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## JUDGES AS FISCAL ACTIVISTS: CAN CONSTITUTIONAL REVIEW SHAPE PUBLIC FINANCE?

Jarosław Kantorowicz<sup>1</sup>

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### Abstract

The judicialization of politics, or alternatively, politization of the judiciary has been much discussed over the last twenty years. Despite this, the way judges influence fiscal policy outcomes remains, to a large extent, unexplored. This paper attempts, at least partially, to fill this research gap. A judicial (constitutional) review constitutes the central element of the current analysis since it is considered as a key institutional device through which Constitutional (Supreme) Courts intervene in politics, including public finance. Specifically, this paper seeks to investigate empirically whether there is any systematic pattern according to which judges executing judicial review shape fiscal outcomes. The conceptual framework is based on the strategic interaction model and the assumption that the Constitutional Courts reflect public opinion (i.e. the Court as a majoritarian institution). Some preliminary results for a panel of 24 EU countries in the period 1995–2005 suggest that a strong judicial review correlates with a smaller size of government, measured as government income to GDP.

### Keywords

Public Finance, Size of Government, Constitutional Court, Judicial Review

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### I. Introduction

The general observation in research covering the topic of political science and law is that policy-making becomes ‘judicialized’ (e.g. Stone Sweet, 2001, Garoupa, 2011, Garoupa and Ginsburg, 2012). According to Vallinder (1995), the judicialization of politics refers to the shifting of decision-making powers from the legislature and the executive to the courts. To a large extent, if not exclusively, the judicialization of politics is due to the presence of Constitutional (Supreme) Courts and especially judicial (constitutional) review.<sup>2</sup> Their

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<sup>1</sup> European Doctorate of Law and Economics (EDLE). The University of Hamburg, Institute of Law and Economics, Johnsallee 35, D-20148 Hamburg, Germany. E-mail: jaroslaw.kantorowicz@edle-phd.eu.

<sup>2</sup> In this paper the terms judicial and constitutional review are used interchangeably. This is despite the slight difference between these two notions. While constitutional review might be pursued by any institutional body, judicial review is strictly conducted by the judiciary.

presence triggers constitutional adjudication, which according to Stone Sweet (2007) constitutes the lawmaking process.

In the Kelsenian tradition, a Constitutional Court is explicitly designed to intervene in politics. This approach views the Court as a *negative legislator*<sup>3</sup> able to reject a law from an *ex ante* perspective<sup>4</sup>, thus executing the right of an abstract review (Kelsen 1942). In fact, the role of the current Constitutional Courts is much broader and their competencies go far beyond the *negative legislator* concept. For instance, the Courts are also able to strike down the law after its promulgation<sup>5</sup> (e.g. a concrete review) and to impose statutory interpretation on the ordinary courts. Additionally, the Courts might be engaged in the lawmaking process (e.g. Slovenia), the verification of the legality of elections (e.g. Lithuania) and the legalization of political parties (e.g. Bulgaria). Interestingly, some of these ancillary duties do not even rely on the interpretation of the constitutional text (Ginsburg and Elkins, 2009). This indicates that judicial power expands far beyond its traditional domain.

The underlying inquiry relevant for the current paper is whether this overall tendency of the judicialization of policy extends to the area of public finance. Hitherto, the mainstream literature on institutional public finance<sup>6</sup> largely disregards judges as key institutional players in budgeting. This paper attempts, at least partially, to fill this gap in the research and add to the scarce literature investigating the role of judges in the area of public finance. In this paper, it is conjectured that, by executing constitutional review, the independent judiciary<sup>7</sup> might have an impact on fiscal policy outcomes such as, for instance, on general government revenue. Whether this impact is systematic (e.g. consistently leading to lower revenue) will be examined in this paper.

Overall, this paper presents a positive analysis. To be precise, its main purpose is to examine empirically whether any systematic way exists in which the judicial review shapes fiscal policy outcomes. The general hypotheses are derived based on the strategic interaction model and the assumption that the Constitutional Courts seek public support and reflect

<sup>3</sup> Stone Sweet (2000) goes even further when referring to the Constitutional Court as a *specialized legislative chamber* able to reject legislative statutes.

<sup>4</sup> An *ex ante* judicial review is performed only in an abstract form, i.e. the Court reviews new provisions without reference to a specific case in which provisions are applied (abstract review).

<sup>5</sup> An *ex post* judicial review can be launched in an abstract or concrete form. The latter is initiated by the Court in connection with a specific case (concrete review).

<sup>6</sup> Institutional public finance literature consists of three strands, i.e. literature on numerical rules, procedural rules and political institutions. The former refers to James Buchanan's concept of rules, such as balanced budget, expenditure, revenue and debt rules. Their sole purpose is to restrain political arbitrariness in public finance. In this vein, once politicians are deprived of full discretion in fiscal policy, fiscal discipline is warranted. The second component of institutional public finance is developed by von Hagen (1992). This approach focuses on the effects of procedures guiding the preparation, adoption and implementation of the state budget. The third element is best conceptualized by Persson and Tabellini (2003). They investigate the impacts of political institutions on different fiscal variables. Their main inquiries pertain therefore to fiscal effects of basic constitutional settings such as (1) the parliamentary versus presidential system, (2) unicameral versus bicameral parliament, (3) proportional versus majoritarian electoral system, (4) unitary versus federal states, and (5) broad versus narrow direct democracy. For an extended overview of the literature on institutional public finance, see Raudla (2010).

<sup>7</sup> Judicial independence means that the judges' decisions and rulings are not influenced by political pressure (Hayo and Voigt, 2007).

general public opinion (Vanberg, 2005). Hence, this study relies on the literature strand relating to the Constitutional Court as a majoritarian institution. The preliminary empirical investigation with respect to the size of government is pursued for panel data of 24 European Union (EU) member states over the period 1995–2005.<sup>8</sup> The results included in this paper show that a larger degree of constitutional review correlates with smaller governments, measured as general government revenue relative to GDP. Consequently, countries where judges are equipped with more constraining judicial review tend to experience lower government revenue compared to GDP.

Constitutional review is the main legal device through which the Court factually intervenes in the political sphere and thereby influences public finance outcomes (see Section 2). In this study, judicial (constitutional) review is defined as the ability of the Court or other judicial body to verify whether the laws and regulations enacted by the legislature are in line with the constitutional provisions and in accordance with procedural requirements (Ginsburg, 2008). The crucial consequence of the review, at least from a theoretical standpoint, is that laws and regulations which fail to comply with the constitutional provisions are invalidated or revised by the legislature in line with the Court's opinion. The rationale behind the ability of judges to review the legislation is given by Landes and Posner (1975). According to them, the review serves as a means of dealing with the commitment problem, which emerges as a result of the incompleteness of constitutional contracting.<sup>9</sup> Consequently, the Constitutional Court, or another institution equipped with judicial review power, functions as an external dispute resolution mechanism between citizens and the state authorities, deterring and correcting the latter for any abuse of power. This is analogous to private contracting, where the existence of formal enforcement mechanisms incentivize parties to comply with the contract, despite its incompleteness. Despite the possible relevance, this study does not comprise a historical overview of the creation and implementation of constitutional (judicial) review around the world. Comprehensive surveys on these topics can be found, for instance, in Deener (1952), and Stone Sweet (2000). Similarly, the current analysis does not relate to the debate on the democratic or, alternatively, undemocratic foundation of constitutional review. For this discussion, see Waldron (2006), Fallon (2008) and Tushnet (2010). Further, this study does not refer to the problem of delimitation of jurisdictions, including conflicts of competence between the Constitutional and the Supreme Courts. Garlicki (2007) offers an in-depth analysis of this issue.

The remainder of this paper is structured as follows. Section 2 provides the motivation and anecdotal evidence on Courts influencing fiscal policy outcomes. Section 3, in turn, comprises a brief survey of literature which is relevant to the topic at hand. Section 4 discusses

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<sup>8</sup> Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia entered the EU in 2004. Bulgaria and Romania accessed it in 2007 and therefore were not EU members in the period under consideration. The remaining countries, i.e. Austria, Belgium, Denmark, France, Germany, Greece, Italy, Ireland, Luxembourg, the Netherlands, Portugal, Spain and Sweden, were members of the EU in the whole period under investigation.

<sup>9</sup> Constitutions, as any other contracts, are incomplete, i.e. they do not regulate for all possible contingencies. This is due to the insurmountable transaction costs hypothetically involved in designing a complete contract (Schäfer and Ott, 2004).

the possible transmission channel between judicial review and fiscal policy outcomes. In addition, it proposes hypotheses for empirical investigation. Section 5 describes the data and Section 6 sketches the econometric strategy to be applied in testing for selected hypothesis. Section 7 discusses some preliminary results and Section 8 enumerates basic limitations of the study. Lastly, Section 9 concludes.

## II. Motivation

The ruling of the German Constitutional Court is probably the most up-to-date example of judicial fiscal activism<sup>10</sup>. In mid-September 2012, the Federal Constitutional Court in Karlsruhe rejected a lawsuit which questioned the German ratification of the European Stability Mechanism (ESM)<sup>11</sup> and fiscal compact<sup>12</sup>. The decision to reject the lawsuit allowed the inclusion of the ESM and the fiscal compact in the German legislation. It is worth emphasizing that such a ruling was indispensable for both of these euro-rescue policies to start operating. However, the Court's role did not terminate with a mere 'no' decision against the lawsuit. Throughout the decision, the judges set a range of formal conditions regarding German participation in the ESM. Particularly, they discretionally capped at 190 billion euro the German contribution to the ESM and required the consent of the German parliament to increase this amount.<sup>13</sup> Thus, on the one hand, the judges approved German participation in the rescue policies, which was potentially important to restore confidence in the Eurozone in light of the debt crisis. On the other hand, they limited the extent of German contribution and imposed rigidities under which the state could augment the scope of the funding. Inevitably, both aspects of this decision affect the budgetary process and consequently curb German public finance.<sup>14</sup>

<sup>10</sup> Judicial fiscal activism is referred to as any decision and ruling of the judges which results in higher or lower taxation and, respectively, higher or lower public spending. Although, in theory the judges should be allowed only to reject or abolish the legislation, in fact judicial fiscal activism might also concern lawmaking, which is occasionally costly for the budget (see the Colombian case further in the current section).

<sup>11</sup> The ESM is the successor of the European Financial Stability Facility. In short, the ESM is a rescue mechanism granting loans to Eurozone Member States. It also aims to provide precautionary financial assistance, purchasing bonds of Eurozone countries on primary and secondary markets and recapitalizing financial institutions (see <http://www.european-council.europa.eu/homepage/highlights/european-stability-mechanism-treaty-signed> accessed on October 22, 2012).

<sup>12</sup> The fiscal compact (officially, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union) constitutes a fiscal constitution for the Eurozone Member States. It provides, among other things, that the limit of the annual structural deficit should not exceed 0.5% of the GDP. However, occasionally, when debt-to-GDP is significantly lower than 60%, the state may run a structural deficit of 1% of GDP. As the Treaty instructs, the new fiscal rule shall be enshrined in the highest national statutory provision, i.e. preferably in the Constitution (see <http://european-council.europa.eu/eurozone-governance/treaty-on-stability?lang=en> accessed on October 22, 2012).

<sup>13</sup> See [http://www.bverfg.de/en/decisions/rs20120912\\_2bvr139012en.html](http://www.bverfg.de/en/decisions/rs20120912_2bvr139012en.html) (accessed on November 5, 2012).

<sup>14</sup> In 1995, another important decision of the German Constitutional Court restrained the fiscal maneuvering of the federal government by declaring unconstitutional the federal property tax (see <http://www.economist.com/node/21562237> accessed on October 21, 2012). Moreover, in 2008, the Constitutional Court in Karlsruhe invalidated the amendment of the commuter tax allowance. The amendment abolished the deduction of costs for travelling to the workplace up to 20 kilometers. In the wake of the Court's decision, the government was obliged to return overpaid taxes, i.e. an amount of roughly eight billion euro (see <http://www.bverfg.de/pressmitteilungen/bvg08-103en.html> accessed on November 25, 2012). Finally, in 2010,

Clearly, Germany is not the sole country where judges played an important role in the fiscal policy area. For instance, in July 2012, the Portuguese Constitutional Court declared the austerity plan, which was launched by the federal government as a measure to contend with fiscal crisis, unconstitutional. The judges opposed a crucial part of the plan which suggested limiting an extra holiday and Christmas pay for public sector workers. In the Court's opinion, the deficit-cutting program infringed the principles of equity. According to the judges, the cost of fiscal consolidation was unequally distributed among public and private sectors, imposing too heavy burdens on the former.<sup>15</sup> It seems plausible to conjecture that, as a result of this decision, the fiscal tightening program in Portugal was delayed. Similarly to Portugal, some austerity measures were ruled unconstitutional, for instance, in the Czech Republic (concerning the reduction of judges' salaries)<sup>16</sup> and in Romania (regarding cuts in pensions)<sup>17</sup>. The list of countries where the fiscal activism of the Constitutional Court has been observed in recent years could be easily extended by including France<sup>18</sup> (cancellation of the carbon tax)<sup>19</sup> and Italy (annulation of the luxury tax)<sup>20</sup>. Overall, each of these decisions by Constitutional Courts limited, at least to some extent, the scope of government discretionary action in the area of fiscal policy.

However, Hungary constitutes another pivotal case. According to the new Constitution of 2011<sup>21</sup>, the Hungarian Constitutional Court is explicitly excluded from ruling on issues related to budget and taxation. This limitation will be upheld until public debt drops to 50% of GDP from the current level of roughly 80% of GDP.<sup>22</sup> Interestingly, prior to this constitutional reform, the Hungarian Constitutional Court was the most activist court in the Central and Eastern Europe<sup>23</sup>, if not the world, including activism in the fiscal policy area (Sadurski, 2002). For instance, in 1995 judges ruled unconstitutional 26 provisions of the austerity plan, such as the abolishment of social entitlements (e.g. sick leave benefits and family allowances), cancellation of pension plans and staffing cuts in higher education

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the Constitutional Court ruled unconstitutional the law imposing higher inheritance taxes on homosexual couples as compared to heterosexual couples (see [http://www.bverfg.de/en/decisions/rs20100721\\_1bvr061107en.html](http://www.bverfg.de/en/decisions/rs20100721_1bvr061107en.html) accessed on November 18, 2012).

<sup>15</sup> See <http://www.bbc.co.uk/news/world-europe-18732184> (accessed on October 20, 2012).

<sup>16</sup> See <http://praguemonitor.com/2010/09/13/constitutional-court-cancels-reduction-judges-salaries> (accessed on October 20, 2012).

<sup>17</sup> See <http://opportunity.ro/en/content/romania%E2%80%99s-parliament-eliminates-unconstitutional-provisions-austerity-plan> (accessed on October 20, 2012).

<sup>18</sup> According to Stone (1995), over the period 1974–1990, all annual budget laws in France were referred to the Constitutional Council. While the budget laws were not necessarily rejected by the Council, the fact that they were subject to the review excluded the radical tendencies and promoted the status quo (Favreau, 1986).

<sup>19</sup> See <http://news.bbc.co.uk/2/hi/europe/8434505.stm> (accessed on October 21, 2012).

<sup>20</sup> See <http://www.mondaq.com/x/186704/Aviation/The+Italian+luxury+tax+on> (accessed on October 21, 2012).

<sup>21</sup> Although the new Hungarian Constitution was promulgated in 2011, it entered into force on January 1, 2012 (see <http://www.europeanvoice.com/article/2012/january/commission-raises-concerns-about-hungary-s-constitution/73086.aspx> accessed on November 18, 2012).

<sup>22</sup> See article 37(4) of the new Hungarian Constitution (see <http://www.mkab.hu/rules/fundamental-law> accessed on November 5, 2012).

<sup>23</sup> The Polish Constitutional Tribunal is also known for its fiscal activism. In 1996, judges abolished the suspension of the indexation of pensions and, in 1997, they struck down a number of provisions of the 1991 Tax Statute (Sadurski, 2002).

(Schwartz, 2002). According to the Hungarian Ministry of Finance, those decisions were equivalent to 20–30% of the value of the entire austerity program. Drawing from past experience and more recent Court's decisions, which once again were mostly unfavorable to the budget consolidation<sup>24</sup>, the *Fidesz-KDNP* coalition government<sup>25</sup> decided to curtail the Court's activity. This controversial move could be pursued because the conservative *Fidesz-KDNP* coalition had attained the qualified majority of 2/3 of parliamentary votes. Due to the restricted role of the Court, the government was able to regain full discretion in fiscal policy and launch a fiscal adjustment process.<sup>26</sup> The latter was, to a large extent, revenue driven, i.e. fiscal consolidation was achieved through an increase in taxes<sup>27</sup> and the nationalization of the private-pension fund<sup>28</sup>. The government's decision to diminish the importance of the Constitutional Court remains controversial and is perceived as a violation of the rule of law and standards of democracy.<sup>29</sup> The Hungarian case demonstrates the dynamics in the relationship between the Constitutional Court and incumbents. Whenever the Court is too activist in restraining political fiscal discretion, governors might intend to undermine its role, once they are able to amend the constitution.

Although this paper focuses on Europe, it is certainly not the only place where the Constitutional Court's decisions interfere with reforms of budgetary allocations and tax collection. It turns out, for instance, that judges are key players in the budget process in Colombia. A decade ago, the Colombian Constitutional Court declared unconstitutional a law imposing a 2% VAT on items which were previously free of taxes and another law which aimed at reducing pensions (Eslava, 2006). Interestingly, constitutional judges in Colombia not only annul laws but are active in lawmaking and the imposing of revised

<sup>24</sup> The Court's cancellation of the retroactive effect of a 98% tax on some severance pay for public sector employees initiated the government's decision to abolish the Court's authority in Hungary (see [http://www.bbj.hu/politics/constitutional-court-annuls-retroactive-effect-of-severance-pay-tax\\_57624](http://www.bbj.hu/politics/constitutional-court-annuls-retroactive-effect-of-severance-pay-tax_57624) accessed on October 20, 2012).

<sup>25</sup> *Fidesz* is a main party of the Hungarian Parliament. It holds roughly 59% of the seats in the lower chamber. KDNP, the coalition partner, occupies another 10% of the seats. Together this gives a majority of more than 2/3, which is required for constitutional amendments. For the special situation of the government coalition and the *Fidesz* party particularly, see <http://www.reuters.com/article/2010/04/12/us-hungary-election-idUSTRE63A1GE20100412> (accessed on November 18, 2012).

