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THE UKRAINIAN CONSTITUTION IN THE ERA OF DRASTIC POLITICAL CHANGES

MARINA LAZAREVA *

1.

This study is an attempt of a *Russian researcher* to have a look at the current *constitutional development of Ukraine* through a prism of similar experience of Russia and pressing tasks facing the national constitutional law. In 2013 the Russian Constitution celebrated its 20th anniversary. This was an occasion for experts and political figures yet again to weigh merits and demerits of the Constitution of the country, and to offer ways to improve the constitutional text and its implementation. There are quite a few Russian scientists advocating not just to change certain articles of the Constitution, but also to adopt its new revision.¹

To the moment when this work was being written only three amendments had been made to the Russian Constitution, namely: i) *terms of office of the President and the lower chamber of the Parliament* – the State Duma, were extended;² ii) *responsibility of the Government to submit its annual performance reports* to the State Duma was introduced;³ iii) *the Supreme Arbitration Court was abolished and a procedure for appointing prosecutors* was slightly changed.⁴ Thus, only the latest changes of the Constitution had a nature of the constitutional reform and were related to merger of the Supreme Arbitration Court with the Supreme Court of the Russian Federation. To our opinion other amendments were not so essential.⁵

2.

Taking a look at the constitutional history of Ukraine after collapse of the USSR, undoubtedly there are many common features with the Russian experience. Despite all said by opponents of closeness between Russia and Ukraine, the both countries have much in common in their political, economic and legislative development. The two neighbouring countries have very similar Constitutions, statutory framework as well as overall legal regulation and practice. However, unlike Russia, Ukraine lived through more frequent and drastic constitutional reforms accomplished not only by passing amendment acts to the Constitution.

Until 1991 the Ukrainian SSR was a member state of the USSR. On July 16, 1990 the *Verkhovna Rada* of Ukraine (Ukrainian parliament) promulgated a *Declaration of national sovereignty of Ukraine*.⁶ The Declaration emphasized a necessity to elaborate and adopt a new Constitution and laws of the country on its basis. The Declaration was one of the largest and most detailed documents of the kind among similar documents of the CIS (Commonwealth of Independent States) members. On August 24, 1991 *Act of Independence of Ukraine* was passed, and on December 1, that year it was endorsed by an all-Ukrainian referendum.⁷

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¹ See, for instance, opinion of *Avakjan S. A.*, senior dept. assistant of Lomonosov Moscow State University, associate law professor. *Проекты законов о поправках к Конституции Российской Федерации* [Bill drafts on amendments to the Russian Federation Constitution]. Constitutional and municipal law, 2013, No. 2. p. 20-25.

² The Russian Federation law on amendment to the Constitution dated December 30, 2008 No. 6-ФКЗ «*On changes of terms of office of the Russian Federation President and the State Duma*». Collected laws of the Russian Federation, 05.01.2009, N 1, art. 1, <http://www.rg.ru/2008/12/31/konstitucia-popravki-dok.html> (time of download: 25 May 2014).

³ The Russian Federation law on amendment to the Constitution dated December 30, 2008 No. 7-ФКЗ «*On controlling powers of the State Duma in regard to the Russian Federation Governments*». Collected laws of the Russian Federation, 05.01.2009, N 1, art. 2, <http://www.rg.ru/2008/12/31/duma-pravit-dok.html> (time of download: 25 May 2015).

⁴ The Russian Federation law on amendment to the Constitution dated February 5, 2014 No. 2-ФКЗ «*On the Russian Federation Supreme Court and the Russian Federation prosecution office*». Collected laws of the Russian Federation, 10.02.2014, N 6, art. 548. <http://www.rg.ru/2014/02/07/popravka-dok.html> (time of download: 25 May 2014).

⁵ At different times several changes had been done to Art. 65 of the Constitution which lists names of the Russian Federation subjects. Such changes are made in a simplified order.

⁶ Декларация про державний суверенітет України (Відомості Верховної Ради УРСР (БВР), 1990, N 31, ст.429). Official site of the Verkhovna Rada of Ukraine: <http://zakon1.rada.gov.ua/laws/show/55-12> (time of download: 25 May 2014).

⁷ Постанова Верховної Ради Української РСР Про проголошення незалежності України (Відомості Верховної Ради України (БВР), 1991, N 38, ст.502). Official site of the Verkhovna Rada of Ukraine: <http://zakon1.rada.gov.ua/laws/show/1427-12> (time of download: 25 May 2014).



Drafting of a new Constitution of Ukraine took six years, more than in other former Soviet republics. From 1990 to 1996 composition of special constitutional commissions was changed several times. The situation was aggravated by a conflict of legislative power and the President (this position was introduced among other changes to the Constitution of 1978). This problem was resolved by signing the so-called Constitutional agreement between the Parliament and the President (*"About main initiatives of organization and operation of the state power and local self-government in Ukraine for the period before adoption of the new Ukrainian Constitution"*) on June 8, 1995.⁸

This catalysed the constitutional process, and on 28 June 1996 after long discussions and revisions the Verkhovna Rada of Ukraine approved a new Constitution of the state.⁹ It entered into force on the day of its approval (Art. 160 of the Constitution). The old Constitution of 1978 and the Constitutional agreement ceased to have effect. Laws and other statutory acts passed before the enactment of the Constitution were declared valid insofar as they were not in conflict with it (Clause 1 of Transitional provisions).

3.

The Ukrainian Constitution of 1996 like other post-socialist constitutions was aimed at creating a democratic state and market economy of a modern kind, and at overcoming consequences of the totalitarian statesmanship. It proclaimed Ukraine to be a sovereign, independent, democratic, social and law-based state. An individual, his life and health, honour and dignity, inviolability and safety were deemed to be of the highest social value. According to the Constitution people were carriers of sovereignty and the sole source of power. The Constitution secured the following principles: rule of law, separation of powers, political, economic and ideological diversity. Local self-governments had been established and their competences had been guaranteed. Ratified international treaties were considered a part of the national legislation. It is worth mentioning that universally accepted democratic values were enshrined.

The mode of amendments to the 1996 Ukrainian Constitution is combined, i.e. the different sections are changed under different procedures. Accidentally or intentionally, a similar mode is applied to the Russian Constitution, though the order of its modification is stricter and more complex (Art. 134-136).¹⁰ To amend "usual" sections of the Ukrainian Constitution it is required to use the so-called *simple double voting*, when the majority of deputies of the Verkhovna Rada in two successive regular sessions shall vote for the amendments (Art. 155). Changes to the "protected" sections such as Section 1 "*Main provisions*", Section III "*Elections. Referendum*" and Section XIII "*Introducing amendments to the Constitution of Ukraine*" must be approved not only by the Parliament but also by the nation in the all-Ukrainian referendum (Art. 156).

It turns out that the Verkhovna Rada of Ukraine is a mandatory participant of any constitutional reform, alongside with the Constitutional Court which draws a *conclusion* that a bill draft about an amendment does not envisage to abolish or limit rights and freedoms of man and citizen and to exterminate independence and territorial integrity of Ukraine (Art. 157-158). As for the role of the President in the above process he has the right to initiate constitutional changes (applicable to any section of the Constitution), and also has powers to set a referendum over an amendment of the Constitution, but only after it has been approved by the Verkhovna Rada.

Adoption of the 1996 Ukrainian Constitution was a stabilizing factor in the political life of the country. Unfortunately a confrontation within the ruling elite almost nullified its positive potential. Ukrainian experts say that nearly twenty years of the state construction bear witness that all presidents of the country made repeated attempts to expand power of the head of the state at the cost of weakening relevant functions of the Parliament and the Government. Virtually every year (except for 1999 and 2005) they

⁸ Конституційний Договір між Верховною Радою України та Президентом України про основні засади організації та функціонування державної влади і місцевого самоврядування в Україні на період до прийняття нової Конституції України (Відомості Верховної Ради (ВВР) 1995, N 18, ст.133). Official site of the Verkhovna Rada of Ukraine: <http://static.rada.gov.ua/NEWSAJT/site/const/dohovir.html> (time of download: 25 May 2014).

⁹ Конституція України (Відомості Верховної Ради України; ВВР), 1996, № 30, ст. 141). Official site of the Verkhovna Rada of Ukraine: <http://zakon2.rada.gov.ua/laws/show/254%D0%BA/96-%D0%B2%D1%80> (time of download: 25 May 2014).

¹⁰ "The Constitution of the Russian Federation" (approved by a nationwide vote on 12 December 1993) (considering the amendments introduced by the Russian Federation laws on amendments to the Constitution dated 30 December 2008 N 6-ФКЗ, 30.12.2008 N 7-ФКЗ, 05.02.2014 N 2-ФКЗ). <http://www.constitution.ru/> (time of download: 25 May 2014).

strived to pass a bill on amendments of the Ukrainian Constitution through the Verkhovna Rada or a referendum.¹¹

Significant changes to the Ukrainian Constitution were made during the so-called 'Orange revolution' at the end of 2004 when negotiations between main political powers of the country resulted in a decision to hold a third round of presidential elections and at the same time to limit powers of the president, specifically those related to forming a Government. On December 8, 2004 the Verkhovna Rada passed *Law No. 2222 About amendments of the Ukrainian Constitution* which strengthened the parliamentary element in the mixed form of government of this state.¹²

In the initial revision of the Ukrainian Constitution a pattern for forming a Government almost replicated the Russian pattern, i.e. the president appointed a prime minister with consent of the parliament majority and he appointed other members of the Government upon recommendation of the prime minister (Art. 114 of the 1996 Ukrainian Constitution). So, the role of the parliament was minor. According to the constitutional amendments of 2004 a *coalition of deputy factions* is formed in the Verkhovna Rada as a result of elections and on the basis of aligned political positions. The faction includes majority of people's deputies out of the constitutional composition of the Verkhovna Rada. This coalition of deputy factions has the right to recommend not only a prime minister but also other members of the Cabinet of ministers (Art. 83). Moreover, correlation of forces in this procedure has changed: now the Verkhovna Rada appoints a prime minister upon recommendation of the president and it appoints other members of the Government upon recommendation of the prime minister (Art. 114). The parliamentary element was further enhanced by a constitutional prohibition for deputies to exit from or not to join a faction of the political party which elected them to the Rada (Art. 81). In reality however the 2004 amendments caused more imbalances in the existing relations between highest government authorities and did not bring a complete solution to the problem of a strong presidential power.

4.

The next major change of the Ukrainian Constitution was the *Ruling of the Constitutional Court on 30 September 2010*, when the Court decreed to deem the 2004 amendments to be non-compliant with the Constitution (this happened even after numerous use and interpretation of certain constitutional provisions by the Court itself) and to reinstate the previous revision of the Constitution.¹³ The Court reasoned that these amendments were passed with violation of the procedure because not all amendments were scrutinized by the Constitutional Court. Even if we set aside the political vector such a step made by a body of constitutional control had an ambiguous character. Firstly, the Ukrainian Constitution implies that the Constitutional Court has no right to reinstate previous revisions of the Constitution. Secondly, it appeared that non-constitutional provisions had been in force for long six years in the country.

A turn of events final to this date but not final in the history of the Ukrainian Constitution happened in February 2014 when the Verkhovna Rada voted for reinstatement of the 2004 Ukrainian Constitution on the ground that in 2010 it was annulled by a ruling of the Constitutional Court, not followed by voting in the Parliament as stipulated by the Constitution.¹⁴ Thus, currently Ukraine has a mixed government with a 'strong' president and a 'strong' parliament which no doubt will lead to yet another constitutional reform in the nearest future.

As a matter of law, the overthrow of Ukraine's President *Victor Yanukovich* was also controversial. The Ukrainian Constitution provides only four reasons for a pre-term termination of powers of a head of the state: voluntary resignation (which shall be held in person at the meeting of the Verkhovna Rada);

¹¹ See: Babenko V.N. *Политические партии и конституционные реформы в Украине (1991-2011)* [Political parties and constitutional reforms in Ukraine (1991-2011)]. Parties and electorate in Central and Eastern Europe (2000 – 2010): Collected scientific works/ РАН. ИНИОН. М., 2012. p.153.

¹² Закон України Про внесення змін до Конституції України (Відомості Верховної Ради України (ВВР), 2005, N 2, ст.44). Official site of the Verkhovna Rada of Ukraine: <http://zakon3.rada.gov.ua/laws/show/2222-15> (time of download: 25 May 2014).

¹³ See: Shcherbanyuk O.V. *Народный суверенитет как приоритет современной конституционно-правовой политики Украины* [National sovereignty as a priority of the modern constitutional and legal policy of Ukraine]. Constitutional and municipal law, 2013 No. 2. p.78.

¹⁴ Закон України Про відновлення дії окремих положень Конституції України (Відомості Верховної Ради (ВВР), 2014 No. 11, ст.143). Official site of the Verkhovna Rada of Ukraine: <http://zakon1.rada.gov.ua/laws/show/742-18/paran2#n2> (time of download: 25 May 2014).

impossibility to perform duties due to health problems; as a result of impeachment (this is a rather complicated and well regulated procedure); or death (Art. 108-111). None of the above mentioned reasons took place. In such conditions it is interesting to note a method used in this political situation. On February 22, 2014 the Verkhovna Rada passed a resolution that “President of Ukraine V. Yanukovich removed himself from implementation of the constitutional powers which poses a threat to governability of the state, territorial integrity and sovereignty of Ukraine, massive violation of rights and freedoms of citizens”.¹⁵ This resolution scheduled early elections of the president.

Taking into account the previous constitutional development of Ukraine, political events in the late 2013 and early 2014 shall be highlighted. Many people call these events either a revolution or a *coup d'état*. It is commonly known that revolutions and *coup d'état* are not legal ways to change power, they are not regulated by the constitutional or legal provisions. On the contrary, revolutionary events violate law, devalue it and above all the constitutional branch of law. On the other hand, it is evident that to normalize the political situation in the country which passed through a *coup d'état* it is required to have a universal regulator of public relations such as law. A new constitutional and other legal provisions shall be created not only by agreement reached within a ruling elite, but they shall rest upon a wide public support, including the ruling forces and the opposition.

Having a look at the existing Ukrainian Constitution, a number of *areas of tension* can be distinguished, i.e. constitutional provisions under a real danger of being violated or which are explicitly violated on the territory of the country.

First of all, we should refer to Art. 8 stipulating that Ukraine recognizes and applies the principle of the rule of law. The Ukrainian Constitution has the highest legal power and its provisions have a direct effect. On the basis thereof, all subjects of legal relations and in particular highest state authorities shall abide by the Constitution, irrespective of any circumstances, even emergencies, like those which took place in the centre of Kiev or Odessa, or in the South-East of the country. Under Art. 68 everybody shall rigorously adhere to the Constitution and laws of Ukraine, and *shall not encroach on human rights and freedoms, honour and dignity of other people*. Under Art. 5 of the Constitution people are carriers of sovereignty and the sole source of power in Ukraine. This section reads as follows: “right to define and change the constitutional form of government belongs solely to people and cannot be usurped by a state, its authorities or officials. Nobody can usurp the state power.” The Ukrainian Constitution does not give the right to the people to resist oppression and to rise in revolt as it is written in the constitutional documents of the USA. But if the massive part of the public is strongly dissatisfied with actions of state authorities as it was witnessed in Kiev back in the late 2013, then the opinion of the people shall not be ignored by the authorities.

5.

Certainly, today the most gruelling issue in Ukraine is the so called ‘*ethnic problem*’. Under Art. 10 of the Constitution “in Ukraine there is free development, use and protection of the Russian and other languages of *ethnic minorities* of Ukraine”. Art. 11 states that “state shall facilitate development of ethnic, cultural, linguistic and religious identity of all indigenous peoples and ethnic minorities of Ukraine”. These provisions imply that the Russian language has no status of the second official language along with the Ukrainian language, despite its wide spread, especially in the South-East of the country. It is called “the language of ethnic minorities”.

Besides, in the light of events of the spring 2014 it must be mentioned that a separate article of the Ukrainian Constitution is dedicated to a status of national Armed forces (Art. 17). Not every constitution has such provisions. For example, the 1993 Russian Constitution has no such norms. Among other things this article envisages that “Armed forces of Ukraine and other military functions cannot be used by anyone to limit rights and freedoms of citizens.” Furthermore, the same article of the Constitution says that on the Ukrainian territory it is prohibited to form and operate any armed organization not specified by the law. Under Art. 37, political parties and public interest organizations cannot have armed functions.

Hence, it is instructive to recall that unlike the Constitution of the United States, which proclaims the right to bear arms as the main constitutional right, there is no such a right in the Ukrainian Constitution.

¹⁵ Постанова Верховної Ради України Про самоусунення Президента України від виконання конституційних повноважень та призначення позачергових виборів Президента України (Відомості Верховної Ради (ВВР), 2014, № 11, ст.158). Official site of the Verkhovna Rada of Ukraine: <http://zakon1.rada.gov.ua/laws/show/757-VII> (time of download: 25 May 2014).

Moreover, Art. 60 of the Ukrainian Constitution runs that “no one is obliged to carry out explicitly criminal commands or orders. Issuance and implementation of an explicitly criminal command or order entails legal liability”.

In sum, this short overview notes that the Constitutions of Ukraine and Russia have one thing in common: they underwent formally only three or four reforms, and this does not come as a surprise because since their adoption very little time has passed. However, if amendments to the Russian Constitution were not so large-scale, the Ukrainian Constitution experienced significant changes, especially in 2004, 2010 and 2014. The common denominator of the constitutional reforms of the both countries is that they exclusively touched upon *a status of government authorities* and “were not aimed at expanding existing freedoms of citizens or changing approaches in the area of economics and development of a civil society”.¹⁶

A certain role was played by the Constitutional Courts, and meanwhile the Russian Court used its power to interpret provisions of the Constitution eleven times (1995-2000), its Ukrainian colleague – sixty seven times (1997-2014, excluding only 2006 when there were no Court interpretations of the Constitution).¹⁷ The Russian Court scrutinized mostly issues pertaining to activity of highest government authorities, legislative process, amendments to the Constitution and territorial arrangement. On the contrary, the Ukrainian Constitutional Court interpreted almost all sections of the Constitution, including a section about a social order and human rights.

6.

Now the both countries are facing the same task of not just choosing and accepting an *ideal* legislation, but making an attempt to implement the *already accepted* proper law constructions, particularly in the sphere of human rights, forms of direct democracy, competitive market economy, and independence of courts. Art. 48 of the Ukrainian Constitution can serve as an example of such a regulation. This article says that “everybody has the right to a sufficient standard of living for him and his family, including enough food, clothes and residence”. There is no question if this provision is good or bad, if it is required or not to forgo such wide social guarantees. In the age of a continuing global economic crisis and an increasingly lower standard of living even in advanced countries, it is pressing for authorities not only to perform institutional adjustments, but also to make an effort to fully implement the existing legislation which equally meets global standards of human rights. People of the post-Soviet countries and their ruling elite must get used to living *in compliance with legal regulations*, and foremost with the Constitution and laws, at the end of the day this will help to unlock the positive potential enshrined in the current legislation.¹⁸

¹⁶ Barabash Y. *Опыт конституционного реформирования в Украине: в поисках европейского идеала* [Experience of constitutional reforming in Ukraine: in search of a European ideal]. Comparative constitutional review, 2014, No. 1 (98). p. 32.

¹⁷ Конституція України (Відомості Верховної Ради України (ВВР), 1996. No. 30, ст. 141) // Official site of the Verkhovna Rada of Ukraine: <http://zakon2.rada.gov.ua/laws/show/254%D0%BA/96-%D0%B2%D1%80> (time of download: 25 May 2014).

¹⁸ See, Strashun B. Конституция России – среда обитания, требующая рационального использования [Constitution of Russia – habitat requiring a rational use]. Constitutional law. East European Review, 1999, No. 4 (29). p.145.

PATERNALISM AND PUBLIC POLICY*

ANTAL SZERLETICS**

1. INTRODUCTION

The phenomenon of paternalism permeates public relations and private life as well. Take, for instance, the case of a benevolent father who prohibits his children to play outdoors on a freezing winter day because he is afraid that they will catch a cold. The state – analogously to a benevolent father – may prescribe the compulsory use of seat belts or prohibit the use of dangerous narcotics to protect citizens from the harmful consequences of their own poor decisions. For sure, benevolent intentions matter, but there is a strong, commonly accepted liberal presumption against someone else, including the state and its agents, determining the right course of action for a competent individual. Thus, it seems centrally important to determine relevant arguments that can be used to justify legal paternalism in democratic societies. In what follows, the study examines various aspects that need to be taken into account when justifying paternalistic public policies. The article starts with a conceptual analysis of paternalism including the identification of possible definitional elements. In the second part, the work proceeds to justificatory issues and introduces the consequentialist and the autonomy-based approaches to justification and examine why and under what circumstances the state should be seen as a better decision-maker than the individual. In the final part, it explores how policy-makers can use the non-coercive methods of libertarian paternalism to ‘nudge’ people to make better (i.e. more beneficial and less self-harming) decisions in their everyday lives.

2. CONCEPTUAL ISSUES

There have been many attempts to define paternalism.¹ Paternalism is not a ‘natural kind’² and – seeing the huge amount of complex and often conflicting definitions – one is tempted to give a stipulative definition of the concept.³ Presumably, this would preclude possible debates over the definition’s correctness because stipulative definitions are arbitrary in the sense that they assign a meaning to a word for the first time.⁴ However, the word ‘paternalism’ has acquired a meaning in ordinary language use and it seems necessary to test the meaning of definitions against the colloquial meaning of the word – even if this is quite vague and uncertain. This correspondence is important but a ‘good’ definition will have to

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¹ A complex definition given by Gerald Dworkin looks like the following. “X acts paternalistically towards Y by doing (or omitting) Z if and only if: (1) Z (or its omission) interferes with the liberty or autonomy of Y; (2) X does so without the consent of Y; (3) X does so just because doing Z will improve the welfare of Y, or in some way promote the interests, values, or good of Y.” Dworkin, Gerald: *Defining Paternalism*. In: Coons, Christian – Weber, Michael (eds.): *Paternalism – Theory and Practice*. Cambridge University Press, Cambridge, 2013, 29. The same definition appears under the “Paternalism” entry of the Stanford Encyclopedia of Philosophy. Dworkin, Gerald: *Paternalism*. In: Zalta, Edward N. (ed.): *The Stanford Encyclopedia of Philosophy*. Summer 2014 Edition. Available at: <http://plato.stanford.edu/archives/sum2014/entries/paternalism/> (3 December 2014).

² Dworkin: *op. cit.* 38. According to the Stanford Encyclopedia of Philosophy, a “kind is natural is to say that it corresponds to a grouping or ordering that does not depend on humans.” Bird, Alexander – Tobin, Emma: *Natural Kinds*. In: Zalta, Edward N. (ed.): *The Stanford Encyclopedia of Philosophy*. Winter 2012 Edition. Available at: <http://plato.stanford.edu/archives/win2012/entries/natural-kinds/> (3 December 2014).

³ Dworkin: *op. cit.* 31.

⁴ Hurley, Patrick J.: *A Concise Introduction to Logic*, Ninth Edition. Thomson Learning Academic Resource Center – Wadsworth, Belmont, 2006, 88.



satisfy a number of other expectations as well; a definition will be judged according to e.g. its consistency, its context and the set of problems it is used to clarify and resolve.⁵

The word ‘paternalism’ carries negative connotations and it is often considered to be morally wrong. People are regularly criticized for being too paternalistic and public policies are frequently attacked under the banner of anti-paternalism by political opponents. The two most common explanations given for the concept’s negative normative content are the impermissible intentions behind paternalism and its coercive character.⁶ It seems to me that the violation of autonomy is implicitly associated with most paternalistic interventions⁷ and any definition that retains autonomy as a central element already implies something for the justification of the concept. Consequently, it is not merely a theoretical question how someone defines paternalism: if something qualifies as paternalism, chances are high that it will be subject to a more rigorous scrutiny. It might be easier to accept an intervention that is not labelled as ‘paternalism’ because it falls outside the scope of the definition.

Gerald Dworkin, in his latest contribution, gives an excellent overview of the different dimensions along which definitions of paternalism might vary (e.g. outcomes vs. motives, motives vs. reasons, acts vs. omissions, violation of autonomy, etc.).⁸ Most definitions seem to share the same fundamental concepts but place emphasis on different dimensions. My understanding is that paternalism can be conceptualized with the help of two additional concepts: autonomy and benevolence. Roughly, paternalism can be defined as interference with someone’s autonomy in order to protect this person from self-induced harm and/or to promote his benefit. It is worth mentioning that we cannot and should not strive for a ‘perfect’ definition: a rough definition, such as this one, might be useful to circumscribe the area of examination but it cannot be complete without giving a settled definition of the other concepts (autonomy, benevolence, harm, benefit, etc.).

