, penalties, and the execution thereof;
i) the granting of amnesty or collective pardon;
j) the statute of public servants;
k) the contentious business falling within the competence of administrative courts;
l) the organization and functioning of the Superior Council of Magistracy, the courts of law, the Public Ministry, and the Court of Audit;
m) the general legal status of property and inheritance;
n) the general organization of education;
o) the organization of local public administration, territory, as well as the general rules on local autonomy;
p) the general rules covering labor relations, trade unions, employers' associations, and social protection;
r) the status of national minorities in Romania;
s) the general statutory rules of religious cults;
t) the other fields for which the Constitution stipulates the enactment of organic laws.

The legislative initiative, according to article Nº 74, lie with the Government, Deputies, Senators or a number of at least 100,000 citizens entitled to vote.

The laws are adopted by the Romanian Parliament, composed of the Chamber of Deputies and the Senate.

According to article Nº 77 of the Romanian Constitution, the laws have to be submitted for promulgation to the President of Romania. After its promulgation, the law has to be published in the Official Gazette of Romania and will come into force 3 days after its publication date or on a subsequent date stipulated in its text.

This complex process is meant to respect de principle of power separation and, of course, to ensure the democratic state.

On the other hand, the enacting process in Romania, in many times, is reversed, through the use of the Emergency Ordinance by the Government.

The Romanian Constitution specifies the attribution of the Government. Article Nº 107 stipulates that the Prime Minister shall direct Government actions and co-ordinate activities of its members, with the observance of the powers and duties incumbent on them. Likewise, the same institution shall submit to the Chamber of Deputies or the Senate reports and statements on Government policy, to be debated with priority. The President of Romania cannot dismiss the Prime Minister.

The Government adopts decisions, rules, regulations and ordinances. The decisions are issued in order to organize the execution of laws. Ordinances can be issued under a special enabling law, within the limits and in conformity with the provisions thereof. The decisions and ordinances adopted by the Government are signed by the Prime Minister, countersigned by the Ministers who are bound to carry them into execution, and are published in the Official Gazette of Romania. Non-publishing entails non-existence of a decision or ordinance.

The most disputed procedure regarding the enacting process is the one related to the legislative delegation. According to article Nº 115, the Parliament may pass a special law enabling the Government to issue ordinances in fields outside the scope of organic laws, and the enabling law has to establish the field and the date up to which ordinances may be issued. If the enabling law so requests, ordinances shall be submitted to Parliament for approval, according to the legislative procedure, until the expiry of the enabling time limit. Non-compliance with the term entails discontinuation of the effects of the ordinance.

It is provided that the Government can only adopt **emergency ordinances in exceptional cases**, the regulation of which cannot be postponed, and have the obligation to give **the reasons** for the emergency status within their contents, and cannot be adopted in the field of constitutional laws, or affect the status of

fundamental institutions of the State, the rights, freedoms and duties stipulated in the Constitution, the electoral rights, and cannot establish steps for transferring assets to public property forcibly. The Parliament has to approve or reject in a law the emergency ordinance, law that shall regulate, if such is the case, the necessary steps concerning the legal effects caused while the ordinance was in force.

Even though the Romanian Constitution stipulates that the Government shall adopt Emergency Ordinances only in exceptional situations, the reality is very different. There are many Emergency Ordinances that stipulate that they shall come into force in three, six or even seven months from the moment they were adopted, on one hand, and, on the other, the multitude of Government Emergency Ordinances clearly shows that they were not adopted due to an exceptional situation. [Deaconu, 2013].

The same problem, related to the enacting process is stressed by the 2015 European Commission Report on Progress in Romania. According to it, the frequent use of Government Emergency Ordinances limits the opportunities for consultation and leads to a lack of legislative clarity [EC: 2015.2: 5]. In the tourism industry, the frequent use of Government Emergency Ordinances can lead to a great instability. Actually, the main Romanian normative act that regulates the general legislative framework related to tourism activity is ***Government Emergency Ordinance Nº 58/1998***, which was modified too many times from 1998 till now. But many other normative acts, on very different levels of importance, regulate the tourism activity as well, which clearly does not offer a stable, predictive, general legal framework. In Romania, although there were two proposals of adopting a tourism law, in 2004 and 2011, both were rejected by the Parliament.

A new modification of **GEO Nº 58/1998** was proposed by the Government approved by the Parliament, but this time with a good direction. December 2014 [Ro. Gov., 84/2014] brought one of the best news for the further perspectives of the Romanian tourist industry: the elaboration of a modification in the VAT rate applied for all ancillary services of tourism accommodation. The following types of combinations accommodation services are going to be subject to the 9 % VAT rate: accommodation without breakfast; accommodation with breakfast included (sold as package); half-board accommodation (accommodation and breakfast, plus lunch or dinner; sold as package); full-board accommodation (accommodation plus breakfast, lunch and dinner; sold as package); and all inclusive services (pre-established combination of accommodation services,

breakfast, lunch and dinner, plus snacks and any type of leisure services provided by the lodging facility and sold as package). Although not yet implemented, the measure is expected to boost up the Romania's tourism. The measure is still welcome despite the 25 years that have been lost.

As it can be concluded from the analyses of the normative acts that govern tourism, in contradiction with the constitutional provisions, not the legislative power is setting the rules, but the members of the Government. This leads to the creating of a very unstable and unclear regulation framework of the tourism industry, and, as can be seen from the economic results, to a lack of development of this sector.

7. CONCLUSION

Legal issues are very important for any developed activity, but, the tourism industry seems to be more influenced by the implementation by the state, through its representatives, of normative acts that sustain the economic activity.

In order to achieve the development of the tourism sector, the first thing that the representative of the state should do is to elaborate a clear and stable legislative framework.

The analyses of the European perspective of the tourism industry clearly shows that the overall economic impact of tourism is considerable. A general legal framework that does not ensure the elimination of the shadow hospitality across Europe, and does not have clear provisions and stability, will only affect the overall tourist experience of the consumer, which could lead to a decrease in the industry's contribution to the development of the economy.

The legislation referring to fiscal policies is very important as well, since it is proven that all the countries that have reduced their VAT rates have had a positive effect on the economy. The Romanian Government, had made some steps in this direction, and, in December 2014 they proposed the reduction of the VAT rates for all ancillary services of tourism accommodation. It seems that the Romanian Government has finally understood that high tourism taxes do not have a positive effect.

According to the information from the World Economic Forum, in the *Global Competitiveness Report*, Romania has a very poor performance compared to its main competitors, ranking close to the bottom of the first half of the overall top. The information extracted from this report should be very clear for our political

leaders who should take all the necessary steps in order to create the necessary environment for tourism development. The effectiveness of a law cannot be assessed by itself; it has to be linked to specific measurement tools, and, according to our findings, it is clear that changes have to be done by the Parliament and Government.

The analyzed data and material capture the extent to which the legal framework is conductive to the tourism sector in Romania. Governments can have an important impact on the attractiveness of developing this sector, depending on whether the policies that they create and perpetuate support or hinder its development. Unfortunately, the results from the analyses show that the Romanian Government does not support the development of the sector.

None of the normative acts adopted by the Government in the tourism field address the environmental issue. Of course, there are Romanian laws that regulate this domain, but, if Romania aims at having a sustainable tourist environment, and at ensuring that the country will continue to be an attractive destination going into the future, special bills should clearly state the regulatory framework in this field. The Romanian Government does not prioritize the sustainable development tourism industry in its economy. In fact, although loudly declared and claimed to be a priority, tourism has been cvasi-permanently subject to unexpected changes, and, most likely, anything but a priority.

The Government should make it clear that tourism is a sector of primary concern, by reflecting it in its budget priorities and in the clarity of the legal regulations adopted. If this were the case, the Government's intentions can have positive spillover effects such as attracting further private investment into the sector, based on the investments and on the security given by a stable legal framework.

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Appendices

Appendix N° 1. Items Included in the Analysis of Tourism Competitiveness

THE TRAVEL & TOURISM COMPETITIVENESS INDEX
Pillar I. T & T Regulatory Framework
1. **Policy rules and regulations:** Prevalence of foreign ownership; Property rights; Business impact of rules on FDI; Visa requirements; Openness of bilateral Air Service Agreements; Transparency of government policymaking; Time required to start a business Cost to start a business; GATS commitments restrictiveness index (Tourism);
2. **Environmental sustainability:** Stringency of environmental regulation; Enforcement of environmental regulation; Sustainability of T&T industry development; Carbon dioxide emissions; Particulate matter concentration (PM_{10}); Threatened species; Environmental treaty ratification;
3. **Safety and security:** Business costs of crime and violence; Reliability of police services; Road traffic accidents; Business costs of terrorism;
4. **Health and hygiene**: Physician density; Access to improved sanitation; Access to improved drinking water; Hospital beds;
5. **Prioritization of Travel & Tourism:** Government prioritization of the T&T industry; T&T government expenditure; Effectiveness of marketing and branding to attract tourists; Comprehensiveness of annual T&T data; Timeliness of providing monthly/quarterly T&T data;
Pillar II. Business Environment and Infrastructure
6. **Air transport infrastructure:** Quality of air transport infrastructure; Available seat kilometers, domestic; Available seat kilometers, international; Departures per 1,000 population; Airport density; Number of operating airlines; International air transport network;

7. **Ground transport infrastructure:** Quality of roads; Quality of railroad infrastructure; Quality of port infrastructure; Quality of ground transport network; Road density;
8. **Tourism infrastructure:** Hotel rooms; Presence of major car rental companies; ATMs accepting Visa cards;
9. **ICT infrastructure:** ICT use for business-to-business transactions; Internet use for business-to-consumer transactions; Individual using internet; Fixed telephone lines; Broadband Internet subscribers; Mobile telephone subscriptions; Mobile broadband subscriptions;
10. **Price competitiveness in the T&T industry:** Ticket taxes and airport charges; Purchasing power parity; Extent and effect of taxation; Fuel price levels; Hotel price index;
Pillar III. T & T Human, Cultural and Natural Resources
11. **Human resources:** Primary education enrollment; Secondary education enrollment; Quality of the educational system; Local availability of specialized research and training services; Extent of staff training; Hiring and firing practices; Ease of hiring foreign labor; HIV prevalence; Business impact of HIV/AIDS; Life expectancy;
12. **Affinity for Travel & Tourism:** Tourism openness; Attitude of population toward foreign visitors; Extension of business trips recommended; Degree of customer orientation;
13. **Natural resources:** World Heritage natural sites; Quality of the natural environment; Total known species; Terrestrial biome protection; Marine protected areas;
14. **Cultural resources:** Number of World Heritage cultural sites; Sports stadiums; Number of international fairs and exhibitions; Creative industries exports.

[Source: own centralization based on Blanke; Chiesa (eds.), 2013: 471-477.]

Appendix N° 2. The List of Dignitaries in Charge of Romanian Tourism (Ministry/State Department/ National Authority) Before and After December 1989

No	Time-span	Person	Official Dignity	Institution in Charge of Tourism
	before the 6th of April 1967, Tourism was not led separately			
1.	6 Apr.-8 Dec. 1967	Nicolae Bozdog	president?	NTO College
2.	Feb. 1967-Dec. 1979	Ştefan Enache	deputy minister	MT
	25 Dec. 1970	**Establishment of MT**		
3.	Dec. 1970-Apr. 1979	Ilie Voicu	prime-deputy of the minister	MT
4.	25 Dec. 1970-1 Mart. 1978	Ion Cosma	minister	MT
5.	7 Mart.-15 Aug. 1978	Nicolae (Ion?) Doicaru	minister	MT
6.	15 Aug.. 1978-7 Mar. 1982	Emil Drăgănescu	minister	MTS
7.	Apr.1979-Jan. 1990	Costache Zmeu	deputy minister	MTS
8.	8 Mart.-9 Sept. 1982	Ion Tudor	minister	MTS
9.	10 Sept. 1982-23 Oct. 1984	Nicolae Gavrilescu	minister	MTS
10.	24 Oct. 1984-22 Dec. 1989	Ion Stănescu	minister	MTS
	after December 1989			
1.	2 Jan.-7 Feb. 1990	Mihai Lupoi	minister	MT
2.	8 Feb.-28 Jun. 1990	Mircea Manole	prime-deputy of the minister	MT
3.	29 Jun. 1990-19 Nov. 1992	Constantin Fota	minister	MCT
4.	29 Jun. 1990-19 Nov. 1992	Petre Baron	chief of department/ state secretary	MCT
5.	Dec. 1992-Dec.1993	Viorel Cataramă	chief of department/ state secretary	MCT?