<sup>26</sup> To some extent, the Hungarian case is analogous to the court-packing attempt announced by Franklin Delano Roosevelt in 1937. The direct reason for this plan was the fact that, in 1935, the U.S. Supreme Court struck down a large segment of the New Deal and, in 1936, it declared unconstitutional some further parts of it (including the Agricultural Adjustment Act, the Guffey Coal Act and the Municipal Bankruptcy Act). According to the judges' statements, the national government had no constitutional capacity to take action for economic recovery in the aftermath of the Great Depression. Although the court-packing attempt failed, the Court eventually ruled in favor of the New Deal legislation. Eventually, a nexus of circumstances led to the Court's agreement. One of those was the retirement of Justice Willis Van Devanter, who was an intellectual leader of the Court's conservative wing. However, growing public sympathy towards the New Deal program also played an important role in changing judges' attitudes (Caldeira, 1987).

<sup>27</sup> For tax increases in Hungary, see e.g. <http://www.bloomberg.com/news/2010-07-22/hungarian-lawmakers-to-approve-brutal-bank-tax-in-defiance-of-imf-eu.html> (accessed on November 8, 2012).

<sup>28</sup> For the private pension-fund nationalization, see e.g. <http://www.bloomberg.com/news/2010-11-25/hungary-follows-argentina-in-pension-fund-ultimatum-nightmare-for-some.html> (accessed on November 8, 2012).

<sup>29</sup> See [http://www.nytimes.com/2011/04/19/world/europe/19iht-hungary19.html?\\_r=3&](http://www.nytimes.com/2011/04/19/world/europe/19iht-hungary19.html?_r=3&) (accessed on October 20, 2012).



spending on the executive. For example, in 2004, the Constitutional Court, dealing with internal displacement problems, determined that the rights of families, forced to leave their premises as a consequence of the state's inner conflict, were violated. In the aftermath of the Court's decision, the government was obliged to develop a compensation mechanism for displaced individuals (Cárdenas et al., 2009).

Judicial fiscal activism is also present in Israel. In a very recent case from 2012, the Israeli High Court of Justice revoked a provision in the Income Tax Ordinance. The latter provision provided tax benefits for certain settlements. According to the Court, the methods by which the settlements were selected for receiving benefits impeded the right to equality and unconstitutionally discriminated between proximate and substantively similar areas. Besides declaring void a provision which provided tax benefits for some Jewish settlements, the Court instructed the legislator to include three Arabic areas for tax reimbursements.<sup>30</sup>

All these cases demonstrate that the review of the constitutionality of the law is crucial for the Courts to influence public finance outcomes. One may therefore conjecture that the judicial (constitutional) review is the main legal device through which the Courts actually intervene in the political domain and thereby affect public finance outcomes. The underlying inquiry as to whether the Courts, through the execution of the judicial review, shape fiscal policy outcomes in a systematic way, remains unanswered.

### III. Related literature

Initial interest in judiciary as a possible explanatory variable of economic outcomes can be traced back to the mid-1970s.<sup>31</sup> However, the continuing interest in the judicial influence on economic policies began in the early 2000s. For instance, Henisz (2000) investigates how the institutional environment, including an independent judiciary, ensures the credible commitment of the government not to interfere with the private property rights. The latter seems crucial, since potential governmental attenuation or the expropriation of private property rights disincentivizes capital accumulation, which is crucial for economic growth. The author presents empirical evidence using panel data of 157 countries over the period 1960–1994. He demonstrates that, by enhancing credibility of commitment, institutional constraints (including independent judiciary) positively affect economic development.

Feld and Voigt (2003), in turn, emphasize that the distinction between *de jure* and *de facto* judicial independence is crucial when analyzing the economic consequences of institutions. While *de jure* independence refers to the mere legal provisions, the *de facto* measure stands for the actual independence of judges. The latter is approximated, among others, through effective term lengths and the degree to which judicial decisions influence government behavior. The authors do not find support for the hypothesis that *de jure* judicial

<sup>30</sup> HCJ (8300/02) *Gadban Nasar and the Local Council of Mazraa vs. State of Israel* and others (see, in Hebrew, <http://elyon1.court.gov.il/files/02/000/083/n48/02083000.n48.htm> accessed on November 19, 2012).

<sup>31</sup> Landes and Posner (1975) were among the first to analyze judicial independence from the economic point of view. According to them, independent judiciary is in the interest of the legislature. The reason for this is that the presence of independent judges prolongs the lifespan of legislation, which is desired by certain constituencies (interest groups).

independence positively influences the growth of real GDP per capita. It is contrary to the *de facto* judicial independence, for which positive impact on rate of economic development is detected. In their empirical investigation, Feld and Voigt rely on cross-sectional data from 56 countries, for which information on the *de jure* and the *de facto* judiciary independence is found.

In Feld and Voigt (2006), the authors extend their cross-sectional analysis to 73 countries. The positive impact of the *de facto* judicial independence on the rate of economic growth is sustained.<sup>32</sup> In addition, it is shown that some of the components of the *de jure* judicial independence positively influence economic development.<sup>33</sup> However, the Constitutional or the Supreme Court's power of judicial review turns out to be negatively correlated with real GDP growth.

In a less rigorous fashion, the positive influence of judiciary independence on economic growth is reported by Wittrup (2010). The author's empirical evidence is based on cross-sectional data from 95 countries. Some of the variables in the model are averaged over the period 1980–2003. The key variable of interest, judicial independence, relies on measures from a perception survey (the Executive Opinion Survey) prepared by the World Economic Forum<sup>34</sup>. According to the author, this perception measure serves as a proxy for *de facto* judicial independence.

Contrary to the aforementioned studies, which seek a link between the judiciary and economic growth, La Porta et al. (2004) discuss how judicial independence and constitutional review ensure economic and political freedom. Their cross-country empirical investigation, encompassing 71 countries, indicates that more judicial independence is correlated with both larger economic and political freedoms. Constitutional review is, in turn, significantly related to economic freedom only when the latter is approximated by the property rights index.

The abovementioned studies are important inasmuch as they investigate the relationship between judiciary and economic phenomena such as economic growth and freedom. The central inquiry of this paper relates, however, to the correlation between the judicial review and public finance outcomes. The relevant literature on the topic at hand is very limited. To the author's knowledge, there are only five academic works which treat judicial independence and/or judicial review as explanatory variables of some of the fiscal policy outcomes.

First, in the theoretical model, Padovano et al. (2003) propose that an independent judiciary enhances political accountability in democratic systems. This increased accountability leads, in turn, to higher social welfare, since the provision of public good is maximized (public revenue is not extracted through political rent seeking). Contrary to this, accommodating judiciary, which colludes with other government branches, results in lower social

<sup>32</sup> A completion of judges' term, marginal changes to the number of judiciaries and competitive wages of judges are the most crucial components of the *de facto* judicial independence conducive to economic growth.

<sup>33</sup> Two components of the *de jure* judicial independence which are positively associated with economic growth are accessibility to the lower court and the length of the appointment term for the highest court judges.

<sup>34</sup> For the methodology of the survey, see <https://wefsurvey.org/index.php?sid=28226&lang=en&intro=0> (accessed on November 10, 2012).

welfare. The latter is due to the extraction of tax revenue by rent-seeking governmental branches.

Second, Vaubel (1996) suggests that the existence of the Constitutional Court is an important factor of expenditure centralization. According to the author, judges of the Constitutional Court have centralist preferences, i.e. they tend to favor and strengthen central institutions inasmuch as centralization enhances their prestige and influence. Consequently, Constitutional Court judges are interested in transferring competences from the province to the federal level, since only then can the Court be in charge of interinstitutional disputes, which were previously ruled at the province level. The empirical evidence is given for cross-sectional data from 50 countries in 1989–1991. In his later study, Vaubel (2009) confirms the previous results and further expands analysis on this area of research. First, the author describes that centralization is larger in those countries where judges of the higher court enjoy independence from the other governmental branches. Second, the author states that centralization is larger when the barriers to constitutional amendment are significant. The dataset for cross-sectional empirical investigation encompasses 42 economies between the years 2001 and 2004.

Third, Tridimas (2005) shows theoretically and empirically that a stronger judicial review and judicial independence are associated with a relatively lower size of government. The latter is measured by central government revenue to GDP. The existence of the Constitutional Court, with the ability to strike down legislation, introduces political uncertainty and limits government discretion in levying taxes. It is assumed that the government is automatically corrected by the Court for setting too burdensome taxation and promulgating tax provisions which are incompatible with the constitution. Consequently, the presence of the Court leads to a decrease in the size of politically optimum redistributive measures. The theoretical underpinnings are supported by the cross-sectional empirical investigation. The latter is conducted for a sample of 52 countries.

In addition, Eslava (2006) presents suggestive empirical evidence that judicial activism in fiscal policy results in a larger public deficit. Her empirical investigation encompasses 23 South and Central American countries in the period 1996–2003. According to Eslava, the larger public deficit is due to the delay in fiscal reform. As she suggests, fiscal consolidation costs usually fall disproportionately on certain social groups. These groups, perceiving that their rights were violated (as compared to other groups, which stayed untouched), are incentivized to take legal action, i.e. file the case with the Constitutional Court, and thus hamper the introduction of austerity measures. Usually, the benefits of fiscal tightening exceed its costs. The benefits are, however, internalized by all citizens and, consequently, are small and difficult to quantify for an individual. This leads to a situation where individuals who benefit from the fiscal consolidation do not organize themselves to secure it. Due to this collective action problem, the Court rules exclusively on cases brought by organized social groups, who lose from fiscal consolidation and thus have an interest in requesting the Court to strike down the austerity measures. As a result, this asymmetry of ruling results in larger deficits and a delay in the fiscal adjustment.

Lastly, Raudla (2011) demonstrates the impact of the Constitutional Court on the tax system, based on the case study of Estonia. In-depth analysis of the Estonian Constitutional

Court's decisions on taxation allows the author to conclude that Courts in transitional economies are willing to impose costly judgments for the public budget. Radula conjectures that, in transformation countries, newly created Constitutional Courts seek to establish reputation and gain public support. As has been stressed, this reputation may be gained by supporting the interest and rights of the taxpayers.

#### IV. General hypotheses

This paper attempts to empirically examine whether the judiciary, through the execution of the constitutional review, shapes public finance outcomes in a systematic way. In constructing theoretical underpinnings for the empirical test, it is necessary to presume which incentives of the Constitutional Court's judges prevail. Hitherto, the literature investigating the judicial behaviors in ruling the constitutionality of law is not unanimous. On the one hand, the *attitudinal approach* perceives judges as unconstrained players who rule on cases based on their political preferences (Segal and Spaeth, 2002). On the other hand, in the *strategic interaction models*, judges' decisions respond to the changing political circumstances and adjust to potential reactions of the other actors, such as the legislators and electorate (Gely and Spiller, 1992).

In this study, the hypotheses regarding the potential influence of the constitutional review on different variables of public finance are derived based on the strategic interaction model presented by Vanberg (2005). A strong assumption is made that judges seeking for the authority and the integrity of the Constitutional Court reflect general public preferences in their decisions.

Constitutional Courts do not function in an institutional or political vacuum (Gely and Spiller, 1990). Contrary to this, Courts are clearly involved in strategic interactions with other actors. These are interactions between the Court and the legislature, on the one hand, and between the Court and the general public, on the other. The presence of the Constitutional Court leads to the adjustment of the decisions made by the legislators, who are aware that over-radical or unlawful provisions might be struck down. This ability of the legislature to assess the Court's reaction and abandon unconstitutional legislation is defined as autolimitation (Stone Sweet, 2000). Public support, in turn, which is the main scope of analysis in the current paper, seems to be crucial to legitimize the Court's decisions and strengthen the execution of its veto power.

As claimed by Mishler and Sheehan (1993), the Court seeking authority and recognition is reluctant to deviate in its ruling from public opinion. This is reflected in Justice Frankfurter's famous expression that "the Courts' authority – possessed of neither the purse nor the sword – ultimately rests on sustained public confidence in its moral sanction" (in *Baker v. Carr*<sup>35</sup>). Similarly, McGuire and Stimson (2004) claim that judges lack institutional capacities to ensure the full effect of their rulings. Consequently, without public support, their preferred outcomes might be rejected and the Court's legitimacy undermined.

<sup>35</sup> The case can be retrieved from <https://supreme.justia.com/cases/federal/us/369/186/case.html> (accessed on November 27, 2012).

Also, Posner (2008) declares that “the usual external constraints on judicial discretion are severely attenuated except for public opinion” (p. 274).

In the same vein, Vanberg (2005) considers public support as a crucial *judicial resource*. As claimed, public support strengthens the *de facto* power of the Constitutional Court and the judicial review in the net of strategic interaction with other political players. Although judges are policy motivated, they are also likely to have institutional concerns. Non-compliance with the judges’ decision by the legislature is possibly costly for the Court, since it undermines its authority by challenging its role in the policymaking. Consequently, a successful evasion of the Court’s ruling weakens its position *vis-à-vis* other political bodies.

Crucial in this setting is the potential *problem of compliance* which emerges due to the fact that the Court’s decisions are not self-enforcing. Implementation of the Court’s ruling involves the cooperation of other actors (especially legislators) who may not wish to comply with a certain decision of the Court. It requires the legislature to act according to the Court’s ruling and revise those provisions which were declared unconstitutional. The legislators’ incentives in deciding how to respond to the Court’s decision are essential. Without any pressure to enforce the decision, legislators are incentivized to act in an opportunistic fashion and evade the Court’s ruling. It cannot be excluded that, even if the law is annulled, legislators might be tempted to re-enact unconstitutional legislation and thus circumvent the Court’s decision (Bossuyt, 2008). As claimed by Vanberg (2005), a key mechanism that creates pressure for legislators is the possibility of a negative public backlash in the event of non-compliance with the judicial decision. Public support for the Court or its specific ruling is therefore perceived as an *enforcement mechanism* and a driving force for judicial decisions to be implemented. In a nutshell, fear of a potential negative electoral reaction (i.e. reputation loss and negative electoral consequence) incentivizes the legislature and the government to revise the unconstitutional provisions or abstain from the re-introduction of unconstitutional law.<sup>36</sup>

There are two types of public support the Constitutional Court might enjoy, namely, specific and diffuse support. Specific support refers to a particular decision of the Court, i.e. one does not necessarily support the Court as such, but is vastly interested in its particular rulings. Diffuse support, in turn, is associated with common support for the impartial Court as an institution. Diffuse support means therefore that one might not agree with a specific ruling of the Court but will still respect it as an independent constitutional safeguard. According to Vanberg (2005), in time, specific support converts into diffuse support for the Court as an institution.

Based on this discussion, it is assumed therefore that the level of diffuse public support the Court enjoys can be enhanced via a specific ruling which is in line with the public

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<sup>36</sup> The empirical investigation of negative electorate consequences as a result of non-compliance with the law by governors has not been yet pursued. Based on anecdotal evidence, Schauer (2012) proposes a refined hypothesis of illegal action of governors and the resulting electoral effect. He claims that illegality of policy does not result in a negative electoral effect if this policy appears to be successful. Contrary to this, illegal action which leads to negative outcomes is likely to result in aggravated negative political and reputational consequences. In the latter situation, politicians are punished for both unsuccessful policy and the breach of the law. Empirical investigation of the underlying hypotheses constitutes a promising avenue of research.

will. According to Gibson and Caldeira (2003) and also Raudla (2010), the specific ruling in line with the public mood occurs in particular shortly after the Court's establishment. At the early stage, the new institution seeks legitimacy, reputation and recognition *vis-à-vis* other institutional and political actors by attracting public support. Similarly, when the Court already enjoys diffuse public support, the judges are aware that this valuable resource can rapidly be wasted if systematically unpopular and unsatisfactory decisions against prevailing public attitudes are made. Overall, public opinion and preferences impose boundaries on the Court's actions and can be understood as driving forces of the judicial ruling. Empirical and anecdotal evidence that the Courts are indeed sensitive to prevalent public moods can be found, for instance, in Mishler and Sheehan (1993, 1994, 1996), Link (1995), Stimpson et al. (1995), Flemming et al. (1997), Dotan (1998), Volcansek (2000), McGuire and Stimson (2004), Vanberg (2005), Friedman (2005), Giles et al. (2008), Posner (2008), Ura and Wohlfarth, and also Casillas et al. (2011).

Although most studies use empirical evidence from the U.S. Supreme Court<sup>37</sup>, Dotan (1998) shows in an anecdotal fashion that the Israeli High Court of Justice often follows the opinion of the majority of the electorate. Those are especially pro-majoritarian decisions limiting Orthodox Jewish law. More importantly, Volcansek (2000) and Vanberg (2005) demonstrate that Kelsenian type Courts are also responsive to public opinion. In interviews conducted by Vanberg (2005), judges tended to state that "the court does not take an opinion poll, but public attitudes does play a role" or "they [the judges] are well aware of the public mood . . . the public mood is very important for the judges" (p. 128–129). Moreover, judges admitted that they cannot frequently allow themselves to rule against prevailing attitudes. Another example of judges tending to reflect public opinion can be found in Poland. In 2010, the Polish Constitutional Tribunal refrained from ruling unconstitutional the law reducing the pensions of the former agents of the secret service operating under socialism.<sup>38</sup> The law cut the retirement benefits of more than 40,000 pensioners by an average of 20%. The case was highly controversial, as it infringed on the protection of acquired rights. The Court's decision was, however, in line with broad public preferences (i.e. 58% of respondents supported this initiative).<sup>39</sup>

As shown heretofore, public support should be crucial for the Court. This support shields the Court's authority (strengthening the enforcement of the decision) and its institutional integrity. Consequently, in the context of fiscal policy, a Court targeting to gain or maintain public support should represent the will and preference of a public which is usually hostile towards any tax increase and abolishment of tax exemption. It is quite intuitive that people universally prefer lower rather than higher tax burdens. For instance, Hansen (1998) shows through a survey that the general public in the U.S. largely opposes the increase of taxes in order to cut the budget deficit.<sup>40</sup> The Eurobarometer (1998) poll, in turn, shows that,

<sup>37</sup> Empirical investigation of the U.S. Supreme Court reflecting public opinion is possible due to the availability of public mood indicators, i.e. the domestic policy mood index (see, e.g., McGuire and Stimson, 2004).