An important question that needs clarification is what the term ‘paternalism’ is predicated of: acts, people, institutions, motives, legal regulations, policies can all be paternalistic. People act paternalistically in private relations, for example a husband who hides the sleeping pills from his suicidal and depressed wife. Legal regulations that allow the sectioning of potentially self-harming mentally ill patients also have a paternalistic character. Yet, the two scenarios are quite different from each other. *John Kultgen* talks about public and private paternalism in this respect and warns us that justified forms of public paternalism might not exactly parallel justified cases of personal paternalism.⁹ Abstract legal regulations treat people in a standardized way and they are less responsive to individual circumstances. Thus, it seems that the justification of paternalistic public policies and legal regulations requires ‘more’ than a single act of private paternalism e.g. from the perspective of democratic accountability. In what follows, the study tries to explore elements that need to be taken into account when justifying paternalistic public policies.

3. JUSTIFYING PATERNALISTIC PUBLIC POLICIES

Due to the interference with individual autonomy, paternalism is a ‘frightening prospect’ for many.¹⁰ However, most people do not deny that paternalism might be justifiable, or even necessary in certain situations.¹¹ The two major factors that are generally taken into account when it comes to the justification of paternalism are the beneficent consequences of the intervention and the autonomy of the person subjected to paternalism. Putting it very simply, it seems that the more beneficent and the less intrusive a paternalistic intervention is, the easier it is to accept it as morally non-problematic.

⁵ Dworkin: *op. cit.* 25.

⁶ Cornell, Nicolas: *A Third Theory of Paternalism*. In: *Michigan Law Review*, Vol. 113. (2015). Paper available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2456419 (3 December 2014).

⁷ It is a debated question whether the violation of autonomy is a necessary element of paternalism. Dworkin: *op. cit.* 27.

⁸ *Ibid.* 26-28.

⁹ Kultgen, John: *Autonomy and Intervention – Parentalism in the Caring Life*. Oxford University Press, New York, 1995, 161.

¹⁰ Conly, Sarah: *Against Autonomy – Justifying Coercive Paternalism*. Cambridge University Press, Cambridge, 2013, 182.

¹¹ The approach of “absolute anti-paternalism” contends that paternalism is never justified and imposes a blanket prohibition on all forms of paternalistic interventions. Kultgen: *op. cit.* 132. The author tends to agree with Conly that those who reject all forms of paternalistic constraints may have “a quite unrealistic picture of human ability” (i.e. the presumption that people are always capable of making perfect choices) and a ‘morally unjustified sense that people deserve to suffer for their own mistakes.” Conly: *op. cit.* 182. Even John Stuart Mill, often considered the “greatest enemy” of paternalism admits certain exceptions to the “harm principle”. See e.g. Mill’s example about crossing an unsafe bridge in Chapter V of *On Liberty*.

Autonomy-based approaches are friendlier to ‘softer’ forms of paternalism that do not interfere with the decision-making of individuals – often because the given person is incapable of making fully autonomous decisions in the first place, either due to mental incapacity or the lack of relevant information that would be necessary to make a fully informed decision. A major distinction, from the perspective of autonomy-based justifications, is the distinction between hard and soft paternalism. In *Joel Feinberg’s* terminology, hard paternalism advocates coercion to protect competent adults against their voluntary self-harming choices. Soft paternalism, on the other hand, allows protection from self-regarding harmful conduct, if ‘the conduct is substantially non-voluntary, or when temporary intervention is necessary to establish if it is voluntary or not’.¹² Feinberg’s proposition that soft paternalism is acceptable while hard paternalism is not seems to correspond to our basic moral intuitions as an ‘ethical minimum’: there is nothing wrong with stopping a child or a mentally ill person from harming himself or herself, while the same is not necessarily true for competent adults making voluntary self-harming decisions. Thus, Feinberg’s account of paternalism roughly comes down to the question what makes a choice ‘substantially’ voluntary or non-voluntary. Voluntariness, however, seems to be an elusive concept, partly because it is tied to other complex, vague and often contested concepts as mental capacity and human rationality.¹³ For example, seemingly irrational self-harming choices might be explained with the different values and personal preferences of people;¹⁴ they are not necessarily attributable to errors in someone’s reasoning capacities.

Consequentialist justifications focus on the outcome of paternalistic interventions. This means that paternalism is morally justifiable if it leads to ‘good’ consequences for the paternalised person or – in other words – if it serves his or her ‘best interests’. The question is how to determine what is actually ‘good’ for the individual: some claim that there are objective elements of well-being that every human being wants to possess (e.g. health), while others claim that these elements are essentially subjective and it is only someone’s revealed preferences that should be promoted through paternalism.¹⁵ When it comes to the justification of paternalism in practice (particularly state-implemented public policies), we cannot limit ourselves to merely one of the previously mentioned models. The study hereby considers a few elements that seem to complicate the picture. (1) Consequences and respect for individual autonomy are usually both taken into account when evaluating the acceptability of paternalistic interventions. It seems to me that neither approach has a fixed priority over the other but priority varies on a case-by-case basis. Consequences often ‘relativize’ other considerations when it comes to public policies and legislation but autonomy can be thought of as constituting a ‘deontological side-constraint’ that reference to consequences cannot override.¹⁶ The question is how to strike a balance between the two values and through what kind of democratic process is it possible to persuade people about the correctness of a paternalistic state action. (2) The rationale behind a paternalistic action is often ‘mixed’ in the sense that the actor might have motives other than benevolent protection to act paternalistically. This is particularly true for the state that has to take multiple reasons into account multiple reasons when regulating complex social issues (e.g. protection of the individual, protection of others, public order, morals, etc.). Actually, it seems that there are very few unmixed cases of paternalism. Even in an apparently ‘pure’ case (e.g. prescribing motorcyclists to wear crash helmets), one can refer to the indirect harm caused to other members of society (e.g. by the additional social security expenses that incur in case of an accident).¹⁷ (3) The state as a paternalistic actor has different characteristics than an ‘ordinary person’ acting paternalistically in the private domain. The state, as mentioned before, is more ‘distant’ from the paternalistic situation and intervenes through abstract regulations that leave less space for appreciating the

¹² Feinberg, Joel: *The Moral Limits of the Criminal Law – Harm to Self*. Oxford University Press, New York, 1986, 12.

¹³ The traditional view of human rationality is increasingly challenged in light of the findings of cognitive psychology and behavioural economics (cf. the issue of libertarian paternalism later in this article). Mental capacity is also a contested concept: the line between capacity and incapacity often seems vague and arbitrary.

¹⁴ The classical example here is the example of Jehovah’s Witnesses (Christian Scientists) who reject blood transfusions for religious reasons even in life-threatening emergencies. Their choice seems irrational from an external perspective but it is questionable whether blood transfusions can be forcibly administered to them. See e.g. Dworkin, Gerald: *Paternalism*. In: *The Monist*, Vol. 56. (1972), No. 1, 66.

¹⁵ Dan Brock distinguishes between “desire” and “ideal” theories of good that roughly corresponds to the subjectivist-objectivist distinction. Brock, Dan: *Paternalism and Promoting the Good*. In: Sartorius, Rolf (ed.): *Paternalism*. University of Minnesota Press, Minneapolis, 1983, 250.

¹⁶ Similarly to Ronald Dworkin’s idea that rights should be conceived as “trumps” that have priority over non-right based social objectives.

¹⁷ This issue is closely related to the distinction between self-regarding and other-regarding acts.

particularities of each case. On the other hand, there are certain factors that make the state a ‘wiser’ decision-maker than the individual. These are explored in the following paragraphs

Bill New examines the justification of paternalistic public policies in economic terms.¹⁸ He argues that contrary to the traditional liberal theory, the state may sometimes be a better judge of welfare than the person himself.¹⁹ It is possible to identify failures in human reasoning and it seems that the state and its officials might be able to reason better in certain situations.²⁰ New distinguishes four such failures. First, individuals might make sub-optimal choices because the amount of information needed is so great or because the ‘causal connections between choice and outcome are difficult to make’.²¹ Human intellect is limited and this leads to a ‘technical inability’ to make good decisions in complex situations. Secondly, people neglect to act in accordance with their best interests (i.e. long term preferences) due to weakness of will (*akrasia*) – consider the example of a heroin addict who wants to stop using the drug but cannot do so because of his addiction. Thirdly, humans are often prone to emotional decision-making, for example ‘becoming attached to making certain choices, such as following a habitual route to work, even if it is longer or less attractive than an alternative one’.²² Finally, people sometimes lack first-hand experience with respect to the consequences of their potentially self-harming decisions; even though most smokers have an ‘abstract’ knowledge of the harmful consequences of cigarettes, they do not have experience of the pain and suffering that smoking-related illnesses will potentially cause to them.

New argues that the state is less susceptible to such failures in reasoning and a paternalistic state policy can be justified if it is shown to produce better outcome than individual choice and if the increase in welfare is sufficient to compensate for the violation of autonomy that the intervention entails.²³ The state can be considered to be more impartial (‘phlegmatic’) than an individual and therefore more resistant to temptation, weakness of will and emotional decision-making: choosing between a luxurious holiday in the present and saving for retirement in the future is obviously less difficult for the ‘impartial’ state than for the person concerned. New claims that the state and its employees also have a wider perspective when it comes to experiences related to possibly self-harming activities. Although public employees (e.g. doctors, nurses, etc.) do not directly experience the negative effects of not wearing a seat belt, they are still in a better position to make a judgment on the harmful consequences of accidents and the prudence of seat belt wearing than ordinary drivers. Finally, relating to the technical inability of individuals to make decisions in complex situations, the state has the advantage to employ experts who can devote themselves to the problem full-time. With the help of experts, the state has a better knowledge of the situation than ordinary citizens.

Response to New’s article further nuances the conditions of acceptable state paternalism.²⁴ Authors argue that it is important to distinguish between those who know that they suffer from a failure of reasoning and those who do not. The ‘sophisticated akratic’ knows that he faces weakness of will in certain situations and he will probably adopt some form of pre-commitment strategy to deal with the problem.²⁵ State intervention is necessary only for the ‘myopic akratic’, the person who is unaware that weakness of will constitutes a problem for him. The same stands for people’s technical inability to make decisions in complex situations. Those who realise their technical inability will hire experts to help with unfamiliar or complex decisions (e.g. medical, legal or investment decisions).²⁶ State paternalism is

¹⁸ New, Bill: *Paternalism and Public Policy*. In: *Economics and Philosophy*, Vol. 15. (1999), Issue 1, 63. The article is also included in the appendix of New’s doctoral thesis available at http://etheses.lse.ac.uk/833/1/New_Justifying_state_interventions_the_case_of_paternalism.pdf (3 December 2014). Page numbers in the footnotes refer to this version of the article.

¹⁹ According to *Mill*’s assumption, the individual always knows best what is good for him, therefore any external intervention aimed at improving someone’s welfare is likely to be a failure.

²⁰ Paternalistic state policies are aimed at correcting failures in human reasoning. State policies can also be aimed at correcting market failures. Inadequate or imperfect information is a standard source of market failure; therefore New argues that state interventions aimed at correcting imperfect distribution of information are not paternalistic. This is contrary to the traditional view that considers inadequate information as a reason for paternalism. New: *op. cit.* 249-251.

²¹ *Ibid.* 251.

²² *Ibid.* 251.

²³ *Ibid.* 257.

²⁴ Leonard, Thomas C. – Goldfarb, Robert S. – Suranovic, Steven M.: *New on Paternalism and Public Policy*. In: *Economics and Philosophy*, Vol. 16. (2000), No. 2, 323.

²⁵ E.g. entering into a Ulysses contract in advance and making sure that the self-harming option is not available to the person when the tempting situation develops. *Ibid.* 326.

²⁶ *Ibid.* 327.

necessary for those ‘who do not know that they do not know enough’ – the difficult question is how to distinguish the former group from the latter in a ‘blanket’ public policy regulation.

A somewhat similar requirement has been articulated by *Thomas* and *Buckmaster* when arguing that an appropriate paternalistic policy should always ‘discriminate between those for whom paternalism is deemed necessary and those for whom it is not’.²⁷ This practically means that paternalism should be limited as much as possible to those who are benefited by the restriction: instances of ‘impure’ paternalism involving the restriction of others besides those who are benefited should be kept to a minimum.²⁸ Proportionality, accountability and efficacy are also important principles when evaluating paternalistic policies. Proportionality requires that an intervention is the minimum necessary to achieve the intended aim of the policy. Accountability means that paternalistic interventions shall be transparent to the person subjected to the intervention. This is particularly important in cases of ‘libertarian paternalism’ that operate by modifying choice-architecture often in a way that is not obvious to the paternalised person. Efficacy implies that the paternalistic intervention is efficient in producing the intended outcomes. Although there seems to be a general consensus that social policies must be evidence-based, it is not entirely clear what evidence shall be considered when determining the efficacy of paternalistic policies.²⁹

To sum up, paternalistic public policies can be justified on a consequentialist basis by reference to the fact that the state is sometimes in a better position to assess what is good for the individual than the individual himself. The state, being more detached (‘phlegmatic’) and having a wider perspective than the individual, is less vulnerable to certain reasoning-failures. It is also necessary that for the intervention to be proportionate, efficient (evidence-based) and accountable to the state. Thus, a paternalistic state policy can be justified if it is shown to produce better outcome than individual choice and if the increase in welfare is sufficient to compensate for the violation of autonomy that the intervention entails.³⁰ However, paternalistic interventions sometimes have unintended negative consequences that complicate this picture. For example, paternalism can cause people to undertake riskier activities because they will act under the (true or false) assumption that they are protected against their own self-harming actions. This is called ‘moral hazard’ in economic literature.³¹

4. LIBERTARIAN PATERNALISM

Libertarian paternalism is a relatively ‘soft’, non-coercive form of paternalism.³² Advocates of the approach, *Cass Sunstein* and *Richard Thaler* start off from the premise that humans are not fully rational choosers and do not always act in their own best interests. Taking the findings of cognitive psychology and behavioural economics into account, it is possible to exploit individual cognitive biases and create regulations that ‘nudge’ people to make better, i.e. more beneficial and less self-harming decisions. Proponents of libertarian paternalism claim that it is an effective, relatively cheap but less intrusive method to promote people’s welfare than traditional forms of paternalism. The idea has received considerable public attention in recent years and has been endorsed by official government politics both in the United Kingdom and the United States.³³ However, libertarian paternalism has also been criticised for

²⁷ Thomas, Matthew – Buckmaster, Luke: Paternalism in social policy – when it is justifiable? In: Parliament of Australia, Department of Parliamentary Services Research paper, No. 8. (2010-2011) 18.

²⁸ Pure and impure paternalism is also called direct and indirect paternalism. A ban on the sale of cigarettes is impure (indirect) paternalism because it limits cigarette manufacturers besides smokers whose benefit is originally intended to be promoted by the prohibition. Gerald Dworkin argues that indirect paternalism requires stronger justification because it involves third-parties ‘who are losing a portion of their liberty and they do not even have the solace of having it done in their own interest’. Dworkin (1972): *op. cit.* 64.

²⁹ Thomas – Buckmaster: *op. cit.* 22-25.

³⁰ New: *op. cit.* 257.

³¹ Thomas – Buckmaster: *op. cit.* 7-8.

³² The adjective ‘libertarian’ refers to the non-coercive and liberty-preserving character of this form of paternalism. Sunstein, Cass – Thaler, Richard: *Nudge – Improving Decisions About Health, Wealth and Happiness*. Penguin, London, 2009, 5.

³³ The Behavioural Insights Team was set up in 2010 by the Cameron administration with the aim to “help Government departments think about non-regulatory means of achieving behaviour change.” See *Report on Behaviour Change* (Science and Technology Select Committee, House of Lords, 2011), 33. The Office of Information and Regulatory Affairs (OIRA), headed by Cass Sunstein, has similar functions in the US when reviewing draft regulations and overseeing the implementation of government-wide policies.

its alleged ineffectiveness and for the moral, political and legal risks it may carry (e.g. slippery slope to hard paternalism, lack of transparency, lack of neutrality, etc.).³⁴

Libertarian paternalist public policies are based on the idea that instead of forcibly taking away self-harming options from people, it is better to present them available choices in a way that they will make 'better' choices themselves. If policy-makers are aware of weaknesses of human decision-making, they can modify 'choice-architecture' so that results are more beneficial to individuals. One such cognitive bias, the so-called *status quo* bias refers to people's inertia not to change the current state of affairs. This means, for example, that changing the default position from non-enrolment to automatic enrolment will have a significant impact on the number of people enrolled to a savings scheme. Another approach focuses on changing the physical environment where choices take place: removing candies and soft drinks from supermarket checkouts ensures that people do not 'give in to temptation' and buy sweets while waiting in the checkout line. People, however, remain free to choose in these cases – it is only that they are more likely to choose an option that is more conducive to their welfare. The efficiency of these interventions is not necessarily high but the costs of implementing such policies tend to be low as well.

The welfare state is often described as having a paternalistic character. It is true that a state which is preoccupied with the welfare of its citizens will sanction policies that do not only increase welfare through redistribution (i.e. increasing someone's welfare at the expense of others) but also policies that 'compel citizens to undertake or abstain from activities that affect that citizen alone'.³⁵ Redistributive policies are not paternalistic in the strict sense of the word, although some of them can be perceived as 'insurance schemes' that will protect a person's future self from the full consequences of certain unwise or self-harming decisions in the present. Most public pension systems serve mixed purposes in the sense that they are partly based on the idea of social solidarity but also have a paternalistic character i.e. they compel people to take care about their own retirement in advance. The increasing transformation of pay-as-you-go pension schemes to defined contribution plans seems to increasingly place social solidarity in the background and paternalism in the foreground.³⁶ As we have previously seen, such paternalism might be justified by reference to the 'myopic akrasia' of decision-makers³⁷ but countries that wish to avoid hard paternalism leave it for the individual to join a pension plan.

In order to create sustainable pension systems, it seems crucial to identify methods that can non-coercively increase participation in voluntary pension schemes. This is extremely important for countries that do not require people to make mandatory pension contributions (e.g. the United States). Hybrid systems, like Hungary, can also make use of such methods in order to strengthen their non-mandatory, private savings based pillar. Libertarian paternalism has come up with possible solutions in this respect. The first one proposes changing the default rule from non-enrolment to automatic enrolment. Although such regulation does not violate autonomy (people remain free to opt-out later), it drastically increases the number of participating employees, since most of them will probably not opt-out after being enrolled.³⁸ Alternatively to automatic enrolment, participation can also be increased by making enrolment administratively easier or 'forcing' employees to actively make a choice between enrolment and non-enrolment when first hired. An additional issue – since most participants do not save enough – is how to get people increase their savings contribution. A possible solution is provided by 'The Save More Tomorrow' program developed by Richard Thaler and Shlomo Benartzi, which aims to increase pension contributions by asking participants to commit themselves in advance in order to the raise their pension

³⁴ For an overview of the most frequent objections, see Sunstein – Thaler: *op. cit.* 235-252. See also Whitman, Glen: *The Rise of the New Paternalism*. Available at <http://www.cato-unbound.org/2010/04/05/glen-whitman/rise-new-paternalism> (3 December 2014).

³⁵ New: *op. cit.* 244.

³⁶ Pay-as-you-go pension schemes – often characteristic to welfare states following the Bismarckian model – are funded by compulsory contributions. The contributions are not capitalized but they are spent immediately to cover payments for current pensioners. In defined contribution schemes contributions are paid into an individual account for each member. On retirement, the member is eligible to receive the accumulated capital and its returns. See, e.g. Natali, David – Rhodes, Martin: *The New Politics of the Bismarckian Welfare State: Pension Reforms in Continental Europe*. In: *EUI Working Papers SPS No. 10*. (2004), 2.

³⁷ Cf. New: *op. cit.* 253; Leonard – Goldfarb – Suranovic: *op. cit.* 325.

³⁸ Sunstein and Thaler refer to statistics according to which participation rates in one pension plan under the opt-in approach were only 20 percent after three months of employment. After switching to automatic enrolment, enrolment of new employees jumped to 90 percent immediately. See Sunstein – Thaler: *op. cit.* (2009) 117-118.

contributions whenever they get a pay rise.³⁹ Finally, offering tax deductions can also make pension savings more attractive to people. Financial incentives are relatively soft instances of paternalism but they do not fall within the ambit of libertarian paternalism.

Sarah Conly criticizes ‘softer’ forms of paternalism for being too costly and inefficient.⁴⁰ She claims that people sometimes continue to choose the ‘wrong thing’ despite all efforts of nudging, incentives or education. In the case of smoking, for example, she argues that an outright prohibition would be desirable instead of spending money on ‘softer’ but rather ineffective measures such as advertising or education. Conly identifies four criteria that acceptable forms of coercive paternalism must satisfy.⁴¹ (1) The activity to be prevented must be opposed to our long-term ends. Applying this criterion to the question of smoking, one can say that the harmful consequences, including the possibility of serious illnesses and premature death, are at odds with the fulfilment of someone’s long-term goals. (2) Coercive measures have to be effective. Since the majority of people accept cigarettes as genuinely dangerous substances, Conly argues that the prohibition of smoking would be more effective than the prohibition of alcohol was in the 1920s in the US. (3) Benefits must be greater than costs. It might be argued that society, overall, would be better off without cigarettes; costs would reduce overtime because smokers who initially suffer from the lack of cigarettes will feel better as their addiction fades. (4) The measure in question needs to be the *most* efficient way to prevent the activity. Conly claims that ‘softer’ methods against smoking (e.g. education, raising of prices) did not work sufficiently. Although the rate of smokers has gone down, more than 20 percent of Americans continue to smoke which shows the inefficiency of ‘soft’ methods. Still, the full prohibition of smoking seems relatively controversial. However, there are other cases when coercion and prohibition seems easier to accept (e.g. ban on trans-fats).⁴²

5. CONCLUSION

The following conclusions concerning the issue of paternalism in the public sphere – can hereby be drawn. First of all, it is important to make a distinction between state paternalism (legal paternalism) and private paternalism. Although both seem to share similar basic elements (i.e. they can be understood as interventions to a person’s autonomy in order to prevent harm to that person or promote his or her benefit), the state has special characteristics that needs to be taken into account when justifying paternalistic public policies. For the sake of conceptual clarity, it should be emphasized that not all public welfare policies are paternalistic in the strict sense of the word. Redistributive policies are only ‘paternalistic’ inasmuch as they are aimed at taking care of the weak but they do not necessarily protect people from self-harming or unwise decisions.

The two major approaches to the justification of paternalism are the autonomy-based and the consequentialist models. In practice, both autonomy-based and consequentialist arguments are considered; a general understanding is that autonomy constitutes a ‘deontological side-constraint’ to consequentialist considerations. Paternalistic public policies are justifiable in situations where it is apparent that the state knows better what is good for the individual than the individual himself; such situations can be the result of different failures in human reasoning to which the state and its agents are less vulnerable to. Libertarian paternalism is also built on certain ‘irrationalities’ in human behavior. It seems that these interventions are more easily accepted than traditional paternalistic interventions because they are less restrictive to individual freedom of choice.

³⁹ Sunstein – Thaler: *op. cit.* (2009) 22-125. See also Thaler, Richard – Benartzi, Shlomo: *Save More Tomorrow: Using Behavioural Economics to Increase Employee Savings*. In: *Journal of Political Economy* Vol. 112. (2004), No. 1, 164. Available at <http://faculty.chicagobooth.edu/Richard.Thaler/research/pdf/SMarTJPE.pdf> (3 December 2014).

⁴⁰ Conly: *op. cit.* 149.

⁴¹ *Ibid.* 150-152.

⁴² *Ibid.* 152-155.

ECONOMIC TRENDS IN THE CENTRAL AND EASTERN EUROPEAN REGION

ESZTER LUKÁCS *

On 25th February 2014 my friends and colleagues of the Faculty of Law and Political Sciences at Széchenyi István University humbled me with an invitation to address the audience of the Winter Seminar 2014 bearing the subtitle Law, Politics, Economy and Society of the Central and Eastern European Countries. The paper below is an epitome of my contribution on the economic trends of the CEE (Central Eastern Europe) region at the auspicious event.