No	Time-span	Person	Official Dignity	Institution in Charge of Tourism
6.	Dec. 1992/3?-Dec.1993	Cornel Grigoruţ	chief of department/ state secretary	MCT?
7.		Gheorghe Albu		
8.		Oreste Ungureanu		
9.		Nicolae Neacşu		
10.	20 Nov. 1992-11 Dec. 1996	Dan Matei Agathon	minister	MT
11.	12 Dec. 1996-17 Apr. 1998	Ákos Birtalan	minister	MT
12.	Nov. 1997-Febr. 1999	Dorin Anton	state secretary	MT
13.	18 Apr.-16 Dec. 1998	Sorin Frunzăverde	minister	MT
	16 Dec. 1998	**Romanian Parliament Decision No 47 Regarding the Abolishment of MT**		
	23 Dec. 1998	**Gov. Dec. 972 Regarding the Organization and Functioning of NAT**		
14.	17 Dec. 1998-12 Mar. 2000	Sorin Frunzăverde	president	NAT
15.	13 Mar.-28 Dec. 2000	Dumitru Moinescu	president	NAT
16.	29 Dec. 2000-19 Jun. 2003	Dan Matei Agathon	minister	MT
17.	Dec. 2000-Jun. 2003	Alin Nicolae Burcea	state secretary	MT
18.		Nicu Rădulescu		
19.	20 Jun. 2003-28 Dec. 2004	Miron Tudor Mitrea	minister	MTCT
20.	2004-2005?	Gheorghe Dobre	minister?	MTCT
21.	Jul. 2003-Mar. 2004	Nicu Rădulescu	chief of department	NAT subordinated to MTCT
22.	Apr. 2004-Febr. 2005	Nicu Rădulescu	president	
23.	Mart.-Jun. 2005	Marius Sorin Crivţonencu		
24.	14 Jun. 2005-1 Aug. 2006	Ovidiu Iuliu Marian		
25.	2 Aug.-6 Dec. 2006	Livia Sima	vice-president	
26.	28 Dec. 2006-3 Apr. 2007	Monica Mihaela Bărbuleţiu	president	NAT subordinated to the Prime Minister
27.	Jan.-May 2007	Marius Bogdan Ivan	vice-president	
28.	3 May 2007-22 Dec. 2008	Ovidiu Ioan Silaghi	minister	MSMECTLP
29.		Lucia Nora Morariu	state secretary/chief of department	NAT subordinated to MSMECTLP
30.	23 Dec. 2008-9 Feb. 2012	Elena Gabriela Udrea	minister	MT, MRDD and MRDT
31.	10 Febr.-1 May 2012	Cristian Petrescu	minister	MRDT
32.	2 May 2012-20 Dec. 2012	Eduard Hellvig	minister	MRDT
33.	21 Dec. 2012-7 Mar. 2014	Maria Grapini	delegated minister	MSMETBE
34.	9 Jan.? 2013-10/11? Nov. 2014	Răzvan Filipescu	president	NAT subordinated to MEc
35.		Mirela Matichescu	vice-president	
36.	7 Mar.-16 Dec. 2014	Florin Jianu	minister	MSMEBET
37.	17 Dec. 2014-present	Mihai Tudose	minister	MEcCT
38.	11 Nov. 2014-present	Simona Allice Man	president	NAT subordinated to MSMEBET and MEcCT

[Sources: own identification and reconstitution based on: Mitroi, 2012; Pop et al., 2007; Neagoe, 1995; http://www.infotravelromania.ro/minister.html; http://www.jurisprudenta.com; http://ziuadecj.realitatea.netl; http://stiri.rol.ro; http://www.wall-street.ro; http://www.telegrafonline.ro; http://www.realitatea.net; http://www.minind.ro/; http://turism.gov.ro/]

Legend:

MCT – Ministry of Commerce and Tourism (Ministerul Comerţului şi Turismului)

MRDD – Ministry of Regional Development and Dwellings (MDRL – Ministerul Dezvoltării Regionale şi Locuinţei)

MRDT – Ministry of Regional Development and Tourism (MDRT – Ministerul Dezvoltării Regionale şi Turismului)

MDPWD – Ministry of Development, Public Works and Dwellings (MDLPL – Ministerul Dezvoltării, Lucrărilor Publice şi Locuinţelor)

MEc – Ministry of Economy (Ministerul Economiei)

MEcCT – Ministry of Economy, Commerce and Tourism (Ministerul Economiei, Comerţului şi Turismului)

MSMECTLP – Ministry of Small and Medium-sized Enterprises, Commerce, Tourism and Liberal Professions (MÎMMCTPL – Ministerul pentru Întreprinderi Mici şi Mijlocii, Comerţ, Turism şi Profesii Liberale)

MSMEBET – Ministry of Small and Medium-sized Enterprises, Business Environment and Tourism (MÎMMMAT – Ministerul Întreprinderilor Mici şi Mijlocii, Mediului de Afaceri şi Turismului)

MSMETBE – Ministry of Small and Medium-sized Enterprises, Tourism and Business Environment (MÎMMTMA – Ministerul Întreprinderilor Mici şi Mijlocii, Turismului şi Mediului de Afaceri)

MT – Ministry of Tourism (Ministerul Turismului)

MTCT – Ministry of Transports, Constructions and Tourism (Ministerul Transporturilor, Construcţiilor şi Turismului)

MTS – Ministry of Tourism and Sport (Ministerul Turismului şi Sportului)

NAT – National Authority for Tourism (ANT – Autoritatea Naţională pentru Turism)

NTO College – National Organization for Tourism (ONT – Organizaţia Naţională de Turism)

UNIVERSITIES AND (REGIONAL) DEVELOPMENT: POSITIVE EXTERNALITIES CREATION

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ABSTRACT

The necessity of human capital development is highly emphasized in the current conditions of national economies. Although its quantification could take in account a number of different components, human capital is most commonly associated with expression through the share of tertiary education, and participation in formal higher education processes. The importance of institutions of tertiary education and of universities is mostly linked to generation potential of the entire (regional) economic development.

Except on the national level, regional level is recognized as a driver of regional economic changes and processes as well. Therefore, the observation of economic development is carried out at these lower territorial levels. This is evident through the increased number of research about universities' impacts on regional development (f.e. Chakrabarti & Lester, 2002; Goldstein & Renault, 2004; Rutten & Boekema, 2009; Goddard & Puukka, 2010; Strauf & Scherer, 2008; Kantor & Whalley, 2013; Veugelers & Del Rey, 2014).

There are many positive externalities on the regional development resulting from the impact of universities. According to *Regional Policy of European Commission* (2011) areas that are exceptionally influenced by universities usually include business innovation, human capital development, community development and institutional capacity of the region whose interactions leads to proactive role in process of regional development. Some authors assert that the result of good connectivity and partnership between the universities and the region is creation of knowledge regions and a knowledge-based society. The aim of this paper is to emphasize mutual interaction of universities in regional economic development and creation of learning regions (knowledge regions). In doing so, the emphasis is on the positive effects that are produced in the region, and consequently the entire national economy.

Keywords: human capital, universities, regional development.

1. INTRODUCTION

In contemporary conditions there is a strong focus on the need to develop human capital. Its added value rests on an extraordinary impact human capital can have on total (regional) economic development. Furthermore, it is known that regions stand out more and more often as initiators and carriers of regional economic processes, so monitoring of the development in these lower territorial levels is not surprising. Great differences in economic and other measurable values within national economies already give enough reason to prefer regional units instead of national. Adequate policies can be tailored in unison with such regional partitions. National economies are larger territorial units which makes them more rigid then regions. With respect to that regions are, according to authors like Corona, Doutriaux & Mian (2006), more frequently the source of technical innovations then national economies. In an environment rich with innovation, high growth rates, enterpreneurial initiatives and high rates of human capital, creation of knowledge regions is a logical path.

Although there are many definitions of a knowledge region, in this paper it is defined as „a teritorial unit with abundant human and social capital, containing structures, organizations and people actively engaged in generating development through science, technology and innovation, and whose interactions achieve a high concentration of technology-based firms and highly skilled knowledge workers and entrepreneurs" (Corona, Doutriaux & Mian, 2006:2; prema Sanz, 2004). It is important to point out, as the authors do, that success of knowledge regions does not depend only on local factors but often on national and international factors as well. One of the indicators of the knowledge region is, according to the definition above, the amount of realized human capital. However, calculation methods of this value are not unified. This provides us with several possible approaches to express this value. The ratio of highly educated individuals in universities as basic carriers of tertiary education is one of the possible indicators of realized human capital. Similar to that, Faggian & McCann (2009:133) say that tertiary-level of human capital is seen to be a crucial feature of economic growth, and in accordance with economic growth and progress. Faggian & McCann (2009:133) state that *„...advanced societies have increasingly evolved towards what has been called „a knowledge-based economy"*. According to OECD's definition (2005) *„the knowledge based economy" is an expression coined to describe trends in advanced economies towards greater dependence on knowledge, information and high skill levels, and the increasing need for ready access to all of these by the business and*

public sectors." Therefore it is noticeable that the foundations for creation of the knowledge region and the knowledge based economy are development of human capital and focus on application of knowledge, information and skills.

Considering increased demand for human knowledge and skills as well as interconnecting different sectors, there has been an increasing number of studies focused on the impact of realized human capital and universities on regional development (f.e. Strauf & Scherer, 2008; Abel & Deitz, 2011; Gennaioli *et al.*, 2013; Veugelers & Del Rey, 2014). Universities usually result in positive effects on regional development. In document of *Regional Policy of European Commission* (2011) is stated that positive external results on regional development include, but are not limited to business innovation, human capital development, community development and institutional capacity of the region whose interaction leads to a proactive role in the process of regional development. Creation of the knowledge region and knowledge-based society, as explained by Strauf & Scherer (2008), is a result of good connections and partnership between the university and the region. In case that partnership emerges between the university and the region, Strauf & Scherer (2008) state that this marks a significant step on the way to achieving a learning region and a knowledge-based society.

Effects of the universities can be direct and indirect. Other then direct effects, Veugelers & Del Rey (2014) also highlight some indirect ones - for example, possibility of attracting other important economic resources into the region, persons that want to explore business opportunities emanating from the campus, inclusion of companies and their employees and other effects. Proximity of a university also has an important role in this transfer of positive influence. Chakrabarti & Lester (2002) point out that the proximity of a university is often connected to recent growth of high tech industries in these regions. Besides, universities do not contribut only to the development of human, but also social capital from the region promoting economic growth of the regions.

In unison with already mentioned achievable effects on human capital and regions coming from universities as institutions of tertiary education, the objective of this paper is to point out the influence that universities make on regional economic development, and also determine the importance of creation of knowledge regions and knowledge-based society.

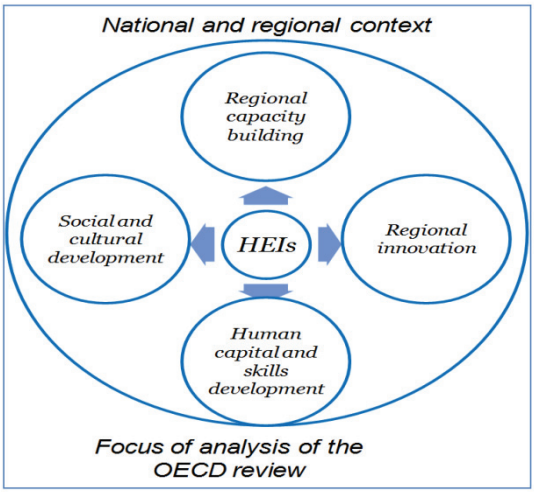
Other then in endogenic economic theories, human capital has found itself under study based on the need to define modern development. One of the more

visible paths of modern development has been defined exactly by strengthened role of universities. Therefore, universities have an important place and a role to play in generating regional development. After introductory notes about regional development, definitions of knowledge regions and knowledge – based society, the second chapter focuses on effects that universities have on regional development. Futhermore, it explores the model of triple helix as a concept applicable in succesful generation of links between universities, business sector and government – so-called triple helix model. The third chapter deals with the contribution of universities in generation of regional development in Croatia, while the fourth chapter consists of conclusions and reflections about topics mentioned above.