<sup>38</sup> Decision K 6/09 of the Polish Constitutional Tribunal (for decision, see, in Polish, <http://www.trybunal.gov.pl/OTK/otk.htm> accessed on November 28, 2012).

<sup>39</sup> See, in Polish <http://wiadomosci.gazeta.pl/wiadomosci/1,114873,4129355.html> (accessed on November 28, 2012).

<sup>40</sup> For instance, 75.3% of respondents oppose increases in taxes in order to cut the budget deficit. Moreover,

although EU citizens are willing to increase public health spending, the vast majority are reluctant to increase taxes to this end. The preferred policy is to cut other spending or to finance it by other means.

In addition, if it is assumed that the electorate is subject to fiscal illusion<sup>41</sup> (*'more for less'* paradox<sup>42</sup>), then the judiciary should not only promote low taxation<sup>43</sup> but also larger public spending. This, in turn, may lead to systematic fiscal imbalance and the accumulation of public debt. It might further be the case that the Court tends to oppose cuts in social spending, knowing that these reductions are unpopular with the public. For evidence that social spending cuts bring social discontent, see De Vries and Hobolt (2012). Moreover, judges might be resistant to accepting cuts in capital and development spending, since they also enjoy large public support. For evidence on the latter point, see Schuknecht (1994) and Brender (2003).

These, however, would not be correct conjectures regarding expenditure and deficit if alternative assumptions about public fiscal perceptions are true. For instance, Peltzman (1992) claims that U.S. voters should be defined as fiscal conservatives, since they systematically punish governments for the growth of public expenditure. In the same vein, fiscally conservative attitudes of the public are presented by Alesina et al. (1998) and Alesina et al. (2011). Despite the conventional wisdom that fiscal consolidation is a politically unattractive venture, these studies do not find empirical evidence for this statement. In OECD countries, incumbent governments radically pursuing fiscal adjustments are not systematically worse off than their counterparts which abstain from fiscal tightening.

Although only in an anecdotal fashion, one may claim that in Switzerland the public is to a large extent fiscally conservative. This conjecture is derived based on circumstances from the 1990s, when the fiscal stance in Switzerland deteriorated and public debt reached

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64.6% respondents stand against tax increase in order to augment spending on domestic programs, such as health care, education and road infrastructure. Lastly, 86.8% of respondents object to any increase of taxes to finance larger spending on national defense. The survey was conducted on 486 Americans (Hansen, 2008).

<sup>41</sup> Although the concept of fiscal illusion could be traced back to John Stuart Mill and Vilfred Pareto, it was Amilcare Puviani who emphasized its importance in the early 20th century. In a nutshell, fiscal illusion refers to the source of government revenue, which is unidentifiable by the electorate, e.g. debt financing. Inasmuch as the electorate is unaware of the revenue source for the expenditure, it does not perceive its burden (Mueller 2003). The debt financing seems less costly than tax financing, due to a failure by the electorate to entirely account for the future tax liability caused by debt re-financing. Some empirical evidence of fiscal illusion can be found in Wagner (1976), and also in Pommerehne and Schneider (1978).

<sup>42</sup> The *'more for less'* paradox relies on the concept of the fiscal illusion. This relates to the fact that people simultaneously desire more governmental services and tax reduction (Welch 1985). An alternative explanation of people's unwillingness to accept an increase of taxes in order to raise social spending could be offered by the behavioral law and economics approach, i.e. bounded willpower. According to the latter, people tend to act against their long-term interests (Jolls et al., 1998). For example, individuals prefer to spend money today rather than saving it for the future. Therefore, tax payers might prefer lower taxes in the present instead of paying for a policy, e.g. social security, which may benefit them in the future.

<sup>43</sup> Of course, this is not to say that Constitutional Courts strike down all legislation which increases taxation. The legislator surely has the power and legitimacy to increase taxation. Consequently, if the legislation which increases tax is in line with constitutional provisions it should be deemed lawful. That is why it is to be declared as unconstitutional such law needs, for instance, which discriminate against one group of people against another. It is presumed that Courts might be more prone to rule the case unconstitutional when the discriminated group is large. Moreover, judges do not act completely irrationally.

the unobserved level of nearly 60% of GDP. In 1995, a dissatisfied public launched a popular initiative to restrain the accumulation of public debt. The aim of the initiative was to introduce constitutional rule to preclude the situation of permanent deficits. The rule was to balance expenditure and revenue in a four-year time horizon (Conseil Federal, 2000). Despite the defeat of the initiative, this example shows that society was concerned about debt accumulation and wanted to use its right to restraint politicians from spending excessively. Eventually, in 1999, the Swiss Ministry of Finance launched a project on the debt brake, which was in line with the social expectations. The constitutional provision of the rule was approved in referendum in 2001. Overall, 85% of voters were in favor of it. The referendum turnout was approximately 37%, which is high for Swiss standards (Kirchgässner, 2005).

Consequently, while there is agreement concerning the fact that people on average prefer lower taxation, there is a lack of consensus on the popular fiscal perception regarding expenditure and deficit. Contrary to fiscal illusion, fiscal conservatism leads to more constrained public spending and lower public deficit. Instead of arbitrarily choosing the prevailing perception on expenditure and deficit, it seems plausible to assume that in some countries fiscal illusion is the dominant fiscal perception of expenditure and deficit (e.g. Greece and Italy) and in some other states the public is fiscally conservative (e.g. Estonia, Luxembourg).

As a result, one can derive hypotheses conditioned to the fiscal perception of the public. They are as follows:

*H1:* The presence of the Constitutional Court or another judicial institution with a strong constitutional review power results in smaller general government tax revenue to GDP regardless of public fiscal perceptions.

*H2:* The presence of the Constitutional Court or another judicial institution with a strong constitutional review power results in smaller general government spending to GDP if public fiscal conservatism prevails.

*H3:* The presence of the Constitutional Court or another judicial institution with a strong constitutional review power results in larger general government spending to GDP if public fiscal illusion prevails.

*H4:* The presence of the Constitutional Court or another judicial institution with a strong constitutional review power results in larger deficits if public fiscal illusion prevails.

It is necessary to mention that information on the fiscal perception of the people is hard to collect. For that reason, in this paper, an attempt is given only to test the first of the hypotheses, i.e. H1.

## V. Data description

As previously mentioned, the Constitutional Court or other judicial entities intervene in the political system through the execution of power to review the legislation. However, the constraining effect of the constitutional review varies across countries and time.

The new dataset by Gutmann et al. (2011) allows for cross-country and cross-time comparability of the constraining effects of the constitutional review, which is a key variable of interest in the current analysis. The measurements refer to the *de jure* constitutional



review, i.e. what are its legal (constitutional) foundations.<sup>44</sup> Gutmann et al. examine four elements of the constitutional review. First, they consider only the constitutional review which is pursued by the judiciary. However, it does not matter if the judges reviewing the constitutionality of the law are seated in a Constitutional Court or a Supreme Court. Therefore, a country where judicial review is pursued by the judiciary receives 1, otherwise 0. If at this stage a country receives 0, it is not subject to further investigation.

Second, analysis is made of who has the power to initiate the judicial review, i.e. whether the authority to file the case for judicial review is given only to political bodies or to the broader public. Gutmann et al. code nine possibilities of initiating the judicial review<sup>45</sup>. The data are normalized on the 0–1 scale, where 1 means that in a particular country all nine channels of filing the case for the constitutional review are present and 0 where none of the channels are identified.

Third, when the constitutional review can be launched is examined, i.e. before (*ex ante*) or after (*ex post*) constitutional review. Gutmann et al. propose to assign 1 to a country where it is possible to initiate the judicial review before and after the promulgation of the law. The value of 0.5, in turn, is assigned to a country where the judicial review can be launched only *ex post* and the value of 0, where the law can be reviewed only *ex ante*.

Finally, the authors investigate the effects of declaring the law as unconstitutional, i.e. it is automatically void or only returned to the legislature for re-consideration. Gutmann et al. assign 1 to a country where the law is automatically void, and 0.5 to a country where the law is returned for revisions to the legislature. Other options are coded 0.

To obtain the aggregate indicator of judicial review, the abovementioned data are normalized on the 0–1 interval. Consequently, the higher the aggregated measurement, the stronger the constraining power of the *de jure* constitutional review *vis-à-vis* legislators. For instance, in 2005, the Netherlands received 0 as there is no formal provision for the constitutional review<sup>46</sup>. Poland, in turn, receives 0.57 as the review is provided for in the Constitution. It can also be determined that the review can be pursued before and after the promulgation of the law. In addition, the list of political bodies to file the case to the Polish Constitutional Tribunal is broad.

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<sup>44</sup> The coding requires a short explanation. For instance, according to Belgian statutory law, there is the possibility of strong judicial review. However, this country was classified as not having judicial review power at all since the Constitution does not include precise provision on judicial review. The rationale behind this coding (concentrated on constitutional provision) is that the strongest judicial review power is given by the Constitution. While statutory law might be changed by a simple parliamentary majority, the Constitution, at a minimum, requires a qualified majority to be amended. Hence, judges are presumed to be more activist when the judicial review power is shielded by the Constitution and not ordinary legislation.

<sup>45</sup> The distinction is made between the following initiators of the judicial review: (1) the head of the state, (2) the head of the government, (3) the government, (4) the first chamber of the parliament, (5) the second chamber of the parliament, (6) both chambers in conjunction, (7) lawyers, (8) the public, (9) the courts.

<sup>46</sup> The Netherlands, together with Switzerland and the Scandinavian countries, are the only states in Europe which did not adopt the Kelsenian type of the Constitutional Court (Garoupa and Ginsburg 2012). For instance, article 120 of the Dutch Constitution states “The constitutionality of Acts of Parliament and treaties shall not be reviewed by the courts” (see, in Dutch, [http://wetten.overheid.nl/BWBR0001840/geldigheidsdatum\\_29-11-2012](http://wetten.overheid.nl/BWBR0001840/geldigheidsdatum_29-11-2012) accessed on November 29, 2012).

It should be noted that the sample under consideration contains 24 EU countries over the period 1995–2005, for which data are easily accessible. Finland, Malta and the United Kingdom are not subject to the analysis since they do not appear in the Gutmann et al. database. Lack of comparable data on fiscal policy outcomes among the EU countries beyond 1995 downwards is a main factor for constraining the time period under investigation. AMECO provides consistent data on the most crucial fiscal indicators for all EU countries only since 1995.<sup>47</sup>

*Prima facie*, it seems that the main fiscal aggregate of interest, i.e. government revenue, is correlated with the degree of the *de jure* constitutional review. The Pearson's correlation coefficient<sup>48</sup> between revenue-to-GDP ratio and degree of constitutional review is equal to roughly  $-0.54$ . A more robust check for a possible relationship between the degree of constitutional review and the fiscal policy outcomes invites, however, more advanced econometric techniques.

## VI. Estimation approach

To answer the underlying inquiry of whether the constitutional review shapes the size of government downwards, panel data model for 24 EU member states over the period 1995–2005 is applied. Panel data allows the increasing of the number of observations and exploiting the cross-time and cross-country variability of data. Specifically, the panel under consideration in this paper has a dynamic form. It is frequent in panel studies on the size of the government to include a lag of the dependent variable as an explanatory variable due to state dependency and persistence (see, e.g. Mukherjee 2003, Prohl and Schneider 2009). Consequently, the equation to be estimated is as follows:

$$y_{it} = \alpha y_{(i,t-1)} + \beta \text{REVIEW}_{it} + \gamma' x_{it} + \eta_i + \varepsilon_{it}$$

$$t = 1, \dots, T \text{ and } i = 1, \dots, N,$$

where  $y_{it}$  stands for the size of government in country  $i$  and time  $t$ ;  $y_{(i,t-1)}$  is the same fiscal policy outcome lagged by one period;  $\text{REVIEW}_{it}$  is a time- and country-specific measure of the degree of the *de jure* constitutional review;  $x_{it}$ , is a vector of control variables;  $\eta_i$  stands for the unobserved country effects; and, lastly,  $\varepsilon_{it}$  are time and country-specific error terms.

As already mentioned, the outcome variable, i.e. the size of government, is measured as government income compared to GDP (data from AMECO dataset). The key explanatory variable, i.e.  $\text{Review}_{it}$  is extracted from Gutmann et al. (2011). The  $x_{it}$  vector contains the set of control variables. Based mostly on Persson and Tabellini (2004), the list of other explanatory variables is included in Table 1. For summary statistics, see Table 2.

<sup>47</sup> For the AMECO database, see [http://ec.europa.eu/economy\\_finance/ameco/user/serie/SelectSerie.cfm](http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm) (accessed on October 27, 2012).

<sup>48</sup> The Pearson's correlation coefficient measures the direction and the magnitude of the linear relationship between two variables.

**Table 1: Explanatory variables used in the empirical investigation**

Variable	Short description
Age dependency (AGE_DEP)	Measured as a percentage of people above 65 years of age (own calculation based on AMECO).
Population size (POPUL)	Millions of people living in a certain country, used in logarithmic transformation (AMECO).
Openness (TRADE)	Measured as export and import relative to GDP (own calculation based on AMECO).
Real income per capita (INCOME)	Measured in euro (AMECO).
Form of government (PARL)	Dummy variables for parliamentary and presidential systems (Golder, 2000).
Electoral formula (PROP)	Dummy variables for majoritarian and proportional (Golder, 2000).
Federal state (FEDER)	Dummy variable for federal state (Forum of Federations, 2012).

*Source: own table*

At this stage of analysis three econometric methods are applied to unravel the potential relationship between the outcome and the explanatory variable of interest, i.e. ordinary least square (OLS), random effects (RE) and generalized method of moments (GMM). Especially with regard to the GMM model, one may argue that there is insufficient number of observations. As Roodman (2009) claims, GMM models are typically designed for situations with few time periods and many cross-sectional units. Excessive numbers of instruments generated by the model may lead to the lower consistency of estimators.<sup>49</sup> However, according to Soto (2009), in small samples with some persistency GMM estimators have lower bias and higher efficiency than OLS. Also, the application of fixed effect estimators is not recommended due to the mediocre variability in the constitutional review indicators within time.

Prior to the estimations, some basic diagnostic tests are performed. First, variance inflation factors do not identify a multicollinearity problem<sup>50</sup>. Second, due to the White test indications of heteroscedasticity<sup>51</sup> of the residual variance, robust standard errors in all specifications were used. In GMM specifications, in turn, a Windmeijer finite-sample correction is applied. Without this correction standard reported errors tend to a downward bias (Roodman, 2006). Lastly, the Durbin-Watson test indicates the autocorrelation of errors. As already stated, the presence of the serial correlation provides the rationale for using model with a lagged dependent variable.

<sup>49</sup> There are two prevailing techniques to decrease the instruments count. One is limiting the lag depth and the other is ‘collapsing’ the instrument set (Mehrhoff, 2009). Hitherto, none of those techniques is used.

<sup>50</sup> The presence of multicollinearity means that two or more independent variables are highly correlated (Wooldridge, 2009).

<sup>51</sup> The presence of heteroskedasticity means that errors do not have constant variance (Wooldridge, 2009).

## VII. Results

The coefficient estimates and their p-values for eight different specifications are presented in Table 2. The variable of interest, i.e. the *de jure* power of constitutional review, exhibits an expected sign, consistent with the hypothesis *H1* proposed in Section 4. Consequently, countries with a high degree of constitutional review systematically tend to have smaller governments, measured as general government tax revenue compared to GDP. It seems therefore that, in countries where the judiciary is entitled to exert strong review, the ruling is in line with the public preferences about lower taxation.

Considering the most developed model (the last column in Table 3), besides the judicial review, one can observe that other variables also have a significant effect on revenue-to-GDP indicator. For instance, lagged revenue-to-GDP is statistically significant at the 1% level, indicating state dependence in revenue-to-GDP. Also, trade variables are statistically significant. This would suggest that openness of the economy negatively correlates with the size of the government. Therefore, one can infer that, for EU countries, the race to the bottom argument holds<sup>52</sup>.

Although those preliminary results must be treated with some reservation (they rely on strong assumptions that Courts tend to reflect public opinion), they indicate an initial support to hypothesis *H1*. While the current study presents mere correlations between the *de jure* power of judicial review and public finance outcome, the causal relationship still needs to be established.

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<sup>52</sup> The race to the bottom hypothesis refers to a situation where a government decides to decrease its tax rates, especially for corporations. The creation of a more competitive tax environment allows the attracting of more foreign investments in the face of growing globalization (Tonelson, 2002).

**Table 2: Effects of judicial review on revenue-to-GDP**

VARIABLES	(1) OLS	(2) OLS	(3) OLS	(4) RE	(5) RE	(6) RE	(7) GMM	(8) GMM
Lagged revenue	0.942*** (0.00)	0.935*** (0.00)	0.932*** (0.00)	0.942*** (24.89647)	0.935*** (37.45838)	0.932*** (49.59577)	0.551*** (0.00)	0.551*** (0.00)
Review	-0.809* (0.07)	-0.923** (0.04)	-0.867* (0.07)	-0.809* (0.06)	-0.923** (0.04)	-0.867* (0.07)	-0.868*** (0.00)	-0.868*** (0.00)
GDP	0.015 (0.13)	0.017 (0.12)	0.019 (0.11)	0.015 (0.13)	0.017 (0.12)	0.019 (0.10)	-0.135 (0.30)	-0.135 (0.30)
Trade	-0.641** (0.01)	-0.554** (0.04)	-0.458 (0.10)	-0.641** (0.01)	-0.554** (0.03)	-0.458 (0.10)	-1.212 (0.48)	-1.212 (0.48)
Age dependency	2.744 (0.44)	2.497 (0.48)	3.298 (0.41)	2.744 (0.44)	2.497 (0.48)	3.298 (0.41)	7.102 (0.77)	7.102 (0.77)
Log(population)	-0.0528 (0.42)	-0.077 (0.32)	-0.067 (0.39)	-0.058 (0.42)	-0.077 (0.32)	-0.067 (0.39)	6.893 (0.40)	6.893 (0.40)
Parliamentary system		-0.106 (0.66)	-0.136 (0.57)		-0.106 (0.66)	-0.136 (0.57)		
Proportional election		-0.281 (0.20)	-0.289 (0.19)		-0.281 (0.19)	-0.289 (0.19)		
Federation		0.145 (0.44)	0.115 (0.57)		0.145 (0.44)	0.115 (0.57)		
Constant	2.456*** (0.01) (11.27349)	2.960*** (0.01) (17.07851)	2.995*** (0.01) (20.22370)	2.456*** (0.01) (15.00002)	2.960*** (0.00) (21.71680)	2.995*** (0.01) (27.11224)	0.041 (0.77)	0.041 (0.77)
Year fixed effects	No	No	Yes	No	No	Yes	No	Yes
Observations	240	240	240	240	240	240	216	216
R-squared	0.964	0.965	0.967	–	–	–	–	–

*Note: P-values in the parentheses. \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$*

*Source: own calculations*

### VIII. Limitations

There are two main limitations of the empirical investigation presented in this paper. The first limitation relates to the number of observations. Currently, the estimations are based on 264 observations (panel data for 24 countries over an 11-year time period), which may lead to a small sample bias in estimators. This reservation applies especially to methods such as the GMM, which require a large amount of cross-sectional observations. Therefore, possible extensions of the cross-sectional dimensions could improve the reliability and robustness of the results.