1. COMMON CHARACTERISTICS OF THE CEE COUNTRIES

Prior to the crisis the CEE countries were among the fastest growing countries in the world. From 2000 to 2008 with the annual GDP growth rate of 4.8% the region was only surpassed by China and India (with 10 and 5.6 percent growth rates respectively) and it outstripped the performance of the developing Asian, Latin American and advanced Asian countries as well as that of the EU and the United States.¹

The small and open CEE economies were heavily dependent on FDI and exports, which made them highly sensitive to changes in the advanced world, primarily to those coming about in the EU. In a PWC analysis titled “Foreign Direct Investment in Central and Eastern Europe” the period 2003-2008 is described as the 21st century gold rush. FDI of the region rose from US\$20 billion in 1997 to US\$30 billion in 2003. From this base, however, inflows leaped more than five-fold in five years, reaching US\$155 billion in 2008, which rounded up to almost ten (9.1) percent of the then global FDI inflows.² Bulgaria, Croatia, Estonia, Latvia and Slovenia had not attracted large amounts of FDI prior to 2003 but saw inflows rise markedly from 2004. The Czech Republic, Poland and Hungary have been major regional destinations for FDI inflows since the mid-1990s. These countries also saw FDI rise from 2003, although by a proportionately smaller amount than many of the other nations in the region.³

In an empirical analysis on FDI in the EU and the CEE countries published in 1998, Paul Brenton and Francesca Di Mauro⁴ observed complementarity between FDI and both exports and imports. The authors have found that FDI enhances the commercial presence of source country firms in the host country. The transfer of source country technology, the presence of source country nationals in the host country, the participation of host country nationals in training courses etc. in the source country, all serve to foster close commercial links that may affect trade in both directions.

The latter very much describes the nature of the relationship among the EU-15 and the new EU members. FDI-flows to the Central and Eastern European Countries have significantly grown in the beginning of the mid-nineties. From being “virtually residual” they reached a level of 40 % of the local GDP in Eastern Europe by 2004. Firms from the EU-15 states were main investors (77.5 % in 2004), followed by US and Swiss firms. Despite the growing FDI-flows towards the New Member States, their share of the EU-15 outflows only amounted 4 % in 2004. Thus, the EU-15 remained with a share of 53 %

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¹ Labaye, Eric – Sjatil, Pal Erik – Bogdan, Wojtek – Novak, Jurica – Mischke, Jan – Fruk, Mladen – Ionutiu, Oana: *A new dawn: Reigniting growth in Central and Eastern Europe*. McKinsey Global Institute, December 2013, 3.
http://www.mckinsey.com/insights/economic_studies/a_new_dawn_reigniting_growth_in_central_and_eastern_europe (3 June 2014).

² UNCTAD: World Investment Report 2009: Transnational corporations, agricultural production and development. United Nations, New York & Geneva, 2009, XVII.

³ PwC Macro Consulting Team: Foreign direct investment in Central and Eastern Europe: A case of boom or bust? In: Economic Views, March 2010, 1-2.
http://www.pwc.co.uk/en_UK/uk/assets/pdf/foreign-direct-investment-in-central-and-eastern-europe-march-2010.pdf (3 June 2014).

⁴ Brenton, Paul – Dimauro, Francesca – Lücke, Matthias: Economic integration and FDI: An empirical analysis of foreign investment in the EU and in Central and Eastern Europe. *Kiel Working Papers*, No. 890 (1998), 21.



from all FDI-outflows the most important destination for EU-15 FDI outflow activities, followed by the USA (12 %).⁵

UNCTAD's 2004 World Investment Report predicted the new EU members, due to the combination of relatively low wages, low corporate tax rates and access to EU subsidies enhanced by a favourable investment climate, a highly skilled workforce and free access to the rest of the EU market, to be attractive locations for FDI both from other EU economies and from third countries. The same WIR issue noted however that the potential rise of CEE countries as FDI destinations did not jeopardise the position of the EU-15 as FDI hosts, in fact, eight CEE countries (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia) saw a fall in their FDI-inflows one year prior to their EU-accession.⁶

WIR 2004 also expected the CEE and Asian countries, especially Poland, China, India and Thailand, to be major recipients of FDI in the following years. There is a huge difference between FDI-inflows to CEE and to ASEAN countries though. While between 1995-2005 emerging East Asian economies attracted 13.9 percent of their FDI-inflows from the United States with further 14.7% from the EU, 10.5% from Japan, 34.9% from Asian NIEs (Hong Kong, South Korea, Singapore, Taipei) and 3.1% from the ASEAN countries⁷, FDI source regions for the new EU countries remained extremely highly concentrated. In 2006 the EU-15 countries held the highest share of productive capacity owned by foreigners in CEE countries, whereas the USA and its many international corporations contributed a great deal of foreign stock to this region.

Thailand attracted 10.5, 10.5, 25.1, 27.6 and 0.9 percent of its foreign capital stocks from the US, EU, Japan, Asian NIEs and other ASEAN countries respectively between 1995-2005, whereas EU-15 economies held 74% of productive capacity owned by foreigners in Poland, while the USA and other international corporations contributed to further 13% and 6% to foreign stock in the Polish economy.⁸

The 2008 crisis and the following global economic downturn massively hit all foreign capital reliant emerging regions of the world, yet, CEE countries were double-smitten due to their asymmetric interdependence with the EU-15, which was exasperated by the sovereign debt crises of a number of European economies.

In a 2012, entry on the Visegrád countries *Radomír Špok* assessed the effects of the 2008 crises on the small, open, and primarily Germany-dependent economies of the Czech Republic, Hungary, Poland and Slovakia. Špok shared the views in the publications of the World Bank (2009), UNCTAD (2013) and *McKinsey* (2013).⁹ He argues that the geographical composition of the foreign trade of the V4 economies clearly shows a collective dependence on Germany, as approximately one-fifth of the Slovakian, one-fourth of the Hungarian and Polish, along with one-third of the Czech exports are directed to Germany. Italy, Austria and France are similarly important importers for V4 products. A decrease in the German demand automatically causes declines in the GDPs of the Central and Eastern European countries. A further common feature is a strong reliance on imports for mineral fuels, especially from Russia. The latter combined with the import of Chinese manufactured goods deteriorates the positive trade balances of the V4 countries maintained with the EU-15.

Geographical proximity and the availability of arm's-length suppliers have always played a crucial role in the internationalisation of business activities. While 80 percent of the world trade is in fact movement of goods and services within global value chains coordinated by transnational corporations¹⁰, the results of UNCTAD's World Investment Prospects Survey (WIPS) 2007-2009 show a high concentration of TNCs in their respective home regions. For instance, companies from European countries are more present in other European countries than are other companies. Similarly, North American companies are better

⁵ Heringhaus, Steffen: *Romania in the EU – New roads of real convergence?* Magister Thesis, RWTH Aachen University, Chair and Institute for Political Science, Aachen, 2008, 24.

⁶ UNCTAD: World Investment Report 2004: The shift towards services - Overview, United Nations, New York & Geneva, 2004, 14.

⁷ Kawai, Masahiro – Wignaraja, Ganeshan: *ASEAN+3 or ASEAN+6: Which way forward?* In: *ADB Discussion Paper*, No. 77. (2007) 25.

⁸ Kornecki, Lucyna: Foreign direct investment and macroeconomic changes in CEE integrating into the global market. In: *Journal of International Business and Cultural Studies*, No. 3. (2010) 9.

⁹ Radomír Špok: Are Central European economies truly similar? In: *V4Revue*, 30. May 2012. <http://visegradrevue.eu/?p=776> (7 June 2014).

¹⁰ UNCTAD: World Investment Report 2013: Global value chains: investment and trade for development – Overview. United Nations, New York & Geneva, 2013, 20.

represented in North America (through cross-border investments between the United States and Canada) than their European and Asian counterparts.¹¹

In his revealing Harvard Business Review article of 2001 entitled “Distance Still Matters: The Hard Reality of Global Expansion”, Pankaj Ghemawat conceived the CAGE-theorem, which explains the relevance of cultural, administrative, geographic and administrative distances when it comes to the evaluation of foreign markets.¹²

The relevance of the above listed types of closeness is undeniable, yet, while in the above quoted 2007-2009 WIPS issue the new EU-12 countries are ranked as FDI host economies right after North America, the EU-15 and South, East and South-East Asia in the most recent 2013-2015 edition the new EU-12 countries are only positioned on the eighth place after East Asia, the US and Canada, the EU-15, the ASEAN (South-East Asia), other developed countries (Australia, Israel, Japan and New Zealand) and Latin America and the Caribbean.¹³ Whereas Asia seems to uphold and further improve its reputation regarding its foreign direct investment attractiveness both for Asian and non-Asian investors, Central and Eastern Europe is losing momentum and is for the most part merely appealing for EU-15 transnational corporations.

The asymmetric EU-15 dependency of the new EU countries is not only expressed in their trade balances and FDI figures, it is further aggravated by its sectoral composition. While the majority (60%) of the FDI targets the service sectors of the new EU countries, the bulk of the manufacturing investments (30%) land in the Central and Eastern European automobile cluster. Nearly two-thirds of automotive exports go to EU-15 markets and 60 percent of these sales are concentrated in Germany, the United Kingdom and France. A growing network of parts suppliers in the CEE also feeds Western European auto plants, particularly in Germany.¹⁴

The studies carried out by Ernst & Young (E&Y) in 2010 and 2013 reinforce the latter findings. The previous study on after-crisis performance of the automotive sector notes that Europe’s industry was less affected by the economic downturn than that of Japan or the United States. The report underlines however the differences between Western and Eastern Europe and the further dissimilarities among the second group. E&Y classifies the Eastern European car industry in accordance with the markets that the producers target. In this sense the CEE countries, especially the Czech Republic, Slovakia and Hungary share common characteristics.

The automotive plants in the Czech Republic and Slovakia operate almost entirely independently of the local market, relying on strong demand in the destination countries in Western Europe. Hungary is also becoming a significant net exporter, with production running at more than twice domestic sales, and that will increase with the Mercedes-Benz plant which came on-line in 2012. Most of the plants in these three countries have been less affected by the crisis than those in Western Europe. The vehicles produced in CEE are mainly small cars — a segment that across Europe has not shrunk in the downturn due to the high customer incentives provided by the different scrappage programs of many European Governments. Many of these plants belong to brands growing in the European market as a whole and these new plants are among the most efficient ones in Europe. Poland suffered a 21% production loss just after the crisis in 2009 as its industry is dependent on both, local demand and export markets. (Romania and Turkey share fairly similar characteristics.)¹⁵

In the European Automotive Survey 2013 E&Y interviewed 300 continental carmakers and delivered intelligence on the operation as well as the jobs creation in the region. Their major findings are as follows:

- a) Auto industry managers in Eastern Europe, France, Germany and the UK in particular look to the future with optimism. In Italy, by contrast, every third respondent anticipates a deterioration in their own business situation;
- b) growth in small cars segment: 52% of respondents expect healthy growth rates in the low-price segment;
- c) 42% of companies plan to step up investment in Eastern Europe; in Western Europe, the corresponding figure is only 30%;

¹¹ UNCTAD: *World Investment Prospects Survey 2007-2009*. United Nations, New York & Geneva, 2007, 21.

¹² Ghemawat, Pankaj: *Distance Still Matters: The Hard Reality of Global Expansion*. In: *Harvard Business Review*, No. 8. (2001), 137-147.

¹³ UNCTAD: *World Investment Prospects Survey 2013-2015*. United Nations, New York & Geneva, 2013, 15.

¹⁴ Labaye et al.: *op. cit.* 17.

¹⁵ Ernst & Young: *The Central and Eastern European automotive market: Industry overview*. 2013.

http://www.ey.com/Publication/vwLUAssets/CEE_automarkets_2010/%24FILE/CEE_automarkets_2010.pdf (11 June 2014).

- d) in the automobile industry considerably more European companies intend to create jobs (28%) than to cut them (11%). In Europe, by contrast, employment is likely to stagnate at best: one in five companies intends to create jobs and the same number plans to reduce headcount.¹⁶

The above quoted survey also polled the 300 car makers on their opinions about productivity in the automotive sector and found that between 2011-2013 the hubs of the Czech Republic, Poland, Slovakia and Hungary demonstrated productivity growths of 7,7 and 1,1 percent respectively but did not further search for the interconnections of FDI and productivity changes.

A 2009 study of the European Central Bank confirmed however that FDI in the CEE countries not only contributes to export, GDP and employment growth, but, especially in the above detailed manufacturing sector, it further results in massive productivity gains. “At the broad sectoral level manufacturing has been the main driver of productivity convergence, whereas gains in services have been less pronounced. Despite this catching-up process, however, a marked gap vis-à-vis the rest of the EU remains. Productivity gains have been accompanied by substantial inflows of FDI, particularly to financial and business-related services and, to a lesser extent, to industry. These general trends, however, mask important differences at the country and industry level. The empirical results point to three main conclusions which seem to be robust to a variety of tests. First, there is a strong convergence effect in productivity both at the country and at the industry level, i.e. productivity growth depends positively on its gap vis-à-vis the euro area. At the country level, this effect is highly pronounced in the Baltic region. At the industry level, the convergence effect is particularly strong in the manufacturing sector. Second, foreign capital in the form of FDI inflows plays an important role in accounting for productivity growth in the CEE region. Third, the impact of FDI on productivity critically depends on the absorptive capacity. More specifically, the effect of FDI on productivity seems to be increasing with a declining productivity differential vis-à-vis the euro area. There is also evidence that the level of human capital is positively associated with a larger impact of FDI. The former type of interaction between absorptive capacity and the beneficial impact from FDI seems to be important in manufacturing, whereas the latter one is more significant in services.¹⁷

The latter findings on the decreasing productivity gaps and increasing levels of human capital as preconditions for productivity growth generated by FDI resonate with Pankaj Ghemawat’s theory on the importance of physical, administrative, cultural and economic closeness very well.

The employment contribution of the multinationals operating in the CEE region has to be further recognised. (In 2011, 1.6 million employees of the total Hungarian employment of 3,856,000¹⁸ filled in private sector vacancies with 413,000 jobs created by partly of fully foreign owned enterprises, thus, multinationals contribute to approximately 10 percent of the total Hungarian employment, whereas they give one-quarter of the private sector openings. It is further relevant to note that the average number of employees at nationally owned enterprises was three in 2009 as opposed to 32 at multinationals.)

The 2009 research titled “Employment impact of relocation of multinational companies across the EU” conducted by EUROFUND delivered significant lessons for the CEE countries:

“Companies originating from their major source of FDI, Germany weathered the crisis reasonably successfully and maintained overall employment levels, albeit with much restructuring within countries and some shifts of activities between countries. Most of the multinational companies included in the study have shifted at least part of their production out of the EU-15 into the new Member States in order to contain or reduce production costs. European multinational companies seem reluctant to make themselves ‘stateless’ and truly ‘global’; most of these companies tend to retain both a strong presence in their ‘mother’ country, in particular in respect of design and development work, and general administration and marketing. This, however, may equally be true of Japanese or US companies, which feature in the case studies from a foreign market perspective rather than from a domestic market one. In other words, a similar study carried out, for example, in the US might come to a similar conclusion about US companies. The capacity of the new Member States to take advantage of their new competitive advantage appears to vary between them, ranging from the Czech Republic, where labour skills, discipline and the quality of infrastructure seem to be important, to Bulgaria and Romania, where low wages are currently the dominant factor. The question is whether companies in these countries which have recently

¹⁶ Ernst & Young: European Automotive Survey 2013: Survey results. 2013.
http://www.academia.edu/6923836/European_Automotive_Survey_2013_Survey_results
 (11 June 2014).

undergone a transition from centrally planned to market economies can also make the transition to locations where their competitive advantage does not reside in low costs alone.”¹⁹

2. CHALLENGES TO FDI ATTRACTION AND GROWTH

The FDI contribution index, created by UNCTAD, aims to measure the development impact or the significance of FDI in a host economy. It looks at the contribution of foreign affiliates to

1. GDP (value added),
2. employment,
3. wages and salaries,
4. exports,
5. R&D expenditures,
6. capital formation and
7. tax payments, as a share of the host-country total (e.g. employment by foreign affiliates as a percentage of total employment).

These seven variables are among those recommended by the *Manual on Statistics of International Trade in Services* (2010) for inclusion in the collection of foreign affiliate statistics. A number of these variables are also proposed by the G-20 in its work on indicators for measuring and maximizing economic value added and job creation arising from private sector investment in value chains.²⁰

According to the World Investment Report (WIR) 2012, the significance of foreign direct investments was the highest in Hungary, followed by Belgium and the Czech Republic and in the same group with Estonia, Switzerland, Ireland, Hong Kong, Panama, Singapore and Sweden.

To generate growth in these FDI-reliant countries it is crucial to identify the incentives of capital attraction. The same WIR 2012 issue sums up the most relevant FDI determinants as follows:

1. Market attractiveness (size of the market, spending power, growth potential power of the market)
2. Availability of low-cost labour and skills (unit labour cost, size of manufacturing labour force)
3. Presence of natural resources (exploitation of resources, agricultural potential)
4. Enabling infrastructure (transport, energy, telecommunication).

In the previously quoted 2013 December study of McKinsey entitled “A new dawn: Reigniting growth in Central and Eastern Europe”, the research institute suggest a growth model for the region that further capitalises on the (manufacturing) export driven capabilities and uncovers further potentials in the sectors of agriculture, construction, retail, transportation and network industries. The document acknowledges, however, that the suggested development may only take place if national investments in infrastructure policies enabling urbanisation and investments in workforce quality create a strong foundation (precondition) for the much desired economic growth.

In the research entitled “*Factoral impacts on regional development in Hungary*”²¹ Csaba Hahn outlines that “accessibility” of the closeness of transport infrastructure (motorways) and the presence of foreign direct investors have a major impact on the economic, social and complex development of regions. The imminence of motorways has a positive impact on the income levels of regions, the overall economic indicators are influenced positively, whereas unemployment drops. Hahn further underscores the linkage between transport infrastructure and urbanisation: motorway constructions have an even more upgrading effect on the economy in more urbanised areas.

He further notes that economic development is strongly influenced by the educational background of the inhabitants, emphasizes however that FDI is very unlikely to have a balancing effect on regional

¹⁷ Bijsterbosch, Martin – Kolasa, Marcin: FDI and productivity convergence in Central and Eastern Europe: An industry-level investigation. In: ECB Working Paper Series, No. 992 (2009), 28.

¹⁸ LogPortál Team: *Foglalkoztatottság és munkanélküliség Magyarországon 2011. július-szeptember* [Employment and Unemployment in Hungary. July-September 2011]. <http://hirek.logportal.hu/foglalkoztatottsag-es-munkanelkuliseg-magyarorszagon> (14 June 2014).

¹⁹ European Foundation for the Improvement of Living and Working Conditions: *ERM case studies: Employment impact of relocation of multinational companies across the EU*, Dublin, 2009, 9-10.

²⁰ UNCTAD: World Investment Report 2012: Towards a new generation of investment policies. United Nations, New York & Geneva, 2012, 31

²¹ Hahn Csaba: A térségi fejlődést befolyásoló tényezők Magyarországon [Factoral Impacts on Regional Development in Hungary]. *Térségi Statisztika*, No. 6. (2004), 544-563.

development as location choices (primarily in the automobile sector) have already been made and reinvested earnings contribute to the enhanced development of the regions previously preferred by foreign investors. The study also implies that public subsidies spent on regional development have a positive impact on the infrastructural improvement of regions; however, they have little or no influence on the social or economic development.

Infrastructure and skilled labour force as FDI attraction incentives thus generators of economic stimulus are by no means Hungary- or CEE-specific determinants. In a 2009 Canadian article that examined the efficiency of government spending on infrastructure, the author came up with the conclusion that shortages in skilled labour may constrain the outcomes of infrastructural investments.²² The latter statement is confirmed by a 2013 release of the Canadian Chamber of Commerce (CCC) published on the Top 10 barriers to competitiveness, identifying inadequate infrastructure planning and a shortage of skilled labour as two of the biggest impediment to Canadian competitiveness in the global economy. In 2011, OECD called Canada the most educated country in the world. But this CCC report claims education isn't providing the opportunities it should.²³ Further extensive literature, from Chile to Myanmar, is available on the magnitude of the absence of skilled labour force being the most immediate hurdle to industry and economic growth.

In a 2009 publication entitled "CEE's dwindling skilled labour supply: the vagaries of unfavourable demographics", Rohit Das and Esha Mendiratta analyse Russia, the Czech Republic, Hungary and Poland as potential offshoring locations. Due to an expected drop in skilled labour force, the authors depict a rather gloomy picture of these countries as potential FDI hosts. While skilled labour supply is calculated to grow from 33 million to 35.4 million in Russia and from 3 million to 5.8 million in Poland between 2005 and 2050, it is expected to drop from 676,000 to 633,000 in the Czech Republic and from 805,000 to 700,000 in Hungary in the same period of time.²⁴

The general problem of unemployment, especially that of youth joblessness and the relevance of employment creation by transnational enterprises has been addressed the author's previous 2013 publication issued in the Jubilee Volume of the Doctoral School of Law and Political Sciences. The article focused on the importance of the growth of foreign investments, thus exports in the CEE countries as highly indebted nation states and leveraged households economic have been in desperate need for capital underpinning the economic growth and the improvement of employment levels after the 2008 and the 2010 European sovereign crisis.²⁵

In the aftermaths of the financial and economic downturns reluctance as common sentiment ruled both investors and analysts, and a great number of publications cautioned about the fact that cash holdings of the greatest global and European multinational enterprises would not translate into investments. The current problem seems to be aggravated by the capital attraction incapability of FDI host economies, which, as discussed above, is rooted in the insufficient supply of skilled labour force.

An EU labour force survey published in 2013 concludes that vocational education and training are able to speed up young adults' transition from education to the world of work, relative to general education graduates students entering the labour market with vocational education and training benefit from a faster transition to work are more likely to have a permanent first job and are less likely to find a first job with a qualification mismatch.²⁶

It becomes more and more evident that both at the levels of secondary and higher education vocationally equipped graduates enjoy a privileged entrance to the labour market. As a result of the widely successful apprentice programmes, Germany and Austria demonstrate historically low youth unemployment levels. In other EU countries, outstandingly in the EU-15 reliant CEE economies,

²² Gilbert, Richard: Skilled labour shortage could interfere with infrastructure plan. In: Journal of Commerce, 04. February 2009. <http://www.journalofcommerce.com/article/id32374> (18 June 2014).

²³ Canadian Chamber of Commerce: Top 10 Barriers to Competitiveness: Tackling the top 10 barriers to competitiveness, 2013. <http://www.chamber.ca/media/news-releases/130212-canadian-chamber-unveils-top-10-barriers-to-competitiveness-for-2013/> (18 June 2014).

²⁴ Das, Rohit – Mendiratta, Esha: *CEE's dwindling skilled labor supply: the vagaries of unfavourable demographics*. Technical Paper, Watson Wyatt Worldwide, London, December 2007, 10-13.

²⁵ Lukács, Eszter: Economic downturn: Fiscal responses and the role of FDI in job creation. In: Kecskés Gábor (ed.): Jubilee volume – First 5 Years of the Doctoral School of Law and Political Sciences Széchenyi István University. Széchenyi István Egyetem Állam- és Jogtudományi Doktori Iskola, Győr, 2013, 213-224.

²⁶ CEDEFOP: Labour market outcomes of vocational education in Europe: Evidence from the European Union labour force survey. Publications Office of the European Union, Luxembourg, 2013, 6.

vocational education and the generation of adequate skills rises the massive question of the financing of education.

According to the Central Statistical Bureau of Hungary, in 2013, the share of non-state financed secondary schools and institutions of higher learning was 48 percent, whereas only 23 percent of the teachers/instructors/professors were employed by non-state owned educational establishments. While half of the state-run educational budget is being spent on payrolls, again, it is difficult to conceive a change in the educational structure without the active involvement of private businesses.²⁷

The main question and the topic of a future investigation is whether European companies are willing to invest in the education of employable workforce in Central and Eastern Europe or is it more likely that they are inclined to relocate their operations to places where the abundance of skilled labour is no stumbling block.

3. SUMMARY

The paper above on the economic trends of the CEE countries is divided into two major parts. The first section of the writing assesses the common characteristics of the CEE countries, which delivers a general positive image of the region with its open economies, FDI attraction capabilities, integration to global, or primarily European, (manufacturing) value chains, increasing productivity figures and its vital closeness to the main EU-15 investors and trade partners.

The second half of the essay concentrates on the FDI-attraction barriers. As all of the CEE countries and the majority of the emerging markets are externally capitalised economies the factors of the end use (consumption, investments, exports) or on the demand side of the economy largely depend on foreign investors or the capital attraction capability of the countries.

Admitting that the CEE region offers an optimistic overall picture, it still needs to be underlined that without further improvements in infrastructure and a profound educational reform targeting all levels of learning as well as the financial architecture of education, long term competitiveness is difficult to foresee.

²⁷ KSH [Central Statistical Bureau of Hungary]: *Oktatási adatok, 2012/2013* [Educational Statistics 2012/2013]. In: *Statistikai Tükör*, No. 32. (2013), 4.