2. EFFECTS OF A UNIVERSITY ON REGIONAL DEVELOPMENT

Universities no longer have exclusively a traditional role to educate and research. The author further states that focus has been moved to an increase of active participation of universities in the process of regional development (Arbo & Eskelinen, 2003; Lindqvist, 2012). Separation from the traditional role focused exclusively on education and research creates foundations for a move towards economy and knowledge-based society. As explained by Barković, Borozan and Dabić (2008:30; according to The World Bank, 2002) there are four strategies of transition to the knowledge economy: a) economic and institutional framework to motivate, use existing and new skills and knowledge more efficiently and advance enterpreneurship; b) educated and skilled population which excels in creation, sharing and use of knowledge; c) dynamic information infrastructure which enables effective communication, information spreading and processing, and d) efficient inovation system which incorporates companies, research centres, universities, consultant and other organizations to influence increase in knowledge creation and adjustment to local needs as well as creation of technology. Furthermore, areas where these extraordinary effects of universities are transferred to can be categorized in four groups (European Commission, Regional Policy, 2011): *i) business innovation, closely linked to the research function of the university; ii) human capital development, linked to the teaching function; iii) community development, linked to the public service role of universities; iv) contribution of the university to the institutional capacity of the region through engagement of its management and members in local civil society*. Integration of all these aspects leads to proactive instead of a passive stance of regional development process.

Picture 1. National and regional context of the influence of high education institutions (HEI)



Source: European Commission, Regional Policy (2011). Connecting Universities to Regional Growth: A Practical Guide. Available on: http://ec.europa.eu/regional_policy/sources/docgener/presenta/universities2011/universities2011_en.pdf, (8.5.2015.)

Universities have multiple effects (Bleaney *et al.*, 1992). One of the effects cited by Schiller (2008) is increased participation of young people in universities which leads to overflow effects, creation positive external impacts and thus generating regional economic growth. Because of this educational, state and local authorities are trying to increase participation of the population in educational processes, especially with respect to high education. Benefits brought by education can be visible both in individual and social effects. As Porter (2007:41) stated: „*There is an escapable linkage between the prosperity of regional economies and the health of their colleges and universities.*"

The greatest impact on the increase of rate of educated people can be realized by promotion of the role of universities, which is a direct road to the creation of knowledge-based society. According to Barković, Borozan and Dabić (2008) there are three major aspects in which universities participate in the creation of knowledge-based society: a) contribution of high education institutions to the creaton of knowledge-based economy and improvement of knowledge and skills of the workforce; b) education is recognised as a crucial factor in economic growth, and c) high education is very powerful in creation of the modern society because it results in the appearance of experts in various fields, promotion of critical thinking and expansion of existing knowledge related to creation of

democratic values and civil society. Abel and Deitz (2009) point out that there is a connection between the level of production and the level of research and development activity in universities, and also between production and human capital in cities where institutions are located. Academic activities of research and development increase the level of local human capital, and overflow effects can influence the demand for human capital. Urban areas influenced by high-level educational activities present a good environment for high-value human capital, and universities affect the increase in level of local human capital by increasing skill supply and demand.

Case studies for middle and eastern Europe emphasize developmental role of universities (Gal & Zsibok, 2012). Authors further emphasize that the role of universities is significantly tied to innovation system, emphasis on the use of high-tech industries, small business owners and strong involvement of universities in building up their regional advantages. Other than that, developmental role of universities is upgraded by the exchange of knowledge between high education intitutions and business community or between high education intitutions and local community.

It is obvious that effects will be conditioned by the size of a university. Owen (1992) investigated differences between sizes of universities concerning few question, for example, encountering barriers, possibility of promotion, etc. Gal & Ptaček (2011) discuss the specific role which mid-range universities have in transitional regions in middle and eastern Europe. Their research is focused on the exploration of knowledge transfer. An innovation-friendly environment is created by connecting universities with the business sector. Less developed regions are more dependant on income and innovations realized through the functions of universities, but these universities usually have worse results compared to similar institutions in regions that are more developed. Due to historic circumstances mid-range universities are mostly located in peripheral regions, have less students enrolled and are less connected to the industry. Furthermore, such institutions show less knowledge overflow effects compared to regions containing capital cities.

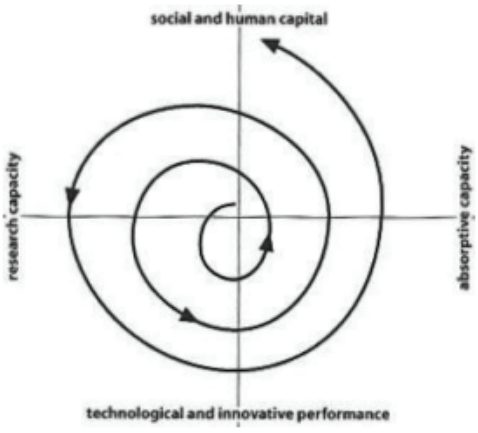
By the interaction of regionalization factors in high-education systems and creation of regional identity and networks the contribution of universities towards the development of specific regions can be accelerated or slowed down (Boucher, Conway & Van der Meer, 2003). Chan (2013) also states that in the last few decades the usual educational role of universities has changed. It is tied to direct and positive influence of universities on economic growth.

Connection between the influence of universities and economic growth in Picture 2. is shown by Karaman Aksentijević and Ježić (2009: 272). They conclude that

„economic growth and well-being are the basis of optimal activity of educational system and development level of research capacity, which determine the level of development of innovation and technology. Educated employees, or human capital, becomes a driving force in knowledge creation and also participates in starting a large number of innovations. Innovations lead to technological changes which greatly accelerate economic growth."

Optimal functioning of the educational system and development level of research capacity is focused towards the capacity to develop innovations and technology in national economy. This concept is surely applicable to lower territorial levels – for example, effects of universities on a regional level. Picture 2. shows an influence sphere within which resources and potentials are realized and brought to a different, higher level. In this manner they have an impact on widening that sphere of influence. It is important to add that these increases are not „jumps" from one level to another. If we take human capital as a reference point, its increase will directly increase research capacities which are evident in technological and innovational performance.

Picture 2. „Ideal" circle of influence on human resources, technology, innovations and absorptive capacity for economic growth and development



Source: Karaman Aksentijević, N., Ježić, Z. (2009).: Human Resources development and research capacity and their impact on economic growth, Zbornik radova Ekonomskog fakulteta u Rijeci Vol 27, No. 2,pp. 263-291.; according to Soete, L. (2007). Notes on UIL-Related Policies of National Governments, In: How Universities Promote Economic Growth, The World Bank, Washington, 2007.

Innovations fund serves as one of connection methods to create interaction between universities and their environment within european governments which therefore have a direct influence on regional knowledge networks (Reichert, 2006). The author states that universities' innovation funds are usually focused on funding research that is either needed for universities themselves or for cooperation between universities and businesses.

Different universities are differently involved in their region's development and some types of universities are more involved than others (Boucher, Conway & Van der Meer, 2003). As authors are emphasizing, type of universities according to the level of impact at regional level are following (Boucher, Conway & Van der Meer: 891):

- Single player universities in peripheral region (encouraging entrepreneurship, science and technology transfer);
- Multiplayer universities in peripheral regions (regional consortia, cultural networks, regional promotion, telematics networks);
- Traditional universities in core regions (strategic planning and knowledge transfer, sustainable development, education and training);
- Newer technologically oriented universities in core regions (city regeneration, widening access to non-traditional students).

Furthermore, although many studies focus on researching regional impact of high education institutions, their role as carriers of regional innovation systems is still relatively unexplored. Further research in the context of regional development should be focused on the analysis of the network of factors connected to a) high education istitutions, b) regional companies, c) collaborative links and d) context of the environment in which high educations institutions are connected with companies (Caniëls, van den Bosch, 2011).

Also, Strauf & Scherer (2008:13) according to Goddard (2000) and Reichert (2006), quote the need for cooperation between universities and other institutions, with universities' role being *i) „not only focusing on global competitiveness but also on the needs and requirements of their location regions; ii) establishing a connection between regional requirements and their range of teaching, research and services; iii) entering into dialogue with regional stakeholders; iv) transferring research findings to the regional development process; v) universities have more to offer than education and research: updating skills of employees, identifying and solving social problems, university expertise is needed*

in an increasingly large range of professional and political fields; vi) working with regional stakeholders and enterprises to create framework conditions that attract creative and knowledge-based institutions and facilities; vii) initiating a self evoluation process through wich they examine their own contribution to regional development; while, according to Strauf & Scherer (2008:14), the manner of actions by regional authorities should be tailored to: *i) perceive universities as regional stakeholders and include them in their „mental map"; ii) use universities as a repository of knowledge; iii) incorporate universities into regional action plan and programms; iv) secure financial aid for joint projects.*

Goldstein and Renault (2004) see the possible contribution of universities to regional economic growth in research, upgrade of human capital through lectures, technological advancement and transfer. They also highlight that research and development lead to knowledge overflow. Furthermore, according to some authors like Charles (2006), universities represent a central mechanism of innovations in a region. Besides innovations, Ďurková, Čábyová & Vicenová (2012) also cite education and research, thus creating so-called triangle of knowledge which ensures business growth and contributes to enhanced business and educational image of and in the region.

Glasgow declaration from 2005 is a good example showing that the importance of universities is not noted only on an academic level but also in official documents. In this document (Reichert, 2006: Foreword; according to *Glasgow Declaration*, 2005) fundamental subject of the discussion is the following:

„Universities advance by taking into consideration their responsibility in accentuation of research and innovations, by optimal use of resources and development of institutional research strategies. Variety of their profiles ensures their focus on the processes of reseach and innovations in collaboration with their partners on regional, national, european and global level."

A specific example of the role of university leadership is provided by Barković, Borozan & Dabić (2008). For universities to become initiators of regional development and the focal point of a regional innovation system, they think that focus should be directed to acquisition of skills by students and researchers, improvement of research capacities with respect to management and financing, intensifying technology and knowledge transfers by strengthening ties between science and industry, actions that lead to internationalization of the university so that its activities could be connected to international scientific community, and

creation of simulative and atractive environment for excellence in study, teaching and research.

Universities can anchor their development based on characteristics of enterpreneurship, in which case we talk about so-called enterpreneurial university. Etzkowitz and Klofsten (2005) use this term to unify the actions of business sector, government and academic staff. In creating a enterpreneurial university, foundations consist of existing academic base or a completely new basis which should, in cooperation with the government and industry, take initiative to create an environment which will ensure regional growth. Realization of these connections enables simplification of processes that start innovations. Walshok (1997) cites several examples of enterpreneurial universities, like *Silicon Valley*in California, *Route 128* in Massachusetts, *Research Triangle* in North Carolina and *Silicon Glen* or *Cambridge* in the United Kingdom. By developing activities based on knowledge while relying on the use of technology, organizational structure and skills of workers and professionals universities can contribute significantly to economic growth and development. Therefore, universities should engage as much as possible in activities that benefit regional economic development. In developing the model of a enterpreneurial university Singer & Oberman Peterka (2010) state that universities can be able to participate or lead processes to triple helix interactions. Also, authors point out (2010:313) an excellent reason to create a triple helix model: „*no single player (University, Industry, Government) can do it on its own without partnering with others, no matter how committed, knowledgeable and entrepreneurial they are individually.*"

It is obvious that individual actions of any part of the triple helix can not be as effective as they are when all parts of the model act in unison with each other.