The second limitation refers to the omitted variables bias. Certain omitted variables might exert joint influence on the size of government and key variable of interest and, consequently, lead to misleading results. For instance, one could think of adding political stability and trust variables to the underlying model. The latter variable could influence both the introduction of the judicial review and the size of government. Countries with a low level of trust could introduce a judicial review in order to assure drafters that a certain constitutional arrangement is kept (Ginsburg, 2006). Similarly, countries with low trust tend to have smaller governments due to people's concerns about the free riding problem linked to wide state policies, such as the welfare state (Nannestad, 2008). This might be a serious problem if one assumes that trust is not constant over time and cannot therefore be canceled out as a country-specific effect. Possible endogeneity problems could be mitigated through the application of instrumental variables.<sup>53</sup> Due to both of those limitations, i.e. sample size and endogeneity problem, the results presented in this paper should be considered as preliminary.

### IX. Conclusion

At this stage of the analysis, the preliminary results indicate that the judicial review negatively correlates with the size of government. Namely, the larger the degree of the judicial review, the smaller the revenue-to-GDP. If this conjecture factually holds, one could derive important normative implications. Hitherto, the literature is not entirely consensual about the effect of the size of government on economic growth. Most empirical studies, however, provide evidence that a smaller size of government covariates with faster economic development. This holds especially for developed countries. For instance, Romero-Àvila and Strauch (2008), for a sample of 15 EU countries (old members of the EU) between 1960 and 2001, demonstrate that an increase in government size measured with revenue-to-GDP negatively affects the growth of GDP per head of population. Similar results for the EU and OECD countries between 1970 and 2004 are obtained by Afonso and Furceri (2010). On the revenue side, indirect taxes and social contributions have a negative and statistically significant effect on growth. Also, Bergh and Karlsson (2010) find that big government negatively correlates with economic development. Their empirical investigation is pursued for OECD countries in two periods, i.e. 1970 to 1995 and 1970 to 2005. Based on those inferences, strong judicial review leading to lower government

<sup>53</sup> To solve the current endogeneity problem, it is necessary to apply instrumental variables. As Angrist and Pischke (2008) underline, finding strong instruments is often very challenging, if not impossible.

size might be indirectly conducive to faster economic growth. For this reason, policy makers should be interested in providing the judiciary with the ability to review the constitutionality of the law.

There are certain obvious extensions and improvements to the current study. The first immediate improvement would be to increase the number of cross-sectional observations. Currently, the analysis relies on 24 EU countries between 1995 and 2005.

The second improvement would include an investigation of whether the Courts in the EU indeed echo public will and preferences in their decisions. This would allow the mitigation of the hitherto strong assumption that the Courts reflect public opinion.

Third, further empirical investigation with regard to expenditure-to-GDP, public deficit and welfare spending, could be pursued. This broader scope would allow for more accurate policy recommendations. It might be the case that, besides lower revenue-to-GDP, a strong judicial review leads to a higher expenditure-to-GDP or a larger public deficit. If this is the case, the policy recommendation is not as clear cut as it is put forth above and policy makers face a trade-off between certain fiscal policy outcomes, once a strong judicial review is present.

The fourth extension could be an attempt to construct more relevant *de facto* indicators of the constitutional review. As has been mentioned throughout the text, the factual influence of judicial review on public finance depends, among other things, on public support for judges' rulings, transparency surrounding judicial ruling, judicial activism and the rigidity of constitutional amendment. As studies by Feld and Voigt (2003, 2006) and also van Aaken et al. (2010) demonstrate, *de facto* indicators might have different effects compared to their *de jure* counterparts.

Although still in a suggestive manner, this study indicates that the judicial review by the Constitutional Court might systematically influence public finance outcomes. As shown, greater degree of constitutional review correlates with smaller size of government, measured as government income compared to GDP. These initial results invite further academic research into the topic at hand.

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## CHALLENGES TO PROFESSIONAL FOOTBALL COMPANIES AND THEIR ANSWERS WITH PARTICULAR REGARD TO ORGANISATIONAL CHANGES

Éva Bába Ms Bács<sup>1</sup>

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### Abstract

Professional football has been going through a period of unprecedented economic growth since the '90s. Football ventures are increasingly becoming medium-sized companies. There have also been organizational changes, reflected in changes in the legal forms of professional football clubs, and in the use of modern controlling, planning, risk and financial management. Important questions remain unanswered with regard to the financing of football clubs, such as the impact of risks or the market value of capital costs. In addition to liquidity and the above, the acceptance of the determinational dependence of certain capital funds on sports results and the development of a strategy suitable for the optimal target system are also important requirements. In this article, we would like to present the answers football companies have given to the challenges they have been facing which affect their organisational system. In the light of international comparison, we examine the status of Hungarian football, which was once world famous and enjoyed better times in the past.

### Keywords

Professional Football, Legal Forms, Organizational Structure, Controlling, Controlling System Building in Football Undertakings

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### I. Introduction

Since the 1990s, professional football has undergone an unprecedented economic resurgence worldwide. From an economic point of view, this sport has evolved into an industry that goes beyond the football clubs participating in the championships that are organized by the various leagues to also involve rather untransparent, complementary economic operations where companies increasingly perform their specific activities on the level of medium-sized enterprises – measured against traditional industrial actors – by following their economic interests.

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<sup>1</sup> University of Debrecen, Faculty of Applied Economics and Rural Development, Böszörményi u. 138, H-4032 Debrecen, Hungary. E-mail: babae@agr.unideb.hu.

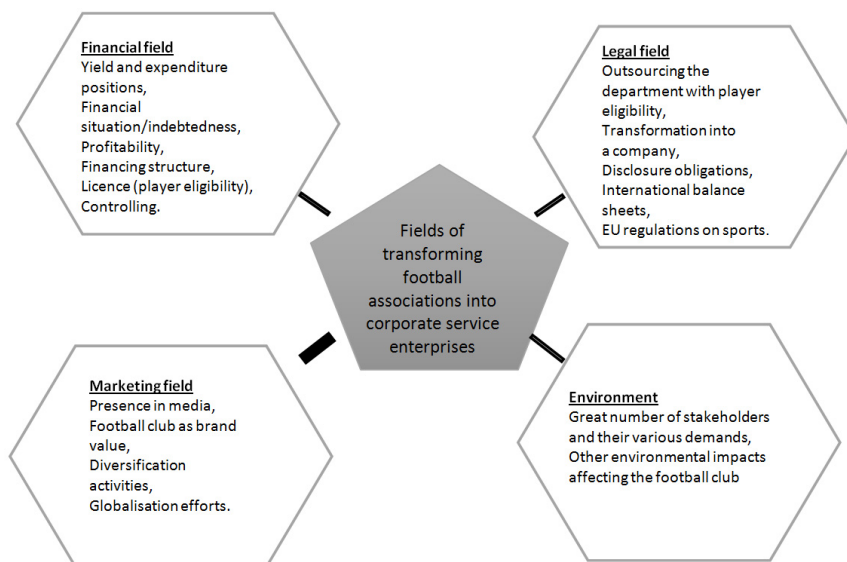
In line with these truly economic processes, football in Hungary should also take steps to become an industry and apply the methods of more developed markets to the work of the Hungarian Football Federation (MLSZ), as well as to its organizational setup and the management of the Football League and professional clubs, both in their acquisition of capital resources and the establishment of control (Borbély, 2012). This is the only way to ensure the long-term, efficient operation of Hungarian clubs in the international scene, the further betterment of the standards of the OTP Bank League, something which is key to attaining positive results for the Hungarian national team.

The general conditions of professional football change at such a pace that most football clubs find it hard to follow in terms of adaptiveness. These changes are so intense that one cannot avoid agreeing with Caesar Luis Menotti, the legendary Argentinean coach: “The world of utopias has now gone. We live in a utilitarian society where football is condemned to big businesses.”

## II. Changes in professional football

Over the past few decades, tremendous changes have taken place in football, both on and off the pitch. We would like to highlight just a single piece of data to illustrate this: in 1963, the monthly salary was DM 1,200 in the level one *Bundesliga* in Germany. Only the world champion Hans Schäfer received double this. In 2005, the average monthly salary reached EUR 26,000–27,000, while the biggest stars were even then earning millions each year. The “off the pitch” changes can be divided into four groups.

**Figure 1: Categorisation of “off the pitch” changes**



Source: Own research

The above revolutionary changes are closely interconnected with each other.



### Financial field

Sales revenues, especially in the case of the teams of big football nations, have increased dramatically in recent decades. The German level one *Bundesliga* had already reached EUR 2 billion in sales revenue as early as in 2010, while for England revenue exceeded EUR 2.4 billion. The numbers are immense, for example in 2010 in Germany, the average number of spectators visiting a match was about 41,000, with a standard ticket price of more than EUR 21. Media revenues have also massively increased. It is highly important to note that professional football is a very costly economic field, where an increase in sales revenues goes hand-in-hand with considerable growth in expenses. Financial stability plays a huge role, and this is reflected in the quality of the management and its setup. From the perspective of our selected topic, organisational changes in the latter and the establishment of controlling organisations have great significance (Haas, 2006).

Capital can be provided through internal or external financing. Football enterprises are highly dependent on *internal financing*, where forms of financing specific to football are especially prevalent. Financing sources in this case can be expanded by increasing revenues and decreasing expenditures or by releasing tied up capital. The main revenues in a classical sense are revenues from media rights and ticket sales, merchandising (image transfer), and revenues from noneconomic areas or areas close to football, which in the case of a football enterprise obviously depend on sports results (Keller, 2006).

In the case of significant economic and intangible results, the dependence of primary revenues on sports results significantly decreases. Examples of this are media rights revenues, which are sold through contracts prior to the launch of the season. For certain periods, these revenues can be considered fixed. In this case, growth opportunities are of course highly limited for the duration of these contracts. Revenue growth can only be achieved thanks to sports results, unexpected successes abroad or by the integrating of new media elements. Revenues from media rights can therefore be considered a given condition depending on the previous season, which of course does not mean that the club should not try to generate as much revenue as possible, as media revenues are usually the most significant and most intensely growing revenue source for professional football clubs. In Germany, in the 2008/2009 season in the Bundesliga I, such revenues increased by 40 percent compared to the 2006/2007 season (4. Bundesligareport, 2011). The revenue structure of the 2009/2010 season is shown in Table 1. The tendency observed is that clubs have to move in the direction of pay-per-view channels instead of free television channels. This is more apparent in Italy, France and England, where revenues are greater as a result. Significant growth is expected in the field of secondary sales and foreign broadcasts, where the main target countries are China and Japan. The role of new media (Internet and mobile) is also on the rise.

**Table 1: German football championship revenues in the 2009/2010 season (Bundesliga 1), in billions of euro and %**

Game and ticket revenues	0.379	21.43%
Sponsorships and advertising	0.512	28.92%
Media revenues	0.505	28.55%
Transfer revenues	0.106	6.01%
Merchandising revenues	0.074	4.7%
Other revenues	0.193	10.93%
<b>Total</b>	<b>1,769</b>	<b>100%</b>

Source: 4. Bundesligareport 2011, [www.bundesliga.de](http://www.bundesliga.de)

### Legal field and international balance sheets

The legal form, structure, organisational setup and management of businesses considered medium-sized even in industrial terms have been necessarily adjusted to changes in the market and the environment. Companies have basically been formed in the following two ways:

- a) The decision of the Football Association makes the outsourcing of the licence department and its transformation into a company possible (e.g. Germany)
- b) The Football Association makes the formation of a capital company a requirement in level one or in both top levels.

Result factors (sports, economic and intangible results) are interrelated and interdependent, with their sum giving us the aggregate result (Bott, 2007). Naturally, the exploitation of opportunities arising due to the operation of incorporated companies emphasises the maximisation of results within the operation. (It would be expedient to discuss legal forms separately, as their significance within football makes this necessary). The economic result of a football enterprise should never be identified as the profit achieved in the fiscal year, as the latter is no more than a snapshot of long-term economic performance. A more interesting issue is what economic activity was used to generate the economic profit of the given year; whether it is the result of the previous championship season, and whether, taking into account the given sports result risks, these economic conditions will be repeated or not in the next season.

The intangible result, the success of a football enterprise, entails value factors that are very difficult to quantify using financial-economic or sports result aspects. This includes the image of the football enterprise, the improvement of which usually results in an increased media presence, the improvement of financial positions or the growth of the market value of the enterprise. Of course this also impacts economic results, as an improved image could lead to increased sponsor involvement. When speaking of intangible results, we should also mention the supporters' strong identification with the club. This strong relationship has a positive impact not only on the economic result, but could also boost the achievement of better sports results. (Many have experienced the legendary 'Fradi-heart', and probably even more have heard of it). But it is important to encourage, reward and pay the players as well (Nagy and Való, 2013). The personal goals of competent club

executives could also strongly influence the intangible results of football enterprises. In this case, professional decision-making considerations play only a subordinated role, and in most cases this particular factor is enforced through the sympathy or dislike shown towards club executives or owners or their acceptance and ability to enforce their interests (Borbély, 2012).

A football enterprise naturally strives to maximise its intangible results and value; however, this can only be achieved at the expense of other result factors, and primarily clashes with the economic result. If the club's management and owner decide to sign valuable star players and managers regardless of the size of the expenditure, this will obviously have a positive effect on the intangible results and naturally on the sports results as well. It is very likely that in the long-term the enterprise's revenues will also increase. In the mid-term, however, such decisions impose significant financial burdens, which could in turn lead to a serious financial crisis for the club. In professional football – as opposed to other economic fields – it is not customary to prepare a separate plan with respect to impact on image. Today, change in image is still an indirect effect of investment. The way of the future is that football enterprises shall directly plan to increase intangible results through certain targeted promotions, e.g. by planning and managing member recruitment, loyalty promotions, etc.

The three main components of the aggregate result and their factors are closely interrelated. For example, the improvement of sports results has a positive impact on the economic result, which in turn leads to an increase in television and ticket revenues and the sale of promotional products, but member contributions and revenues from sponsorship deals could also grow. Improving sports results also affect intangible results: the club becomes more respected, supporter ties become stronger and media interest increases. A good economic result has a favourable effect on sports results, as the sufficient liquidity provided through profit and appropriate management allows the club to provide an incentive wage and premium payments without any problems. We should also emphasise that a good economic result also has a positive effect on the intangible result. Opportunities open up to finance supporter projects and clubs as well as significant advertising activity. Star players and managers can be signed to the extent of expanding financial opportunities. The intangible result also has an effect on the factors of the other two result components: sports results improve through the impact on public opinion, but the economic result also improves, since television revenues and the sale of endorsed products increase. In the event of sufficient interest, live broadcasts can be set up, while member contributions as well as sponsorship revenues rise. Understandably, sponsors highly appreciate the significance of image (Allen, 2011). A football enterprise acts correctly if it strives to achieve the maximum of the composite result made up of the aforementioned three components.

### **Marketing field**

Presence in the media is of paramount importance. The football club is sold as a brand value. Diversification activities and globalisation efforts appear followed by the entry into the large Asian and other foreign markets with modern media tools.

### **Environment**

At modern and successful professional football teams, the number of stakeholders increases significantly and harmonising their various needs is a very high level management task.

### **III. Organizational adaptation of football enterprises**

Football is now the scene of structural changes worldwide that are embodied in the alteration of the legal forms of enterprises backing professional football, as well as the spreading application of modern controlling, planning, risk and financial management tools. From an economic perspective, with these recently emerging elements, football clubs have started to build up a modern and complex, specialized sector where the most important requirement until the end of the championship season is the maintenance of licensing conditions.

#### **Role and significance of legal forms and organizations of enterprises in football**

In line with the international outlook, I primarily wish to rely on the peculiarities of German professional football, since it best represents the presumable mainstream of the development of football. Let us review the forms of undertaking in German League football, and what the changes in trends are.

On the basis of the 1998 Resolution of the German Federal Parliament, it is also possible to operate football undertakings in the form of an incorporated firm, which means that members are not responsible for the liabilities of the company (these are share companies, limited liability companies, and limited share partnerships), in addition to the classical form of association (official Bundesliga website, 2011). The main point here is that part of the association participating in League football can be outsourced into the form of incorporated firm. It is interesting that, in Germany, 21 teams from League 1 and 36 teams from League 2 are currently operating in the form of incorporated firms (Figure 2).

**Figure 2: Distribution of legal status in Germany (I–II. League clubs)**

Legal Form	Frequency
Association	15
Share comp.	2
LLC	4
LLC with right	5
LLC & Co.LP.	10
I.–II Liga , Total	36



■ Association ■ Share comp. ■ LLC ■ LLC with right ■ LLC & Co.LP.