CARDINAL ASPECTS OF LIBERALIZATION OF INTERNATIONAL TRADE, AND ITS EFFECT ON NATION-STATE SOVEREIGNTY

ALEX PONGRÁCZ *

1. CLASSIC NATION-STATE SOVEREIGNTY AND ITS RELATIONSHIP WITH TRADE POLICY

Bodin, the first systematic theorist of the doctrine of sovereignty, examining the traits of sovereignty, a. k. a. the attributes of the main source of power in the last quarter of the 16th century, was able to put a comprehensive list together with ease.¹ In his work entitled *On the Rights of War and Peace* (1625), Grotius could still be confident, talking about sovereignty, to define the essential meaning of it as a power “whose act are not subject to the control of another, so that they can be rendered void by the act of any other human will”.² With the same confidence he could also say that the general subject of this highest power is the state, *the perfect community*. In their writings Bodin and *Hobbes* espoused the necessity of strong national power as opposed to feudal anarchy, territories ruled by mini-kings and oligarchs, chaotic conditions of religious and civil wars. This is why they urged to create a strong power with the function of maintaining law and order³. Thanks to these theories, the state became an operating mechanism, a *neutral machine*, which “transforms right into law, constitution into constitutional law, law into order - into a calculable instrument of forced psychological motivation to be applied to the populace”.⁴ The dynastic state was soon to be replaced with the entity of the civil state. Thus, Bodin’s and Hobbes’ sovereignty theories, serving to legitimize the new system, led to the emergence of the concept of state sovereignty.⁵ Following a brief empire-building intermezzo (the reign of *Karl V*), the plural system of modern European nation states has developed and this system had been made universally dominant in 1648 by the *Treaty of Westphalia*.

Due to the absolutization of the concept of sovereignty, the first “threads of connection” between state and economy started to develop. The state, at this time, interfered with economical processes only a little, with decisions on economic policy being made by the state itself, rather than by a person (i.e. the king). This is how mercantilism could become the mainstream ideology of this era in the economy, and absolutism in politics. The economic realm was de facto subject to the interests of the state.⁶ *Fichte*’s concept of the *closed trading state* has found active followers among public authority figures: many preferred the possible existence of a state which influences economic life with increasing intensity, reforming economic structures using centralized, well-planned policies and replaces the regulative role of the market with a system based on central control.⁷

However, in Western Europe, as the messenger of the modern world, capitalism has taken root, creating the rational-capitalist organization of free labor: an economic system which has the imperative to gain continuous profit by rational, capitalistic means as its central focus, and where the appropriate course of action is decided by how much profit is to be made with how much investment.⁸ *Calculatory capitalism* thus became the “catalyst” for a reliable, understandable, rational political and legal system.⁹ Money has taken on a tremendously more powerful role and the increasing vigor of industry and trade has created

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¹ Bodin, Jean: *Az államról (About the State)*. Gondolat Kiadó, Budapest, 1987, 115-122.

² Grotius, Hugo: *On the Rights of War and Peace*. John W. Parker, London-Cambridge, 1853, 37.

³ Bayer, József: A politikai gondolkodás története (The History of Political Thought). Osiris Kiadó, Budapest, 2003, 104.

⁴ Cs. Kiss, Lajos: Egy keresztény Epimétheusz (A Christian Epimetheus). In: Schmitt, Carl: A politikai fogalma (The Concept of the Political). Pallas Stúdió – Attraktor Kft., Budapest, 2002, 271.

⁵ Shaw, Malcolm N.: *Nemzetközi jog (International Law)*. Complex Kiadó, Budapest, 2008, 43.

⁶ Galgano, Francesco: Globalizáció a jog tükrében. A gazdaság jogi elemzése (Globalization in the Context of Law. Legal Analysis of Economic). HVG-ORAC Lap-és Könyvkiadó Kft., Budapest, 2006, 46.

⁷ Bretter, György: Fichte eszményi állama (Fichte’s Platonic State). In Bretter György: Itt és mást. Válogatott írások. (Here and Other. Assorted Writings). Kriterion Könyvkiadó, Bukarest, 1979, 439.

⁸ Weber, Max: A protestáns etika és a kapitalizmus szelleme (*The Protestant Ethic and the Spirit of Capitalism*). Gondolat Kiadó, Budapest, 1982, 11-12.

⁹ Szigeti, Péter – Takács, Péter: *A jogállamiság jogelmélete (Law Theory of the Rule of Law)*. Napvilág Kiadó, Budapest, 2004, 46.



that middle class of great reputation which had the impossibility to continue the chaotic ways of the feudal world in its interest. Trade barons and bankers – such as Fugger or Whittington – began to accumulate more power than feudal notabilities and their freely available capital even gained them political influence.¹⁰ Thus capitalism was born and along the same lines of logic, the liberal state, the product of the 19th century that Carl Schmitt identified as the liberal century was also formed.

The biggest critic of this state model was *Carl Schmitt*, who described it as a system where public power is being reduced to the minimal possible level of influence, preventing economic intervention as much as possible, following the dogma according to which society and the economy make their own decisions, governing themselves by their own immanent principles, like the laws of physics. “The freedom of contract and trade prevailed in the free play of the social and economic forces, and as a result, the greatest economic prosperity seemed assured, as long as the automatic mechanism of free trade and of the free market steered and regulated itself according to the economic laws (through the supply and demand, the competitive exchange, the capital accumulation of political economy).”¹¹ Bódog Somló gives a graphic description of the liberal dogma which gives free reign to the blows dealt by the “invisible hand”: they claim that “the automatic self-regulation of supply and demand, the development of money and currencies, all these institutions that hold the utmost importance in trade and industry, are institutions which emerged without any state interference, and they are all more perfect and more important than the well-defined results of well-defined state intervention”.¹² According to such an analysis, *Adam Smith*’s thesis of the invisible hand is nothing else but the declaration of the faith that “only peace, mild taxation, and a viable justice system are needed to elevate a state from the lowest point of barbarism to the highest point of flourishing, and everything else will be brought on by the natural flow of things”.¹³ Legislatively speaking, this means that after the Industrial Revolution, most states declared civil liberties, including the liberty of industry and trade. The separation of law and economy, however, led to the victory of the dogma which defines law as a function of the state, in all nation states. “Thus, tension grows continually between internationally expanding trade and national rights bound by state borders.”¹⁴

2. THE DECLINE OF CLASSIC NATION-STATE SOVEREIGNTY AND THE GATT/WTO REGIME

The post-WW2 “golden age”, that is, the welfare state of Keynesian organizational capitalism, although it represented a paradigm shift from the classic concept of economic policy known as liberalism,¹⁵ later there came another paradigm shift against the practice of welfare states by the neoliberal orthodoxy, gaining ground from the late 1970s onwards and attaining complete dominance. This paradigm shift has also received government approval by the Thatcher (1979) and Reagan (1980) administrations from the dawn of the 1980s onwards. Under the leadership of global powers of regulation preferring the neoliberal model, such as the *International Monetary Fund* (IMF), the *World Bank*, and the *World Trade Organization* (WTO), the idea of globalization being “necessary” has gradually gained ground. The globalization of markets called for uniform rules throughout the whole of international trade, as a prerequisite. These new players completely revamped the old argument about economic relations being built upon trade/monetary relations between sovereign nation states.¹⁶ The new *lex mercatoria* “aims at the comprehensive regulation of trade relations which function independently from the political sphere of state influence, within the

¹⁰ Fisher, H. A. L.: *A History of Europe: From the Origins to the End of the 17th Century.* Eyre&Spottiswoode, London, 1949, 774.

¹¹ Schmitt, Carl: *The Way to the Total State.* In: Schmitt, Carl: *Four Articles. 1931-1938.* (Edited by Simona Draghici). Plutarch Press, Washington D. C., 1999, 7-8.

¹² Somló, Bódog: *Állami beavatkozás és individualizmus* (*State-Intervention and Individualism*). Grill Károly Könyvkiadó Vállalata, Budapest, 1907, 175-176.

¹³ Somló: *op. cit.* 180.

¹⁴ Galgano: *op. cit.* 47-48.

¹⁵ After World War II a new economic system emerged in Western Europe. One of the most characteristic elements of postwar Western regime was state interventionism. The mixed, mostly private, partly state-owned economic system based on Keynes’ ideas. Ivan T., Berend: *An Economic History of Twentieth-Century Europe.* Cambridge University Press, Cambridge, 2006, 196.; Kaposi, Zoltán: *A XX. század gazdaságtörténete I. 1918-1945.* (*The Economic History of the 20th Century. Vol. 1. 1918-1945*). Dialóg Campus Kiadó, Budapest-Pécs, 1998, 76.

¹⁶ Csáki, György: *A nemzetközi gazdaságtan és a világgazdaságtan alapjai* (*International Economics and the Fundamentals of the World Economy*). Napvilág Kiadó, Budapest, 2011, 177.

economically united class of traders”.¹⁷ This meant that for the first time after the Second World War, global-international organizations have appeared; which not only determined general goals for national states but also established rules and mechanisms of conduct - in such vitally important areas as finances and world trade.¹⁸ Obligations that accepted by the WTO form international trade relations abiding by the principle of mutualism and avoidance of discrimination, which limits the possibility of utilizing protectionist trade policies in most key areas of operation. On top of that, in this system there are severe financial consequences for “deviant” behavior, i.e. the conscious and frequent disregard of rules; and in our time, the practice of the *pacta sunt servanda* principle is a very characteristic trait also for organizations evaluating international credibility.¹⁹

Organizational Framework of Liberalizing International Trade

After the bitter experience of WWII, one of the central issues for the new world trade system was the rebuilding effort in Europe and the Far East, and the United States has proven to have a great enthusiasm for this. The Atlantic Charter already proposed the establishment of a world trading system in 1941; in this, access to national markets was defined as to rest on the grounds of equal opportunity and the requirement of openness of all national markets.²⁰ The following significant stage was the world trade conference in Bretton Woods, New Hampshire – with the participation of 44 nation states –, where “in the interest of a stable international economic order” a threefold international organization system was created. In order to aid international monetary cooperation and expansion of commerce, to protect the stability of international currencies, to coordinate national monetary policies and to provide credit for countries afflicted with temporary debt and difficulties, a new international monetary institution, the International Monetary Fund (IMF) was created. For supporting the postwar rebuilding effort, as well as investments and innovations, there was the *International Rebuilding and Innovation Bank* (World Bank). And last but not least, for the revitalization, coordination and stabilization of international trade and the destruction of obstacles to commerce, the *International Trade Organization* (ITO) was established.²¹ Although the international trade and labor conference organized by the United Nations in Havana in 1947 has constructed the *Havana Charter* which defined the multilateral order of international trade, and would have even created the ITO, but this organization remained only a skeleton and could not begin its actual operation yet.²² While the basic by-laws of the ITO were declared in the Charter signed by 56 nation states - the USA didn't ratify it and this rendered the whole thing ineffectual. *Richard Senti* says that the main reason for this was that “the ITO was too liberal for the protectionists, and too protectionist for the liberals, so most representatives rejected the agreement, albeit with diametrically opposed arguments”.²³

Thus, the *General Agreement on Tariffs and Trade* (GATT), created in 1947 with the participation of 23 nations, became on one hand the system of agreements between the signatories concerning their policies of foreign trade, but on the other hand it also had an extensive apparatus and order of protocols.²⁴ According to the evaluation of András Blahó and Árpád Prandler, GATT is not an international organization but an international treaty, which in effect functioned as an organization through its secretaries - and by the same token, it is better to see GATT member states as parties in a contract.²⁵

Cséfalvay thinks of GATT as a “*provisory proven successful for half a century*”, which, apart from its successes in the field of liberalization, was a trade system built upon the unstable foundation of two- and more sided

¹⁷ Galgano: *op. cit.* 58.

¹⁸ Simai, Mihály: A világgazdaság a XXI. század forгатagában. Új trendek és stratégiák. (The World Economy in the Turbulent 21st Century. New Trends and Strategies). Akadémiai Kiadó, Budapest, 2007, 50.

¹⁹ Ibid. 67.

²⁰ Vörös, Imre: A nemzetközi gazdasági kapcsolatok joga. I. kötet. (The Law of International Economic Relations Vol. 1.) KRIM Bt., Budapest, 2004, 75-76.

²¹ Cséfalvay, Zoltán: *Globalizáció 1.0. (Globalization Version 1.0.)* Nemzeti Tankönyvkiadó, Budapest, 2004, 97-99.

²² Vörös: *op. cit.* 76.; Práger László: A globális gazdaságon innen és túl (The Global Economic and Beyond). Aula Kiadó, Kalocsa, 2008, 101.

²³ Wohlmeyer, Heinrich – Quendler, Theodor (eds.): The WTO, Agriculture and Sustainable Development. Analysis of the Effects of the World Trade Order on the Agricultural Markets in light of Conditioning Sustainable Development. Austrian Association for Agriculture Research, Vienna, 2000, 68.

²⁴ Mádl, Ferenc – Vékás, Lajos: Nemzetközi magánjog és nemzetközi gazdasági kapcsolatok joga (Private International Law and the Law of International Economic Relations). ELTE Eötvös Kiadó, Budapest, 2012, 199.

²⁵ Blahó, András – Prandler, Árpád: Nemzetközi szervezetek és intézmények (International Organizations and Institutions). Aula Kiadó, Budapest, 2005, 329.

negotiations and contracts, and on top of that, used the toolkit of negative regulations: the purpose behind its rules and agreements was the demolition of previously built obstacles in the way of international commerce. The GATT thus can be evaluated as a loose system of member states – or contract parties –, which had the obvious advantage of allowing member states to freely and voluntarily choose whether for themselves they accept a given contract as binding or not, so everyone accepted the conventions only if they would see fit. This mechanism served the purpose of ameliorating the effects of opening the market, so “its possible negative effects would manifest themselves only gradually, and stay at a socially containable, manageable level”.²⁶

According to the evaluation by *Bruhács*, the GATT greatly contributed to the expansion of the world trade, and as a true multilateral trade system it realized a significant reduction in the customs fees on industrial goods - but it was less successful in the fight against other obstacles of commerce, such as quantity limits and subventions. The author also counts it as a success that the GATT provided an organizational framework for world trade negotiations during the multilateral negotiations (a.k.a. “rounds”).²⁷ This opinion is also shared by *Simai*, who claims that the negotiation rounds arranged under the aegis of this agreement greatly contributed to the reduction of customs fees between developed industrial countries, and the demolition of quotas in the international trading of industrial goods.²⁸

The GATT system, however, was about to face many problems. Many areas of economic relations were not included in the agreement (for instance flow of capital and services). And this is a problem because from the 1980s onwards the dynamic international flow of goods and services has been more and more prominent and international trade has begun to include goods such as software and other IT services, telecommunication, financial advice, advertising and cultural services.²⁹ GATT did not address the international trade of intellectual products, either. The third problem concerning the operation of GATT was the gain in the influence of transnational corporations.³⁰ According to *Simai*, the meaning of the phenomenon of transnationalization, as part of economic globalization is that in a process originating from the decision-making centers of international (as in, independent from national interests) companies, transactions within any given national sphere of economy are subjugated to the interests of global corporations, thus integrating certain areas of national production and service into global corporate systems.³¹ Don Kalb observes that the currently prominent forms of globalization can be seen as “*political project of globally imposed marketization*”, which is mainly sponsored by the transnational class segments of supranational agents and their comprador allies in dependent countries/economies.³²

Taking all these tendencies into consideration, as a result of the Uruguay Rounds series of negotiations (beginning in 1986 and dragging on until 1993), a contract packet was created, which completely restructured the former GATT 1947 system. This agreement, signed in Marrakesh (Morocco) on 15 April 1994 and has been in effective from 1 January 1995, brought the *World Trade Organization* (WTO) into existence³³.

This one now can clearly be identified as an international economic institution which mainly concerns itself with the rules of trade between states exerting its influence by the following activities: establishing, policing and supervising international trade agreements and mediating emergent conflicts³⁴. But the WTO can also be seen as a two-faced institution. Proponents of globalization or “global free competition” think that it is the “most harmonic mediator” of trade policy debates between nation states, the “manager” of the liberalization of international trade built upon the foundation of “solid international legal principles” and operating by a neutral and professional protocol.³⁵ However, critics of globalization see the WTO as

²⁶ Cséfalvay: *op. cit.* 106-107.

²⁷ Bruhács, János: Nemzetközi jog. III. kötet. Nemzetközi szervezetek. (International Law. Vol. 3. International Organizations). Dialóg Campus Kiadó, Budapest-Pécs, 2001, 114.

²⁸ Simai: *op. cit.* 246.

²⁹ Csáki: *op. cit.* 179.

³⁰ Vörös: *op. cit.* 78-79.

³¹ Simai, Mihály: Kihívások, alternatívák és útvesztők a globalizálódó világban (Challenges, Choices and Mazes in the Globalizing World. In: Bayer, József – Lévai, Imre (eds.): Globalizációs trendek. Tanulmányok (Trends of Globalizations. Studies) MTA Politikai Tudományok Intézete, Budapest, 2003, 62.

³² Kalb, Don: From Flows to Violence. Politics and Knowledge in the Debate on Globalization and Empire. In: Anthropological Theory, No. 5. (2005), 176-177.

³³ Bánrévy, Gábor: A nemzetközi gazdasági kapcsolatok joga. (The Law of International Economic Relations) Szent István Társulat, Budapest, 2001, 48-49.

³⁴ Blahó – Prandler: *op. cit.* 332.

³⁵ Ibid. 333.

nothing but an omnipotent organization “representing the interests of transnational corporations”, which is “a severe danger to citizens and to democracy”, putting trade above all values and “treating the whole world as marketable goods”,³⁶ thus decreasing the maneuverability of state trade policy while increasing the power of transnational players in the economy game.³⁷

One of this is certain: the WTO greatly transforms and controls the area of movement of nation states in trade policy and its activity already influences even the social policy of its member states.³⁸ Also, its tasks and licenses drastically exceed those of the GATT regime. In the words of Sonali Deraniyagala and Ben Fine: “the WTO seeks to bring about international harmonization of institutional, regulatory and legal standards through a variety of agreements and standards. Trade policy, therefore, now extends to issues previously considered to be beyond the realm of international trade, such as domestic investment, intellectual property and legal reform”.³⁹

The first pillar of the WTO is the GATT 1994, with its main concern being the trading of goods, thus, the following goals still remained very important: reducing customs and other means that restrict international trade, eliminating unequal treatment and expanding access to all markets. The second pillar is GATS (General Agreement on Trade in Services). And the third one is TRIPs and TRIMs (Trade Related Aspects of Intellectual Property Rights & Trade Related Investment Measures) as well as regulations concerning commercial investment.⁴⁰ According to critical opinions, each of these WTO agreements limits developing countries in their practice of industrial policy because they don't leave enough policy space for economic policy.⁴¹

It also can be observed that the WTO, as an independent organization under international law – as opposed to the GATT – wants to achieve the liberalization and regulation of the whole of international trade. To do this, it mainly uses the “arsenal” of positive control: it has established new, previously unheard regulation regimens which are binding to all members, so its activity affects the internal legal environment of member states far more drastically and directly. Thus, the activities of the WTO cover a far wider area than just customs policy, affecting the economic and social policies of member states as well. The WTO creates, on a multilateral basis, agreements and rules binding to all member states, so these member states have no option to apply the rules they like in an “*à la carte*” way. This is true even though the decisions of the WTO are made by member states with consensus.⁴²

3. DISPUTE SETTLEMENT IN THE FRAMEWORK OF THE GATT & WTO

According to the founding document of the GATT, its own decrees were mainly just suggestions; the GATT could not use sanctions.⁴³ In the GATT system, dispute settlement was sort of in between diplomatic and legal means of conflict management.⁴⁴ The procedure itself was defined in the 22nd and 23rd articles of the founding document of the GATT. According to this, the contract signatories were required to “kindly consider” the possibility of consultation and provide “a suitable occasion” for these in all cases of complaints concerning the operation of the Agreement. Moreover, if any of them wanted it, the contracting parties could conferee upon any issue, if in the problematic case there wasn't a suitable solution. Even in cases of neglecting to fulfill any duties accepted within the agreement or executing a decision of economic policy directly opposing the rules of the agreement, there was no possibility of sanctioning: the victim could only give a written complaint or recommendation to the offending party, or any other parties whom he deemed to be interested in. But the offending party was only required to

³⁶ George, Susan: A WTO. Korlátlan világkereskedelem vagy szolidáris globalizáció? (The WTO. Untrammled World Trade or Solid Globalization?) Napvilág Kiadó, Budapest, 2003, 9-10.

³⁷ Vigvári, Gábor: Beágyazott autonómia és a WTO. Fejlesztéspolitikai lehetőségek a Kereskedelmi Világszervezet szabályrendszerében (Embedded Autonomy and the WTO. The Opportunities of Development Policy in the Rule System of WTO). In: Fordulat, No. 8. (2010). 41.

³⁸ Cséfalvay: *op. cit.* 106.

³⁹ Deraniyagala, Sonali – Fine, Ben: Kicking Away the Logic. Free Trade is Neither the Question. Nor the Answer for Development. In: Sundaram, Jomo K. – Fine, Ben (eds.): The New Development Economics: After the Washington Consensus. Zed Books, London, 2006, 48.

⁴⁰ Bánrévy: *op. cit.* 49-52.

⁴¹ Vigvári: *op. cit.* 44.

⁴² Cséfalvay: *op. cit.* 106-107.

⁴³ Káldyné Esze, Magdolna: Nemzetközi kereskedelem. A nemzetközi vállalkozások gazdaságtana. (International Trade. Economics of International Enterprises) TRI-MESTER Bt., Tatabánya, 2004, 236.

⁴⁴ Bruhács: *op. cit.* 121.

“kindly consider” this complaint. Then finally, the issue at hand could be presented in front of all parties who, following an obligatory investigation of the matter, gave recommendations to the affected parties and were required to make a decision only as an *ultima ratio*, as a “necessary evil”. The most drastic possibility of sanctioning was allowing one or more of the contracted parties to suspend the use of concessions or other obligations included in the agreement.⁴⁵ However, to use any economic sanctions, all members had to give consent to them, including the country against which these sanctions were used.⁴⁶

As opposed to this, the dispute settlement protocol of the WTO was created focusing on the following point of view: dispute settlement is a “*primus inter pares*” guarantee of the reliability and security of the multilateral trade system. This protocol follows these 4 principles:

- i. uniformity; as in, all WTO agreements are subject to the dispute settlement forums' decisions, and to the protocol code;
- ii. automatism; i.e. there is no need for anybody's consent for the creation and mandates of panels, nor for the establishment of protocol rules and all conclusions and recommendations can only be prevented from being obligatorily effective by reaching consensus;
- iii. the legal nature of trade disputes, i.e. decisions of the dispute settlement authority are always obligatory;
- iv. lastly, the two-track approach: consult first and you can set the process resulting in an obligatory decision into motion only if the consultation fails.⁴⁷

So, in line with the 4th paragraph of the foundation document, parties in a dispute are mainly obliged to negotiate with each other within 60 days. They announce these negotiations to the *Dispute Settlement Body* (DSB) on its first meeting. If the consultation stage yields no results, on the second meeting of the DSB, a *Dispute Settlement Committee* is established. This committee has 20 days to acquire case studies concerning the issue(s) at hand (plus additional 10 days if the CEO was asked to establish the committee). This is followed by the investigation of the Dispute Settlement Committee, where the affected parties are also given a hearing. The real story, the factual basis of the dispute is summarized in the so-called intermediate report, which must be sent to the participants of the conflict so they can react to it. In the 6 months following the establishment of the committee, the final report must be made and within 9 months of the establishment of the committee, this report must be “published”. After this “basic protocol”, there can be an appeal stage, if any (!) member wants to exercise this right. The selected appeal committee investigates the causes of the appeal and makes a decision within 30 days. If the DSB has accepted the appeal report, it becomes effective and the execution stage begins. The loser needs to put a report together in which he describes how he will fulfill the requirements of the decision “in a reasonable timeframe”. In the absence of this fulfillment, the parties must agree on an amount of compensation corresponding to the damage that caused the dispute in the first place. If they cannot reach consensus, the WTO can apply the most drastic sanction: the DSB gives free reign to “retaliation” until the requirements in the decision are beginning to be fulfilled. This retaliation can happen in the branch of industry where the original dispute originated from or in any other sector, or even concerning any other agreement.⁴⁸

The dispute settlement protocol of the WTO has frequently been criticized because of the wide berth given to the DSB. *Susan George* called this body the “Supreme Court” of the WTO, which “accumulates” legislative, executive and judiciary roles, as it can make judgments, it can use sanctioning and it can render certain laws created by legislatures of the member states “illegal”.⁴⁹ With this, according to George’s evaluation, the WTO controls the entire sovereignty of its member states. Of the judges of the DSB she has claimed that as experts on economic law, they only take economic interests into consideration when making their decisions and neglect environmental or public health concerns. The author proposes that the DSB should be “forced” to conform to the principles of international law (George here mainly alludes to the *Universal Declaration of Human Rights*, the agreements of the *International Labor Organization*, and multilateral agreements concerning the environment and conservation). She also says that sanctioning

⁴⁵ A GATT és Magyarország csatlakozása. (The GATT and Accession of Hungary). Közgazdasági és Jogi Könyvkiadó, Budapest, 1975, 61-62.