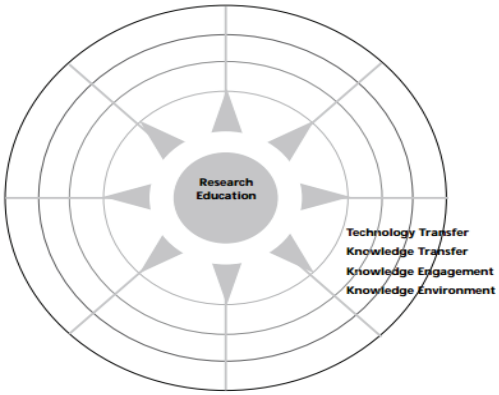
2.1. TRIPLE HELIX

Element of knowledge is one of the basic initiators of economic activity. That is exactly what Cooke & Leydesdorff (2006) are affirming while highlighting the need for activity on the university – industry – government relation. This relationship is known as the *triple helix* model. Studying of this model is currently the focal point of numerous researches, e.g. (Etzkowitz, Dzisah, Ranga & Zhoub, 2007; Kima, Kimb & Yangb, 2009; Martin, 2011; Lawton Smith & Leydesdorff, 2012). All three parts of the triple helix model must be based on interactive dialogue which enables the prosperity of all three sectors.

According to Reichert (2006), the activity of government representative, university and industrial sector is usually manifested by the relationship in which universities are impellers and basis of economy knowledge for politicians. The need for interaction between industrial sector and universities is based on their mutual replenishment of supply and demand for available individuals and their knowledge acquired at the universities. Demand for specified workforce stems from the need to secure and keep global competitiveness and development of innovative products, which is way easier when there is mutual interaction. Some researchers, f. e. Dan (2013), are emphasizing advantages and disadvantages of university and business cooperation. One mutual matter when considering positive effects of university – region partnership, as Strauf & Scherer (2008) are emphasizing, is a significant step of achieving a knowledge-based society. They are also identifying five different relations between universities and their location region.

Except for the three parts of triple helix model, considering the regions of knowledge, public influence also becomes significant. That way triple helix model becomes richer and leads to assumption that regions of knowledge rest on four factors, apropos system better known as the so-called *quadruple helix system*. The mentioned relationship is based on will to strengthen the bond existing between universities as the source of knowledge, but also return flow of knowledge and innovations of industrial world towards the practice of universities. The attempt is to establish environment based on knowledge. Picture number 3 gives insight into areas on which knowledge, implemented through research and development, has influence. Highlighted areas of knowledge influence are directed towards transfer of technology and knowledge, engagement around knowledge and creating environment which benefits development i.e. the advancement of knowledge.

Picture 3. The new importance of universities: expanded activity of expected influence



Source: Reichert, S. (2006: 19). The Rise of Knowledge Regions: Emerging opportunities and challenges for Universities, European Universities Association (EUA).

The activities of four separate areas which are highlighted are not only restricted to fields specified, but are also significantly deepened and transferred to other areas. They are usually directly or indirectly connected with those mentioned. Therefore, it is impossible to separate them as individual units because their activity is performed on all levels related to research and development (Picture 3). Except for the expanded diagram of influence, Reichert (2006)[1] also brings overview of areas in which changes for universities and regions should be carried out, pointing out the following areas:

- Education and specialization of students in accordance to demand existing in the industrial sector, so that individuals who achieve university qualifications would be able to participate in labor market;
- Conduction, managing and support of researches in order for universities to become competitive, which is in accordance to expectations of politicians and holders of economic policy;
- Transfer of technology and knowledge in order to create prosperity based on knowledge;
- Investing resources such as time, money and other, attracting individuals of different profile to create economy and society based on knowledge;
- Creating attractive environment which can speed-up reactions when creating society of creative individuals.

[1] More detailed insight in table, areas and the way that the changes are expected to be made; see in: Reichert, S. (2006:20). The Rise of Knowledge Regions: Emerging opportunities and challenges for Universities, European Universities Association (EUA).

Specified areas are set-up as sort of management needs with implementation of knowledge in all structures and levels. They should rest on individuals who are supposed to work on creation of successful, creativity and innovativeness based society using synergetic activity effect. The final effect is growth of innovations, researches and development which are all potential success indicators of certain economy. Everything mentioned will result in improved competitiveness of economy and its development.

Universities are more and more, just like the regions, centered and focused on internationally open cooperation and investments in improvement of innovations and creativity. Apart from innovations and creativity exceptional focus is on creating and developing human capital as the basic resource. Therefore, the rest of research paper will discuss situation in Croatia and status of universities in some parts of Croatia.

3. POSITIVE UNIVERSITY CONTRIBUTION: CROATIAN CASE

Foreign countries sometimes give examples of universities that are not necessarily one of the biggest employers given the number of students and programs they are offering, but effects coming from those universities are not to be neglected. Much controversy is raised about the need to found two more universities, North University and University in Slavonski Brod which proves that Croatia has also accepted this kind of practice.

As stated in *Transfer of founders' rights over University North to Republic of Croatia Law, NN 64/2015)*[2], founding new university creates a fertile land for initiating entire social and industrial development all around the University. The percentage of highly educated individuals in this part of Croatia would probably become higher, also with higher possibility of starting industrial and similar activities that are usually the results of higher education. (*Transfer of founders' rights over University North to Republic of Croatia Law, NN 64/2015).* Given example is not isolated case, considering that founding of another university, University of Slavonski Brod, is also being started (*Draft of Founding University of Slavonski Brod Law, with final draft (2015*)[3].

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2 Transfer of founders' rights over University North to Republic of Croatia Law, draft with final law proposal, NN 64/2015. (2015). [Zakon o prijenosu osnivačkih prava nad Sveučilištem Sjever na Republiku Hrvatsku, NN 64/2015]. Available at: *public.mzos.hr/fgs.axd?id=22930, (23.9.2015.)*

3 Draft of Founding University of Slavonski Brod Law, with final draft (2015). [Prijedlog Zakona o osnivanju Sveučilišta u Slavonskom Brodu, sa konačnim prijedlogom, 2015].

Given the newly founded University, it is evident that the expansion tendency of university network is present in Croatia. It is familiar that universities can contribute to human capital. The results of certain researches, e.g. Abel & Deitz (2011), speak in favor of this strategy. During their research authors are emphasizing that colleges and universities can raise local human capital levels by increasing both the supply of and demand for skill. Škare & Lacmanović (2013) point out the necessity of universities to evaluate and measure the benefits given to society by higher level of education, as well as contribution of high education institutions to regional development, all within the regional needs of economy and society. As Maronić, Barišić & Glavaš (2011) have stated: „*human capital is a major tool for achieving competitive advantages in the global market*". Other researches, e.g. Ederer, Schuler & Wilms (2007:5), also find human capital as the last straw: „… *no other resource but human capital can lift them out of the situation they are in today*." Tertiary education is a need of contemporary modern democratic society. Furthermore, they claim that the country cannot secure sustainable growth and advancement without higher education. Besides that, European Union stresses the need for *entrepreneurial education*[4] in order to develop human capital, considering it to be the most important resource for sustainable economic and social development.

The practice of European Union's projects has proved that universities can be the initiators of regional development. The example which confirms that academic community is taking over the active role is a project for two faculties of University of Zagreb (University of Zagreb, 2015). Next positive instance is the current project of University of Rijeka, named "Development of research infrastructure in campus of University of Rijeka". Primary cause is the competitiveness increase followed by numerous specific goals making positive effects on its environment. For instance, increase in human resources required in science and technology, increase of projects, transfer of technology and copyrighted intellectual property created as a result of research activity (Development of research infrastructure on Campus of University of Rijeka, EFRR, 2014.-2015.).

These are just examples of separate positive practice, but they should not stay the only ones. Founding of new universities could start local and regional

[4] According to CEPOR (2013.), entrepreneurial characteristic, behavior and attributes can be applied in different contexts, not only in business. Entrepreneurial education develops proactivity, innovativeness and responsibility of individual at the same time, as well as readiness to take over risks while making decisions and solving problems.

development in areas in which they are founded, with adequate planning of programs compliant with labor market demands.

4. CONCLUSION

Building a thriving environment is enabled in cases when universities take over the active role. Furthermore, cooperation with other institutions is required, as stated by Strauf & Scherer (2008) with regional authorities, employees, enterprises, society and others.

Creating and forming new universities should be in accordance to needs of certain field and should offer knowledge and skills to workers in areas for which there is an objective basis for possibility of their implementation. Therefore, creating new universities should be initiated and supported by the industry at the same level, i.e. in the same profiles, so that new recruits could contribute in creating new value. Besides, study training programs should be implemented in order for new recruits to be able to participate in the whole business process. The whole procedure university-business interaction of sectors should be supported by government.

Trend of creating new young universities must be seen as a chance to strengthen current practice on the existing universities due to competition created in education market. On the other hand, young universities will have the chance to create more flexible programs which are more adaptable to labor market demands in local and regional sense.

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GOOD CORPORATE GOVERNANCE: PRIORITIES AND PRINCIPLES

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ABSTRACT

In the last period it has been observed a growing concern for developing and implementing good Corporate Governance (C.G.) practices due to their major impact on companies' image, market share, companies organic growth, customers and long-term strategy. Setting the right methods, processes and instruments will provide the premises for building a strong image on the market that will capture investors attention, willing to invest their resources in that company's future. On the other side not paying enough attention to C.G, can lead to several crises with serious consequences,on companies expense, that no company should risk.

Corporate Governance within developing countries remains an issue of major concern, leaving room for study and analysis. Considering the particular context of emerging countries, those companies that are preoccupied for implementing good C.G. principles, require particular procedures, methods, and unique instruments that are often different from the ones implemented by companies operating on developed countries. This article is meant to describe the meaning of Corporate Governance principles, as well to provide an image regarding the role within companies management and its influences on getting higher profits. Thus, the author underlines the content and implications of C.G. by presenting several approaches of various authors that addressed this subject over time, and underlining the principles meant to provide a general perspective of the values and priorities that should be taken considered by every company that wants to implement a Good C.G. Also, in the empirical part, the author wants to present the priorities of Corporate Governance within a developing country like Romania by underlining how large companies set their priorities in terms of governance and how this influences companies' position and image on the market. The research is based on the analysis of 87 questionnaires, and the respondents were top managers, HR managers and heads of CSR departments within large companies that operate on Romanian market and are based on 87 valid questionnaires. Even if this study relies on a small sample, significant conclusions might be drawn from this study and many future research opportunities can rise.

Key words: corporate governance, corporate internal control, corporate external control, good practices of corporate governance.

1. INTRODUCTION

Concerns regarding corporate governance (C.G) have been intensified due to its direct influence on investor's earnings. Numerous crises generated by notorious companies, sustain the importance of C.G, in reducing immoral and unethical behavior in their struggle for getting higher profits (Hopkins, 2001). The increased concern towards G.C. of top managers, business owners, investors and society is leading not only to society consolidation on ethical principles, but also to strong frameworks that in the end reduce the risks of fraud and corporate scandals (Asha, 2012). Critics of globalization deemed large corporations as being the promoters of environmental abuse due to their appetite for profit. Also, many companies choose to manage their activities respecting the limits imposed by law, in order to avoid penalties that will erode their earnings. Nevertheless, more and more managers realize that promoting a transparent behavior characterized by ethical and moral principles beyond legal requirements will lead to a positive impact on long-term.

Setting and implementing the appropriate corporate governance practices for every company is a complex matter mainly because of the asymmetries from one country to another, increasing competition, the particularities of each organization, shareholders pressure to get higher profits, constantly changing environment that makes some practices to become very quickly obsolete, etc. Moreover, if we refer particularly to emerging countries implementing the best practices of C. G. becomes even a greater challenge given by the unpredictable environment characterized by factors such as economic and political instability, legal and judicial system often too vague expressed, low living standards, company's future uncertainty, poor control, protecting investors, political involvement, lack of clarity regarding the principles, procedures, measures considered accepted, etc. Wishing to get higher performances, the attention of companies is more and more oriented towards achieving higher financial results through a responsible approach to business based on continuity, that can never occur without having strong foundations build on good C.G. principles. Developing an efficient management system is a matter of interest for all companies regardless the market where these operate - developed or developing markets-, and including members in the board such independent directors and external managers whose performance should be evaluated based on a transparent system considering their performance, diminishing the control of the general manager (CEO) becomes a basic and very often implemented approach (Cutting & Kouzim, 2002; Monks, 2002).

C. G. within developing countries, remains an issue of major concern, leaving room for study and analysis given the particular context that impose particular procedures, measures, and unique structures. However lately it has been observed a growing concern manifested by large companies to implement performing C.G. practices due the major impact on investors willingness to put their money in companies with a transparent activity and with the right attitude towards stakeholders, like employees, customers, community, shareholders, etc. This article addresses the issue of corporate governance, providing insight into the content and principles underpinning corporate governance aimed to ensure company's performance and functionality. Also the author wants to present the priorities of Corporate Governance within a developing country like Romania by underlining how large companies set their priorities in terms of governance and how this influences companies' position and image on the market.