Source: Dworak, 2010

### Advantages and disadvantages of registered association

Funding, registering and operating an association is relatively simple, and the rules are transparent. All strata of society like to make use of the advantages of this form of a non-profit company having a legal personality which provides tax benefits. The registered associations fill such an important social role in Germany that they are exempted, in respect of public purpose activity, from corporate income tax, industrial tax, real estate and property tax, and in addition are only charged a beneficial 7% general turnover tax (VAT). Normally, the general rate of VAT is 19%. However, these tax benefits affect professional football undertakings to only a minor extent, as these professional associations may obtain only a small amount of revenues exempt from taxation. The tax benefit mostly helps amateur and mass sports. Unfortunately, significant is the tax evasion (Nagy, 2011). A further drawback of operations in the form of associations is that there are no rules concerning the distribution and utilization of the realized profit. In consequence, most of the football clubs expend realized profits on efforts to increase the value of the team of players, while having a much weaker focus on raising financial reserves, which would otherwise be beneficial for long-term operations.

The rules relating to associations do not provide satisfactory protection even for lenders. Associations are answerable with their own assets for their liabilities, but there are no detailed legal prescriptions in the relevant law of associations in Germany. Of course, in principle, regulations may be set up relating to publicity, application of profits and

collateralising loans in the statutes of associations, which is, however, scarcely feasible. We can hardly suppose that the elected management of an association would set up restrictions on itself. Logically, all this has a negative impact on the opportunities for financing with outside capital.

It follows from all this that a registered association may only make restricted use of any potential financing options. An increase in equity is allowed primarily through the retention of profits, but we must add that the profits may only be increased up to a certain limit per year, in order to maintain the non-profit status of the company. The hosting of shares and the involvement of contributed capital may only be secured after transformation into an incorporated firm. Therefore, in the event of associations, funding by banks or private individuals who are committed to the given association will be possible in line with own revenues and subsidies. The first-mentioned resources may cover current expenditures to a minor extent; they mostly play a part in the financing of long-term projects. Due to the aforementioned lack of publicity and mechanisms of control and protection, the issuance of bonds or of so-called participation certificates poses difficulties for associations.

We can ultimately state that the registered association will continue to function as one of the most significant legal forms of professional football in Germany, in spite of the fact that the law of associations is far from providing satisfactory conditions for the operations of football clubs carrying out modern business activities. Thus, it is no wonder that in Germany there appears a strong inclination towards the transformation from the form of association into the form of incorporated firm. This does not mean that the clubs (mainly the amateur and mass sports clubs) will turn away from the form of association. Professional football is just such an area. The best example of an efficiently operated association is VfB Stuttgart.

The traditional form of association as a basic model of management may also be successful in professional football, but it is true that this is realised also thanks to Stuttgart's main sponsor, its exclusive partners and its team partners. The list is deserving of attention: Gazi, Mercedes Benz, Puma EnBW, Kronbacher, BW Bank, Breuninger, Kärcher, and Coca Cola. Therefore, is no wonder that VfB Stuttgart was and is very successful.

#### Records of VfB Stuttgart:

##### *German championship:*

- Winners (5): 1950, 1952, 1984, 1992, 2007
- Runners-up (4): 1935, 1953, 1979, 2003

##### *German Cup:*

- Winners (3): 1954, 1958, 1997
- Runners-up (2): 1986, 2007

##### *German Super Cup:*

- Winners (1): 1992

##### *German League Cup:*

- Runners-up (3): 1997, 1998, 2005

*Oberliga Süd I:*

- Winners (3): 1945–46, 1951–52, 1953–54
- Runners-up (3): 1949–50, 1952–53, 1955–56

*2nd Bundesliga Süd II:*

- Winners (1): 1977

*Bezirksliga Württemberg-Baden:*

- Winners (2): 1926–27, 1929–30
- Runners-up (1): 1925–26

*Gauliga Württemberg:*

- Winners (4): 1934–35, 1936–37, 1937–38, 1942–43
- Runners-up (4): 1938–39, 1939–40, 1940–41, 1941–42

*UEFA Cup:*

- Runners-up (1): 1988–89

*UEFA Cup Winners' Cup:*

- Runners-up (1): 1997–98

*UEFA Intertoto Cup:*

- Winners (2): 2000, 2002

### **Incorporated firms**

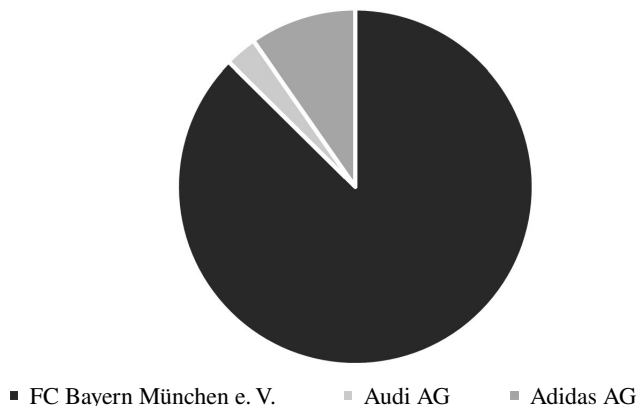
However, the real concept of an incorporated football firm refers more to the outsourcing of football undertakings and of the fields neighbouring football into incorporated firms, or, respectively, to the transformation thereof into incorporated firms. The surviving association operates as a so-called parent association, and it usually holds the majority of votes in the incorporated football firm.

### **Share companies**

Share companies are advantageous if there is a great need for capital and if it is possible to involve further financiers in joint financing. However, in the course of the acquisition of capital, the majority of votes is in each case an indispensable requirement for the parent association, which can be secured through the issuance of registered shares and/or preference shares with restricted transferability (Nagy, 2012a). In the first case, the permission of the management of a share company is also required for the acquisition of shares, while the latter do not secure any votes for the shareholders, and their issuance may not exceed the sum of the shares already issued (ordinary shares and shares with restricted transferability). In this way the formation of an undesirable majority may be prevented; but obviously, the involvement of capital will also be narrowed due to the restrictions, since in the event that a contribution of further capital is required due to the increase of capital or losses, the parent association may incur obligations of payment in order to secure the majority, because the licence rights are possessed in this case by the parent association. The League Association strictly controls compliance with each regulation.

FC Bayern Munich has succeeded in setting up a successful company limited by shares. Successful Football Club: Bayern München Share Company (Figure 3).

**Figure 3: Ownership structure**



Source: FC Bayern München website

According to pre-agreed plans, up to July 2011, Audi AG increased its share to 9.09% in three phases. As a result, the company approached the existing share of Adidas AG. The association has retained shares making up a quota of 81.2%, while the amount of subscribed capital has risen to EUR 27.5 million. The company limited by shares is the sole owner of the Allianz Arena München Stadion GmbH, which constructed and now operates the stadium. Until 2006, this limited liability company was 50% owned by TSV 1860 München, which then – due to financial difficulties – sold its share to FC Bayern München AG for a consideration of EUR 11 million.

Records of Bayern München:

- Most Bundesliga titles won: 21
- Most *Bundesliga* games won (907) and points achieved (3095)
- Most game days on top of the league: 592
- Most average points per game in the Bundesliga: 1.93
- Most Bundesliga goals scored: 3412
- Most consecutive wins in the Bundesliga (19 March–20 September, 2005): 15
- Most games won in a club's first Bundesliga season (1965–66): 20
- Biggest lead over second-place finisher (2002–03): 16 points
- Championship with fewest points under the 3-point rule (2000–01): 63
- Championship with the most losses in a season (2000–01): 9
- As a negative record, Bayern's match in Dortmund in the 2000–01 season was the most unfair match in Bundesliga history, with 15 cards being shown (10 yellow, 1 yellow-red, 2 red), and of those, 12 (8, 1, 1) were shown to Bayern players, which is also a record in Bundesliga history.



- Most championships won: 22
- Most *cups* won: 15
- Most *league cups* won: 6
- Most doubles won: 8
- Only club to win the double (*Bundesliga* and *cup*) twice in a row (2005–06 and 2006–07)
- Only club to win a championship in both men's and women's football
- Fastest goal in *Champions League* history: After 10 seconds by *Roy Makaay* on 7 March, 2007, against *Real Madrid*
- Last club to win the Champions League/European Cup three times in a row: 1974–76
- Highest aggregate win in the UEFA Champions League knockout stage: 12–1 on 24 February, 2009, (5–0) and 11 March, 2009, (7–1) against *Sporting CP*

### Limited liability companies

The legal form of limited liability companies is also highly popular in other sports, such as in the field of handball and ice-hockey. Limited liability companies tend to take various forms in football.

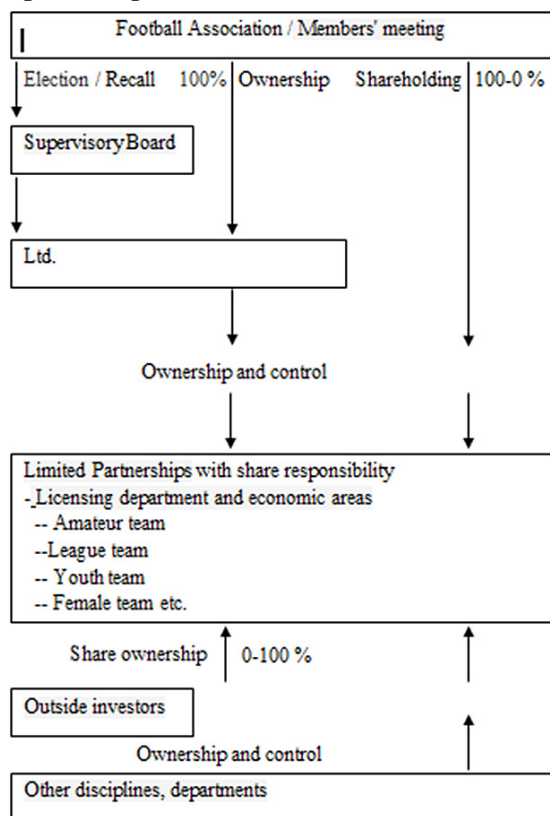
- a) One of these forms represents a limited liability football company where all the businesses associated with football are included, and which is generally operated as a subsidiary of a parent company otherwise not involved in football. The license is held by the parent company. In this case, it is the majority owner, the parent association, which determines the foundation of the limited liability company. This solution in fact means the establishment of a subsidiary limited liability company. An example here could be Borussia Mönchengladbach.
- b) The other form of limited liability companies is the entity holding the right to participate in championships, where management by the parent company is also in place, but in this case the entire license comes into the possession of the subsidiary. Nevertheless, all the other areas (marketing, merchandising, etc.) remain with the parent company, or are outsourced to further entities. An advantage of this limited liability company form is that the license has to be secured by the company that uses it, and therefore it is not the entire parent company that needs to comply with the strict licensing requirements, as on the whole the parent company may be in a much worse situation than the limited liability company focusing solely on professional football.
- c) The third situation is when the limited liability company plays an essential role within the group, and agrees to apply a broad range of tools for capital acquisition, while preventing external investors from having any significant say in terms of management.

From among these various solutions, in Hungary it would be expedient to frame a limited liability company representing a real pool of capital resources that is a part of a business group which facilitates access to capital without causing management problems. In this case, the group in fact operates a limited partnership via the limited liability company and where any investor can enter into the position of the limited partner without causing any change in management. Towards this end, Hungary should implement the necessary legal changes, and in addition the attitudes and management practices of clubs also need to be modified.

### **Limited Partnership with Restricted Liability of Partners**

This is a company which has a legal personality, in which, as is well-known, at least one of the partners (the general partner) must bear unlimited and joint and several liability vis-à-vis the creditors. The other owners, who have other interest in the registered capital embodied by the share capital, need not warrant for the liabilities of the company (dormant partners). This is an intermediate legal form that displays the characteristics of a share company and the personal liability existing in the case of limited partnerships, where the general partner provides for the management of the undertaking. The supervisory board elected by the general meeting of the dormant partners supervises the work of the general partner, acting with personal liability, on the one hand, and executes the resolutions of the general meeting, on the other, which includes the dormant partners' declaration of acceptance and agreement in the case of more important decisions. Within the scope of legal forms, such solutions are interesting for football clubs, since they are vested with the characteristics of restricted liability covering the general partner of a limited partnership, and at the same time they open up a lot of alternative opportunities for finding equity. This limited partnership with restricted shareholders' liability also exists in the case of the forms of GmbH & Co. KG.

**Figure 4: Organizational Scheme “Limited Partnerships with share responsibilities”**



Source: Dworak, 2010

In the case of the legal form operating with the limited liability of a limited partnership, the parent company as a general partner may not restrict its personal liability. Thus the association should act simultaneously as both general partner and dormant partner if it wishes to retain the aforementioned limited partnership directly as its own property, which is not at all permitted from the legal aspect. Therefore, it is required to insert a limited liability company between the existing association and the limited partnership. This subsidiary LLC is a personally answerable general partner, and it functions as managing director at the same time. The shareholders, as dormant partners, may consist of the parent company itself and of external investors. This has the advantage, on the one hand, that the parent company is secured by an LLC of limited liability, and on the other, that the possibility exists to increase the dormant partners' share in the limited partnership up to almost 100% without violating the rules of the League Association relating to majority share. In Germany, 10 GmbH & Co. KG companies were operating in 2009 in the Licence Leagues (League 1 and 2). See Figure 2.

Should a football GmbH & Co. KG be floated on the stock exchange, it must tolerate a significant handicap as opposed to the companies operating in the form of a share company, if it has also issued preference shares without voting rights. It is a further problem that the possibility of efficiently controlling the leading bodies of an incorporated firm is also missing in the form of football GmbH & Co. KG for potential investors; they must satisfy themselves with the role of dormant partner if they are not members of the parent association. Unfortunately, this may repel potential investors or, at least may be taken into account as a significant negative factor upon the valuation of the participation. It is very important in this solution that separation between the rights of general partners and dormant partners should be complied with strictly in practice. It frequently occurs that potential investors link their possible commitments to being involved in the direction and operation of the undertaking, which will of course appear understandable from the point of view of caring for the safety of their investment. In the case of a football GmbH & Co. KG, any influence by investors may only be implemented within certain limits. By the way, this is shown by the objection made by the League Association against an investor agreement entered into by TSV 1860 München in the 2009 spring season. The investor agreement contained decisions in respect of persons as conditions for contract, which would have had the consequence of illicit influence on the side of the dormant partner, and/or it would have secured the right of veto in respect of the decisions of the associations.

We can finally state that the outsourcing of significant branches of a football undertaking into the form of an incorporated firm should be deemed a considerable step forward in comparison with the deficient regulations of the operations of associations, regarding the economic professionalism of football clubs, partially from the side of commercial law and partially from the side of shareholding law. Through the introduction of the organizational and legal structures necessary for football clubs to be considered professional, there are further positive effects generated for football companies: for example, the football undertaking has to reevaluate its assets due to the transformation, which usually has a positive effect on the proportion of equity. This is still complemented by the fact that, in the event of incorporation, equity will increase through the accumulation of profits based on the compulsory regulations of the application of profits. Incorporation allows external investors to get involved in football undertakings, which may be implemented through investment into the respective business quotas of an LLC or a share company or a limited partnership. Here we must stress above all the obligation of publicity and information, which makes the incorporated firms transparent for potential investors of debt capital, and allows for reliable credit ratings and risk assessments. Furthermore, it is also advantageous that incorporated football firms operate similarly to incorporated firms functioning in other fields, from the point of view of the protection of creditors. Finally, a large palette of alternative financing is available for incorporated firms which are not available for the original legal form and organizational structure of associations. Nevertheless, it should be underlined that, in the event of the use of the form of the incorporated football firm, it is about the transformation and change of the organizational unit of execution and not the total abandonment of the form of association. The form of association will continue to be

the main form for football undertakings and a fundamental solution for the procurement of capital. Due to the reasons above, in this respect professional football is partially exempt.

#### IV. Changed business model

As a result of the above changes, the business model of professional football has been fundamentally transformed.

**Table 2: Comparison of the two models of football**

<b>Source of financing</b>	government revenues	business revenues
<b>Role of budget constraints</b>	soft budget constraints	hard budget constraints
<b>Feature of the owner</b>	no real owner	real owner(s)
<b>Operational framework</b>	Non-profit: form of social club	corporate form of company
<b>Role of football</b>	legitimacy of the political system, improving morale	service as a subfield of the entertainment industry

*Source: András, 2004*

In the case of developed football countries and market economies, the business model has clearly prevailed in professional football. While in the developing countries, in spite of all the required structural changes, a mixed system has been formed that still bears the elements of the state model.

#### V. Organizational requirements for professional football entities in Switzerland

In Switzerland, the Football League stipulates rigorous reporting obligations, and in addition it prescribes the structures and mandatory statuses for the operation of a Super League team. Relying on these foundations, right-minded Calvinistic Puritanism operates all the clubs in highly structured forms. Therefore, I would also recommend the introduction of the Swiss organizational requirements in OTP Bank League.

*Swiss mandatory minimum organizational requirements for the teams of the Super League:*

- 1 person, UEFA-licensed trainer
- 1 person, assistant trainer with Super League license
- 1 person, goalkeeper trainer with Super League license
- 1 person, fitness trainer
- 1 person, managing director and administration manager (the same person can work in both functions)
- 1 person, finance manager
- 1 person, marketing manager
- 1 person, media manager

Recommended: 1 person, security expert, possible cooperation with the representatives of supporters (Lehmkuhl and Siegrist, 2009).

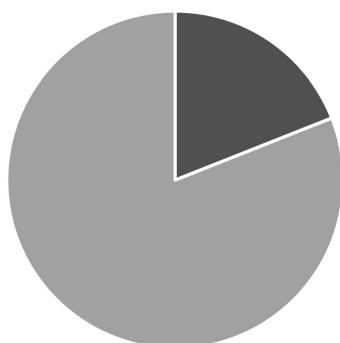
In Switzerland, any omission of monthly reports or non-fulfilment of payment obligations would promptly entail a fine of CHF 10,000. In response to further omissions, negotiations are commenced in relation to the withdrawal of the license.

## **VI. Teams of the OTP Bank League by legal forms of business and organizational forms**

At first sight, it can be claimed that there is nothing wrong with clubs participating in the OTP Bank League in terms of their restructuring into capital companies, as in Hungary the formal conversion of first-league clubs into capital companies has actually been implemented (Figure 5). In Switzerland, this restructuring move has been executed on the basis of the Association's mandatory requirement. In contrast, as has been pointed out above, the German first league still has a number of clubs operating in the form of associations. Restructuring into capital companies has also been implemented in the Greek first league on a mandatory basis.