⁴⁶ George: *op. cit.* 40.

⁴⁷ Bruhács: *op. cit.* 120-121.

⁴⁸ Blahó – Prandler: *op. cit.* 337-338.

⁴⁹ George: *op. cit.* 23.

should be executed by the means of monetary fines rather than “taxes” on certain products that actually punish the producers.⁵⁰

4. SUMMARY

From the study, it could be seen how fundamentally the state, which was once a separate public power with a claim to omnipotence, was transformed through the course of centuries. If we examine the classical sovereignty catalog of Bodin or Hobbes, we can draw the conclusion that many of the functions of nation states have become marginalized. With the wide acceptance of the liberal-monetarist point of view in economic policy and the increasing intensity of globalization, the influence that states could exert upon trade policy also diminished, which manifested itself in the quickening of the liberalization process. This is supported by the proponents of global capitalism - they even offer this as a model to follow for developing countries. However, antiglobalist movements vehemently attack this practice, demanding either comprehensive reforms or the complete rejection of the monetarist worldview which claims the deconstruction of states as its final goal. From our point of view as “Science as a Vocation”, we can only clearly state that while during the era of welfare states even the GATT functioned more as an organization sensitive towards national interests, after that, with the welfare state being demolished and the notion of “global free competition” becoming widespread, and of course the emergence of the WTO, the liberalization process significantly influences national economic and social policies. Obviously, the “expansion” of the effects of WTO agreements raises a number of legitimate concerns, for which the men of science must find solutions that stand on sound objective foundations, yet, also reflect upon social effects.

⁵⁰ *Ibid.* 97.

FINANCIAL CORRECTION APPLIED IN CASE OF IRREGULARITY

KINGA SZANDRA SZABÓ *

1. INTRODUCTION

Rules regarding the use of financial supports provided by the European Union might be infringed and in practice they are actually infringed; the complete investigation of such activities are served by irregularity procedures. If it is established in the course of such procedure that the financial support has not been properly used in accordance with the law or the contract, it results in serious legal consequences for the beneficiary (the winner of the tender) and may also jeopardize the financial interests of the European Union and Hungary.

In the present study the author puts emphasis on the demonstration of the most serious legal consequence, namely the (partial or full) repayment of financial support, i.e. the application of financial correction from civil law and public law aspect. However, this study only covers the Hungarian procedure in case of improper use of financial supports arising from the European Regional Development Fund, European Social Fund and Cohesion Fund.

In this topic only a few literature can be found in Hungary. Usually, monographs provide help to prepare an application to tender, while periodicals and publication of institutions of the EU deal with statistics, so examination of legal peculiarities of the system is generally ignored. Therefore, the author believes that the present study deals with an actual, current and relevant topic.

2. IRREGULARITY PROCEDURE

We can become acquainted with the legal background of irregularity procedures held/to be held regarding the financial period 2007-2013 from *Governmental Decree 4/2011. (I. 28.)* on the use of financial supports arising from the European Regional Development Fund, European Social Fund and Cohesion Fund in the financial period 2007-2013, from *Governmental Decree 55/2005. (III.26.)* on the recovery procedure of financial supports provided by the European Union and related state aids used unlawfully, improperly or not contractually and from *NFM direction 26/2012. (X. 24.)* on the unified operational handbook, and furthermore, on Union level primarily from the *Regulation EC 1083/2006*, *Regulation EC 2035/2005* and *Regulation EC 2168/2005*.

2.1. Definition of Irregularity

On one hand, 'irregularity' means any infringement of a provision of Community law resulting from an act or omission by an economic operator which has, or would have, the effect of prejudicing the general budget of the European Union by charging an unjustified item of expenditure to the general budget,¹ and on the other hand, any infringement of national law and any breach of obligation undertaken in the contract which jeopardize or would jeopardize the financial interests of Hungary.² The authority carrying out the procedure shall pay attention to the realization of elements of the above definition when it investigates unlawful, improper or not contractual use of financial support. The interpretation of breach of any provision of law or contract concluded in order to receive the financial support (hereinafter: grant agreement) is clear, however, for the first sight the prejudice of financial interests is difficult to interpret but can be explained as follows. According to *Regulation EC 1083/2006*, firstly Member States are entitled to financial supports arising from the Structural Funds, then, Member States divide it among the winners of several tenders in the framework of operational programs.

The use of money provided from the Structural Funds is evaluated by Member States and the managing authority shall also send an annual report to the European Commission on the execution of the operational programs. Thus, the number of irregularity procedures and their result has a significant

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¹ Regulation EC 1083/2006 Art. 2. Section 7.

² Governmental Decree 4/2011. (I. 28.) 2.§ (1) 24.



importance. Withdrawal and reduction of funds that is, when funds are not used in accordance with the original plans, infringe Hungary's interests because the Commission imposes sanctions on Hungary for the not proper execution of the financial support system and withdraws the money from the country. The reason beyond that sanction is that the aim of the Structural Funds is to solve the structural problems of certain regions and Member States while paying attention to the purpose of sustainable development. Furthermore, when Hungary or the EU cannot recover the improperly used financial support, expenses of a specific budget heading reduce and a certain amount of money will be unable to be used, it 'disappears'.

2.2. Irregularity Procedure

According to *Governmental Decree 4/2011. (I. 28.)*, an irregularity procedure can only be started after that the grant agreement is concluded with the beneficiary or the grant document (e.g. in case of alleviated consideration of a financial support) is issued. The procedure starts with the emergence of suspicion, which is recognized by the authority providing the financial support during a controlling, or the authority gets to know it from a third party. The procedure shall be finished within 45 days, which deadline can be extended once with another 45 days. During this period, so before passing a final decision, the legal entity carrying out the procedure has the opportunity to check the relevant documents and investigate the circumstances of the case, to hear persons and make on-site supervision.

The procedure can end with two types of decisions: one which establishes the irregularity and its legal consequences, and the other which determines that no irregularity was established. The law provides remedy opportunity for the beneficiary against the irregularity decision; the beneficiary is entitled to turn to the under-secretary leading the Prime Minister's Office.

According to Subsection (3) of Section 90, in case of establishment of an irregularity the following legal consequences can be applied alignment with the gravity of irregularity:

- i. reduction of eligible costs of the project and at the same time obligation of repayment of the unduly financial support,
- ii. cancellation of the grant agreement,
- iii. disqualification from the financial support system for a fix term but the maximum of 5 years, or
- iv. other legal consequence defined in EU law.

2.3. Financial Correction

Option a) and b) above means financial correction which can also be applied for a part of the support depending on the amount of money affected by the irregularity. However, the cancellation of the grant agreement, according to Subsection (1) of Section 320 of *Act IV of 1959 on the Civil Code* (the 'old' Civil Code), results in the termination of the contract with retroactive effect to the date of execution of the contract. The performed services, or in this case the money shall be refunded to the authority which provided it. According to Subsections (5)-(6) of Section 90 of *Governmental Decree 4/2011. (I. 28.)*, the financial correction shall be determined uniquely based on the documents of the case, and the amount of correction shall match the amount of money which incorrectly bothered the national budget and the Structural Funds. If the unique quantification of the rate of financial correction is not possible, it will be disproportionate to revoke all the money or it would give a misleading result, a flat-rate correction shall be applied. Flat-rate correction shall be based on the seriousness of the irregularity and the financial consequences of the irregularity.

With regards to the fact that the actual provision of financial support often takes place in more instalments, it can happen that the beneficiary does not receive all the instalments of the financial support (i.e. the total fund) before the irregularity decision is passed, in which case the withdrawn amount can be set-off in the amount that have not been paid out yet.

It is a great disadvantage for the beneficiaries that the repayable amount of money is subject to an interest equivalent to the basic rate of interest – in accordance with section 232 of the Civil Code –; while in case of delayed payment it is subject to a late payment interest. Furthermore, if penalty has been stipulated in the grant agreement, it can be also vindicated against the beneficiary. However, payment in instalments is an advantage. The execution of the decision on repayment, i.e. management of receivables includes a special element beyond the normally applied methods, receivables can be recovered as taxes and the national tax authority is obliged to carry out such procedures.

2.4. Financial Correction Applied by the European Commission against the Beneficiary

Not only a Hungarian legal entity is entitled to pass a decision on financial correction but also the European Commission, according to *Regulation EC 659/1999*. If a supposed unlawful financial support is brought to the attention of the Commission from any source, the Commission examines the information and starts the investigation promptly; the Commission gives opportunity for the Member State to make its remarks in the procedure. If at the end of the procedure a decision on repayment is made, the given Member State shall make the necessary actions to recover the money from the beneficiary. According to the judicial practice of the European Court, if a financial support was given by breach of law, the financial correction is always determined. The repayment is subject to late payment interest with regards to the fact that the fund was unlawfully used free of charge from the first time.³ Such case was carried out in 2008 regarding the fund provided to the waste water treatment plant of Csepel, Hungary. The Commission, in its final report, intended to determine a repayment of 10 billion HUF. The project was funded by the European Union in 65% and by the Hungarian State in 25%. The amount of money to be repaid was 25% of the fund. The reason behind the decision was that the Commission regarded it as serious irregularity that not the good type of public procurement procedure was started in the project. The controllers of the Union believed that it was a normal project but in the opinion of the Hungarian authority it was rather a complex project, thus, Hungary did not accept the argumentation of the Commission.⁴

2.5. Prejudice of Financial Interest of Hungary

At the definition of irregularity the author mentioned that irregularities may jeopardize the financial interest of Member States and the European Union. It is especially true when the beneficiary cannot completely meet its repayment obligation. It is reflected principally by two legal regulations.

On one hand, the European Commission may call the managing authority for repayment. In this case if the receivable is not recovered, the affected amount shall be transferred from the budget to the bank account of the managing authority in the given payment deadline,⁵ thus, Hungary will lose the money but the European Union will not.⁶

On the other hand, as it was already mentioned at the beginning of section 2 of this study that the European Commission may impose a sanction on a Member State for the non-appropriate execution of the support system. It is considered to be partial or full financial correction of the fund given from the Structural Funds to a Member State and imposed by the Commission upon the failure to meet the above obligation.⁷

3. EXAMINATION OF CIVIL LAW AND PUBLIC LAW ELEMENTS

In the relation when the legal entity provides the financial support and the beneficiary enters into a contractual legal relationship by concluding the grant agreement, the contractual parties according to the Civil Code, are equal. Section 2 of this study puts attention to the fact that in case of providing EU financial support, we cannot speak about a general civil law relationship because the law includes special provisions applicable to this relationship and on the side of the legal entity providing the financial support we can recognise authority powers, as well. I demonstrate this unique relationship from this aspect below.

³ Radnóczy Zsolt: *Támogatások az Európai Unióban* [Funds in the European Union]. Akadémiai Kiadó, Budapest, 2004, 226-228.

⁴ Eldugott szennyes [Hidden Laundry]. In: *HVG*, 2008. No. 47. (22 November 2008), 80.

⁵ Governmental Decree 4/2011. (I. 28.) 104.§ (3)

⁶ It was stated in connection with financial supports related to agricultural policy that the Member States often use a 'trick' in order to avoid the prejudice of their financial interests. When debts are deemed to be irrecoverable (if the beneficiary is insolvent or if the cost of the recovery action is likely to exceed the amount recovered), the regulation allows Member States to write them off. In such cases the debts are removed from the debtor accounts submitted to the Commission. If this write-off takes place before the four- and eight-year time limits, then the 50/50 rule does not apply and the amount is effectively charged in full to the EU budget. This creates the risk that debts are written off prematurely – that is before all possible recovery steps have been exhausted – in order to avoid the application of the 50/50 rule and the related charge on Member States. See in detail, *Recovery of Undue Payments Made under the Common Agricultural Policy*. European Court of Auditors Special Report, No. 8 (2011). Publications Office of the European Union, Luxembourg, 2011, 25.

⁷ Regulation EC 1083/2006, Art. 99.

Firstly, this study found it important to emphasise that not only an administrative-type body (e.g. managing authority) is entitled to conclude a grant agreement but also incorporated business associations (the so-called intermediate bodies) are allowed to do this by the authorization of law. In case of contracts concluded by intermediate bodies, it is remarkable that an intermediate body, mostly as a limited liability company or a public limited-liability company, owns such special rights which do not belong to any contractual party in a normal contractual relationship according to civil law.

The legal entity providing the financial support is entitled to carry out an irregularity procedure upon law authorization, so it is not the grant agreement which provides opportunity for the commencement of such procedure. However, both have close connections: the breach of the grant agreement, the improper use of the fund starts the irregularity procedure, while if an irregularity is established the legal entity providing the financial support is entitled to cancel the agreement or reduce the amount of the financial support. According to law, the legal entity providing the financial support carries out the irregularity procedure upon law, although the effective grant agreement is a prerequisite for that. Furthermore, even Subsection (1) of Section 92 of Governmental Decree 4/2011. (I. 28.) says that the irregularity decision determines, modifies and terminates rights and obligations arising from the contractual relationship of the beneficiary and the legal entity providing the financial support. In my opinion this specialty needs special attention. From the text of law we may conclude that the beneficiary must accept the unilateral irregularity decision and cannot use a remedy in front of a court or higher administrative body. There is only one remedy where the under-secretary leading the Prime Minister's Office has competence. It is very surprising for me because the under-secretary is neither a court, nor a higher administrative body and is dedicated to perform many different tasks. Thus, the legal entity providing the financial support has an exclusive, discretionary power to pass a decision on irregularity and this power cannot be taken away from the entity and judicial review is also excluded. Moreover, the irregularity decision can also come from Brussels, from the European Commission which institution is not a contractual party of the grant agreement (however, it is generally known that a part of the fund is provided by the European Union) and against its decision no remedy is ensured according to *Regulation EC 659/1999*; the beneficiary shall accept the decision and bear the legal consequences. Another peculiarity of this legal relationship is that if irregularity is established and the legal entity providing the financial support cancels the agreement, the national tax authority can recover the repayable amount as taxes charged with late payment interest. Section 301 of the Civil Code is applicable for late payment interest, which means that the interest is equivalent to the basic rate of interest despite the fact that in several cases two business associations are the contractual parties and according to section 301/A of the Civil Code, a higher interest could be counted. Of course, ignoring the latter provision is not unlawful, only less money will be recovered if the recovery is successful. Usually, the grant agreement defines the Civil Code as a law that prevails, however, the Civil Code and accordingly, the Code of Civil Procedure cannot be applied for all elements of the contractual relationship because in an irregularity procedure such provisions shall also be applied which are different from the regulations of the Civil Code.

Hungarian courts has already dealt with the applicability of the Civil Code, the cancellation of the grant agreement and the competence of civil court, the legal situation was not clear until the Supreme Court passed its economic decision of principle no. 2237/2010. I summarize the case behind the decision below because the author finds it important to get to know the different opinions of courts in this matter.

4. INSTEAD OF CONCLUSION – CASE STUDY

In the subject-matter the legal entity providing the financial support established in the irregularity procedure that the beneficiaries had committed irregularity and they shall repay the received fund. The legal entity also cancelled the agreement and the beneficiaries asked the court for judicial review of this cancellation. Later it was also a primary question in the case whether the civil court is competent in settling the legal dispute or not. The legal entity providing the financial support argued in the procedure at first instance that the grant agreement cannot exclusively be regarded as a contract based on the Civil Code because this legal entity had a competence transferred from the Community to carry out the irregularity procedure, which was acknowledged by the beneficiaries by signing the agreement. In contrast, at first instance the Metropolitan Court of Budapest stated⁸ that the Civil Code shall prevail at the

⁸ Court ruling of Metropolitan Court of Budapest [Fővárosi Bíróság] No. 22.G.41.644/2007/38.

interpretation of the parties' relationship and the civil court has competence to consider the legal dispute on the cancellation of the grant agreement. The Court referred to the fact that the right of cancellation was provided for the legal entity providing the financial support in accordance with law, and the Civil Code was stipulated in the agreement as a law applicable to the interpretation of the agreement. Anyway, the court established that the cancellation was lawful and rejected the beneficiaries' claim, who submitted an appeal against the decision.

The Metropolitan Court of Appeal (Fővárosi Ítéltábla) had a different point of view in the subject-matter⁹ and repealed the first instance ruling. The court at second instance believed that the legal entity providing the financial support concluded the grant agreement as an administrative body which is entitled to exercise official authority. Accordingly, public law shall prevail in the interpretation of the content of the contract, the rights and obligations of the parties. Thus, a public relationship existed between the beneficiaries (as clients) and the legal entity providing the financial support (as an authority) despite the fact that the Civil Code was stipulated in the agreement as a law that prevails. Moreover, the court emphasized that the beneficiaries shall repay the fund due to the irregularity decision, not as a consequence of cancellation of the agreement. Furthermore, the court ruling said that the civil court is not entitled to settle the dispute and there is only remedy against the irregularity decision.

The case continued at the Supreme Court as judicial review of the former court decision was requested. The Supreme Court stated in its ruling¹⁰ that the court of first instance was correct and the civil court has competence to settle the legal dispute between the parties based on the below reasons. Subsection (3) of Section 12 of *Act CXL of 2004 on the administrative authority procedure and general rules of services* (hereinafter: Ket.) lists that in the application of the act which administrative bodies shall be regarded as a body having authorization for settling authority matters. The legal entity providing the financial support is not mentioned in the list, in items a)–c). Although, Subsection (3) d) of Section 12 of Ket. says that any organisation, public body or entity which was not founded for performing administrative tasks is qualified as an administrative body if law authorizes it with authority power. Subsection (4) of Section 12 of Ket. includes that in such a situation all cases shall be defined where the provision of Ket. prevails. (These legal regulations are still in effect today.)

However, the court of second instance did not refer to any law according to which the legal entity providing financial support or its director should be regarded as an entity having authority power in making a decision on the cancellation, and did not refer to any law which stated that Ket. shall be applied. According to civil law, cancellation of a contract can be based on law or on a contract. The unilateral declaration on cancellation is a civil law declaration which was made by the legal entity providing the financial support upon the contract and not as an entity exercising authority power. None of the legal regulations stipulated that the legal entity providing financial support is entitled to cancel the contract in its authority power and no law said that Ket. is applicable for the review of this decision, the court established that the legality of the cancellation shall be examined in a civil law procedure and a civil court is entitled to run the case. The Supreme Court obliged the court of second instance to carry out a new procedure where the competence of civil court did not come up again.

⁹ Court ruling of Fővárosi Ítéltábla No. 9.Pf.21411/2009/3.

¹⁰ Court ruling of the Supreme Court [Legfelsőbb Bíróság, now Curia] No. Gfv.IX.30.1862010/7, which is also known as the economic decision of principle [gazdasági elvi határozat] No. 2237/2010.

THE PROTECTION OF AIR PASSENGERS' RIGHTS ON THE BASIS OF INTERNATIONAL AND EUROPEAN LAW

MAGDALENA MAJEWSKA*

1. INTRODUCTION

Over the last twenty years, air transport has had the largest development in Europe and worldwide. It is estimated that the annual increase in air traffic within the European Union after 1980 gained 7.4 percent. In 2011, airlines in 191 countries belonging to the International Civil Aviation Organization (ICAO) transported 2.7 billion passengers around the world, an increase of 5.6 percent than in the previous year,¹ while in 2010 European airlines alone transported 760 million² passengers. The total number of departures in 2011 is over 30.1 million.³ Currently, every day more than 25 000 aircrafts fly over the skies of Europe, 18 percent of which are delayed (average delay per delayed flight) for more than 15 minutes.⁴ In 2011, the average delay was 28 minutes.⁵ In the same year, 126 accidents involving commercial aircraft occurred all over the world, of which 16 resulted in death of 414 people.⁶ These figures will naturally provoke the interest of scholars in the subject of the passenger rights.

Often we observe – or even we, ourselves are involved – situations that directly concern the issue of the liability of the carriers and the need to enforce customer's rights at the airport. Therefore, this issue will be the subject of this study. The subject of passenger rights became extremely current, mainly due to work undertaken by the Committee on Transport and Tourism of the European Parliament on amendments to the Regulations of the European Parliament and Council Regulation No 261/2004 and 1107/2006,⁷ as well as other legal acts related to this issue in the European Union.⁸ The powers of using the airline services, like all others, will find its basis in relevant documents. Their protections in public international law are guaranteed by the following acts:

- i. Convention for the Unification of Certain Rules Relating to International Carriage by Air, Signed at Warsaw on 12 October 1929, (hereinafter referred to as the Warsaw Convention);⁹
- ii. Convention for the Unification of Certain Rules for International Carriage by Air signed in Montreal 28 May 1999 (hereinafter referred to as the Montreal Convention);¹⁰
- iii. New York Convention on the Rights of Persons with Disabilities drawn in New York on December 13, 2006.

In turn, protect the rights of air passengers in the European Union provide the following acts:

- i. Regulation (EC) No 889/2002 of the European Parliament and of the Council of 13 May 2002 amending Regulation Council Regulation (EC) No 2027 /97 on the carrier's liability aviation accidents lotniczych¹² (hereinafter referred to as Regulation No 889 /2002).¹¹

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¹ Annual Report of the Council, International Civil Aviation Organization, http://www.icao.int/publications/Documents/9975_en.pdf (10 April 2013).

² Jerzy, Litwiński: *Linie lotnicze świata w 2010 r.*, Urząd Lotnictwa Cywilnego [Airlines of the World in 2010.The Civil Aviation Authority].

http://www.ulc.gov.pl/_download/publikacje/porty_krajowe_11.pdf (10 April 2013).

³ Ibid.

⁴ Coda Digest. Delays on air traffic in Europe. Annual 2011,

<http://www.eurocontrol.int/sites/default/files/content/documents/official-documents/facts-and-figures/coda-reports/CODA-Digests-2011/coda-digest-annual-2011.pdf> (10 April 2013).

⁵ Ibid.

⁶ Annual Report of the Council..., *op. cit*

⁷ Regulation (EC) No. 1107/2006 of the Parliament and of the Council of 5 July 2006 concerning the rights of disabled persons and persons with reduced mobility when travelling by air, Dz. U. L 204, 26. July 2006 r., 1-9.

⁸ More: Majewska, Majewska: *Ochrona praw osób podróżujących drogą lotniczą w świetle najnowszych propozycji Parlamentu Europejskiego* [Protecting the rights of people traveling by air in the light of the recent proposals of the European Parliament]. *Przegląd Komunikacyjny* Vol. 58. (2013), No. 1, 26.

⁹ Dz. U. 1933 nr 8, poz. 49.

¹⁰ Official Journal of the European Union L 194, 18/07/2001 P. 0039 – 0049, [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:22001A0718\(01\):en:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:22001A0718(01):en:HTML) (30 May 2014).

¹¹ Official Journal of the European Union L 140 z 30.5.2002, 246-249.



- ii. Regulation (EC) No 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing common rules compensation and assistance to passengers in case of denied boarding and of cancellation or long delay of flights, repealing Regulation (EEC) No 295/91¹² (hereinafter referred to as Regulation 261/2004);
- iii. Regulation (EC) No 2006/2004 of the European Parliament and of the Council of 27 October 2004 on cooperation between national authorities responsible for the enforcement legislation on consumer protection ("Regulation on cooperation in the field of consumer protection").¹³
- iv. Regulation (EC) No 2111/2005 of the European Parliament and of the Council of 14 December 2005 on the establishment of Community list of air carriers subject to an operating ban within the Community and on informing passengers using air transport repealing art. 9 Directive 2004/36/WE.¹⁴
- v. Regulation (EC) No 1107/2006 of the European Parliament and the Council of 5 July 2006 concerning the rights of persons with disabilities and persons with reduced mobility when traveling by air.¹⁵
- vi. Regulation (EC) No 1008/2008 of the European Parliament and Council of 24 September 2008 on common rules performance of air services in the Community (hereinafter referred to as Regulation No 1008 /2008).¹⁶

Not all of those regulations will be discussed in detail in this paper due to its limitations. The author will only present a comparison of rights called, for the purposes of this article, fundamental rights such as the right to information, timely transport and related rights to compensation for delayed or canceled flights, boarding and the related compensation in the event of boarding refusal, secure carriage and related entitlement to compensation in case of death, injury or health disorders, carryon luggage, and related entitlement to compensation for its loss or delay in delivery. At the outset, it should be stressed that the Community signed the Montreal Convention indicating its intention to accede to the Agreement by ratifying in the Point 5 of the preamble of Regulation No 889 /2002. This decision caused a need for changes to previously existing Council Regulation (EC) No 2027/97¹⁷ in order to harmonize European and international standards. Without a doubt, despite the conducted harmonization of European legislation and international comparison of the rights of passengers in the two legal regimes is necessary due to the slight, but still existing differences in the entitlements. It has become necessary to become aware of their existence in view of the increasing mobility of the population, not only in the EU but also outside it. It is also necessary due to the growing interest in travel in the eastern direction by European Union citizens and disruptions occurring during these travels. The subject of the preliminary analysis will be the scope of individual acts.