2. CORPORATE GOVERNANCE: APPROACHES AND CONCEPTS

The concept of Corporate Governance (GC) was used for the first time in XIX century both in economic and law domains, to facilitate contracts implementation and to protect property rights and collective action. According to Parker (1996), the term has become widely used in the 1980s along with the company's intention to avoid assuming responsibility for actions with devastating effects on society (Vinten, 2001). According to Asha (2012) World Bank used for the first time this concept in the 1989, by associating it with the people that operate within an organization. Milton Friedman was among the first who attributed to the corporate governance definition, referring to the complexity of the actions that involves specifically managing a team and its actions, according to owners and shareholders expectations, meant to sustain companies to achieve large profits, while respecting the rules imposed by society (Monks, 2002). C.G. is the branch of economic studies that underlines how companies increase their efficiency, by using institutional structures as constitutive norms, hierarchical structures, internal rules and regulations, which represent a powerful tool, available to shareholders that can be used to motivate the executive team to achieve desired outcomes (Mathiesen, 2002).

Because more and more companies have realized that fierce competition impose a modern vision, by diminishing the control of the owner of company and relaying more on professional management choose to focus more on implementing good corporate governance practices. Listed companies have even

a more powerful reason due to the and the need to inspire stability, credibility and certainty to investors necessity to attract capital and to protect both proprietary and appointed managers (Kiel and Nicholson, 2002). According to Francis (2000) the concept has enjoyed popularity due to economic disasters caused by the absence and inconsistency of the god governance practices and especially because within the last decades a need for change was manifested imposed by perusing sustainable development to reach high performance. In this context it was realized the need for having a structure that holds the primary role in ensuring an efficient management (ex. board director) meant to impose a course of action (Adams, 2002). With the passage of time there has been a growing awareness of the fact that C.G. will lead to positive effects on both the economic development of the country and on the company's outputs (Clarke, 2004).

Whether it is perceived as a process or set of actions meant to enable good governance (Colley et al., 2004), or is viewed as being a system by which companies are directed and controlled (Cadbury, 2000), C.G. appears to be easily to define, but difficult to analyze and appreciated (Mathiesen, 2002). C.G. refers to the set of mechanisms in place used to ensure good relationship with stakeholders, stressing the role played by them in a strategic decisions, monitoring and evaluating the impact on company's performance (Linall et all, 2003). C.G. has a decisive role in company's processes because of its main role in generating value (Turnbull 2002). Shleifer and Vishny (1997) defines C. G. as company's mechanisms used by investors to get the result for their investment. Ruin (2001) approach reveals that C. G. refers to a group of people working together, having not only the capacity, but also the authority to direct, control and manage an organization. A comprehensive and complex definition is that of Australian Standard (2012), where GC is regarded to be the process by which an organization is directed, controlled and mastered, implying authority, responsibility, administration, management, guidance and control, being acknowledged the need for constant control and balance in the managerial activities. A similar approach is also provided by the CIPFA / SOLACE (Chartered Institute of Public Finance and Accountancy and the Society of Local Authority Chief Executives, 2010).

According to World Bank Report (Hopkins, 2001) "C.G. refers to the structures and processes which impose the future path that a company should take". The European Central Bank has a similar perspective, according to which C.G. being associated with the procedures and processes by which an organization is controlled and guided by setting rights and responsibilities for various participants within an

organization - such as board of directors, managers, and other stakeholders - rules and procedures used in the decision making process (World Bank, 2004). Good G. C. lead to both higher performance and increase corporate responsibility (Marita, 2009). G. C. highlights how businesses are run and organized in a responsible and transparent way, and how management performs its duties according to the laws, rules and codes of conduct (Jamali et all, 2008), being associated with the assembly of steps taken to protect the shareholder's interest. Corporate governance mechanisms influence in a decisive way the implemented strategies and how companies report their activities to external and internal environment.

Next we will refer to a number of approaches that are designed to create a perspective on how companies should approach GC, bay referring to a set of principles established that provide direction to that properly implemented can ensure companies future.

3. PRINCIPLES OF CORPORATE GOVERNANCE WITH POSITIVE IMPACT ON ORGANIZATION

Implementing the concept in different organizations tends to have a different meanings and implementation systems (Davies and Schlitzer, 2008), being difficult to name a general model, appropriate to all organizations operating in the same country (Organization for economic Cooperation and Development, 1998). According to (Watson, 2009; Solomon & Solomon, 2004) there can be identified two broad approaches embodied in internal and external model of corporate control:

- *The Corporate Internal Control* (Insider Model of Corporate Control) -which refers to the fact that the GC structures take into consideration company's major stakeholders like - employees, managers, creditors, customers, suppliers and community- referring to those actors who are in direct relationship with the company and that currently established collaboration. In this category can be classified countries like France, Germany, Italy and the Netherlands.
- *The External Corporate Control Model* (Outsider Model of Corporate Control) – makes distinction between the named managers and owners - referring to the fact that GC must serve the owners interests, meanwhile shareholders can exert major pressure on the way objectives are achieved reaching in the end the final profit.

However, comparing several corporate governance principles can provide a general perspective of the values and priorities considered valuable in setting the future strategy of the (see table 1).

Table 1. *Principles of Corporate Governance*

Cadbury Principles (Cadbury, 2000)	ASX Principles (ASX Corporate Governance Council, 2003)
– Setting requirements and responsibilities, by avoiding granting absolute power to a single person / group of people; - Board of directors must have clear responsibilities differing from those of others employees with the managerial role within the company; - The board should contain of executive and non-executive directors; - Transparency of the board decision making process based on clear management control systems.	- Developing an effective management control system; - Establishing the premises of the board to create value in the company's interest; - Making decisions in accordance with ethical and responsible principles; - Ensuring the integrity of financial statements; - Providing a clear and transparent image of companies results; - Respecting shareholders rights; - Timely risk forecast and efficient risk management; - Encouraging performance; - Fair remuneration base on the performance; - Respecting stakeholders interests.
Bank for International Settlement (BIS, 2015)	**Business Roundtable Association (2015)**
- Implementing efficient risk management systems with the clear purpose of surveying board's activity; - Emphasize the importance of the board's collective competence; - Avoiding risk by setting risk management teams, internal audit and control functions, without neglecting the importance of culture to drive risk management; - Provide guidance to select board members and senior management; - Compensation systems and incentive structure form a key component of the governance.	- The Board of directors has as a main responsibility to supervise the CEOs and top management activity; - Managers must create the perfect balance between efficiency and ethical and responsible behavior in order to serve shareholders interests; - Financial reporting must be consistent with reality; - The company has the responsibility to communicate effectively both with shareholders and other stakeholders; - Managers should be able to meet in the absence of the General Manager (CEO) and other leading managers; - Every company is responsible for its employees who need to treat them in a fair and equitable manner; - Companies must have a C.G. committee composed of independent directors holding responsibilities such as appointing directors, providing information to a board and board performance evaluation.
Organization for Economic Cooperation and Development (OECD, 1999)	**Sarbanes-Oxly Act (2002) developed by the US Congress governance requires.**
- Providing protection and recognition for shareholders rights; - Equitable treatment of all shareholders; - Provide the best solutions to stated problems only in the company's best interests; - Provide a timely and transparent reporting of companies resources, board actions and accountability.	- Having an internal independent audit committee; - Assumed responsibility by the executives and financial managers for internal controls proved by documents, serving as a warranty that financial reports are free of misstatement; - External auditors must not have any relation with the board; - The majority of managers that of the listed companies should be independent.

Source: Adapted after *Cadbury(2000); ASX , (2003); BIS, (2015), OECD, 1999; Business Roundtable*

Association (2015); Sarbanes-Oxly Act, (2002).

The general trend is that C.G. first of all must be characterized by efficiency, transparency and clearly manifested respect for human integrity and interests of those involved, without harming with intention, any of the parties that have interest in the company. Nevertheless, manager must be aware of the costs and the consequences of their practices if are not in compliance with the principles of good C. G, and they should constantly struggle to avoid them, by setting clear measures to ensure economic growth, gaining customers loyalty and creating long-term value. This can no longer happen without setting clear rules, methods, instruments that drives company to raise its capacity to govern responsibly. In order to facilitate the development of appropriate systems for G.C. Reed (2002) considers that companies that are using their own resources to make investment on the loans expense, are more likely to gain investor confidence trough increasing transparency, strengthening capital market and enhancing competitiveness to improve the performance of local companies.

4. GOOD PRACTICES FOR HAVING A PERFORMING BOARD

Depending on the company's market approach and decision to prioritize its stakeholders, of a companies' C.G. follows a series of principles and rules that radically change company's strategic approach. There are great varieties of means available to avoid excess of power and to raise board performance, but showing preference for some of them on expense of other underlines companies values, core competencies, and future market approach. C.G. directly depends on factors such as board independence, the existence of the Audit Committee, the types of investors / financiers, company's profitability, degree of internationalization / export orientation, consumer perceptions, founders /owners involvement in the management (Reaz and Arun, 2006); the institutional investors influence, shareholder, financiers influence (Uddin and Choudhury, 2008), domain of activity, company ownership, the percentage of foreign members in the board, the number of members holding the majority (Farooque et al. 2007), etc..

To ensure the balanced structure, the Board of Directors should include external managers being selected from the most representative clients, suppliers, consultants, local community members where the company operates (Porter and Olmsted, 2006). This will set the premises for reaching higher performances by having on key management position, people with skills and competencies able

to drive the company to reach external stakeholders expectations. Nevertheless, to protect the integrity of external managers, a basic rule that board of directors should comply with, is to exclude other type of relations with investors, than manager - shareholder. Including external managers in the Board provides insight of companies approach to reinvigorate and raise performance within the company as well it is a mean to attract competent resources meant to guide the company towards growth and performance. Nevertheless, they should be selected based on clear performance standards, agreed by all board members, taking into account their expertise and their achievements, being recruited and selected from a larger number of candidates identified by institutional investors (Reaz and Arun, 2006; Uddin and Choudhury, 2008, Farooque et al. 2007Porter and Olmsted, 2006, Gilson and Kraakman, 1991). Excess of power can be avoided by setting clear performance indicators at both individual and company level, such as performance quantification methods and results control, market indicators (share, sales volume, companies reputation, brand notoriety, quality of products, services relative to the competition, sustainable responsibility, relationship developed with employees and customers, etc. (Porter and Kramer, 2011).

Having a transparent relation with shareholders will raise the confidence of other stakeholders that decision making process is based on fair principles that enable company to reach market expectations. Moreover, having an open relationship with external shareholders can be possible by setting annual meetings where top 10 shareholders can meet the board of directors. This will facilitate open communication between these two parties and will reduce the risks of conflict (Gompers et al., 2010).

Rating manager's performance should be an ongoing process. Shareholders should be aware of the results achieved and the initiatives proposed during their mandate. This situation will give shareholders higher control on company's future business approach, once some members are failing to meet their expectations. To ensure transparency and a good relationship with shareholders, investors have the right to ask whenever deemed appropriate, information on the remuneration system used for members of the board, performance instruments considered and differences in results achieved from each member compared to other. To ensure flexibility of the board it should not exceed 10 members and the number of external managers should not be greater than of the internal manager's report being at least two to one (Gilson and Kraakman, 1991). Also, board members must commit not to be in the same time members in more than three boards and

their mandates should be clearly specified in time, for example 10-15 years, as well as the age limit retirement should be mandatory (Lipton and Lorsch, 1992)

The credibility and integrity of the board of directors should be reinforced by the audit committee whose members should include independent managers responsible to liaise with the external auditors at least twice a year (Daily et al., 2003). Periodic audits are mandatory and their confidentiality should be a priority, being under legal protected against defamation and having the right to anonymity, once the frauds were identified and suspicions of irregularities were perpetrated by Board members.