**Figure 5: Teams of OTP Bank League by legal forms of business and organization**

<b>OTP Bank League</b>	
<b>Football Club</b>	<b>Legal Form</b>
Győri ETO	limited liability company
VIDEOTON	limited liability company
Budapesti Honvéd	limited liability company
MTK Budapest	share company
Ferencvárosi TC	share company
DVSC-TEVA	share company
KTE-Phoenix	limited liability company
Újpest FC	limited liability company
DVTK	limited liability company
Kaposvári Rákóczi	limited liability company
PMFC Matias	limited liability company
MVM-Paks	limited liability company
Lombard Pápa Termál FC	limited liability company
FGSZ Siófok	limited liability company



■ share company    ■ limited liability company

Source: Own research

Nonetheless, another issue is how much in Hungary the preferred form of capital companies ensures additional capital resources (Nagy, 2012b). For instance, a club achieving successes both in the sport and economic fields currently operates as a private company limited by shares, with a single private person being its sole owner. Here, the question is how much the form of a one-man company serves the ends of capital acquisition, as the amount of the capital subscribed by the sole owner is only HUF 49 million. On the other hand, one can find a limited liability company with two legal entity partners and registered capital of more than one billion Hungarian forints. The individual situations can be highly varied. In view of the unfortunate, yet typical lack of capital resources that is a dominant feature of domestic football in spite of the corporate income tax allowances and preferential aids, I would propose the establishment of real capital companies, especially the operation of groups described above (Borussia Dortmund). Similarly, in Hungarian football, such capital companies have to be established that are able to attract additional, fresh capital resources. A large proportion of business processes – primarily in the field of ticket sales and player trading transactions – remain outside the balance sheets. Considerable problems are caused by kickbacks provided on corporate income tax allowances and other aids, as well as other uncertain and invisible incomes and expenses (Kotlán, Machová and Janíčková, 2011).

In several respects, the government would be interested in elevating 3–4 clubs in Hungary to make them capable of outstanding and high-standard sporting and economic performance, which would have economic, budgetary benefits – not to mention the social implications that cannot be directly assessed by means of economic indicators (Bács and Szima, 2012). The balance sheet figures of DVSC Futbalszervező Zrt. reflect significantly positive results for the past four years, and, moreover, the owners were paid dividends in an amount of HUF 800 million based on 2009 profits, while a decision was made on the establishment of the training center of the Debrecen Football Academy, an investment of HUF 800 million (Bács and Szilágyi, 2012).

## **VII. Establishment of controlling organizational units at football enterprises**

In Germany, the teams of Leagues 1–3 were involved in a questionnaire survey concerning the application of controlling. 53 associations and capital companies responded to the questionnaires, which indicated an extremely positive approach to the effort (Table 3).

**Table 3: Application of controlling at German football clubs**

<b>Time of application of controlling</b>	<b>Distribution (%)</b>
1–5 years	58,5
5–10 years	13,7
more than 10 years	17,1
no answer	10,3

*Source: Controlling im Profifußball, Roßbach, Th:2011, p. 43*

It is an even more interesting question to see what means of controlling the clubs of Leagues 1–3 use in Germany – some of the clubs apply more than one of these tools (Table 4).

**Table 4: Applied controlling devices and methods in Leagues 1–3. of Germany**

<b>Controlling devices and methods</b>	<b>Rate of application (%)</b>
Benchmarking	27.27
Comparison of planned and factual figures	12.12
Balanced Scorecard	9.09
Obtainment of liquidity	6.06
Rolling forecasts	3.03
Scenario procedures	3.03
Profit and loss analysis	3.03
Detailed budgeting	3.03
Target cost analysis	3.03
Quarterly and monthly reports	3.03
Addison controlling tool	3.03
Own analyses	3.03
Deviation analyses	3.03
ABC analysis	3.03
Business plan	3.03
Others	3.03

*Source: Controlling im Profifußball, Roßbach, Th:2011, p. 44*

An important question is what are the controlling targets, i.e. what is the focal point of control in football enterprises (Table 5).



**Table 5: The subject-matter of controlling in Leagues 1–2 of Germany**

Subject of controlling	Intensity (%)
merchandizing	79.3
payments	89.7
operations	89.7
stadium use	79.3
media rights	82.8
sponsorship	96.6
player transfers	69.0
marketing	89.7

Source: *Controlling im Profifußball*, Roßbach, Th:2011, p. 46

Considering that in Hungary many first-league clubs prepare only annual budgets to serve as the basis of economic management, one could claim that it is not only goal scoring and excellent defense where Hungary has gaps to close nowadays, but also in the field of the application of developed methods of a market economy. Long-term successes can be achieved only with a firmly grounded, stable organizational and financial background (Borbély, 2008, Nagy, 2013).

## VIII. Conclusion

In summary, it has to be pointed out that financial foresight and controlling constitute such indispensable subsystems for football associations and enterprises responsible for the alignment and coordination of various other processes and subsystems. With reliance on the set of indicators of controlling, a higher level of transparency is put in place to support the supply of information and managerial decisions. As a result, environmental changes become recognizable in their early stages, and therefore the necessary measures can be taken sooner, which then allows active management. Furthermore, controlling promotes the continuous review and correction of own activities. For this reason, it is very much expedient to set up a planned, documented and consciously implemented system of controlling both in the operative and strategic fields. The above-described tools that have already been partly applied by the German clubs – such as the Balanced Scorecard – are eminently suitable for helping to find adequate responses to future challenges. These means of controlling can be combined with each other, and therefore the Balanced Scorecard system can be structured together with a risk management system and detailed budgeting (Haas, 2006).

Controlling has an increasingly important role in the operation of foreign football clubs, though its potential still has not been exploited optimally in major football nations. The processes will be accelerated by UEFA's new licensing regulations posing strict requirements and attributing an even more significant role to financial stability (financial fair play). Football is becoming increasingly professional and business-oriented, a process which requires the application of modern management systems. The application of controlling is spreading, which improves the effectiveness of the business areas. This relatively new,

gradually strengthening aspect, i.e. the economic side of football, seems to be extremely important for the clubs and the federations alike via the issuance of licenses. Additional stakeholders include football-related market vendors, agents, owners, as well as shareholding companies, creditors and even auditors. Abroad, in the major football nations, the current focal point of debate is the organizational forms of controlling systems. Experts deem it to be expedient to operate independent controlling departments organized in the light of the individual controlling tasks at the football clubs.

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## SOCIALLY MARGINALIZED ENVIRONMENTS, UNEMPLOYMENT AND MEDIA

Oto Moravčík<sup>1</sup> & Jarmila Vidová<sup>2</sup>

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### Abstract

In any society, regardless of its homogeneity and heterogeneity, there are minority groups, or those that require special attention and treatment because of their social and cultural characteristics, physical appearance, or because they have a lifestyle which differs from the dominant group and this causes them to be allocated the social status of minorities. The ongoing transformation of the economy since 1989 is now a major effect which continues to affect economic development. The planned economy and socialist market economy was replaced with the principles of free enterprise and the market mechanism. The market economy is closely tied to the labor market, which we view as the meeting point of labor supply with labor demand, resulting in labor costs – or wages. Position in the labor market is one of the most important factors through which an individual integrates into the social fabric.

The aim of this scientific article is to describe the role of the media and outline its potential use in order to achieve changes in behavior and increase education levels in socially marginalized environments and resulting in greater social inclusion.

### Keywords

Ethnic Minorities, Unemployment, Community Center, the Roma Minority, the Media, Social Groups, Social Exclusion, Social Inclusion

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## I. Introduction

Marginalization in the labor market affects a large part of the Roma minority, is often a primary source of poverty and ultimately means exclusion from better living standards and opportunities to succeed at a particular company. While high unemployment is a major problem for most of the Roma minority, residents of segregated Roma settlements are

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<sup>1</sup> Tax Office, Ševčenkova 32, 850 00 Bratislava, Slovak Republic. E-mail: otto.moravcik@gmail.com.

<sup>2</sup> University of Economics in Bratislava, Faculty of National Economy, Dolnozemska cesta 1, 852 35 Bratislava, Slovak Republic. E-mail: vidova@euba.sk. jvido@upemail.sk.

particularly disadvantaged, since their chances for employment are generally limited to seasonal and casual labor.

The marginal status of Roma in the labor market is influenced by several factors which affect the country as a whole. These include, for example, the radical loss of heavy industry, which employed large numbers of Roma under the previous regime, the disintegration of peasant cooperatives, changes in the structure of demand for unskilled labor in the labor market, and increasing competition from alien workforces. According to the National Labour Office, Roma have, since 1999 and the introduction of the recording of ethnic data, made up around 20% of all unemployed persons.

A particular characteristic of Roma unemployment is that it is basically long-term unemployment. Among the most important reasons for the high unemployment levels of Roma are low educational and qualification levels. This creates one of the riskiest categories of vulnerable social (long-term) unemployment: Roma youth who experienced a period of work and then became (long-term) unemployed without even having had the minimum work experience in the labor market. Long-term youth unemployment can lead to a culture of unemployment, which ultimately affects the labor market. Media campaigns calling for the education of the Roma minority could help to address this issue.

Society is significantly influenced by the media. Mass media has become one of the most effective mechanisms used by globalization movements in the contemporary world as a means of bringing about the globalization of culture. The media today creates common models, ideals or even language – crossing national cultural borders in the process. Media activity modifies and partially suppresses cultural identity built up over years and levels differences. The word media has its origins in Latin and suggests the concept of an intermediary. Denis McQuail counts the following as the most important forms of media: print media (books and newspapers), movies, broadcasting, radio broadcasting, television, music recording and new electronic media. H. Marshall McLuhan, Canadian theorist and media literary critic, rhetorician and professor of English literature, renowned as the founder of media theory, argues that the media can be considered as raw materials or natural resources, exactly the same as coal, cotton and oil.

Mass media is significantly involved in the shaping of public opinion, attitudes and lifestyles. Theories on the functioning and behavior of individuals affected by levels of media coverage have for a long time been described by sociologists, psychologists, teachers and theorists of mass communication (Bandura-Walters, 1973, Eron et al., 1972, Thomas et al., 1977; Braun, 1981, Hapala, 1995, and many others). Most authors agree that the public role of the media is threefold (Hagen, 2004): informative function, a function to allow individuals and groups to disseminate facts and opinions and its position to criticize those who exercise power, or undermine democracy. If we had to clarify the role of the mass media, it would primarily be its informational effect, as a means to raise public awareness, education and training.

In every society, regardless of its homogeneity or heterogeneity, there are minority groups, those that require special attention and treatment because of their social and cultural characteristics, physical appearance, or because they have a lifestyle different from the dominant group. Leaving aside the causes of the social status of minorities, it is essential

that the media respect this fact. The importance and role of the media in marginalized social research is precisely the subject of the present scientific article.

The issue of national minorities has been one of the main themes of European and global politics since the fall of the ideological division in the world at the end of the 20th century. Stronger negative effects gradually began to rise to the surface, associated with the emergence of European nation-states in the second half of the 19th century.<sup>3</sup> The emergence of problems of national minorities depends on the existence of a national majority that deliberately or unknowingly excludes other ethnic groups, both recognized and unrecognized, from the process of decision-making, or restricts their opportunities in life. Minorities in the theoretical context refers to different groups in society, differing by national, ethnic, religious and linguistic identity, a multiplicity of factors which may cause inequalities in society. There are several definitions of ethnic minorities. Gabal (1992) defines a minority as a group of people who as a whole does not accept the national identity of the country in which they live. Fabjan (1993) sees it as the sum of all individuals who are discriminated against or disadvantaged on the basis of their character. In general, all definitions refer to the historical, cultural and emotionally perceived membership of a particular group. Mutually different groups thus differ only slightly in terms of the institutionalization and organization of their territorial existence, its legal framework and the historical rate of occurrence of a subjective sense of group belonging.

Smith (1991) considered a minority population to be one with a common origin, sharing cultural elements linked to the history of the territory or country and having a measure of solidarity. Minorities can have superior, although not pertaining, power and status, have adequate access to power and status, or have fewer rights, privileges and opportunities. It is ethnic minorities which, in the modern European state, require special attention from a political point of view, as their relationship to the state in which they live is a special problem in the field of theoretical discussions of minorities' perceptions of their qualitative and quantitative nature. Minorities can therefore be understood in the context of a civil or collectivist perspective. The individualistic concept of minority defines it as the sum of those individuals who are united by a common awareness of belonging. On the other hand, the collectivist perception of minorities see them in the context of supra-individual units affected by objective facts and features, vide Pritchard (2001). Ultimately, it is the perspective used which determines the concepts behind the legal protection of minorities. The individualistic perspective acts to create safeguards for the individual, as a member of a specific minority. The primary subjects of this protection are therefore single representatives of each group, while the group as such is protected as a sum of individuals, with the protection of minorities seen as a concretization of human rights. This is implemented through passive measures and active discrimination against the development of a separate cultural identity. By contrast, the collectivist perspective protects minorities as a whole in their relations with external groups, on the basis of a functional complex of economic, social, political and settlement relationships and structures. Under this initiative, minorities have the right to their own arrangement of these social spheres,

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<sup>3</sup> Minorities in the theoretical context refers to different groups in society, differing by national, ethnic, religious and linguistic identity, a multiplicity of factors which may cause inequalities in society.

in a figurative sense, and to autonomy and self-determination<sup>4</sup>. Trends in Europe in terms of the rights of minorities to protection have been subject to many changes over the centuries and were allocated a certain amount of geopolitical balance of power in the region, something which is reflected in the conduct of international organizations and their standards for the legal protection of minorities.

In the Slovak Republic, ethnic minorities officially account for more than 10% (unofficially almost 20%) of the population. The most numerous national minority in Slovakia was, according to census of 2001, the Hungarian minority (9.7%), followed by the Roma minority (1.7%), and Czechs (0.8%), while other minorities, which do not even represent 1% of the population, include the following: Ruthenian, Ukrainian, German, Jewish, Polish, Moravian, Croatian, Russian, Bulgarian, and Serbian. In 2010, 430,000 Roma were living in the Slovak Republic, with forecasts that this number could reach 530,000 to 550,000 by 2025.

Opinion polls indicate long-term tension, prejudice and aversion on the part of the majority to minorities. The status of minorities in the Slovak Republic, and the problems affecting them, are a long-term priority on the political agenda and in public debate in Slovakia, and there is no reason to regard this trend as secondary, or solvable in the short term. The problems are only being compounded by the continued exclusion and segregation of the Roma. Due to the double marginalization of the Roma, the situation can be expected to deepen regardless of the processes of globalization or European integration and irrespective of the improving economic situation in Slovakia; Roma living in segregated Roma settlements will remain in a state of deprivation and the gulf between the majority population and the Roma will remain open. This trend will be reversed only if the majority and its representatives accept the costs of financing social programs and the accompanying investment in infrastructure. Otherwise, poverty will be reproduced in Slovakia at an extremely rapid pace and we will not succeed in preventing the formation of visible pockets of poverty (the “Hungry Valley” of Moravčíková and Kučírková, 2006).

The demographic behavior and reproduction of the Roma population differs from the reproductive behavior of the majority population. The most obvious manifestation of this is the different age structure of the Roma compared to the rest of the population. It can be assumed that the number of Roma in Slovakia, as well as their share in the total population, will increase. In terms of potential threats, there is a rather dangerous trend towards the gradual dominance of ethnic Roma in some districts of Slovakia and the possible migration of marginalized regions of the majority population. Changes to the unfavorable prognosis can be influenced by the media and the education of the younger generation.

## **II. Ethnic minorities. Roma in the media in the Slovak Republic**

Marginalization is, according to Moravčíková and Kučírková (2003), a socio-economic process in which some social groups, social spaces, cities and regions become marginalized from major economic, social and civilizational streams. It is associated with the

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<sup>4</sup> Gabal (1992).



slowdown and stagnation of their overall development as a result of their recession and differentiation from society and there is reflected in their economic, social and civilizational backwardness. The result of marginalization is marginality, which in turn translates into structural and situational characteristics and opportunities for development. Leimgruber (1994) has earmarked four main objective approaches: geographical, economic, social and environmental. Mehretu and Sommers (1998) added the political and cultural approach. Subjective approaches dominated sociological works in the past, but geographical research is increasingly gaining in importance. The idea is that marginality arises as a result of human decisions and is not fully rational, i.e. is not based only on objective information, and therefore it is necessary to take into account the research and perspective of the observer. For Leimgruber (1994), these perceptual approaches are divided into internal “persons directly affected by marginality” and are seen from the perspective of other external groups. Leimgruber’s (1994) approach to social marginality can be described as follows: *“marginality refers to a group of people whose socialization process was somehow impaired or to individuals within a group or multiple groups, and in none of them were fully integrated.”* The earmarking of groups in given social structures can acquire a dual nature. First, voluntary earmarking due to the desire to follow their own specific rules or an unwillingness to adapt to surrounding social norms and seek integration into the surrounding social standards and integration into the surrounding social system, such as the segregation of Roma communities in isolated settlements on the edges of villages (Leimgruber, 1994).

On the other hand, exclusion can also be forced upon minorities by the majority society based on various criteria (such as race, religion, way of life), conservatism and a reluctance to accept differences from mainstream society, which then acts as the rule for all except those thus controlled. An example would be the racial segregation of African Americans in the U.S. from the 18th century to the 20th century and, in Slovakia, the attitudes of the ultra-national “Slovak Congregation” group against minorities (including Hungarians, Roma, and Jews). The consequence is that these groups face a greater risk of poverty (Rochovská, 2004, Džambazovič, 2007), depression, a decline in active participation in public life, increased socio-pathogenic episodes and a subsequent tendency towards social marginality. Marginalized groups are often concentrated in specific areas where they are concentrated voluntarily (such as, “China Town” in U.S. cities, or the district of Friedrichshain-Kreuzberg in Berlin, also called “Little Istanbul”) or displaced by the majority society (Arabs in urban areas). It the intersection of social marginality and spatial marginality which is the focus of Gurung and Kollmair (2005), the socio-spatial approach of defining the human dimensions of marginality and the attempt to understand the processes of exclusion, inequality, human resources and spatial segregation.