In accordance with Art. 1 of the Montreal Convention, it is applicable "to all international carriage of persons, baggage or cargo performed by aircraft for reward. It applies equally to gratuitous carriage by aircraft performed by an air transport undertaking." In general, the act actually repeats the provisions of art. 1 of the Warsaw Convention of 1929, and the difference is only that the Montreal Convention uses the phrase "loads" (cargo) instead of previously used word "goods" (goods). The original definition of international carriage contained in the Warsaw Convention has been modified by provisions of the Hague Protocol¹⁸ and after that it coincides with the definition in the Montreal Convention. However, the definition of air transport undertakings or the carrier is not found here, despite the fact that it lays down its legal situation.¹⁹

At this point desirability of reproducing the definition of both the Warsaw and Montreal Convention should be emphasized. It stems from the fact that both systems exist in parallel but formally independent systems because not all state parties to the first accepted the other, and if so, did not denounce (so far) of the Warsaw Convention. Since this raises collisions of international obligations the Convention Montreal

¹² Ibid. L 46 z 17.2.2004, 10-16.

¹³ Ibid. L 364 z 9.12.2004, 1-11.

¹⁴ Ibid. L 344 z 27.12.2005, 15-22.

¹⁵ Ibid. L 204 z 26.7.2006, 1-9.

¹⁶ Ibid. L. 29 z 31.10.2008, 3-20.

¹⁷ Council Regulation (EC) No 2027/97 of 9 October 1997 on air carrier liability in the event of accidents, Dz.U. L 285 z 17.10.1997.

¹⁸ Protocol to amend the convention for the unification of certain rules relating to international carriage by air, signed at Warsaw on 12 October 1929, The Hague 28 September 1955, <http://www.mcgill.ca/files/iasl/hague1955.pdf> (31 May 2014).

¹⁹ Polkowska, Małgorzata – Szymajda, Izabela: *Konwencja montrealaska. Komentarz. Odpowiedzialność cywilna przewoźnika lotniczego* [The Montreal Convention. Comment. Civil liability of the Air Carrier]. Liber 2005, 21.

contains Art. 55 stating that it has priority of application by state parties in relations between the countries party to the new Convention in this respect, they are also parties to one or more documents of the Warsaw system, or the territory of any state party to the new Convention, in this respect that the country is also a party to one or more documents of the Warsaw system. Regulation (EC) No 889/2002 already in the Art. 1 contains information that it introduces the relevant provisions of the aforementioned Montreal Convention in respect of the carriage of passengers and their baggage by air. In this article, however, we can also find the record that it establishes certain supplementary provisions and that it extends the application of these provisions also in relation to carriage by air within each Member State. Therefore it extends the scope of application of the provisions of the Montreal Convention to carriage made within each Member State of the EU, thus modifying for this purposes of this Regulation, the definition of international carriage contained in the Convention.

Regulation (EC) 261/2004 Art. 3 says, however, that it shall apply to:

(a) to passengers departing from an airport located in the territory of a Member State to which the Treaty applies;

(b) to passengers departing from an airport located in a third country to an airport situated in the territory of a Member State to which the Treaty applies, unless they received benefits or compensation and were given assistance in that third country, if the operating air carrier of the flight concerned is a Community carrier.²⁰

At the same time, in the case 173/07²¹ Spokesman of the Court of Justice considered that the passengers on a return flight from a third country to a Member State are not “*passenger (s) departing (I) from an airport located in a Member State*”- within the meaning of Art. 3. Para. 1 point a) of the Regulation No. 261/2004 and therefore do not fall within the personal scope of application of this Regulation, if the air carrier of the flight concerned is not a Community carrier, even if a flight to destination place and return flight were booked at the same time.

2. THE SCOPE OF THE RELEVANT RIGHTS

2.1. Right to Information

Regulation No 261/2004 in Art. 14 provides for the obligation to inform passengers about their rights. It imposes an obligation on air carriers to place the information about these rights at a prominent place at check-in, and its content according to Article 20. In addition, it imposes the need to submit individually written information about passenger rights to people who were actually denied boarding or whose flight is canceled or delayed for at least two hours. It also emphasizes the need to provide such information to the blind or partially sighted by other available means. Moreover, Art. 6 of the Regulation No 889/2002 states that all air carriers offering their services in the Community have an obligation to ensure that a summary of the main provisions governing liability for passengers and their baggage, including deadlines for the payment of compensation and the possibility of making a special declaration for baggage, is available at all points of sale, including sale by telephone or via internet. Along with the information requirements set above, in accordance with the provisions of the Regulation, all the carriers in respect of carriage by air provided or purchased in the Community, have the duty to provide each passenger with a written indication of:

- (a) the applicable limit of liability of the carrier for the flight in case of death or injury, if such limit exists;
- (b) the applicable limit of liability of the carrier for the flight in case of destruction, loss or damage of baggage and warning that the baggage of greater value than the specified amount, should be reported to the airline at check-in passengers and baggage or should be separately, fully insured by the passenger prior to travel;
- (c) the applicable limit of liability of the carrier for the flight for losses caused by delay.

²⁰ <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32004R0261> (30 May 2014).

²¹ Opinion of the Advocate General of the Court of Justice of the European Communities on 6 March 2008, *Emirates Airlines Direktion für Deutschland v. Diethe Schenkel*, C-173/07, *LexPolonica*: 272942.

The Warsaw Convention and the Hague Protocol supplement, however, do not contain similar records relating to the information obligation incumbent on the air carrier. The Montreal Convention in Art. 3 only contains a record that the passenger receives a notice in writing stating that, if this Convention applies, it governs and may limit the liability of carriers in respect of death or injury and for destruction, loss or damage of baggage, and for delay. Therefore, the scope of information guaranteed by the provisions of the legislation in force in the European Union is undoubtedly much broader than that of the international regime. Passengers traveling from or to the EU countries and using the services of European Union carriers are able to orient themselves to their rights significantly faster and easier due to provisions of the Regulations. In addition, it should be noted that the right to information governed by the EU also affects the price information and this issue was not raised in acts of international importance. The probable cause of this is the period of their formation. This problem has been settled in Art. 23 of Regulation No 1008/2008, prescribing that the publicly available tariffs and air rates, including conditions of carriage and the price which the passenger has to pay have to be always demonstrated. Also, this price must also include the applicable tariffs and air rates, taxes, surcharges, fees and charges in detail that are impossible to avoid and possible to demonstrate at the time of publication of the offer. This information should be presented in a clear and transparent way at the beginning of booking and consent to their acceptance by the customer shall be optional. So, detailed regulation only appeared in 2008 and there was a, no doubt, Community (now EU) reaction to the not always clear practice of air carriers.

2.2. The Right to Timely Transport: Transport Delay

The issue of flight delays is extensively regulated both in the European Union legislation and in international instruments, although, the very definition of delay is not found in any of them. Article 19 of the Warsaw Convention (unchanged by the Hague Protocol) refers to the responsibility of carriage for damage occurring from delay in the carriage of passengers, baggage and goods. By contrast, Article 20 (which also remained unchanged) exempts the carrier from liability if it proves that the carrier and persons acting as its employees have taken all necessary measures to avoid the damage or that it was impossible for them to take the measures. These provisions were developed similarly in articles 19 and 20 of the Montreal Convention. In the first, only the word "community" and "goods" were replaced by "people" and "load". This article is also supplemented with a record of which in the Warsaw Convention was devoted a separate article (Article 20), namely the release of the carrier from liability for damage occasioned by delay if it proves that it and its employees and agents took all reasonably, necessary measures to avoid the damage or that it was impossible for them to take such measures. The wording of this article, compared to a similar record in the earlier convention, is more flexible and realistic and creates easier to accept and fulfill standard.²²

Article 20 of the Montreal Convention expands this exemption from liability for the causes when the damage is caused by the negligence or other wrongful act or omission of the person claiming compensation, or the person from whom he or she derives his or her rights or to which such persons have contributed. In such a situation, in accordance with the provisions of the quoted document, the carrier shall be wholly or partly exonerated from its liability to the claimant to the extent to which such negligence or wrongful act or omission caused or contributed to the damage. Limits to the carrier's liability have not been established in the Warsaw Convention, so it seems that limit fixed by Hague Convention should be adopted, and it is 250 000 francs for both delay and harm to the person. Regarding the second Convention, the limit is determined there and it is 4 150 Special Drawing Rights (SDR), then increased to a higher amount. It is presumed that the carrier is not at fault and will not be charged until reason (passenger) did not demonstrate that due to the delay in the carriage suffered damage.²³

The Art. 6 of Regulation Nr. 261/2004 regulates the issues of flight delays. It provides that if the operating carrier has reasonable reasons to predict that the flight to be delayed beyond its scheduled start of concrete specified in article standard time on the route of the designated therein the length²⁴ of the

²² Polkowska et al.: *op.cit.* 60.

²³ Ibid.

²⁴ Article 6:

- a) two hours in case of flights to 1500 kilometers ; or
- b) three of more hours in case of flights in the EU that are longer than 1500 kilometers and other flights with the length in between 1500 and 3500 kilometers; r
- c) four or more hours in case of other flight that described in point a) or b)

passengers offered by the operating air carrier help in the form of meals and drinks in a reasonable relation to the waiting time, and the possibility of holding two phone calls or sending two teletype or two fax messages, or e-mailing. In a situation when the reasonably expected time of departure is at least the day after the deadline departure previously announced, the assistance will take the form of hotel accommodation with provided transportation between the airport and place of accommodation (hotel or other).²⁵ In contrast, when the delay is at least five hours, however, the expected departure will take place on the same day as the original flight, passengers are entitled to reimbursement within seven days, by the means provided for in Art. 7, Para. 3 of the Regulation, the full cost of the ticket at the price at which it was bought, for the part or parts of the journey not made and for the part or parts already made if the flight is no longer serving any purpose in relation to the passenger's original travel plan. Passengers can also apply for a place in the return flight to the first point of departure at the earliest possible date.

2.3. *The Right to Travel: Flight Cancellations*

The above discussed international conventions were silent on a definition of the transport cancellation and – differently to European Union law system – do not regulate this issue that is treated in details in Regulation 261/2004 in Art. 5.

In case of flight cancellation passengers are guaranteed assistance by the operating air carrier in accordance with Art. 8 and Art. 9, Para. 1 point a) and Art. 9, Para. 2, as well as, in the case of re-routing when the reasonably expected time of departure of the new flight is at least one day after the scheduled start of the canceled flight, the assistance specified in Article. Article 9, Para. 1 point. b) and c) and, with some exceptions, have the right to compensation by the operating air carrier in accordance with Art. 7. Situations where passengers are deprived of such rights, are those in which they were informed of the cancellation at least two weeks before the scheduled time departure or during a period of two weeks up to seven days before the scheduled time of departure and were offered re-routing, allowing them to depart no more than two hours before the scheduled time of departure and to reach the final destination less than four hours after the scheduled time of arrival. This also applies to passengers who have been informed of the cancellation less than seven days before the scheduled time of departure and were offered re-routing, allowing to depart no more than one hour before the scheduled time of departure and to reach the final destination less than two hours after the scheduled time of arrival. The Regulation also guarantees the need to provide passengers, which were informed of the flight cancellation explanation of the possible alternative transport.

Moreover, the Regulation limits the liability of the operating air carrier on the payment of the compensation provided in Art. 7 in a situation when air carrier can prove, that the cancellation was caused by extraordinary circumstances which could not have been avoided even if all reasonable measures. The obvious and *expressis verbis* regulated issue is that the burden of proof of whether and when the passenger has been informed of the cancellation, rests on operating air carrier.

2.4. *Right to Boarding: Denied Bording*

Which the problem of denied boarding, which is caused by the so-called over booking, we as passengers, meet more often. It has been calculated that in 2002 in the European Union 250 000 of passengers were denied entry on board.²⁶ Low cost airlines (but not only) sell more tickets than they are able to offer on a given passage, hoping that not all passengers decide to finally take advantage of their services. The problem of over booking has not yet been regulated by any of the documents dealing on an international scale but it is already regulated by European Union. The definition of this phenomenon is in Art. 2 of the Regulation 261/2004 and means a refusal to carry passengers on a flight, although they have presented themselves for boarding under the conditions laid down in Art. 3. Para. 2 of the Regulation, unless it is reasonably justified, in particular reasons of health, the requirements security or inadequate travel documentation. Article 4 of that document contains the relevant records relating to denied boarding. This provision refers to the entire procedure to be followed in such situations, explaining that at the time, the carrier has reasonable grounds to anticipate a refusal boarding, it shall first call for volunteers to surrender their reservations in exchange for benefits under conditions agreed between the passenger and the air

²⁵ Art. 8 lit. b) Regulation 261/2004, s. 14.

²⁶ Polkowska, Małgorzata: *Ochrona praw pasażerów w transporcie lotniczym*, [Protecting the Rights of Air Passengers.] *Jurysta*, No. 10-11 (2006), 24.

carrier serving. In accordance with the provisions of the Regulation, volunteers should be given assistance under the terms of Art. 8, treating it as an addition to the benefits mentioned in this paragraph. However, if the number of volunteers comes forward to allow the boarding of other passengers with reservations, the operating air carrier may, against their will, deny boarding, in that case it must immediately compensate them in accordance with Art. 7 and assist them in accordance with Art. 8 and 9 of Regulation.

2.5. The Right to Safe Carriage: Compensation in Case of Death, Injury and Disturbance of Health

According to Article 17 of the Warsaw Convention the air carrier is responsible for damage caused in the event of death, wounding or any other bodily injury suffered by a passenger if the accident which caused the damage, occurred on board the aircraft or during any operations of embarking or disembarking. It does not conform for all activities associated with effected journey, made or occurring at the airport (which was the subject of the analysis of the Polish Supreme Court, in the case number I CR 330/7028²⁷). Article 22 limits the liability to the amount of 25 000 francs per passenger, claimed, however, that it is possible to determine the upper limit by special agreement. The Montreal Convention governs the liability for death, personal injury and also health disorder in the Art. 17, acting almost the same as the Warsaw Convention. Its composition insists, however to meet the conditions in the form of an accident on board the aircraft or during any of the operations of embarking or disembarking. In Art. 21 the boundaries of compensation for these events had been established and it is assumed that the carrier is always responsible for damage caused by death or personal injury to a passenger or upset health to the size of 100 000 SDR for each passenger (strict liability regime, independent the degree of fault of the carrier).²⁸ Importantly, if the carrier proves that such damage was not due to the negligence or other wrongful act or omission of the carrier or its servants or agents, or when such damage was solely due to the negligence or other wrongful act or omission of a third party (right of recourse) it shall not be more than the listed consequences.

In European Union law above mentioned issues have been regulated in a different manner. Regulation 889/2002 states that there are no financial limits on liability for death or injury of a passenger. Air carrier cannot contest claims for compensation for damages amounting to 100 000 SDR (approximate amount in local currency). Above this size the air carrier can defend itself against a claim by proving that it was not negligent or otherwise at fault. Moreover, according to the wording of the Regulation, if a passenger is killed or injured, the air carrier must, within 15 days of establishing the person entitled to compensation, make an advance payment, to cover immediate economic needs. In case of death, this advance payment shall not be less than 16 000 SDR (approximate amount in local currency).

2.6. Right to Carry Luggage: Responsibility for Corrupted or Damaged Luggage

One of the basic matters governed by international law and European Union law is the carrier's liability for defective or damaged luggage. It has already been settled in the Warsaw Convention, that in Article 18 (not amended by the Hague Protocol) provides that air carriage is responsible for damages in case of destruction, loss, or damage to, the expedition baggage or cargo, if the incident that caused the damage took place during the carriage by air, and Art. 19 additionally governs the liability for baggage delay. Furthermore, in the second paragraph of Article 18 air transport is defined as the period during which the baggage or goods are under the care of transporting, regardless of whether they are at the airport, on board of the aircraft or in any place in case of landing outside the airport. This period does not cover any carriage by land, sea or river, made outside the airport. The Convention limits the liability of the carrier baggage accepted for shipment and goods (as amended by the Hague Protocol) to the sum of 250 francs per kilogram, except in the case of deposit by the consignor at the time of going to the carrier package special declaration of interest in delivery and payment of any additional payment. In this situation carriers will be obliged to pay compensation up to the amount of declared sum, unless it proves that this amount exceeds the consignor's actual interest in delivery. In the event of loss, damage or delay of part of baggage accepted for shipment or goods or any object contained therein, to determine the limit of liability takes into account only the total weight of the package or packages. However, if loss, damage or delay of one

²⁷ Wyrok Sądu Najwyższego [Judgment of the Supreme Court] from 19.01.1971 r., I CR 330/70, OSPiKA 1972/2 poz. 31, LexPolonica, Nr 319259

²⁸ Polkowska et al.: *op. cit.* 65.

part of the baggage accepted for expedition or cargo, or of any object contained therein causes reduction in the value of other packages covered by the same baggage receipt or the same letter, to determine the limit of liability should take into account the total weight of the packages.

As for the items, which takes care of the passenger carrying responsibility is limited to 5,000 francs in relation to one passenger. A slightly different issue is governed by Art. 17, Para. 2 and subsequent of Montreal Convention stating that the carrier is liable for damage sustained in case of destruction, loss or damage to, checked baggage upon condition only that the event which caused the destruction loss or damage took place on board the aircraft or during any period within which the checked baggage was in charge of the carrier. Destruction in the meaning of this Convention need not be caused by an accident,²⁹ and the carrier is not liable if the damage resulted from the inherent defect, quality or vice of the baggage. On the other hand, in the case of unchecked baggage, including personal items, the carrier is liable if the damage resulted from its fault or that of its employees or agents.³⁰ Also the traveler is entitled to claim from the carrier the rights under the contract of carriage, if it admits the loss of checked baggage, or baggage has not arrived after 21 days from the date on which it should arrive. The term of its delivery shall be calculated from the time arranged in accordance with the timetable of arrival.³¹ According to the provisions of the Convention, unless otherwise specified, the term "baggage" means both the accepted and adopted. Similarly, as in the case of the Warsaw Convention, the issues of delays in the delivery are regulated by Art. 19. The limits of liability of the carrier can be found in Art. 22, according to which in the case of destruction, loss, damage or delay the liability has been limited to 1 000 SDR for each passenger unless he has made, at the time when the checked baggage was handed to the carrier, a special declaration of interest in delivery at destination and has paid additional charges. In such a situation, the carrier is liable for an amount not exceeding the declared amount, unless he proves that the sum is greater than the passenger's actual interest in delivery at destination. Establishing a permanent limit of liability for damages arising from a carriage of baggage, this provision has become more equitable for passengers than similar regulations contained in the Warsaw Convention (the limit based on weight), because the value of the baggage is not related to its weight.³² European Court of Justice³³ also held that determined in Art.22, Para.2 limit of the carrier's liability should be applied to the entire damage, regardless of whether it is the nature of the material, or moral. Responsibility for destroyed, damaged or delayed baggage regulates the Regulation 889/2002, under which, in the case of baggage delay, the air carrier is liable for damage unless it took all reasonable measures to avoid the damage or taking such measures was not possible. The liability for baggage delay is limited to 1 000 SDR (approximate amount in local currency). The air carrier is also responsible for the destruction, loss or damage to baggage up to 1 000 SDR (approximate amount in local currency). In the case of checked baggage, it is liable even if not at fault, except where the baggage was defective. In the case of unchecked baggage, the carrier is liable only if at fault. Moreover, in accordance with the provisions of the Regulation, the passenger can benefit from a higher limit of liability of the carrier for baggage by submitting special declaration at check-in and by paying a supplementary fee. In any case, if the baggage is damaged, delayed, lost or destroyed, the regulation imposes an obligation on the passenger as soon as possible submit a written complaint to the carrier. In case of damage to checked baggage, the passenger must write and complain within seven days, in the case of delay within 21 days. In both cases, the period shall run from the date on which the baggage was placed at the disposal of the passenger.

3. SUMMARY

The analysis presented in this article shows that despite many existing similarities, the differences are relevant in these different legal regimes. At the same time it refers to how important it is to be aware of these differences in the daily life of every European, or just a passenger. In summary, the rights of citizens of the European Union in this field should be assessed as far broader and more far-reaching, but even these, although seemingly quite detailed and comprehensive regulations are subject to debate on possible

²⁹ Polkowska et al.: *op. cit.* 56.

³⁰ E. g. when the baggage is damaged by the cabin crew to help the passenger locate it on a shelf.

³¹ Polkowska, et al.: *op. cit.* 56.

³² *Ibid.* 68.

³³ Wyrok Trybunału Sprawiedliwości [Judgment of the Court of Justice] 06.05.2010 r., C-63/09, ZOTSiS 2010/5/I-4239-4260, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62009CJ0063:PL:HTML>.

changes. At this point it should be noted that the existence of even the best legislation cannot be assessed as complying with their duties until their provisions do not become common and used knowledge.

ISSUES OF SELLING MOVABLES PLACED IN PUBLIC WAREHOUSE BY AUCTIONS

GABRIELLA NÉMETH *

1. INTRODUCTION

Different issues arise from selling the tangible assets placed in public warehouse by auction. During the public (executive) auction of personal properties, the protection of proprietary rights and the protection of creditors' interests may conflict. And because the real owner and the effective possessor of goods is not the same person, moreover, public warehouses may have their own creditors claiming for compulsory execution, thus, it is worth reviewing some aspects of this legal situation. In the present study the author summarizes the characteristics of public auctions, the representatives of the public warehouse transaction and the specialties of the legal fate of the chattels placed in public warehouse.

According to the regulations of the *Civil Code* on public auctions, the purchaser in good faith may acquire the ownership of tangible assets from the owner (or become an owner if the asset has not been the property to anybody, in case of original method of acquisition). In this respect, the new *Hungarian Civil Code* did not brought essential changes. As the acquisition by auction constitutes original acquisition, a declaration by the previous owner is not needed.¹

A particularity of the warehouse auction compared to the Civil Code is that in such circumstances the ownership of the goods may also be acquired, even if the depositor was not the owner. However, the rules on the public warehouse auction were determined by the *Act XLVIII of 1996 on the public warehouse as lex specialis*. During the execution procedure it is prohibited as of law to put the goods placed in public warehouse on auction (as well as these goods are not subject to the property of the public warehouse according to the *Act on Bankruptcy Proceedings and Liquidation Proceedings*).

2. POSSIBLE PARTICIPANTS, SUBJECTS AND RISKS OF WAREHOUSE TRANSACTIONS AND THE EXECUTION PROCEDURE

Let us have an overview on the possibility for warehouse goods being the subjects of execution and on the parties or possible participants of the execution procedure. The act on execution has separate provisions on those assets which are exempt from execution² and expressly removes goods and merchandise placed in public warehouse from executable tangible assets.³ Chattel is obviously not the same as the deed issued in relation with the chattel called warehouse warrant, which may be subject to execution and in case of insolvency proceedings it shall be considered an asset of the organization under bankruptcy or liquidation procedure. (Otherwise the liquidation of the weight note possessor may not prevent the possessor of the warrant to claim for sale of the goods according to the provisions of this Act by the public warehouse, the bankruptcy and liquidation of the warrant possessor may not have effect on the right of the weight note possessor.⁴)

The depositor receives a commercially negotiable deed, the so-called warehouse warrant, which is issued by the public warehouse in the form and with the content stipulated in the warehouse act. The warehouse warrant consists of weight note and warrant, and the joint possession of both notes grants the license of the delivery of goods. These tickets – contrary to goods placed in public warehouse as escrow – may be acquired by auction and enforcement, however, the goods itself in public warehouses shall not be drawn into the auction by the executive, or cannot be subjects of a seizure. This also means that with this

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¹ *Act IV of 1959 (old Civil Code)*. The former Hungarian Civil Code had been in force until March 16th, 2014, Section 120.

² *Act LIII of 1994 on judicial execution*, Section 89, Para. (1): It cannot be under seizure – even with the consent of the debtor – those assets which are exempt from execution by the law. (2) If the law stipulates alternatively the round of those assets which are free from execution, the exemption is on the appointed assets by the debtor presented on the seizure. (3) According to the order of the court even not executable goods may get under seizure due to the enforcement of the purchase price, the given loan for the purchase price for the goods, and furthermore for the preparation and repair fee of the goods.

³ *Act LIII of 1994*, Section 96, Para. (1) and (2).