Gaining shareholders loyalty is vital to ensure continuity of the business and to maintain its stability on the market, this being possible as long as their expectations are satisfied. This can be achieved by providing a transparent framework for negotiation, taking into account that management will considered, regardless of size and shareholding. This means that every shareholders decision, no matter the quality holder and category in which it belongs, should have equal rights and duties (ex. dividends) in accordance with the percentage of shares held (Monks and Minnow, 1995).The influence of the management must be balanced with the expectations of shareholders, so a majority vote of shareholders should allow the adoption of major changes in the company such as: choice / dismissal of directors, determining the duration of the mandate, influencing decisions concerning the interests of shareholders, request Meeting special procedures aimed at influencing the establishment of achieving data such shares, decisions about the company's expansion into other countries (Norwani et. al, 2011).

According to United Shareholder Association for a greater transparency and lower mitigation abuses, board of director should be changed to a shorter period of time, if possible annually (Manry and Stangeland, 2003). To ensure fair representation of investors interest the board should include representatives of the key stakeholders, (Minow and Bingham , 1993). Also, a viable way to raise managers' commitment is to encourage them to share ownership in the company by paying dividends, or paying their performance with shares being in accordance with the position held, without harming shareholders interest, and taking into consideration companies long-term objectives and future strategy (Hanson, 1991).

A competent management makes the difference between success and failure, this depending significantly on the owner's ability to attract and retain well trained and experienced managers, but also to reward and motivate them properly

according to performance achieved. One way to motivate managers and thus to establish a closer relationship between managers and shareholders, is to provide investing opportunities within the company. In this context an important aspect is to set leverages to avoid abuse of power like setting a floor price to avoid unrealistic growth of shares price, managers being rewarded only for the real growth of the company. Board of directors should appoint an independent director or a special commission with special duties and responsibilities with the purpose to ensure the flow of information to shareholders and to ask them to find opinion decisions.

Higher performance on long them can be achieved only by having solid strategy investments with direct impact on technology, innovation and human capital. This can be achieved through by raising company's performance in accordance to the market needs (Department of the Treasury, 1997). Thus human resources becomes a key factor, so developing a well trained, loyal and dynamic teams relies on top management ability to adopt strategic decisions and to properly implement them at each management level. This can be possible by using tools meant to gain employees loyalty, namely by creating investment opportunities not only for managers but also for employees.

5. RESEARCH METHODOLOGY

This study is designed to highlight the priorities of C.G. to reach sustainable development at the level of large companies that operate in Romania. The purpose is to propose a model that comprises the most important elements that enable companies to have a good C.G. as well to observe the main typologies of the companies according to the C. G. principles used. Also, it will be analyzed if companies image and market share is influenced by the principles that characterized their C.G.

The research is based on the analysis of 87 questionnaires, and the respondents were top managers, HR managers and heads of CSR departments within large companies that operate on Romanian market. The implementation process took place from November to January 2015, and has reached 1146 large companies operating on Romanian market, via e-mails. We got 87 valid answers and a response rate of 13.17%. Although this is a low percentage due to the topic addressed, the results can be very well generalized and clear strategies might be highlighted.

The hypotheses established were:

H1: Large companies that operate on Romanian market rely more on owners/ major shareholders decisions regarding companies future strategy.

H2: There is a causality relation between the C.G and company's image on the market and market share.

The limits of this study is given by the small number of respondents, which stems from the method used to disseminate the research instrument, the low availability the respondents to fill in the questionnaire, the lack of readiness and of social awareness, and the difficulty of finding suitable respondents to provide reliable answers.

6. RESULTS INTERPRETATION

In order to create the model of C.G. it was conducted a series of bi-varied analysis, using 12 qualities (Reaz and Arun, 2006; Uddin and Choudhury, 2008; Farooque et al. 2007; Porter and Olmsted, 2006; Gilson and Kraakman, 1991; Porter and Kramer, 2011; Gompers et al., 2010; Daily et al., 2003).). The author tested the validity and consistency of the model used to find the most important priorities that characterize Good C. G. using Cronbach Alpha (Cronbach, 1951) and item-to-total correlation eliminating the items that fail to explain the studied phenomenon. The more Cronbach (α) coefficient is closer to one, the more data shows an increased confidence. Item-to-total correlation, Cronbach α coefficient linked closely to measure the degree to which an indicator is correlated with the others indicators included in the model. For a better identification of items included in the model we used the option and the Cronbach α if item deleted "to exclude variables that do not contribute significantly to the model (see table 2).

Table 2: *Priorities of Corporate Governance within large companies*

	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted	Cronbach α initial and final
Unhappy shareholders with actual managers can manifest their dissatisfaction and their reasons.	.632	.737	0.794Þ 0.843
A vote of the majority of shareholders leads to important changes (ex. election of new directors, calling special meetings)	.209	.790	
Board of directors include major stakeholder representatives.	.766	.718	
Accounting and compensation system is based on creating value to shareholders.	.619	.740	
There is a committee that ensures the informational flux between the board and shareholders.	.611	.740	
Manager's compensation system is direct linked to performance.	.351	.768	
Alternative measures of performance (ex. product leadership, employee attitude, public responsibility), are used all the time.	.713	.740	
Stock option plans are designed to encourage employees to hold their stock over long term.	.580	.743	
Within the company there are comities representing employee's interests.	.203	.782	
The number of outside directors in the board is larger than internal directors.	-.070	.807	
The size of the board is maximum 10 members.	.197	.791	
Board members are established according to a set of qualifications (ex. education, experience, nationality)	.462	.760	

Source: Own research

The resulted model is made of seven items that underline the main priorities of C.G. As it can be seen majority shareholders vote, does not lead to major changes even if the board structure include major stakeholder representative, which demonstrate that their opinion does not lead to significant changes. Nevertheless, in order to reach higher performances C.G priorities include investment opportunities for employees meant to gain their commitment to company, hiring performing managers based on clear criteria of evaluation, considering qualitative indicators as performance evaluation.

In order to see if we can find if there can be identified different typologies of companies, knowing if some items are more important than others in setting the priorities of C. G. as well as understanding the correlation between analyzed variables, it has been performed a factorial analyses (see table 3). The KMO indicator is 0,787, and the Total Variance Explained formed three factors

that explain 76,654% of the model variation (V1=50,310%; V2=16,674%; V3=13,213%).

Table 3. *Factor analyses of most important priorities of Corporate Governance within large companies that operate on Romanian market*

Structure Matrix			
	Component		
	1	2	3
Unhappy shareholders with directors can register their dissatisfaction and their reasons.	.918	.062	.330
There is an committee that ensures the informational flux between the board and shareholders.	.907	.045	.447
Board of directors includes representatives from major stakeholder.	.746	.482	.469
Accounting and compensation system is based on creating value to shareholders.	.746	.596	.362
Stock option plans are designed to encourage employees to hold their stock over long term.	.144	.972	.252
Board members are established according to a set of qualification (ex. education, experience, nationality)	.278	.207	.871
Alternative measures of performance (ex. product leadership, employee attitude, public responsibility), are used all the time.	.479	.208	.846

Extraction Method: Principal Component Analysis.

Rotation Method: Oblimin with Kaiser Normalization

Source: Own research

The variables components describe three different typologies of companies that underline different priorities when it comes of their C.G. First factor emphasizes a more complex perspective that put in the centre "the stakeholders (shareholders, suppliers, clients, etc)" contribution to manage company's future and their role within board's decision making process. The second factor obtained, underlines that employees play a major role within company's struggle to reach performance so there is of a major importance providing them investment opportunities to stay in the company and to be committed to the cause employees. The third factor describes that a good C.G is based on alternative methods and measurements meant to evaluate not only board members performance, but also indicators that emphasizes company's performance on the market.

Following a factor analysis, it has been evaluated how the components of the model are influencing companies image and notoriety on the market (see table 4). Among the variables considered there can be seen that the considered items

have approximately similar influence. Nevertheless providing stock options to employees (Xi3) has the highest contribution in raising notoriety on the market.

The linear regression is: *Y=2.264 +0.309*Xi1 +352* Xi2+ 0.339* Xi3*

The statistical formula demonstrate that companies image and reputation on the market will increase as long management performance evaluation will be made base on the value created for the shareholders, as the employees will have better access to stock option plans, as long company's performance will be evaluated based on alternative indicators, not only financial ones.

Table 4. *Coefficients- Impact of Good Corporate Governance on companies image and reputation*

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	2.264	.403		5.624	.000
Unhappy shareholders with directors can register their dissatisfaction and their reasons.	-.083	.104	-.129	-.798	.428
There is a committee that ensures the informational flux between the board and shareholders.	-.249	.101	-.375	-2.455	.017
Board of directors includes representatives from major stakeholder.	-.071	.080	-.121	-.888	.378
Accounting and compensation system is based on creating value to shareholders.	.309	.100	.314	2.088	.000
Stock option plans are designed to encourage employees to hold their stock over long term.	.352	.079	.573	4.465	.000
Alternative measures of performance (ex. product leadership, employee attitude, public responsibility), are used all the time.	.339	.117	.369	2.834	.000
Board members are established according to a set of qualification (ex. education, experience, nationality)	.108	.105	.122	1.028	.308

Source: Own research

It is noted that the variation model represents, approximately, the test value F = 8.857 and the value of materiality is p = 0.000, where p <0.01, demonstrating that the variation explained by the model is not random but is influenced by the considered factors. The intensity of the bond established between the model and the dependent variable, where R = 0.704, that indicates a linear correlation between the values observed of high intensity.

Other aspect measured was to identify how the component of the model are influencing companies market share (see table 5). The most relevant C.G.

practices that positively influence company's market share are including major stakeholders' representative within the board, providing employees better access to stock option plans, by using alternative measures of performance evaluation.

*The linear regression is: Y=1.608 - 0.683*Xi1 +0.605*Xi2 +701* Xi3*

Table 5. *Coefficients- Impact on Impact of Good Corporate Governance on market share*

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.608	.659		5.624	.000
Unhappy shareholders with directors can register their dissatisfaction and their reasons.	.129	.170	-.129	-.798	.428
There is a committee that ensures the informational flux between the board and shareholders.	-.249	.101	-.375	-2.455	.017
Board of directors includes representatives from major stakeholder.	.683	.131	.121	.888	.000
Accounting and compensation system is based on creating value to shareholders.	.575	.164	.314	2.088	.041
Stock option plans are designed to encourage employees to hold their stock over long term.	.605	.129	.573	4.465	.000
Alternative measures of performance evaluation (ex. product leadership, employee attitude, public responsibility), are used all the time.	.701	.192	.369	2.834	.000
Board members are established according to a set of qualification (ex. education, experience, nationality)	-.432	.173	.122	1.028	.308

Source: Own Research

7. CONCLUSIONS

G. C. has a decisive impact on a company's financial situation. Thus, developing a set of principles to guide corporate governance is essential for any company that wants to improve its market position. Change starts from inside, and the principles and measures meant to ensure an effective management is the first step in any business activity to reach performance, and higher profits and thus playing an active role in society's development. G. C. and strategic competitiveness are closely connected, mostly because company's performance significantly depends on how board of directors is organized, the values considered, and the internal objective prioritization.

Stakeholders play a decisive role in shaping the strategic decision, so companies must base their core values designed to prioritize stakeholders on the vision and

mission commitments. Such an approach is necessary in order to propose a set of directions on approaches that should cover the company in the future social strategies so as to produce a favorable result, both for the company and for external stakeholders.

National competitiveness forced companies to find various ways to differentiate, by implementing those C.G. principles that best fits the organization. Building these principles on strong foundations will positively influence company's ability to attract more customers and to have a good image on the market. A company will be better perceived on the market as long it will be focused on rising companies performance bringing more value to shareholders, as long employees will have more opportunities to invest their money in the company and as long the management will use alternative measurements to evaluate companies performance. Moreover, customer's willingness to buy companies products depends on including major stakeholder's representatives in the Board, which can be explained by the fact that companies will satisfy better customer's expectations. Also, providing employees better access to stock option plans raise employees loyalty towards company, as well it will provide free access to advertising, because they will feel that holding a small part of the business will make them fill that are doing that for themselves. As long as the management pays attention to components like product leadership, employee attitude, public responsibility, customers willingness to buy companies products will raise, providing the perception that a company preoccupied for a sustainable development is more appreciate and customers are more likely to support their activity.