The media has a great political, social and cultural impact. Its basic function is the transnational public good. (Lužica, 2007) The role of the media should be, in education, culture, popular science, youth and other areas, to provide regular and systematic information about the activities of the majority as well as ethnic minorities. With regard to the Roma minority, its history, culture, tradition and contemporary life, the goal of television should be to develop mutually positive relationships between the Roma and the majority of

citizens and lead to greater tolerance, understanding and seek to correct opinion regarding this minority.

State law, which allocates to the Roma national minority the same rights as other minorities, inter alia to develop their language, culture and art, is enshrined in the highest legislative measures, namely the Constitution of the Slovak Republic, Article 12, Chapter 2, and provides for the equality of all citizens, regardless of nationality, religion, creed and social competence. Articles 34 and 35 regulate the right of national minorities to learn the official state language, the right to establish and maintain educational and cultural institutions, receive information in their mother tongue, the right to use their mother tongue in official interactions, and to participate in addressing matters concerning national and ethnic minorities. This right manifests in the form of various legislative measures. The existence of an independent media in modern democratic society is a necessity and a prerequisite for the free dissemination of ideas and to ensure freedom of expression. The mass, especially nationwide, media have an essential role in civil rights education, to promote a spirit of tolerance, overcome and combat discrimination and anti-racism. The specific impact of the media derives from its ability to change society. The mass media have a significant impact on people's thinking, shape public opinion and help to create the value system of society (Cangár, 2003).

Until 1989, Slovakia had 25 national periodicals, but none were Roma-produced. The Roma media in Slovakia since 1990 has sought to meet several goals in order to operate inside the Roma community and strengthen its national pride and human and civic pride.<sup>5</sup> It also aims to interact with the non-Roma majority and provide enough information to help eliminate the prejudices and stereotypes inherent in the historical perception of the Roma. At the same time, however, it attempts to meet the needs of the Roma minority that arise from the European Charter for Regional or Minority Languages. Last but not least is the development and preservation of customs and the Romani language (Hrvolová, 2006). Slovak Radio has, since its inception, been a critical phenomenon in our social, cultural and political life. In 1991, Slovak Radio national-ethnic editors in Presov began broadcasting programs for ethnic minorities. Presov's editors began to broadcast for the Roma minority on 31 December, 1993. The program structure consisted of news broadcasts in Romani (30 minutes per week), a Roma cultural revue (every two weeks) and a Roma magazine (monthly).<sup>6</sup>

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<sup>5</sup> According to data from the Institute of Journalism Studies in Bratislava, there were 54 national titles in 1991, seven of which were about the Roma (IVO 2000). First to be issued was the magazine, *Roma*, from November 1990, followed by *Romipen* magazines, *Nevipen*, *Roma revue*, *Lulu*, *Romane Vasta*, *Termipen*, *Sama daj*. Not all were written in the Roma language, but in a combination of languages, with some only published in Slovak.

<sup>6</sup> The first editor of Roma minority broadcasting on Slovak Radio was Ing. Igor Dužda. In 2010, its studios broadcast almost 12 hours a day during the week; on Saturday, studios in Bratislava and Kosice broadcast four hours, the studio in Banská Bystrica broadcast 3.5 hours. On Sunday, the studio in Bratislava broadcast one hour, with one and a half hours in Banská Bystrica, and in Kosice, two hours. Radio Patria – the editorial office of the national-ethnic broadcaster – aired 520 hours in 2010; Radio Regina in Košice aired 208 hours over the weekend. Regina participated in the creation of radio programs of news, current affairs, literature and drama, and music. Media Inc. Ltd., the independent studios of Radio Regina broadcast 18,754 hours of their own programming in 2010.

Based on the data in Table 1, we can conclude that the largest number of broadcasting hours in 2010 was for the Hungarian minority, at 4,380 hours (85.73%), Roma broadcasts lasted only 126 hours, which is only 2.47%. The editors of national-ethnic broadcasting last year broadcast six hours of direct transmission consisting of liturgy from Greek Catholic and Orthodox churches.

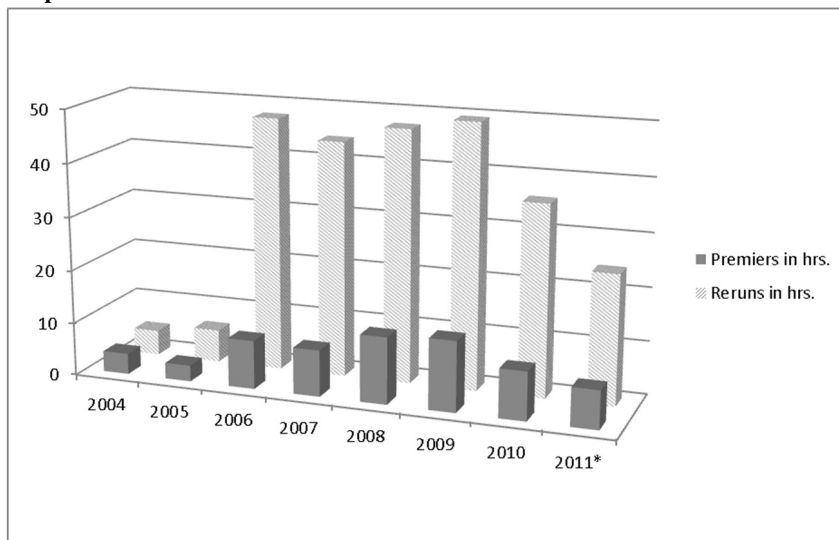
**Table 1: Number of hours broadcast for nationalities and ethnic groups in 2010**

Nationalities and ethnic groups	% share	Hours
Broadcast in Hungarian lang.	85.73	4,380
Broadcast in Russian lang.	5.36	274
Broadcast Ukrainian lang.	5.50	281
Broadcast in Roma lang.	2.47	126
Broadcast in Czech lang.	0.31	16
Broadcast in Polish lang.	0.31	16
Broadcast in German lang.	0.31	16
Total	100,00	5 109

*Source: Annual Report of Slovak Radio, 2010*

2010 was the last year of operation of Slovak Radio. From 1 January, 2011, Act. 532/2010 of the the Radio and Television of Slovakia came into force and Slovak Radio became one of its constituents. This led to a significant shift in thinking about the future of public service media. Law 532/2010 regarding the Radio and Television of Slovakia legislated that radio and television broadcasters must provide programming in their mother tongue for minorities and ethnic groups living in the Slovak Republic (Vašíčková, 2006). A milestone in broadcasting for various ethnic minorities was 20 January, 1992, when the independent Ruthenian-Ukrainian magazine was first broadcast. One month later this was followed by a separate Roma magazine, then named Romale. Hungarian magazines already enjoyed a firm position on the TV screen by that time. Broadcasts in German were added in 1993 and in 1998 there followed a separate magazine for the newly-created Czech ethnic minority living in Slovakia. The first Polish magazine came to the screen in 1999. Attempts were then made to codify the Ruthenian language, with the separation from Ukrainians being recognised in Slovak television broadcasts. So the Ruthenian and Ukrainian national magazine aired separately. Since 2001, other ethnic groups have regularly been represented: Jewish, Bulgarian, Croatian and others. 2010 has shown that ethnic groups have their stable and unalterable place on Slovak television.

Slovak Television (now RTVS) provided space in previous periods for broadcasts on national minorities, as evidenced by information from the Department of Controlling RTVS. Graph 1 compares the available information on the length of airtime for the Roma minority from 2004 to 2011. The total broadcast time was a total of 326.0 hours, with the most hours broadcast in 2009 and the least in 2004. Reruns exceeded first runs by several times; first runs accounted for 66.7 hours, while reruns accounted for 259.3 hours (Graph 1).

**Graph 1: Total broadcast time**

Source: Department controlling RTVS, 2011

Note: 2011\* – broadcast from 1.1.2011 to 31.10.2011

The RTVS program structure remains unchanged, but it is the intention of producers and editors in the coming period to improve awareness about the life of the Roma community, its needs and possible solutions to its own problems, and raise awareness of other people in Slovakia of the life of the Roma community and create the conditions for increased sensitivity towards the Roma community. Although a greater effort is being made to produce programs for ethnic minorities, these efforts are usually influenced by the amount of funds intended for programs of this kind out of the RTVs budget.

### **III. Analysis of the impact and importance of television in socially marginalized environment**

Support for marginalized groups in society is one of the primary tasks of the government as well as NGOs. The most numerous and specific group in Slovakia are members of Roma communities. Television should support the production of programs broadcast to national minorities. The aim of this part of the article is, through the scientific interpretation of research results, to highlight the influence of television on socially marginalized groups and their development. To fulfil this objective, we have chosen to study a community center which brings together people from ethnic minorities with different mother tongues. We conducted a survey to find out how community residents view the impact of television broadcast programs on their development, including their opinion on the quality of the programs broadcast.

Television – mainly through public service, as prescribed by law – provides an image of them in their native language. The programs are in the native language of the minorities but subtitles enable them to be watched by members of the majority. We examined whether the majority of society paid them sufficient attention because of television coverage. Also, whether marginalized groups, in particular Roma, find that television programs create an accurate image of their identity.

The research respondents were residents of a community center at which, during our research, there were 250–520 people, mostly Roma, with mental and physical disabilities, or were less educated, with diverse means of communication and expression in their mother tongues of Slovak, Hungarian and Roma (we used three languages in the questionnaire, to ensure sufficient understanding of the issues). The 50 participants were residents aged 15 to 65 years. The research reached only a small percentage of the population, because of the limited size of the device and frequent changes of the residents in the community center. The residents of the community center must be registered for work. Based on the well-functioning co-operation of the community center with the Institute for Romology, those who do not work are provided with work. During its six years of existence, the community center and the Institute for Romology has managed to find jobs for its occupants, who may then pay their earnings for accommodation in the center.

Research was conducted with the help of community social workers over three years, 2009, 2010 and 2011. Given the fact that some people were not literate in the Slovak language, the respondents were questioned in Slovak, Hungarian, and Roma languages. Many of these people claimed to be of Hungarian nationality, and not Roma, which is also of concern, as they are not an excluded majority society; on the contrary, they have been incorporated into the society jointly with another minority. In the survey, we tried to be as objective as possible, in order to avoid generalizations. This was particularly the case in terms of the specification of direct knowledge of the phenomena and processes based on the uniqueness of the object of study, which played a particularly important part in understanding, empathy, acceptance and role play with an emphasis on everyday situations. The research was conducted by questionnaires and also through interviews. The interviews included additional questions aimed at finding out what the residents of the community center considered their biggest problems, how to engage in work, what is the unemployment rate, or whether they have problems paying rent and energy (gas, electricity), the social services in Dunajska Streda<sup>7</sup> considered inadequate for Roma, the amount of income in the household and the type of school attended by their children.

### **The research results**

The survey involved 50 respondents out of a total of 250 to 520 people, which was in the range of 11.11–20% of the total population centers. The percentage completed of the survey each year was 100% – out of the 50 questionnaires, 50 questionnaires were returned. The respondents were aged 18–70 years and we divided them into six age scales: in the first age range, the respondents were 18–25 years of age; in the second age range

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<sup>7</sup> Dunajska Streda is a city south of Bratislava where the community center is located.

were respondents of 26–35 years of age; in the third age range were respondents of 36–45 years of age; in the fourth age range respondents were 46–55 years of age; in the fifth age range respondents were 56–65 years of age; in the sixth age range respondents were 66–70 years of age.

**Table 2: Age structure of selected respondents in the period 2009–2011**

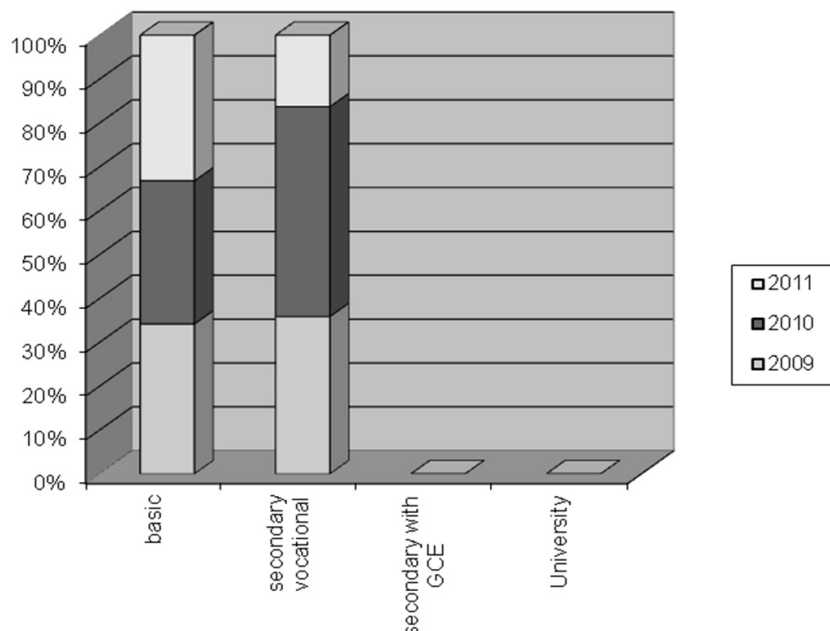
Age	Number			Portion in %		
	2009	2010	2011	2009	2010	2011
18–25	9	11	12	18	22	24
26–35	7	9	6	14	18	12
36–45	14	12	13	28	24	26
46–55	9	7	11	18	14	22
56–65	5	6	4	10	12	8
66–70	6	5	4	12	10	8
Total	50	50	50	100,00	100,00	100,00

*Source: Table prepared according to the survey*

The indicators listed in Table 2 show that the largest number of respondents was, in 2009, represented by the third age range, with 14 respondents; the case was the same in 2010 and 2011. In 2011, compared to 2009, the population aged 18–25 years increased. In 2011, the population declined in the third age range (36–45 years) compared to 2009, from 14 to 13. The numbers of respondents in other age scales changed significantly. In 2009, the largest proportion were people in the third age range (ages 36–45), at 28%. The lowest proportion of residents were in the fifth age range (aged 56–65 years), at 10%. In 2011, out of 50 respondents who participated in the research, 26% were in the third age range (aged 36–45 years) and 24% in the first age range (aged 18–25 years), while 22% were aged 46 to 55 years. The numbers in other age scales accounted for smaller shares.

Out of the total number of respondents in 2011, 26 were males, or 52%, while there were 24 females, or 48%. In 2011, the total number of men decreased to 26, or 38%, from 35, or 70% in 2009. The highest number of women in our study was in 2010, at 62%, which was 100% more than in 2009. In 2011, the number of women decreased by 14%, to 48%. Regarding the educational composition of the population in the community center, out of the total number of 50 respondents in 2011, 47 had only basic education, representing 85.45%, three respondents had a secondary vocational school education, accounting for 5.45%. A secondary education with GCE was represented by zero percent. Three respondents had a secondary vocational education, representing a value 6%. A primary education was held by the largest portion of respondents, at 94% (Graph 2).

**Graph 2: Educational structure of population centres (2009–2011)**



*Source: Graph prepared according to the survey*

When asked when respondents watched television, it was natural that the largest audience was for programs after 7 PM – 34 respondents, or 68%, fell into this group. As with ordinary households – i.e. not only in this community center – the highest viewership is when people have time for themselves after work. The time after 7 PM is of course a period which includes news television programs on public television stations, commercial television stations or otherwise. A large share of the audience also watched in the afternoon after 3 PM. In 2011, 11 out of 50 respondents answered YES to this question, representing 22%. A smaller audience can obviously be found at night, accounting for 3, or 6%, with 2, or 4% answering that they watched television in the morning.

When asked: “Which kind of programs do you watch?” it was not difficult to guess in advance that the Roma population mostly watched entertainment and music programs, and this turned out to be the case in reality. Up to 43 to 48 of 50 respondents answered that they mostly watched entertainment and music programs. For sports, documentaries and children’s programs, the viewership was almost the same, ranging from one to three respondents for each type of program. There was also some viewership of various political programs, talk shows and talk shows with political overtones (see Table 3).

**Table 3: Which kind of TV programs do you watch?**

	Number			Portion in %		
	2009	2010	2011	2009	2010	2011
Music and entertainment	43	45	48	86.0	90.0	96.0
Children	1	0	0	2.0	0.0	0.0
Sport	2	3	1	4.0	6.0	2.0
Documentary	2	1	1	4.0	2.0	2.0
Political	2	1	0	4.0	2.0	0.0
Total	50	50	50	100.0	100.0	100.0

*Source: Table prepared according to the survey*

The answers to the question “Do you think TV represents the Roma minority accurately?” were more interesting. There were many answers to the question: strongly disagree: 8 to 16%; disagree: 1–2%; unsure: 19–38%; agree: 21–42%; fully agree: 1–2%. The responses to the question show that respondents are dissatisfied with the programming and content, with most feeling that they broadcast negative information relating to Roma issues.

We expected the answers given to the question “What program on Roma would cheer you on TV?”. Music is an important aspect of life for the Roma, and, in 2009, 54% respondents said they would like more music programs; in 2010, the number was 41% of respondents, and 98% in 2011. More entertainment programs on television were wanted by one respondent, i.e. 2% out of the total respondents. Other types of programs, such as documentaries, the respondents had no interest in, with a response of 0%.

In our study, we were interested in the effect or impact the TV programs they watched had on the population in the center. In 2009, entertainment programs were watched by a lower percentage of the population, considering that they are relaxing and that the rest of the population consider them educational and instructive. 2010 changed mainly insofar as these programs fulfilled a more aesthetic function and also promoted learning. The selection of programs also depended on educational attainment. As the population centers only have basic education, their preference was for watching entertaining music programs. It can clearly be seen that the programs watched are seen as a means of entertainment and to provide a temporary escape from everyday, and that there was no desire to reflect on the content while viewing. The selection of programs was also dependent on the low educational level of the Roma population of the community center. This level affected the interests of the respondents as well as the programs watched.

#### IV. Conclusion

Each of us encounters the media, whether printed or electronic, every day, no matter what level of society we come from. The media is part of our daily life, not only informing us, but to some extent also affecting us, whether we want to admit it or not. Slovak Television must, according to the Constitution (Article 12 on the rights of national minorities and Chapter 34 to disseminate and receive information in their mother tongue), fulfil a public service function by offering information about the lives of ethnic minorities in their



native language. Representatives of national minorities living in Slovakia have the opportunity to broadcast not only to promote their identity, but also to discuss their problems. Broadcasting for national minorities on Slovak Television has continued for over 20 years. The Roma minority in Slovakia is a group which is heavily affected by mass media, especially television broadcasting. The media image of the Roma is part of the attitude of the majority towards the Roma community, including its degree of acceptance of their characteristics, habits and cultural attitudes, and also includes attitudes towards other national minorities living in the same culturally-mixed region.