⁴ *Act XLVIII of 1996 on public warehousing*. Section 38, Para. (4) and (6).



original acquisition mode the ownership of goods may not be acquired directly through the auction but “only” by the acquisition of the warehouse warrant.

The main characteristics of warehouse transactions are worth reviewing and we shall also analyze the following problems: Who owns the goods placed in public warehouses? What kind of goods may be placed in public warehouses? Why are goods placed in the public warehouses? What do public warehouses do and what is allowed to do with the goods? How goods are removed from public warehouses? Whose interests would be harmed by the transfer of ownership of movable property by execution auction?

It is also to be monitored against which party of the warehouse transaction may the enforcement procedure proceed; and the problem that whose goods – owned or possessed – may or may not be subject to execution of each execution auctions, shall be construed according to this. The act on enforcement procedure expressly removes the chattels and goods placed in public warehouses from the executable properties, however, does not do so with the warehouse warrant or the public warehouse’s own, executable movable property.

The goods and merchandise that may be subject to execution shall be examined in terms of possible legal acts in the given execution process that is, against whom the enforcement procedure is going on, the public warehouse or the former depositor (or possibly the possessor of the ticket which authorizes disposal). Accordingly, execution procedure may be:

i) *against warehouses* (who is the real possessor of the goods) *as debtors*, where the aim is to take securities on the public warehouse’s owned and possessed asset in the protection of the public warehouse’s creditors,

ii) *or against such person who has a warehouse warrant* (one is entitled to the handover of goods upon the delivery from the public warehouse), thus, may be considered as the owner of goods who is not the possessor and has a creditor but is not warehouse himself.

In both cases the execution may seem problematic, since in the first case the chattel is not owned by the public warehouse, although it possesses it, in fact, it is also possible that it was not owned by the depositor either before it was placed into the public warehouse. Thus, the owner of the goods possessed by the public warehouse in the moment the execution procedure was initiated, may be theoretically unknown as well. According to the act on public warehousing, public warehouses are not entitled and nor obliged to consider whether the depositor is the owner of the goods, and the transfer of warehouse warrants may not be announced to the warehouse either. This fact turns out by the presentation of the warehouse warrant’s endorsement. The warehouse transaction secures that upon the goods placed into the public warehouse the ownership may change several times without moving the goods only by endorsement.⁵

In the second case the creditor tries to acquire the goods from the debtor during the enforcement procedure against the takeover entitled owner. However, instead of the goods, the owner “only” possesses the value note of the goods, the chattel itself is in a safe keeping escrow, as a matter of fact, may be presented in the note issuer public warehouse. In addition, only the joint possessor of the weight note and the warrant may be regarded as a full owner without any restrictions.

2.1. Execution against the warehouse as debtor

In the first case, the warehouse is that commercial organization against which enforcement procedure may be initiated by a creditor on a sort of legal ground. The executive, according to the duly submitted claim of the creditor, which means the request of the claimant possessing the entitled appropriate material may initiate the enforcement procedure.

In public warehouses not only the warehouse’s own asset but escorts placed in the public warehouse may also be found. On the basis of the warehouse act, the public warehouse shall separately store the deposited chattels from its own asset, right up on the protection of the creditors, so the public warehouse

⁵ The warehouse warrant is a negotiable instrument. This means that it is transferable by endorsement as well as the bill of exchange, and the transfer even occurs if the transfer is not in accordance with its notice. The warehouse warrant is transferable together and even with the separate transfer of the warrant and the weight note. The warehouse warrant shall be endorsed upon transfer.

shall state the warehoused stock substance on the value represented on the warehouse warrant monthly, by the 15th day of the following month after the month under review in its financial accounts.⁶

According to the warehouse act, goods placed by the depositor do not become own properties of the public warehouse (only temporary, well separated and registered trust). Therefore, it is necessary to clearly demonstrate it in the act on enforcement that goods placed in public warehouses may not be taken under execution procedure against the public warehouse.

2.2. Execution against the real owner of goods as debtor

Enforcement procedures may be filed against the owner, as debtor as well, who is not a public warehouse but the goods in its property have been previously placed into a public warehouse. This is attested by the warehouse contract and the warehouse warrant issued at the initiation of the custodial escrow. Goods get out of the possession of the owner into the warehouse and the proprietary rights are attested by the negotiable warehouse warrant which certifies the right of delivery. The executive cannot acquire the goods, only the warehouse warrants through seizure if it still in the possession of the owner against whom an enforcement procedure has been brought.

This restraint of enforcement outstands whether the enforcement procedure is against the public warehouse, whether the enforcement procedure is against such third party who claims him/herself as owner or who is entitled to dispose over the goods. Accordingly, the ownership is exclusively expressed by the joint possession of the issued and market circulated warehouse warrant (weight note and warrant), which is an obligation of the public warehouse to deliver the goods.

It is mentioned here that the enforcement auction as a legal instrument of the original acquisition of ownership since the *Hungarian Civil Code* may not be applicable as contracting technique for private auctions.⁷ Recently, the rules of contract law of the Hungarian Civil Code and besides general rules also provisions of agency contracts and contracts of carriage shall be applied, thus, in the case of private auctions it shall only be referred as derivative acquisition of ownership method. Usually, first and foremost may be from the owner, unless exceptions are allowed by the law. Consequences arising from the principle of '*nemo plus iuris*'⁸ and questions of the implied warranty and warranty of title may be geared to this. In this present case the applicability of exemptions allowed by the enforcement law are examined in connection with public warehouse auctions and due to these aspects question of taking goods placed into public warehouses into auction along the above mentioned logic shall be examined.

Public warehouses are such private limited companies or a foreign seated company's branch offices in Hungary which are licensed and are under the supervisory of the State, where goods may be temporarily placed into the custody of public warehouses under contract. Public warehouses' activity is to store and trust the goods under the provisions of the warehouse contract and according to the act on warehouses and issue the warehouse warrant and deliver goods. The public warehouse activity does not mean the right to dispose over the ownership of goods, only their possession and treatment within the applicable legal framework, which means the custody due to the contract, the appropriate treatment during the custody (the preservation of the quality and quantity), and then at the end of the duration of custody it may include the obligation for delivery.

The main feature of public storage operations is precisely a legal ground for a long term but not with a permanent effect, the ownership and the possession of goods (chattels placed in public warehouse) may separate from each other and the ownership may be transferred without the move, transport, or delivery of goods due to the release of warehouse warrants.

Any negotiable asset as following from the warehouse act may be placed into the public warehouse and be public warehouse goods except for cash and security. This is clearly stated in several sections in the act on public warehousing. This is a kind of guarantee against "hiding" money of security for enforcement procedure. The possession of certain goods, may be subject to authority permission. Those may be placed into warehouse only in compliance with the relevant rules of law and on the grounds of an authority permission.⁹

⁶ Act on public warehousing, Section 4/A, Para. (3).

⁷ Légrády, Gergely: *Az árverésről – gondolatok egy Janus-arccú szerzőismódról* [On the Auction – Thought on a Janus-faced Method of Acquisition]. *Polgári Jogi Közlemények*, Vol. 9 (2003) No. 1, 18.

⁸ *Nemo plus iuris ad alium transferre potest, quam ipse habet*. (Ulp. D. 50, 17, 54.)

⁹ *Act XLVIII of 1996*, Section 2, Para. (8).

Due to the exclusive and other exclusionary character of the ownership it shall be protected *eo ipso*, since the autonomy and independence of the individual may suffer harm without the protection of the already acquired assets.¹⁰ The right to property¹¹ secured by the Hungarian *Fundamental Law* may not be harmed either during any enforcement procedure or auction or during public warehouse storage, thus, it would be against the Fundamental Law if the act on public warehousing, the act on implementation and the Hungarian Civil Code were regardless of the ownership of goods involved in warehouse transactions.

Public warehouses draw interested parties' attention to these circumstances. Therefore, goods do not become the property of the public warehouses, only become their possession. However, during the period of public storage operations, goods placed into public warehouses will be replaced by the warehouse warrant in the depositor's assets, since during bankruptcy procedure against the depositor it shall be recorded as assets, and during enforcement procedure, goods placed into public warehouse may not be confiscated, only the warehouse warrant is reserved. Goods placed into public warehouses do not fall within the scope of liquidation procedure.

3. POSSIBLE SUBJECTS OF PUBLIC WAREHOUSE GOODS – THE POSSIBLE TANGIBLE ASSETS OF EXECUTION

The act on public warehousing negatively regulates the question that which goods may be placed into public warehouses. It does not say what tangible asset may be deposited as public warehouse goods but it stipulates that cash and negotiable instruments are not subject to public warehousing.

It is interesting that the German *Civil Code* (BGB) and the *Commercial Code* (HGB) contains provisions not only regarding public warehousing¹² but regarding commercial purchase and loan transactions, as well.¹³ Moreover, in case of further delay, (or, if the chattel may not be eligible to be deposited by its nature) after a new and proper notice, the chattel may be delivered to auction on its market value by the proper entitled person (or even by a free purchase to a third party). In the Hungarian law system similar deposit options for late commercial transactions cannot be found.

In the Hungarian legal system the prohibition of public storage of cash and negotiable instruments is specific. It derives from this negative, exclusion based regulation that anything that is not cash or negotiable instrument may be deposited as moveable asset in public warehouses. This ascertainment is very important as enforcement law contains very specific provisions regarding enforcement actions and how the executive shall carry it out, depending on the possible tangible asset as subjects of the execution. However, if this good is a chattel or merchandise placed into public warehouse, these provisions may not be applicable. Thus, for example, a stock or business shares of a company are deemed as negotiable instruments, those may not be placed in public warehouses.

During the seizure of for example gold, platinum, silver and currencies, the executive takes in the assets and pays the seized foreign currency into the executives' deposit account on the following working day. During the seizure of gemstone and typographically produced negotiable instrument, the executive also takes the assets and deposits it into judicial escrow.

In case of seizure of dematerialized securities, the executive notifies the account managing investment supplier of the debtor, who puts the reserved securities into a locked sub-account according to the statutory provisions of the act on securities until further action by the executive. During the seizure of cash, the executive takes the seized cash and on the following working day it is paid into the executive's deposit account. When museum pieces, books or other things of historic interest or archival material are seized, the executive shall send the prompt notification with a copy of the seizure minutes to the competent museum, library or archives according to the nature of the subject matter. In case of the seizure of vehicles, the executive shall also seize the car documents, registration book, etc.

Therefore, all these acts can only be carried out by the executive if the asset. Whereas, goods placed into public warehouses are not in the possession of the owner of the public warehouse, the seizure may not be

¹⁰ Téglási András: A tulajdonhoz való alkotmányos védelem – történeti áttekintés [The Constitutional Protection of Property – Historical Overview]. *Jog- és Politikatudományi Folyóirat*, Vol. 2 (2008) No. 4, 3.

¹¹ *The Fundamental Law of Hungary*. Article XIII. (1) Every person shall have the right to property and inheritance. Property shall entail social responsibility. (2) Property may only be expropriated in exceptional cases and in the public interest, in legally defined cases and ways, and subject to full, unconditional and immediate indemnity.

¹² HGB §§416, 420

¹³ BGB 372.§ and 383.§ (1).

interpreted on them because the goods may and shall be taken from the owner debtor in order to seizure. However, the warehouse warrant possessed by the debtor may be seized as materialized, typographically construed securities.

According to the provisions of the act on enforcement, the reserved and non-expendable tangible asset – pursuant to the fundament principle – should be left in the custody of the debtor, which may be used by the debtor without the harm of texture or use of material, but may not have the right to alienate or encumber. The breach of these by the debtor is a crime according to the Criminal Code, as well.¹⁴ Another legal difficulty is that in public warehouses it is not the owner who uses and safekeeps the movables, since by giving the goods into deposit only the possession falls out – in totally legitimate way with a conclusion of a warehouse contract – of the hands of the owner to the custodial deposit.

Regarding the movables originally placed in the public warehouse by the debtor it may lawfully arise that during the proper commercial marketing not the former depositor is entitled to dispose over it. Towards the thorough examination of this problem we shall mention auction as a legal title called original acquisition in the Hungarian Civil Code, which is a typical procedural act of the official enforcement procedure.

4. THE ENFORCEMENT OFFICIAL AUCTION AS ORIGINAL PROPERTY ACQUISITION METHOD

According to our former Hungarian Civil Code; the one who acquired the chattel by authority decision or auction in good faith becomes the owner regardless who the former owner was.¹⁵ In the *New Hungarian Civil Code*¹⁶ which came into force in 2014, this provision is unaltered and continually exists. The transfer of the possession of goods is necessary on the auction in order for the auction buyer to obtain the ownership of the chattel. Very important circumstance is the buyer's good faith, since the acquisition requires the declaration and co-operation of the original owner, however entering into contract with him/her is not necessary.

The original acquisition mode, mentioned in the Hungarian Civil Code, comes to an effect only if the auctioneer is an authority, not an individual or a private organization. The official auctioning has two main criteria: *by means of duress* and the process has an official aspect itself that is *a qualified authority body that conducts the auction*.¹⁷

Although, via auction not only ownership and possession is acquired by the acquiring party but also third party rights having encumbered the goods are terminated, in case the purchaser was really acting in good faith. These provisions were not directly included in the former Hungarian Civil Code but the legislative power found it necessary to state these legal details in the New Codex during the re-drafting of the Civil Code reforms.

Actions mentioned in the Hungarian Civil Code mean the transfer in the judicial execution procedure in which the auction buyer with the highest offer may be considered as acquirer. (Here, mentioned regulation of the Hungarian Civil Code may not be applicable for private auctions, moreover, the Hungarian Civil Code has no specific regulations for that at all, however, the general rules of contract law shall be applied.¹⁸ So private auctions – for example auctions on art treasures and books – are not considered as the above analysed original acquisition mode, thus, restrains stipulated during the judicial execution procedure may not be automatically applicable for those either, for example that goods placed in public warehouses may not be taken to auction (court auction).

The Hungarian legal system mentions more than a dozen type of auctions (tax enforcement, restitution auction, business share auction, liquidation auctions, auction on privatization, etc.), and out of them the judicial execution auction is considered as public auction.¹⁹ Public auction is obviously considered as forced liquidation, thus, for example, an ordered auction during the liquidation procedure, as well as the

¹⁴ *Act C of 2012 on the Hungarian Criminal Code*, Section 405, Para. (1): Any person who conceals his assets serving as cover for a debt existing under a contract-made in writing, and thereby prevents settlement of the debt in full or in part is guilty of a misdemeanour punishable by imprisonment not exceeding one year.

¹⁵ 'Previous' *Civil Code*, Section 120, Para. (1).

¹⁶ *New Civil Code* (in effect) Book 5, Section 41.

¹⁷ Légrádi: *op. cit.* 9.

¹⁸ *Ibid.*

¹⁹ *Ibid.* 10.

sale of assets of liquidated organizations (for example a ruined public warehouses), whose rules show significant similarity with court auction rules.²⁰

5. SPECIFIC RULES OF THE PUBLIC WAREHOUSE AUCTION – NO PUBLIC AUCTION

The auction in the act on public warehousing as forced liquidation procedures does not constitute of such elements like public auctions discussed above. The public warehouse is not an authority and even though this auction also includes as many forced items as enough to be ordered without the consent of the depositor, it does not mean an official auction. In case of the existence of the defined legal conditions, the possessor/holder of the warehouse warrant may reclaim the purchase of the goods and the settlement of his/her claim from the purchase price.²¹

Therefore, in this case a specially controlled auction procedure takes place where the rights of third parties are not infringed, the possessor of the warehouse warrant is a party of the public warehouse relationship and the auction is in accordance with the regulations of the act on the warehouses.²² Accordingly, not only the creditors' (warehouse warrant holder) interests are under eligible protection but also the owner of goods during the legal accounting relation stipulated by legislation loses its ownership and reduces its debt to the creditor.

Unlike the official auction, regarding the public warehouse act, on such auction the auction buyer acquires ownership even if the lender was not the owner of goods placed in the warehouse, since the public warehouse may not be obliged to verify the ownership of goods.²³ The public warehouse is only obliged to ensure the quality, quantity and the origin certified by the depositor of goods placed in the warehouse but not the ownership.²⁴

The specific provisions of the warehouse auction in act on public warehousing neither refer to the Hungarian Civil Code, nor does the implementation law determine the date of the transfer of the ownership, it only clarifies the auction, the method of keeping the minutes, the asking price, the knock down and the framework rules of the mandatory contract.²⁵ Both the buyer and the creditor shall be notified about the place and time of the auction, in fact, the seller and the buyer may also make a bid on the auction. (In case of the absence of the notification the debtor is liable for the damages of the creditor.)

6. SUMMARY

According to the above described review it may be concluded that the primary purpose of the law regulating the judicial execution procedure, which is a type of the official auction, is to protect creditors interests even in case of auctioning the assets of debtors.

Contrarily, the act on warehouses allows a non-owner lender to put a chattel into public warehouses (but only those which are not originated from a crime, excluding cash or securities) allowing such situation in which the property of a third person is placed into a temporary escrow custody, where the owner is not or just subsequently notified about the contract (the warehouse contract) between the safekeeper and the depositor.

²⁰ Act IL of 1991 on bankruptcy and liquidation procedure, Section 49.

²¹ *Act XLVIII of 1996*, Section 32, Para. (1): If, the amount stated on the warehouse warrant is not paid to the possessor of the warrant within three days after the expiration, he/she may require the sale of the public warehouse placed goods and the satisfaction from the purchase price. The first endorser has the same right against the possessor of the warrant if he/she redeemed the warrant.

²² *Ibid.*, Section 34, Para. (1) If the goods shall be sold, and on the warehouse warrant stipulated data meets with the conditions of the rules of Budapest Stock Exchange, the public warehouse may sell the goods on the stock market. Subsection (2): If the goods cannot be sold on the stock market, or if the sale failed to seven days following on the stock exchange, the goods shall be purchased by auction. Subsection (3): The buyer acquires ownership even if the depositor was not the owner of the goods both by stock market and auction sale.

²³ *Ibid.* Section 23, Para. (1).

²⁴ *Ibid.* Section 15.

²⁵ *Ibid.* Sections 35-36.

Among others, this is the reason why the act on judicial execution shall contain a clear prohibition, which states that goods placed into public warehouses shall not be the subject of judicial execution procedure (auction). According to the act on public warehousing – since the public warehouse is not the owner but the temporary possessor and custodian of the possessed assets –, is not possible for a creditor's requested and initiated judicial execution procedure (which aims at the debtor's assets) that a custodian may issue such property, whose ownership was not required to be considered during the reception into deposit.

NORMS OF INTERNATIONAL LAW AND INTERNATIONAL TREATIES AS PARENT LEGISLATION FOR RUSSIAN CRIMINAL PROCEDURE LAW: SOME PROBLEMS

ANTON LIUTYNSKII *

1.

The relationship between international standards and national laws is very important for the Russian legal science and practice. It was common in the Soviet legal culture to consider the national standards as the only source of law. The international rules of law were not actually taken into account and were not applied in practice. Major changes in the governmental and legal systems of the country in the past twenty years have somewhat changed the situation but not completely. In many aspects the inertia of the previous legal culture still remains.

The Russian Constitution, adopted in 1993, declared: “The universally recognized norms of international law and international treaties and agreements of the Russian Federation shall be a component part of its legal system. If an international treaty or agreement of the Russian Federation establishes other rules than those envisaged by law, the rules of the international agreement shall be applied” (Part 4 of Article 15).¹ This rule has created a principal legal basis for including international law into the Russian legislation. This article is devoted to the criminal procedural aspect of the problem, so a closer look can be taken at the implementation of Art. 15 of the Constitution of the Russian Federation, especially at criminal proceedings.

The Criminal Procedure Code repeated almost verbatim the above-mentioned constitutional norm (Part 3 of Art. 1 of the Code).² The Plenum of the Supreme Court – an assembly of the judges of the superior courts of Russia, authorized to give explanations to all the lower courts to ensure the unity of legal practices – published a special decision on the application of the generally recognized principles and norms of international law and the international treaties of the Russian Federation by the courts of law in 2003.³ To better understand the specific problem of the relationship of international principles of justice and the Russian criminal justice system, it is necessary to outline some important provisions that are relevant not only for Russia but also for many other countries, especially in Eastern Europe.

These observations are the followings:

1. One ought to distinguish between the terms “*generally recognized principles and norms of international law*” and “*international treaties of the Russian Federation*”. The Plenum of the Supreme Court has pointed out that the generally recognized principles of international law should be understood as the fundamental peremptory norms of international law accepted and recognized by the international community of States as a whole, the deviation from which is unacceptable. The generally accepted rule of international law must be understood as a legally binding rule of conduct accepted and recognized by the international community of States as a whole (Paragraph 1, Resolution of the Plenum of the Supreme Court of 10.10.2003 No. 5).⁴ In our view, the major international instruments of the United Nations such as the Charter of the United Nations of 1945, the Universal Declaration of Human Rights of 1948, the International Covenant on Civil and Political Rights of 1966 can be referred to the regulations containing the universally recognized principles and norms of international law. In addition to the written norms, legal scholars consider the

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¹ *Constitution of the Russian Federation*, www.constitution.ru/en/10003000-02.htm. (15 March 2013).

² The *Criminal Procedure Code of the Russian Federation* of 2001 (18 December). Help legal system “ConsultantPlus”.

³ *Resolution of the Plenum of the Supreme Court of the Russian Federation* on October 10, 2003 No. 5/. http://www.vsrfr.ru/vscourt_detale.php?id=1177 (15 March 2013).

⁴ Ibid.



traditional legal practices established by the recognized courts, such as the European Court of Human Rights, as universally recognized norms and principles of law.⁵ This was also confirmed by the decision of the Plenum of the Supreme Court, under which the Vienna Convention on the Law of Treaties clarified that both the context and the subsequent practice in the application of the treaty which establish the agreement of the parties regarding its interpretation must be taken into account during the interpretation of an international treaty. Thus, the Russian Federation as a member of the Convention for the Protection of Human Rights and Fundamental Freedoms recognizes the binding jurisdiction of the European Court of Human Rights on the interpretation and application of the Convention and its Protocols. That is why it is considered necessary to take the practice of the European Court of Human Rights into account.

2. “*The international treaty of the Russian Federation*” means an international agreement concluded by the Russian Federation with a foreign state (or states), with an international organization or with any other entity having the right to enter into international agreements in written form and regulated by international law. International treaties become a part of the Russian legal system only in case of adoption and ratification, in accordance with a specific procedure established by a special law.⁶

The provisions of the officially published international treaties of the Russian Federation which do not require the publication of internal regulations for their implementation operate in the Russian Federation directly. The Convention for the Protection of Human Rights and Fundamental Freedoms of 1950, ratified by Russia in 1998, is an example of such international treaties.⁷ An international treaty which became a part of the Russian legal system has the highest legal force in relation to the applicable law, including the Criminal Procedure Code. The correlation of legal powers of the generally recognized norms of international law and the Constitution of Russia is an issue of significant practical and theoretical interest. To cut a long story short, we would like to join the opinion of the priority of the international law if it establishes a wider range of individual rights than the Constitution of Russia.

A considerable amount of the international treaties relating to criminal proceedings are the treaties prescribing the rules of cooperation in criminal matters between the individual states and the Russian Federation, for instance: the *European Convention on Extradition* of 1957 or the *European Convention on Mutual Assistance in Criminal Matters* of 1959 (both ratified in 2000). In our opinion, the international agreements that secure human rights in criminal proceedings are of more practical and theoretical interest.

On the one hand, the inclusion of international legal rules into the Russian legal system contributes to its improvement and development. Ratification of an international treaty itself may encourage the bodies of legislative powers to adopt changes and amendments to the existing criminal procedure legislation in order to eliminate the emerged contradictions. On the other hand, the presence of the implemented norm of an international law in the Russian legal system allows the participants of proceedings to directly apply these rules in criminal case practices. However, as it is noted in the literature, the legal culture of Russian law enforcement officials does not always contribute to this. For example, according to some estimates, 63% of judges prefer the norms of national law while making a decision.⁸

2.

Having described the general theoretical basis of co-relation of the international standards of criminal justice and the national legislation, we would like to examine some problematic aspects of the topic of cooperation of the Russian Federation and the Council of Europe.

The Council of Europe is an international organization, an important institution of cooperation among all countries of Europe within the field of legal standards, rule of law, human rights, democratic development and rapprochement of European countries. The most important international standards of justice are being implemented into the legislation of European countries, including non-EU countries. As a member of the Council of Europe, Russia has assumed to sign and ratify all the conventions of the Council of Europe in addition to the main document (the Convention for the Protection of Human

⁵ Lazarus, V. A. – Tarasova, A. A. (eds.): *Criminal Procedure. Actual Problems of Theory and practice: a Textbook for Masters*. Moscow, 2012, 60.