Studying how C.G is perceived and addressed by larger companies operating on a developing market like Romania is a topic of interest for theoreticians and practitioners because it provides insight about the most often used C.G. practices. Moreover, it enables to analyze if there are differences among how managers perceive the impact of C.G. practices on external stakeholders and how external stakeholders perceive the impact of C.G.

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AGE CONSCIOUSNESS – OPENNING OUR MINDS TO AGEISM

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ABSTRACT

Age discrimination, as one form of discrimination is the most discussed form of discrimination in the social sciences. This is due to many changes – from the demographic to legal, medical and the like, but this is also due to the fact that many other forms of discriminations such as by race, gender or ethnicity have already been intensively discussed in the public and academic arena and much of the attitudes expressed have been institutionalized in terms of antidiscrimination laws and other regulative. Butler coined the word 'ageism' to follow the trend of wording discriminations on *–isms* such as sexism or racism and he defined it as „a process of systematic stereotyping or discrimination against people because they are old, just as racism and sexism accomplish with skin color and gender. This article focuses on age discrimination, i.e. ageism, as a particular type of discrimination that has not yet been fully addressed compared to other more popular types including sex, race, and religion discrimination. The purpose of the paper is to draw attention to age as discriminatory in the society as well as to provide an overview of age discrimination legislation in the international and national arena which is becoming increasingly important in the light of a rapidly aging population in most (industrialized) countries worldwide.

Key words: age discrimination, stereotype, prejudice, age discrimination legislation.

1. INTRODUCTION

The issue of discrimination, particularly age discrimination, has been receiving increased attention in both the popular press and in academic research. This may be attributed to several factor such as changing demographics of labour force whereby labor force is getting older, an increase in the lawsuits dealing with age discrimination that have been the outcome of changing legislation and passage of various laws dealing with it or by the simple fact that people are living healthier and longer lives (Hassell and Perrewé, 1993).

Discrimination has proven to be a challenging issue since it appears in many forms and in different intensity and as such it requires a multidisciplinary approach to combat it. Numerous states and international organizations are trying to eliminate or at least reduce the many faces of discrimination by introducing various legal documents, legal regulative, norm and the like, but it seems that discrimination tends to be to a great extent immune to such legal and institutional efforts.

The focus of this paper is the age discrimination as a particular type of discrimination. Ageism, in term of negative attitudes, stereotypes, and behaviors directed toward older adults based solely on their perceived age, has not yet been fully addressed compared to other more popular types of discrimination such as sex, race or religion. Thus, the purpose of the paper is to draw attention to age as discriminatory factor in the economy and society as well as to provide an overview of age discrimination legislation in the international and national arena which is becoming increasingly important in the light of a rapidly aging population in most (industrialized) countries worldwide.

The paper is structured as follows: after introductory remarks, the section two of paper deals with the discrimination and related notions such as prejudice, stereotype and the like. Section three of the paper focuses on the age discrimination, i.e. ageism, a term coined follow the trend of wording discriminations on *–isms* such as sexism or racism. Various definitions are stated in order to prove the complexity of this notion. In addition, the section discusses about the ways ageism appears as well as it provides literature overview of unequal treatment evidences based upon age that can be noticed in many domains of human life. The section four of the paper deals with the legal framework that regulates the issues of age discrimination on the international and national level as well as it

provides selected examples of age discrimination issues. The section five of the paper is concluding.

2. DISCRIMINATION AND OTHER RELATED NOTIONS

The notion discrimination originates from the latin word *discriminare,* which means to separate. It depicts the practice of unequal treating a person or group of people differently from other people or groups of people, based upon the ethnicity, gender, age, social status and the like (Vidaković Mukić, 2006:153).

Discrimination is usually a consequence of stereotypes. A *stereotype* is a general impression about a group of people, objects or activities. As such it has quite useful function in reducing cognitive load since it is not possible to make intimate acquaintance with all the individuals we meet, see or hear about in order to make accurate judgment about them. It is a basic survival strategy to use short-hand representations (stereotypes) about groups of people in order to function effectively. Stereotypes are formed out of input from the environment, including what people are told by their family members or friends, personal exposure to members of the stereotyped group, books and journal articles, and images and information in the media (Australian Human Rights Commission, 2005).

Prejudice is an unjustified or incorrect attitude (usually negative) towards an individual based solely on the individual's membership of a social group. For example, a person may hold prejudiced views towards a certain race or gender etc. (e.g. sexist).

Palmore (1999: 19) offers an interesting explication of 'stereotypes' and 'negative attitudes'. Stereotypes are mistaken or exaggerated beliefs about a group, while negative attitudes are negative feelings about group. Former are more cognitive and later are more affective, but both go well together. Negative stereotypes usually produce negative attitudes and negative attitudes support negative stereotypes.

Social norms, defined as the behavior considered appropriate within a social group, significantly influence prejudice and discrimination (see, for example, Pettigre, 1959; Rogers, 1962). An interesting research conducted by Minard (1952) investigated how social norms influence prejudice and discrimination. He observed the behaviour of white and black miners while in the mine (below the ground) and outside (above the ground) in a town in the southern United States. The results have shown that below ground, where the social norm was friendly

behavior towards work colleagues, 80% of the white miners were friendly towards the black miners. Above ground, where the social norm was prejudiced behavior by whites to blacks, this dropped to only 20%. Thus, white miners were conforming to different norms above and below ground. Whether or not prejudice is shown depends on the social context within which behavior takes place.

3. AGE DISCRIMINATION: A CHALLENGING CONCEPT OF AGEISM

Age discrimination, as one form of discrimination is the most discussed form of discrimination in the social sciences (psychology, sociology, economics). This is due to many changes – from the demographic to legal, medical and the like, but this is also due to the fact that many other forms of discriminations such as by race, sex or ethnicity have already been intensively discussed in the public and academic arena and much of the attitudes expressed have been institutionalized in terms of antidiscrimination laws and other regulative.

Age discrimination has been augmented by the fact that the *youth* is a value strongly embedded in the Western culture (Macnicol, 2006). For example, the youth has a great value in the American culture that efforts to stay young fuel a multibillion dollar industry since the prevailing view is *"If I can buy enough pills, cream, and hair, I can avoid becoming old"* (Esposito, 1987 in Calasanti, 2005).

Similar to cases of discrimination by sex or race, the age discrimination refers to the negative attitudes, stereotypes, and behaviors directed toward older adults based solely on their perceived age (Butler, 1980). Butler coined the word *'ageism'* to follow the trend of wording discriminations on *–isms* such as sexism or racism and he defined it as „a process of systematic stereotyping or discrimination against people because they are old, just as racism and sexism accomplish with skin colour and gender. Ageism allows the younger generations to see older people different than themselves; thus they subtly cease to identify with their elders as human beings" (Butler, 1975). This general definition of ageism stereotypes and discriminates specifically against old (see also Butler, 1995).

While Butler's definition of ageism is the most cited across the literature, the research on ageism is marked by many more definitions of this concept. For example, in the review of the publication *Ageism: Stereotyping and Prejudice Against Older Persons (Nelson, 2004)* definitions of ageism are ranging from one component to even eight have been indicated. For example, in the one-part definition ageism is defined as prejudice against older persons; a two-part definition considers ageism as negative attitudes and behaviors toward the elderly

(Nelson, 2004: 28); there is a definition of ageism that uses the traditional three components of attitudes: (1) an affective component such as feelings one has toward older individuals; (2) a cognitive component such as beliefs or stereotypes about older people; and (3) a behavioral component such as discrimination against older people (Nelson, 2004: 131); a four-part definition includes above states components while distinguishing between personal and institutional discrimination (Nelson, 2004: 340). The most complexed definition of eight-parts arises when it is recognized that all four of the above components can be negative or positive toward elders (Nelson, 2004: 340).

According to International Longevity Center-USA (2006), there are four categories of ageism identified (Anti-Ageism Task Force, 2006):

- *Personal ageism* – ideas, attitudes, beliefs and practices on the part of individuals that are biased against persons or groups based on their age.
- *Institutional ageism* – missions, rules, and practices that discriminate against individuals and/or groups because of their older age.
- *Intentional ageism* – ideas, attitudes, rules or practices that are carried out with the knowledge that they are biased against persons or groups based on their older age. This category includes practices that take advantage of the vulnerabilities of older persons.
- *Unintentional (or inadvertent) ageism* – ideas, attitudes, rules or practices that are carried out without the perpetrator's awareness that they are biased against persons or groups based on their older age.

Ageism has a lot to do with assumptions and stereotyping. As suggested by various definitions, the attitudes towards older people can be positive or negative. *Positive stereotypes* that are accepted and considered to represent all older people usually include following attributes: kind, wise, influential, free, happy, politically powerful. Unfortunately, the *negative stereotypes* tend to dominate and they include negative images of old people being sick, disabled, ugly, depressed, unable to learn, demented and the like.

Ageism can be demonstrated in both explicit and implicit way. *Explicit ageism* occurs when occurs when there is a conscious awareness, intention or control in the thoughts, feelings or actions of an institution, law or person in regards to the treatment or consideration of an older adult. On the other hand, the *implicit ageism* convers implicit stereotypes and prejudice against older adults. According to Levy and Banaji, 2004: 51), the implicit age stereotypes are thoughts about the

attributes and behaviors of the elderly that exist and operate without conscious awareness, intention, or control; this is also called automatic or unconscious stereotypes. Furthermore, the implicit age attitudes are defined as feelings toward the elderly that exist and operate without conscious awareness, intention, or control; this is also called automatic or unconscious prejudice.[1] Levy (2009) also points out that once the people are perceived to be 'older adults', by the external forces of social interaction, formal policy qualification and self-perception, implicit ageism becomes self-referential.

Ageism tends to be treated differently than other forms of discriminations (e.g. sex, race, disability) due to the fact that it is inherent to all persons with no exception. Namely all people must and will grow old and because of such universality ageism is often treated less seriously than other discrimination forms.

Evidences of unequal treatment based upon age can be noticed in many domains of human life such as workplace (e.g. McCann and Giles, 2002, Finkelstein, Burke, and Raju, 1995) where discrimination is presented in terms of mandatory retirement age or in health care facilities (e.g. Caporael and Culbertson, 1986; DePaola, Neimeyer, Lupfer, and Feidler, 1992). The age discrimination can be in terms of expectancies that doctors hold regarding the capabilities of older individuals that may shape recommendations and decisions on (potential) treatments.

The idea that life occurs in pretty much fixed stages contributes to ageism. According to that idea, a person lives a life in accordance with his/her age – he/she has to have kids at certain age, should have a career at certain age and suppose to retire at certain age. However, in reality people make different choices in their lives regarding children, work, retirement and the like and these choices rarely fit rigidly set age-related boxes. Even though this idea is obsolete, it still persists in many societies across the world (Glover and Branine, 2001: 51).

One cannot omit the role of mass media in reaffirming the stigma that old people are automatically mentally or/and physically challenged thus reinforcing negative stereotypes (see, for example, Pickett, 2002, Dahmen and Cozm, 2009;Rozanova, 2010). Even if older people are portrayed in a positive way, often it is used to promote anti-aging message. Many researches have been done to evaluate the response of media to population ageing. For example, there was a study analyzing newspaper, television and magazine content for depictions

1 One should point out that ageism can also apply to stereotypes and prejudice directed at the young.

of ageing in Canada and Russia. It has been found that in both cultures older age groups were underrepresented, negative portrayals far outweighed positive portrayals, and older individuals with disabilities were virtually absent from advertising unless they were advertising assistive devices. Another study conducted in the United Kingdom has found that 55% of adults over 50 feel that businesses have little interest in older people's consumer needs; 46% often do not feel that advertising/marketing is aimed at them; and 50% find advertising/marketing that is obviously targeting older people to be patronizing and stereotypical. Yet another research has shown that 75% of respondents to a survey of people ages 60 and older thought that the media ignored the views of their age group. Such a lack of representation in the mass media has an important impact on older people and their societal position. Namely, it may contribute to marginalizing older adults, who already feel the effects of ageism and a sense of diminished worth and participation in society.

All taken into consideration, ageism and age discrimination are much harder to address than other forms of discrimination and consequently it is more difficult for national governments to create legal and institutional framework to advance the wellbeing of older adults. Namely, older adults' needs easily become subsumed to the needs of other age groups, or to the administrative needs for efficiency or cost cutting. If we take into account the pressures for scarce resources and given similar need, the fact that one is older often becomes the justification for not receiving a benefit or service or not be treated as a sufficiently high priority. In any cost-benefit analysis based on remaining years or future productivity, older adults are always at a disadvantage (Law Commission of Ontario, 2015).