⁶ *Federal Law of 15.07.1995* (N 101-FZ) as amended on 25 December 2012. “On international treaties of the Russian Federation”, Collection of laws of the Russian Federation. 17 July 1995, N 29, Art. 2757.

⁷ Convention for the Protection of Human Rights and Fundamental Freedoms (signed in Rome)

⁸ Lazarus-Tarasova: *op. cit.* 64.

Rights and Fundamental Freedoms), as well as to implement principles concerning fundamental human rights in criminal proceedings into its national law.

However, some problematic issues on the matter can hereby be indicated:

1. *Many conventions on human rights in criminal proceedings are still not signed and ratified by the state authorities of Russia*, though Russia, being a member of the Council of Europe, has assumed obligations to ratify the main international acts and to include the relevant principles in the Russian domestic legislation. As a result, important principles remain unimplemented (e. g. the European Convention on the Compensation of Victims of Violent Crimes. The preamble of the Convention refers to social solidarity and the need to compensate for the harm caused by crime, especially when the offender is not identified or is without resources. The damage caused by crimes can be different: i) physical, ii) property and iii) moral. The given Convention (Article 2) provides that those states-members of the EU which have adopted the agreement must take compensation for the most serious harm – the physical harm, as well as they must help dependents of the crime victim. This is consistent with an international legal act (however, a non-binding soft law document) of another level - the *Declaration of Basic Principles of Justice for Victims of Crime and Abuse of Power* (adopted by the UN General Assembly on November 29, 1985),⁹ which defines the terms “restitution” (compensation of damages by the offender) and “compensation” (help from the community and the state). In our opinion, these are the absolutely morally sound principles based on humanism, concerning people and the State responsibility of citizens and taxpayers.

Many domestic legal systems have long ago included the provisions under which victims of crimes have the right to claim compensation from the state, no matter whether the offense is solved or not. It is interesting to see the experience of France, for instance, where a number of articles of the Criminal Procedure Code are devoted to the management of this problem and the principle of subrogation works (the state finds the guilty party and charges it with the expenses). Such practice can be seen not only in Europe but also for example, in the U.S.

There one can observe the laws and practice of state compensation to the crime victims and their families regardless of whether the guilty party is found or not, working both at the federal and at state level. For this purpose, special funds have been established.

Up to now, Russia remains a country where the state is not obliged to compensate a citizen for damages caused by crimes and, as a rule, it does not do it. Some time ago attempts were made to address this issue at state level. The draft law “On the victims of crimes” providing the right to state compensation for some categories of victims (serious bodily injured, victims of sexual assault, etc.) and their families was developed. The law also defines the financial basis for compensation in the form of a special fund generated by fines and other similar sources.

The victim has the right to legal and social assistance as well as to fair and reasonable compensation for the harm caused by an offense, and (or) to state compensation. The draft law sets the aims of compensation for the state: 1) restoration of social justice; 2) availability and fairness of compensation to the victim, including cases when the guilty person is not established, disappeared, cannot be prosecuted or punished, and 3) efficiency in providing victims with compensation.¹⁰

In particular, in accordance with the idea of the draft law, the state guarantees the provision of specified cash compensation: to the victim, who as a result of committing a crime against him was seriously bodily injured, or became infected with HIV/AIDS, became a victim of sexual violence, is in a difficult financial situation, became a victim of theft, fraud, extortion, property damage by fraud or abuse of trust. Compensation is also provided to the dependents of the victim who died as a result of crime. It was planned to establish The State Federal off-budget fund for victims to provide these benefits. The draft law defines the fund’s sources as follows: criminal fines; means from property confiscation; public funds received from the sale of physical evidence of criminal cases, bails, rendered to the state budget, voluntary contributions of citizens and legal entities, etc. The draft law sets the limits of state compensation. However, this law has not been adopted yet.

⁹ Declaration of Basic Principles of Justice for Victims of Crime and Abuse of Power, adopted by the UN General Assembly Res. No. 40/34.

¹⁰ Draft Federal Law “On the victims of crime” Published on February 24, 2012 at the website of “Российская газета (Rossiyskaya gazeta)”, <http://www.rg.ru/2012/02/24/poterpevshie-site-dok.html>.

2. *The inclusion of international standards of justice in the Russian criminal procedure law is not always complete.* For example: the right to fair and public hearing within a reasonable time, set forth in Art. 6, Para. 1 of the Criminal Procedure Code of Russia, in some spheres (period of detention) is not actually implemented.

In 2010, the Russian criminal procedure legislation reflected such an important principle of international justice as the right to trial within a reasonable time. It is formulated in such international legal acts as the Convention for the Protection of Human Rights and Fundamental Freedoms (Article 6), the International Covenant on Civil and Political Rights of 1966 (Article 14, the right to trial without undue delay). The inclusion of this principle in the Russian Criminal Procedure Law and the adoption of a separate law “On compensation for the violation of the right to trial within a reasonable period of time” can be considered as a reaction to the existing problems of judicial red tape and inefficient proceedings, which are taken into consideration by the European Court of Human Rights during examination of the complaints of Russian citizens. This situation is especially dangerous when it comes to criminal justice when a person under prosecution is held in custody (under arrest). According to the Russian law being in effect, the period of detention during the investigation process in some cases may take up to 18 months, and the defendant shall appear in court only after that. Judges may extend the period of detention for defendants in every three months. In our view, this principle needs to be more specified in certain norms, limiting possible time of criminal prosecution because the concept of “reasonable time” is not being understood the same by different representatives of court and law enforcement authorities.

3.

The study of the relationship of the generally recognized international norms and principles and the national legislation on criminal proceedings is *very important from theoretical and practical points of view*. The direct applicability of the international legal norms in specific situations is the issue of particular interest.

The state participation within the international agreements *contributes to the development of its national legal system, promotes humanization and rapprochement* with the generally accepted legal principles.

The delay in ratification of important international legal acts may have a negative impact on the realization of fundamental human rights.

The development and improvement of national legislation should be thoroughly examined *with relation to generally accepted rules of international law*.

COOPERATION BETWEEN THE RUSSIAN FEDERATION AND THE VISEGRAD GROUP COUNTRIES ON EFFORT AGAINST TERRORISM AND ORGANIZED CRIMES

ANTON SMIRNOV *

1. INTRODUCTION

International terrorism is 21st century global issue which constitutes a considerable danger for the world community. Its expansion becomes a threat which is even stronger due to the existing problems: organized crime, drug and arms trade and human trafficking.

The topicality of the listed problems is conditioned by the increasing amount of danger due to the large expansion and more media coverage of such acts and plots (which slightly varies in different countries) and their wide geographical coverage. These issues have currently become global and are characteristics not only of a certain country or state but of entire continents. In order to overcome the existing threats cooperation is required, that is why this problem is one of the major directions of the world organizations like the United Nations, the European Union, the North Atlantic Treaty Organization and each particular state, including Russia.

An effective struggle against the above-mentioned threats require cooperative effort. Moreover, the criminal world possesses large amounts of different resources, utilizes the latest technology¹ (hires and trains adherences on internet, for instance). A distinctive characteristic of the present-day criminality is rapid progress and adaptation. There is a great influence of economic factor, i.e. aiming at the maximizing of profit, which is partly invested in criminality development and partly in settling into legal world economy. In recent times we have observed that different branches of crime are combining. For example, terrorists lend pirates assistance in forces and support drug mafia for financial assistance in return.

Just before the New Year's celebration in 2013 in Volgograd, the Russian Federation, two horrifying terrorist attacks had taken place. They were committed on public transport and caused 32 deaths. These impudent terrorist attacks have appeared to be a recollection of the times when the entire South Russia as well as now the Northern Caucasus was considered to be the area endangered by terrorists. World community largely reproved the inhuman action and expressed its sympathy for the victims. Hungarian Ministry of Foreign Affairs claimed that the disaster which happened in Russia reminds that the world community's duty is to cooperate against terrorism threatening the peace and safety of the world. Having considered these events, leaders of many countries have grown anxious about whether it is possible to hold the 2014 Winter Olympic Games in Sochi safe enough.

2. COOPERATION EFFORTS

The cooperation of the effort against terrorism and organized crime is conducted on 3 levels: (i) *international* (cooperation in the United Nations Organization, the International Police), (ii) *regional* (cooperation in the Commonwealth of Independent States, the European Union, the Organization on Security and Cooperation in Europe, the Council of Europe) and (iii) *bilateral* (on the basis of two-way deals, state or department level, collaboration of law-enforcement, investigative and judicial authorities).

The present article pays deep attention to bilateral cooperation of the Russian Federation and the Visegrad countries, namely Poland, Hungary, the Czech Republic and Slovakia.

The bilateral cooperation among these states in these cases is based on intergovernmental and interdepartmental agreements. In 1992, the interdepartmental agreement on cooperation was signed by the Russian Federation Ministry of Internal Affairs and the Polish Ministry of Internal Affairs. In pursuance of this agreement *both departments are engaged in maintaining cooperation according to the followings:*

- a) Combat different branches of crime: crimes against life, health, freedom, personality, dignity and property;

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¹ E.g. hires and trains adherences on internet.



- b) Anti-terrorism and fight against international organized crime;
- c) Combat illegal acquisition, transfer, sale, storage, transportation, or bearing of firearms, its basic parts, ammunition, explosives, and explosive devices;
- d) Fight against illegal making, acquisition, storage, transportation, sending, or sale of narcotic drugs or psychotropic substances;
- e) Struggle against forgery, manufacture, or sale of falsified documents, government awards, stamps, seals and forms;
- f) Financial and business crime control;
- g) Combat crimes against items of historical and cultural values;
- h) Detection of criminals, fugitive suspects, missing persons, as well as performing activities related to the identification of people whose identity has not been established;
- i) Identification of unknown corpses;
- j) Combat crimes and achieve public order and security maintenance on railway, maritime and air;
- k) Illegal migration control;

The forms of interdepartmental cooperation are the following:

- a) Exchanging the information of crimes being prepared and already perpetrated and persons involved as well as archives and documents;
- b) Exchanging professional experience of work, legislative and other standard regulation acts, research literature describing the activity and operation of law-enforcement agencies, and rendering mutual assistance in educating and training personnel;
- c) Mutually beneficial exchange of forensic and special technologies, means of communication and special transport;
- d) Exchanging research and technology information of operation of law-enforcement agencies, cooperative conducting of researches, and elaboration of scientific programs on problems that concern all of the partners, as well.

In addition, the Russian Federation and Poland signed two agreements; one of the being the Agreement on legal assistance and legal relations in civil and criminal cases between the Russian Federation and the Republic of Poland from 1996² and the other one being the Agreement on mutual protection of classified information from 2008.³ The latter one regulates cooperation of the Federal Security Service of the Russian Federation, the Internal Security Agency (ISA) of Poland and the Military Intelligence Service on information protection. Also in May 2013, the President of the Russian Federation, Vladimir Putin assigned the Federal Security Service of the Russian Federation to make an agreement with the Military Intelligence Service of Poland on cooperation and interaction in military counterintelligence.

3. THE EFFORTS TAKEN BY THE RUSSIAN FEDERATION AND THE V4 COUNTRIES

Regarding the Visegrad countries (V4 Countries), the Hungarian and the Russian Government signed the *Agreement on cooperation regarding the struggle against crime*, especially its organized forms.⁴ An advantage of this agreement is that cooperation is conducted by a number of law-enforcement authorities, not single

² «Договор между Российской Федерацией и Республикой Польша о правовой помощи и правовых отношениях по гражданским и уголовным делам» от 16 сентября 1996 года [*Agreement on legal assistance and legal relations in civil and criminal cases between the Russian Federation and the Republic of Poland* since 16 September 1996].

http://www.mid.ru/BDOMP/spd_md.nsf/0/881B1E77D5FC05E344257C8C00398810 (11 February 2014).

³ «Договор между Российской Федерацией и Республикой Польша о взаимной защите секретной информации» от 08 февраля 2008 года. [*Agreement on mutual protection of classified information between the Russian Federation and the Republic of Poland* since 8 February 2008].

http://www.mid.ru/BDOMP/spd_md.nsf/0/243BB72B69C3E14D44257C8C0039637E (10 February 2014).

⁴ «Соглашение между Правительством РФ и Правительством Венгерской Республики о сотрудничестве в области борьбы с преступностью, особенно в ее организованных формах» от 07 июля 1997 года. [*Agreement between the Government of the Russian Federation and the Government of the Republic of Hungary on cooperation in the struggle against crime, especially in its organized forms* since 7 July 1997].

http://www.mid.ru/BDOMP/spd_md.nsf/0/54F7C19AF6F2DFD644257C8C003989AF (12 February 2014).

departments. Another similar agreement was signed by the Government of the Russian Federation and the Czech Republic in 2011.⁵

According to the agreement, the departments of the Russian Federation involved in cooperation are the followings: the Ministry of Internal Affairs, the Federal Security Service, the Federal Customs Service, the Federal Service for Financial Monitoring, the General Prosecutor Office, the Federal Migration Service, the Federal Drug Control Service and the Ministry for Public Health and Social Development. The departments of the Czech Republic involved in cooperation are the followings: the Ministry of Internal Affairs, the Presidium of Police, the Ministry of Finance, the Financial Research Service and the Directorate-General of Customs Service. In 1994, the Ministry of Internal Affairs of the Russian Federation and the Ministry of Internal Affairs of Slovakia signed an Agreement on cooperation.⁶ Also, two agreements on mutual confidential⁷ and classified information protection were entered into.⁸

Within the United Nations Organization Report entitled “*Measures to eliminate international terrorism*”, it was mentioned that Hungary is included in 14 universal documents concerning the struggle against terrorism and 10 regional documents of the same sort of obligations under the guidance of the Council of Europe. The new Hungarian Criminal Code includes three crimes (but there are much more reference on terrorism within the act. e. g. homicide), connected with acts of terrorism: *act of terrorism*, *concealment of an act of terrorism* (for example, concealment of authoritative information about acts of terrorism) and *sponsorship of terrorism*.⁹

Besides, Hungary adopted a *Plan of action against money laundering and sponsorship of terrorism*. In particular, the Hungarian legislative authority took some certain measures to introduce amendments to Act CXXXVI of 2007 on the prevention and combating of money laundering and terrorist financing (Act CLXXX of 2007 on the implementation of financial and asset-related restrictive measures ordered by the European Union, and on respective amendments to other laws), some modifications were made in restricting measures, respecting Act CLXXX of 2007 on finance and active assets prescribed by the Act of the European Union.

In 2011, the amendments were introduced into legal basis of activities of the Centre for Terrorism Combat, controlled by the Ministry of Internal Affairs of Hungary in order to define the set of goals and authorities concerning elicitation and exploitation of data more precisely and enhance operation in developing international cooperation.

Slovakia is now the party of thirteen agreements within the subject of counter-terrorism. Slovak legislative authorities are taking measures to recognize this agreements and documents in its domestic legislation enacting laws like Criminal Code, Criminal Procedure Code, act on police, act on implementation of international sanctions, act on anti-money laundering, anti-sponsorship of terrorism act, act on the use of nuclear energy for peaceful purposes, act on mining activities, explosives and mining activities governance act, the technical requirements for products, and evaluating its compliance with these requirements, as well as a number of other decrees and decisions. In order to establish specific tasks for relevant ministries and terms for their fulfillment the National Counterterrorism Plan was adopted for the period of 2011-2014. The Slovak National Counterterrorism Plan states that now there are not any threats of terrorist attacks in the country. However, it is worth mentioning that it is a potential threat if the country's territory

⁵ «Договор между Правительством Российской Федерации и Правительством Чешской Республики о борьбе с преступностью» от 08 декабря 2011 года. [Agreement between the Government of the Russian Federation and the Government of the Czech Republic on cooperation in the struggle against crime since 8 December 2011]. http://www.mid.ru/BDOMP/spd_md.nsf/0/97E04DCAF606CF2744257C8C003965B1 (1 February 2014).

⁶ «Соглашение о сотрудничестве между Министерством внутренних дел Российской Федерации и Министерством внутренних дел Словацкой Республики» от 29 мая 1994 года. [Agreement on cooperation between the Ministry of Internal Affairs of the Russian Federation and the Ministry of Internal Affairs of Slovakia since 29 May 1994]. http://mvd.ru/Deljatelnost/documents/m_soglasch/?noredirect=1 (29 January 2014).

⁷ «Договор о взаимной защите информации ограниченного доступа между Правительством Российской Федерации и Правительством Словацкой Республики» от 29 апреля 1997 года. [Agreement on mutual classified information protection between the Government of the Russian Federation and the Government of the Slovak Republic since 29 April 1997]. http://www.mid.ru/BDOMP/spd_md.nsf/0/0281226C8BA9588844257C8C00398447 (29 January 2014).

⁸ «Договор о взаимной защите секретной информации между Правительством Российской Федерации и Правительством Словацкой Республики» от 07 ноября 2006 года. [Agreement on mutual confidential information protection between the Government of the Russian Federation and the Government of the Slovak Republic since 7 November 2006]. http://www.mid.ru/BDOMP/spd_md.nsf/0/117F4D0E33E4FD9B44257C8C003962F4 (13 February 2014).

⁹ See Act C of 2012 on the Hungarian Criminal Code. Sections 314-318.

(any country's territory can be used for such acts) can be used by criminal groups and terrorist organizations for transit, logistical support and preparing future terrorist attacks.

Signing interdepartmental agreements would allow identifying and promptly eliminating international channels of terrorist financing more effectively. To achieve this goal, the countries need to increase the level of cooperation between states on a bilateral basis, not only from Slovakia but also with other members of the Visegrad Group.

Detection and prevention of such crime or terrorist activity within the territory of the Russian Federation is the reason why the cooperation is necessary and has a great importance for the Federation. As an example, Russia can consider counterterrorism operation by the Czech partners. In 2011, the Czech police liquidated the terrorist organized group of North Caucasian natives who legally reside in the Czech Republic. The detained foreigners forged documents, identity cards, weapons and explosives, as well as collected funds to support terrorist movements. It was the first time in the history of the Czech police when the paragraph forbidding to supporting terrorist movement was used.

Talking about cooperation in the struggle with the sponsorship of terrorist activities, it should be noticed that the importance of coordination not only in tracing the sources of funding but also depriving terrorists of the ability to use the funds for criminal purposes. "Suspicious transactions", such as money laundering for sponsorship of terrorism tend to play a minor role. The exchange of operational information related to terrorist activities between the intelligence agencies of the Russian Federation and the countries of the Visegrad Group is necessary.

In order to achieve more effective cooperation, it is necessary to complete intergovernmental *the Russian Federation – the Republic of Poland* and *the Russian Federation – the Slovak Republic* agreements on cooperation in the effort against organized crime. Those will allow involving a larger amount of services and departments of the above mentioned states into cooperation, which would make our interaction much more efficient.

Furthermore, the states ought to develop bilateral cooperation on operational level as well as on international-legal level. The international-legal level implies the approximation of states' laws on extradition and sheltering of criminals and statutory and regulatory work of other different sorts. Whether the struggle against terrorism and organized crime is really effective and whether or not it may be called successful, largely depends on the surgical cooperation of security services.

Collaborative operation of the Criminal Investigation Department of the Ministry of Internal Affairs of the Russian Federation and the Directorate for Combating Organized Crime of the Czech Police may serve as an example. As a result of the operation, a dangerous, special criminal was attached. In order to improve combating organized crime in the Russian Federation, the state needs to develop and maintain contacts with the Europol. The European Police Office is a law-enforcement agency of the European Union, aiming at providing law-enforcement authorities of countries and members of the European Union with information, practical and force assistance, helping them to fight against international organized crime, terrorism and other heavy kinds of international crimes.

The relationship between the Russian Federation and the Europol started in 2003 at the *Russia-EU summit* in Rome, when the *Agreement on cooperation* (so-called strategic agreement)¹⁰ was signed. It determined relevant authorities of the Russian Federation responsible for implementation, contained statements about exchange of strategic and technical information of conditions and development level of criminality, and described investigative measures assumed by police and criminalistics experts, etc.

In March 2004, the Russian National Contact Center was formed as an entity of the National Central Bureau (NCB) of the Interpol in Russia by the Ministry of Internal Affairs in order No. 859. The Center was ordered to cooperate with the Europol in its work and to ensure information exchange between special authorities of the Russian Federation (like the Ministry of Interior, the Federal Security Service of Russia, the Federal Customs Service, the Federal Drug Control Service, and the Federal Financial Monitoring Service, as well) and the Europol. Another function of the Center is elaborating and preparing measures to develop the collaborative mechanism of its organs and services. As a main competent authority within the Agreement on cooperation between the European Police Office and the Russian Federation, the Russian National Contact Center provides functions of the Ministry of Internal Affairs of

¹⁰ "Соглашение о сотрудничестве между Российской Федерацией и Европейской полицейской организацией" от 06 ноября 2003 года. [Agreement on cooperation between the Russian Federation and the European police organization since 6 November 2003].

http://archive.kremlin.ru/interdocs/2003/11/06/0000_type72066_55349.shtml (28 January 2014).

the Russian Federation within its competence. Main functions of the Russian National Contact Center are the following:

- a) Providing, accepting, processing and directing the requests of the Russian Ministry of Internal Affairs' branches, answering requests of component authorities of the Russian Federation and other information coming from the Europol;
- b) Directing requests and answers for the Europol's requests as well as other information accepted from competent authorities of the Russian Federation and the Russian Ministry of Internal Affairs' branches to the Europol in established order;
- c) Providing assistance for established procedures for handling confidential information contained in documents incoming from the Europol and competent authorities of the Russian Federation, documents of the Russian Ministry of Internal Affairs' branches, and adopting measures to prevent the possibility of an unauthorized transfer of information to excluded businesses and individuals;
- d) Formation of databases of documentary and background information in established order, including proprietary databases on matters relating to cooperation with the Europol;
- e) Consultative and methodological assistance to competent authorities of the Russian Federation and the Russian Ministry of Internal Affairs' branches for cooperation with the Europol;
- f) Analysis within the competence of the practice cooperation between competent authorities of the Russian Federation and the Europol;
- g) In the established order participation in the development of proposals for improving cooperation between competent authorities of the Russian Federation and the Europol on matters within the competence of the Russian National Contact Center;
- h) Participation in the development of international agreements and laws, and regulations on the Russian Federation's cooperation with the Europol in the established order and within the limits of authorities' competence;
- i) Fulfilling other functions and full powers in accordance with laws and regulations of the Russian Federation.

In order to fulfill its tasks and functions the *Russian National Contact Center has right to:*

- a) request documents, references and other materials necessary for performing particular tasks from the relevant Russian Ministry of Internal Affairs' branches in established order;
- b) in established order usage of databases of the Russian Ministry of Internal Affairs;
- c) use logistics, human resources and other support of the NCB of the Interpol and the Ministry of Internal Affairs of Russia.

Finally, it is necessary to mention the followings. Criminal activity of armed gangs and transnational terrorist organizations is widely spread and actively conducted through the territory of the countries of the European Union. Due to this fact and in order to efficiently combat international terrorism, measures taken should not only include detection and suppression regarding every individual crime of terrorism in a particular region but detection and suppression of terrorist activity upon the whole. Combating international terrorism needs a comprehensive solution and necessitates joint efforts of the Russian authorities cooperation with their colleagues of the Visegrad group, which cooperation is rapidly developing and is being performed at the operational level.

In order to increase the cooperation's efficiency in combating international terrorism, the comprehensive system of action framework is to be created and developed, which would include following:

- a) Developing and signing intergovernmental and interdepartmental regulatory legal acts, like agreements between Poland and Slovakia on cooperation in combating organized crime, or agreement on ministerial level between the Russian Federation and the Europol;
- b) Carrying out joint operational efforts and promotional measures with the intent to combat organized crime;
- c) Carrying out joint operational efforts and promotional measures in the field of counterterrorism and cooperation with the National Anti-terrorism Committee of Russia and the Commonwealth of International States Anti-Terrorism Center member states.

4. CONCLUSION

Developing and signing intergovernmental agreements on cooperation between the Russian Federation and the Visegrad group's countries is the requirement of successful cooperation and information exchange between maximally possible intelligence services.

It is worth highlighting that carrying out joint operational efforts and promotional measures in the field of counterterrorism and combating organized crime on international level will bring interstate and interdepartmental cooperation to a whole new level. It will also contribute to the improvement of counterterrorism policy development; besides it is necessary to take the experience of counterterrorism efforts of the Russian Federation and the Visegrad countries into consideration. Another thing is prevention of crimes and terrorist attacks at the step of its preparing to be committed. Collecting and analyzing information about criminal groups, terrorist organizations and finding out financial channels or other ways of assisting them in their criminal activity.

The preventive mission requires a high level of engagement of the Visegrad group countries and the Russian Federation. Only joint efforts of the international community can make it possible to efficiently solve the global problem of international terrorism and organized crime. This is the necessary condition for a successful solution of problems in this area.