3. AGE DISCRIMINATION LEGISLATION: WHAT ARE THE PROTECTIONS?

When dealing with a deeply entrenched form of discrimination, legal protection is often looked to as a way to tackle broader issues such as ageism. As mentioned earlier, ageism can be described as 'a process of systematic stereotyping of and discrimination against' older people who are 'lumped together' as being the same and treated unfavourably because of their age (Butler and Lewis, 1982).

INTERNATIONAL LEGAL FRAMEWORK

International organizations are trying to regulate and prevent all forms of discrimination including discrimination based on age by their own legislation.

The United Nations is definitely the most important international organization trying to prevent any form of discrimination. The *Universal Declaration of Human Rights* of 1948 (Official Gazette, International Agreements No. 12/2009) explicitly emphasizes equality of all people by birth and all rights regardless of skin color, race, sex and certain other circumstances. There are also the *United Nations Convention on the Rights of the Child* of 1989 (Official Gazette, International Agreements No. 12/93.), which applies the latter acts to every child, the *Convention on the Elimination of All Forms of Discrimination against Women* (1979, Official Gazette - International Agreements No. 12/93.), which prohibits any form of discrimination against women, and of course the *Convention concerning Discrimination in Respect of Employment and Occupation* (1958, Official Gazette - International Agreements No. 2/94.), which prohibits any form of discrimination in employment in general. In the Republic of Croatia, international legal framework in general is of great importance as International Agreements are above the law and all laws must be adopted in accordance with the Croatian Constitution and International Agreements to which Croatia is a party.

THE EU LEGAL FRAMEWORK FOR PREVENTING ALL FORMS OF DISCRIMINATION

By its own legal framework, the European Union has been trying for years to suppress any form of discrimination on the European territory. The main legal sources in this area are the following four directives:

- *Council Directive 2000/78/EC* of 27 November 2000 establishing a general framework for equal treatment in employment and occupation (OJ L 303, 2.12.2000),
- *Council Directive 2000/43/EC* of 29 June 2000 implementing the principle of equal treatment between persons irrespective of racial or ethnic origin (OJ L 180, 19.7.2000),
- *Council Directive 2004/113/EC* of 13 December 2004 implementing the principle of equality between men and women in the access to and supply of goods and provision of services (OJ L 373/37, 21.12.2004), and
- *Directive 2006/54/EC* of the European Parliament and of the Council of 5 July 2006 on implementing the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation (OJ L 204/23, 26.7.2006).

- Within the framework of the Council of Europe, we should definitely mention the 1950 *European Convention for the Protection of Human Rights and Fundamental Freedoms* (Official Gazette - International Agreements Nos. 6/99 and 8/99.).

NATIONAL LEGAL FRAMEWORK FOR THE PREVENTION OF DISCRIMINATION

As a social state, the Republic of Croatia also prohibits any form of discrimination by its own regulations. The *Constitution of the Republic of Croatia* (Official Gazette Nos. 56/90, 135/97, 8/98, 113/00, 124/00, 28/01, 41/01, 55/01, 76/10, 85/10, and 05/14.) is the fundamental law which explicitly prohibits all forms of discrimination. The *Anti-discrimination Act* (Official Gazette Nos. 85/08 and 112/12.) is a basic act in the fight against all forms of discrimination that ensures the protection and promotion of equality as the highest value in the constitutional order of the Republic of Croatia. The *Criminal Code* (Official Gazette Nos. 125/11 and 144/12.) and the *Criminal Procedure Act* (Official Gazette Nos. 152/08, 76/09, 80/11, 121/11, 91/12, 143/12, 56/13, 145/13, and 152/14.) govern criminal offenses related to discrimination and entitles everyone to the right to equal treatment regardless of any differences. There is also the *Labor Act* (Official Gazette 93/14), which prohibits discrimination in employment and occupation.

As we recall from earlier, ageism does not imply only elderly but it applies to stereotypes and prejudice directed at the young. This is particularly true when it comes to emloyment and work in general. Young people who intend to get a job will have difficulty finding a job because potential employees often require work experience that young people do not have. But, how would any young person get work experience if he/she has not been hired by anyone? Unfortunately, these are factual and not legal issues because legislation does not regulate the same issues accurately or it does not regulate them at all. The very same shortcoming in legislation is a great opportunity for the implementation of this type of discrimination. Some studies show that in Croatia the likelihood of employment of youth up to 24 years of age is 39.6%, and of persons aged 25 to 34 years it is 44.4% (Bayley, 2006: 85). Youth unemployment in Croatia has never been below 32%, but it is slowly declining. Also, employers are often inclined to lay off workers older than fifty, due to the opinion that they often tend to be sick, that they will soon have to be replaced by others due to their retirement, etc. This

offends the honor of employees in relation to their occupation to which they have very likely dedicated almost their entire lives. In the aforementioned *Labor Act,* the legislator is trying to protect persons with more experience so that in the event of excess workers, the employer can lay off only those persons with less work experience. Unfortunately, this provision is often violated discriminating in this way older employees. With a new wave of an active employment policy, vocational training is provided only for persons who are under twenty-five years of age, and who have just completed their education (Puljiz, 2008: 197). In that respect, age-based discrimination concerns the violation of the fundamental human right to honor and dignity. Furthermore, very often employers make work-related differences by age groups. Young people are by far most commonly found in the service sector, especially in occupations that rely on direct contact with customers. Such occupations do not require special knowledge and skills, but rather innate emotional labor, attractiveness and communication skills.

Older persons are found as leaders, managers and experts, and particularly in the field of agriculture and as machine operators (Matković, 2008: 494). The situation in the last few years is taking its toll because of the economic crisis, and employers were forced to lay off a number of workers, who were mostly older than fifty. A young person is rarely seen in the streets, taking part in various workers' strikes.

In addition to the area of labor and employment, age-based discrimination is also found in other domains of human social action. Few years ago, a racial discrimination scandal was recorded in the Miss Universe Croatia Pageant, but very little is said about constant age-based discrimination. According to the Miss Universe Croatia rules, women younger than 18 and older than 27 cannot apply for the pageant. A woman's beauty, physical attractiveness and intellect, which also enters the same competition, cannot and must not be measured in years. The provision that a woman must be over 18 years old is understandable because a woman younger than 18 is too young to take part in such an event. However, the other age determinant, the one stipulating that a woman must not be older than 27, needs a comment. A woman can be beautiful and attractive in her thirties and even in her later years: There is no age limit on beauty just a perception of it. Organizers of the beauty pageant have very easily and indirectly implied that beautiful women are only the ones older than 18 and younger than 27, which is not tre and is considered as a stereotype leading to discrimination. Discrimination based on age was also present in the Family Act (Official Gazette

Nos. 116/03, 17/04, 136/04, 107/07, 57/11, 61/11, 25/13, and 05/15) until 2007. The provision pursuant to which the adoptive parents could not be older than 35 was definitely not in line with contemporary family principles because today a family with descendants is often founded when both partners are in their thirties. For the same reasons, the provision in question was amended in 2007 by a novel with no upper age limit for adoptive parents. However, until the recent changes in 2015, discrimination based on age existed in the Road Traffic Safety Act (Official Gazette Nos. 67/08, 48/10, 74/11, 80/13, 158/13, 92/14, and 64/15) in the provisions relating to young drivers (up to 24 years of age) who were not allowed to operate a vehicle whose power was greater than 80 kW. This provision was deleted, but a certain kind of discrimination still exists. Pursuant to the currently applicable Act, young drivers are persons up to 24 years of age who are not allowed to e.g. drive more than 80 km/h on a road and 100 km/h on a road intended exclusively for road motor vehicles and 120 km/h on a highway. The term "young driver" should be used for people of all ages who have just passed a driving test, and the main criterion should be driving experience and not age.

Hypothetically, is there a difference between a driver who passed the driving test immediately when he/she turned 18 and a driver who took the driving test just one day before his/her 24th birthday, or a driver who passed the driving test at the age of 35 or even later? The difference exists only in age, while driving experience of all three drivers is equal. Thus, one cannot conclude that drivers aged 18-24 years are worse than other drivers.

The problem of age-based discrimination is one of the hottest social problems, but it has not reached its peak. For the same reasons, governments of a number of countries are trying to act preventively on the overall situation through various measures such as harmonization of policies and practices to improve the understanding of issues related to discrimination, developing the skills of effective prevention of discrimination, strengthening the means of action and support organizations to share information and best practices, networking at European level, taking into account the specific characteristics of the different forms of discrimination and promoting and spreading the values and practices that are essential in the fight against discrimination, including campaigns that raise awareness of this problem (Bilić, 2007: 565). One such campaign was launched in the Republic of Croatia through cooperation of the Ministry of the Interior and the Organization for Security and Cooperation in Europe (OSCE).

At a roundtable on combating hate crimes (based on all forms of discrimination), the participants agreed to further strengthen their cooperation in the said area. On 23 October 2006, in Dubrovnik, the Ministry of the Interior of the Republic of Croatia and the ODIHR (the Office for Democratic Institutions and Human Rights of the Organization for Security and Cooperation in Europe) signed a *Memorandum of Understanding* on combating hate crimes. Due to the same cooperation, advanced training on combating and preventing hate crimes took place at the Police Academy in Zagreb. The training was attended by 9 police officers who gained knowledge and skills to become training instructors who will in the coming period continue to train other police officers (Ministry of the Interior of the Republic of Croatia, 2012). However, six years have passed since this campaign, and we cannot confirm that certain things have changed radically. Positive changes, such as the novel to the 2007 Family Act, are taking place, but very slowly. A certain number of years will be necessary to establish the rule of law in the society we live in, and, accordingly, the right to equality of all citizens regardless of all our differences which, based upon the Latin saying *Varietas delectat* (eng. Variety is delighting), can make the world more beautiful and joyful.

CONCLUDING REMARKS

Age discrimination, i.e. ageism has drawn attention of many academic scholars but mostly in the field of sociology, psychology and gerontology which is not surprising taking into consideration of their field's focus. However, since the effects of age discrimination are evident in many areas of human life, there is a need to intensify research on ageism from the perspective of other social sciences such as economics and law. By dealing the issue of ageism in terms of gender, disability, political economy or particular laws, one could better understand the ageism and its effects in the society.

When it comes to the field economics dealing with age discrimination, the majority of discussions are in term of workplace and employment law. It would be of advantage to research ageism in the context of political economy that can offer many "venues" in terms of ideological approaches including neo-liberalism or classical liberalist. The same holds true for the field of law. It would be quite beneficial if ageism is examined in term of various theoretical approaches such as, for example, feminist legal theory, critical races theory, mental health law theory and the like.

While the theoretical research significantly contributes to the understanding of the ageism, why it arise and how it may be remedied, the practical solutions (on the policy level) are even more challenging. Changes attitudes and consequently creating public policies that prevent and/or reduce age discrimination calls for many actions out of which some may include following:

- Education about identifying and preventing ageist attitudes and practices should be incorporated into the diversity programs at the all level of (national) education system – from primary schools to faculties as well as the part of the education in the workplace.
- Refocusing the media attention to older people as active, healthy and successful in their ageing; speaking out when age discrimination arises, publicizing that age discrimination is against the law.
- Lawmakers and policymakers should work on closing the gap between the law on paper and the implementation of the law in the practice; one should promote positive discrimination in terms of affirmative actions of older persons as a legitimate step in the national laws; age perspective should be incorporated in all policy actions targeting to eliminate discrimination on the basis of age;
- Science can contribute to empowerment of older people through scientific projects that focus on the elderly. Such projects should be promoted and financed on the national level since the evidence-based studies can significantly contribute to policy making based upon scientific results.
- Programs that provide and support the care of older people should be ensured in order to make it easier to families and care-givers. Such programs may include tax incentives for formal care or financial aid to care-giver.

Such a list of potential activities does not do justice to the complexity of the battle against the age discrimination, i.e. ageism, but it is an indication of direction that policy developers and legislative drafters should take into consideration when trying to find better ways to advance the wellbeing of all citizens (particularly those subjected to ageism) on the individual or institutional level.

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