The aim was to monitor the impact of television on the Roma minority. The research showed that television has an impact on the respondents and that they mainly watch TV shows for music and entertainment and have no interest in watching other programs. The fact that television programs have an impact on their development can also be seen by the fact that they give names of serial characters to their children, try to find an escape from reality in an ideal world and identify with the lives of TV heroes. Experience shows that, even if the Roma minority has a problem with obtaining sufficient funds for the purchase of equipment or accessories, such as satellite receivers and the like, they are nevertheless determined to receive television signals.

The ideal situation would be the existence of Roma TV, for which the Roma themselves would prepare the program structure and participate in the creation of programs, thus ensuring their authenticity. This would hopefully eliminate the possibility of their being dissatisfied with broadcast content and broadcast programs.

The creation of separate Roma television fiction by Slovak Television would be a move away from commercial broadcasting and towards the creation of more specific programs that contribute to pluralism and cultural diversity. We favor the idea of Marc Raboy that communication with the public shall be such as to meet the needs of public culture with global reach and local experience, and therefore to be geographically accessible, acting in its content, dedicated to ethnic groups and respecting the cultural development and democratization of society. We might also have contributed, by this research, in influencing the decision-makers of these programs, leading to new programs for minorities in society and informing them about the work of some of the Roma, their achievements and thus contributing to changing their lifestyle.

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## DEVELOPMENT OF CONCEPTS AND MODELS OF PERFORMANCE EVALUATION FROM THE 19<sup>TH</sup> CENTURY TO THE PRESENT

Jana Hornungová<sup>1</sup>

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### Abstract

The main aim of this paper is to provide a framework of concepts and models from the area of performance measurement. Due to the fact that the business environment is constantly changing, changes also occur in the trends relating to performance. Traditional financial performance measures have been highly criticized and the need identified to integrate non-financial perspectives, such as level of innovation, degree of motivation, intellectual capital and other criteria. Intellectual capital is often a crucial factor in the creation of value in a company. This paper provides a literature review supplemented by the author's research in the field of performance. The article shows that the performance appraisal system is currently focused on several areas that could affect the performance of the company, which is also part of the overall performance of the economy in the form of GDP growth. Based on the research, it can be said that, for the sample tracked, the selection of performance evaluation system does not depend on the legal form of the business.

### Keywords

Performance, Measurement, Concepts, Models

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## I. Introduction

There are currently a number of concepts and models that are used to measure performance. Rigby (2010) presents, through Bain & Company, a great awareness of the need for management and the fact that it is desirable to choose the right management tools and process of performance measurement. He states that the successful use of management tools requires an understanding of the strengths and weaknesses of each tool and especially the ability to use the right tools in the right way and at the right time.

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<sup>1</sup> Brno University of Technology, Faculty of Business and Management, Kolejní 2906, 612 00 Brno, Czech Republic. E-mail: hornungova@fbm.vutbr.cz.

In this dynamically changing business environment, the adoption of the appropriate performance management and measurement (PMM) framework has been recognized as a major challenge. Product manufacturers and service providers are largely service operations, so traditional accounting measures, such as cost schedules, variance reports, profit and loss statements, etc., and a static view of costs, are no longer appropriate in the modern business environment (Quinn et al., 1990).

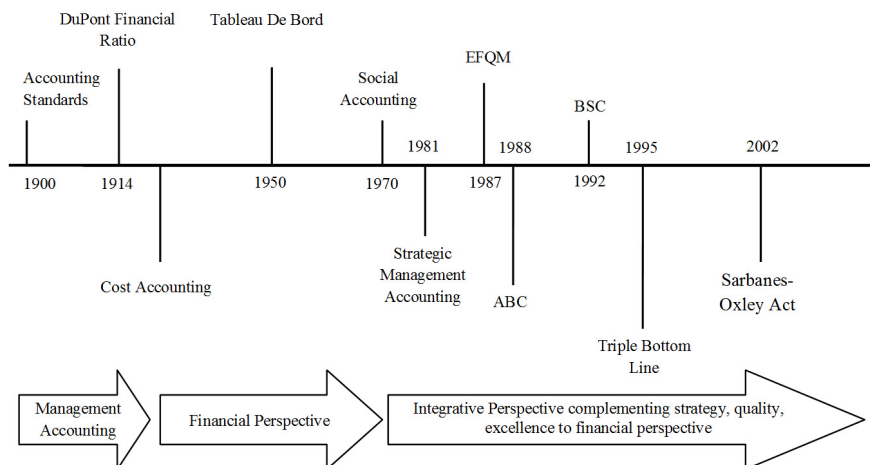
The aim of this paper is to define and categorize the development of concepts of performance measurement over time. In order to achieve this aim, a critical literature review and questionnaire survey (primary research) was used. The area surveyed was Information and Communication Activities, and the focus was especially on companies in the Czech Republic with more than 250 employees.

The structure of the article is as follows. Section 2 describes the theoretical background of performance measurement systems. Section 3 reveals the estimated results and the last section discusses the results (key findings) with the summary of other selected groups of models.

## II. Methodology of literature review

Yadav et al. (2013) have elaborated upon historical developments that occurred in the area of performance evaluation models and the trends which have resulted in changes in these models over the years. These authors have created a timeline which captures the performance evaluation models and how the models evolved over time. This timeline is illustrated by Figure 1.

**Figure 1: Developments in performance assessment**



Source: Yadav, et al. (2013)

Early 19th century models for performance measurement and evaluation were considered forms of traditional management accounting and cost accounting. Experience in cost management has shown this to be inadequate and misleading, as it was simultaneously

monitoring the costs of products, activities, processes and quality. Performance evaluation focused on process management in isolation (Bititci, 1994; Yadav et al., 2013).

New findings led to the creation of the ROI model by the Du Pont Corporation. The development of ROI led to the pyramid of financial ratios which are still widely used as a diagnostic tool to measure the financial health of a company. Over time, this has already been seen to not be entirely satisfactory, since it did not point to indicators leading to continuous improvement in activities, something which is required in today's competitive environment.

Subsequently, the Tableau de Bord model was introduced. This stressed the importance of the relationship between financial and non-financial measures. The principle of this model is to focus on daily business operations and not pay too much attention to strategic issues (Epstein, Manzoni, 1997).

Other concepts should support the importance of complementary aspects of performance with respect to accounting (i.e., due to financial and accounting measures): Social accounting, strategic management accounting, ABC, Sarbanes-Oxley Act.

With the creation of the EFQM model, which was awarded the National Quality Award, the assessment of performance was evaluated according to quality and excellence, which can also be seen as a measure of higher performance, due to the quality and reliability of its products (Yadav et al., 2013).

The revolution in performance evaluation, however, came about with the introduction of the BSC by Kaplan and Norton in 1992. This proved to be complementary to a financial measure that, when evaluating performance, is also engaged in operational and strategic processes. Kaplan and Norton identified financial performance as a lagging indicator which depends on the performance of primary main factors (customer satisfaction, quality, innovation, excellence and improvement activities). The integration of non-financial criteria, such as quality, innovation, strategic orientation, human resources, in the traditional financial evaluation has brought the prospect of the integration of performance management, an important stage in this revolution in the performance of enterprises (Yadav et al., 2013; Paladino, 2007).

Over time, performance evaluation has affected the sustainability of enterprises, their impact on society and the environment. Economic growth, social progress and environmental "health" led to the concept of the Triple bottom line, a framework for assessing and reporting corporate performance according to economic, social and environmental parameters (Elkington, 1997). It emphasizes that profit is not the only concern of an enterprise; environmental and social obligations are also major driving factors in achieving higher performance.

It can thus be seen that there are a range of development models and concepts for the evaluation of performance. Companies must choose the model or concept that best corresponds with their activities and focus and which can assess performance based on those factors important to the company.

Timeline models have been presented as having changed and improved over time. As for their use and their popularity, this can be illustrated by the following table, which shows, based on research by Bain & Company, the ten most-used management tools. Table 1

shows the ranking for the last two reporting periods, i.e. 2010 and 2012 (the company has conducted research since 1993). These tools also illustrate some of the models which were represented on the timeline (Bain & Company, 2012).

**Table 1: Top 10 Management Tools**

Rank	2010	2012
1.	Benchmarking	Strategic Planning
2.	Strategic Planning	CRM
3.	Mission and Vision Statements	Employee Engagement Surveys
4.	CRM	Benchmarking
5.	Outsourcing	Balanced Scorecard
6.	Balanced Scorecard	Core Competencies
7.	Change Management Programs	Outsourcing
8.	Core Competencies	Change Management
9.	Strategic Alliances	Supply Chain Management
10.	Customer Segmentation	Mission and Vision Statements

*Source: Bain & Company (2012)*

Katic et al. (2011) continue to address the issue, considering the most widely used performance models to fall into two groups:

- Models which emphasize self-assessment – e.g. the EFQM model. This model helps the company find areas in which it can continue to improve (self-assessment within the company), but also allows comparison with competitors (benchmarking). Some authors believe that there is currently much evidence of the successful application of EFQM or other similar models, fulfilling the principles of TQM (Total Quality Management), providing significant economic and social effects for the organization (Marinič, 2008).
- Models designed to support the management and improvement of business processes – such as the performance pyramid or BSC.

Katic et al. (2011) consider the main feature of these models to be linked to corporate strategy and the development of non-financial indicators. The current situation entails a need to consider corporate strategy as a causal chain of causes and consequences.

A critical evaluation of models of corporate performance has been made by Vouldis and Kokkinaki (2011), and many models were also identified by Franceschini et al. (2007). These authors, through the analysis of existing models, define the following models of corporate performance:

- Balanced Scorecard;
- EFQM;
- ISO 9001:2000;
- Performance Prism;
- Six Sigma;
- Tableau de Bord.



### **Tableau de Bord**

Tableau de Bord is mainly used when evaluating a company's management. This concept is not only focused on financial indicators, but also addresses the issue of objectives, since vision and mission are translated into a set of objectives, of which the key success factors are identified and subsequently converted into a series of quantitative key performance indicators. The principle of this model is to focus on daily business operations and not pay too much attention to strategic issues (Epstein, Manzoni, 1997; Watts, McNair-Connolly, 2012).

### **EFQM**

This model is considered one of the most sophisticated and complex tools for the permanent and systematic improvement of business performance. Great emphasis is placed on its results, including financial ones. The model is structured into nine basic criteria, five of which are tools (techniques) that the firm should implement to maximize results and the remaining four results that determine what the firms have achieved (Watts, McNair-Connolly, 2012; Nenadál, 2004). The main principle is the achieving of excellent results in several ways that are acceptable to corporate management and support its strategy. This model comes from Nenadál (2002) and is based on the principles of Total Quality Management (TQM), which incorporates the following elements: customer focus, continuous improvement, participatory, social consideration.

### **Balanced Scorecard**

Balanced Scorecard reflects many of the attributes of the other guest models, and in the context of performance evaluation is based on vision and strategy. The model was based on the realization that no performance indicator can capture the whole complexity of the undertaking and its impact on the surrounding area. Balanced Scorecard translates the strategy into objectives which are part of performance measurement under the four following perspectives: financial, customer, internal business processes, and learning and growth. The basis of this model is that businesses use a balanced set of measures, which includes performance in terms of financial and non-financial measures (Yadav et al., 2013; Watts, McNair-Connolly, 2012). The result of the application of BSC should therefore be sustainable business growth in line with the strategy defined by top management, wherein the short-term financing of success is not something that will reduce investment in longer-term factors necessary for growth and the effective functioning of the company. Because this is a very complex method of strategic management, it is very popular, especially for large companies that can afford it financially and carry it out in-house (Kaplan, Norton, 2002). At the same time, Vouldis and Kokkinaki (2011) add that it is possible to take advantage of this comprehensive model at different levels across the organization, services, team or group.

## **Six Sigma**

Six Sigma is a business management strategy, originally developed by Motorola, the main tools of which include measurement and statistics. This model aims to identify and remove causes of errors in the processes of production and trade, and uses the DMAIC methodology. The Six Sigma process starts with the customers and the goal is the maximum satisfaction of their requirements. It is therefore necessary to trim off everything not directed towards this goal. Enterprises provide specific instructions on how to avoid errors in all activities (from order to final expedition). Six Sigma provides a comprehensive methodology for performance measurement processes and its improvement (George, 2010). To introduce the concept of Six Sigma to the management of the company, eight assumptions should be agreed upon:

- The continuous improvement of processes;
- All activities of the company are composed of processes;
- Senior management support;
- The determination of priorities, the expansion of the competence of employees, support for the involvement and teamwork of employees;
- Continuous assessment of the performance of the process;
- The effort to approach statistical indicators, including for those persons who do not have a very positive relationship with statistics;
- It is important to identify the subject of the measurement and the method of measurement;
- Work teams within the Six Sigma area are usually smaller groups of people interested in a particular problem, with the support of its leadership (Töpfer, 2008).

Vouldis and Kokkinaki (2011) further focus on the basic principles of this model, and argue that it should do the following: measure key processes and customer requirements with business goals, the creation of the standards of the measurement system, defining the relevant indicators, providing training in the field of project management and the Six Sigma model, defining objectives, flexible teams for the improvement of quality and profitability and the reduction of time and waste.

## **Performance Prism**

The Performance Prism system is presented in the form of a three-dimensional model in which each of the parties express viewpoints from which the undertaking is measured, based on the Balanced Scorecard model, which represents the first generation of performance measurement frameworks. As one of the performance measurement systems, the second generation, compared to the first generation, incorporates the wishes and needs of all stakeholders (Vouldis, Kokkinaki, 2011). Performance Prism integrates stakeholders in terms of five aspects – the satisfaction of stakeholders, post stakeholders, strategy, skills and processes. In the long term, the firm assesses the financial perspective set of entities (Neely et al., 2001).

### **Performance measurement from a macroeconomic perspective**

In all international comparisons of competitiveness and economic performance, gross domestic product (GDP) is a commonly used indicator, in terms of the statistical output of the System of National Accounts. GDP is considered a partial restriction in the evaluation of economic performance; there is also the issue of depreciation (amortization), taking into account “household” production, the issue of measuring the value of public goods and capturing qualitative changes in products and services. Major limitations are questions related to the sustainability of economic growth and prosperity, including: the excessive extraction of natural resources, environmental degradation and the effect of free time (Hronová, et al., 2009).

In recent years, performance has been specifically associated with sustainability, i.e. it also takes into account the social and environmental component, as complementary factors of economic performance. Sustainability should be seen as a dynamic relationship between the flow able and state variables. The intensity of the current use of resources should be such that the final state of these resources allow future generations the same opportunities for growth and prosperity. Resources should be spent excessively, i.e., to destroy intergenerational equity. The net national product should be modified to fit the maximum sustainable value, it should allow the same level of consumption today as in the future (Nečadová, 2012; Osberg, Sharpe, 2002).

With higher performance, the company will contribute more to GDP growth, which is desirable for any economy, because not only can companies improve quality, the quantity and cost aspects of their inputs, but they can act as a driving force for not only economic but also social development.

### **III. Materials, Methods and Results**

The basis of the empirical research was a questionnaire prepared as part of the doctoral thesis of the author. For the purposes of the author’s research, businesses were selected which met the following two conditions:

- Registered economic companies from section J (CZ-NACE) – Information and Communication Activities in the Czech Republic;
- Enterprises with > 250 employees.

A basic sample was made of 56 companies who received the questionnaire. 32 out of the 56 companies answered (effectiveness was almost 57.14%). In terms of identification, it can be significantly statistically evaluated which types of legal form predominated: joint-stock companies (43.8%) and limited liability companies (56.3%).

The question of business performance is which performance appraisal system is used in the specified companies.

In relation to the identification of areas and selected systems performance evaluation, the following statistical hypothesis was established:

**Statistical hypothesis:** *“The legal form of the company does not affect the choice of how to evaluate the performance of the company.”*

It has been suggested that the chosen legal form of the business has no effect on the system performance of enterprises. To verify this hypothesis, answers to the following questions were used from the questionnaire: “The legal form of your company.” and “What business performance evaluation system is used in your company?”. For the basic test of mutual dependency, the chi-square test of independence was used, null hypothesis  $H_0 : \pi_{ij} = \pi_{ij,0}$ , which states that random variables are independent against the alternative hypothesis  $H_1$ .

- $H_0$ : There is no relationship between the legal form of a business and its enterprise performance evaluation system.
- $H_1$ : There is a relationship between the legal form of a business and its enterprise performance evaluation system.

In this case, the dependence is upon two nominal variables (contingency). The basis for the detection of this dependence is the chi-square test of independence, the result of which is shown in Table 2. The output was obtained using IBM SPSS Statistics software.

**Table 2: Calculation of  $\chi^2$  test of independence for Statistical Hypothesis**

	Test criterion	The minimum level of significance
Chi-square	4.107	0.534
Likelihood ratio	5.241	0.387

*Source: Own research*

The resulting value of the minimum level of significance was tested at a 5% significance level ( $\alpha = 0.05$ ). If the resulting value is less than or equal to  $\alpha = 0.05$ ,  $H_0$  is rejected. Based on the calculation, it was found that the value of the Pearson chi-square statistics was 0.534. This result is greater than the chosen significance level ( $0.534 > 0.05$ ). In this case, therefore,  $H_0$  is not rejected at the 5% significance level, while  $H_1$  is rejected.  $H_0$  thus remains, as there was a failure to refute the hypothesis because it has not been demonstrated that there is a relationship between the choice of the legal form of business and the chosen system of evaluating the performance of the company.

⇒ Statistical hypothesis confirmed.

In the sample of enterprises, it makes no difference matter whether it is a corporation or limited liability company and thus this fact does not affect whether the focus is on classic or modern systems performance assessment. It certainly would be interesting if the relationship between these two variables were to be confirmed. Due to restrictions on large businesses, it could not be determined whether there is any difference between small, medium and large businesses.

Currently, debate continues as to whether companies are proponents of traditional evaluation methods of economic performance, or are already using some of the modern or comprehensive approaches to performance assessment.

Based on the research, financial indicators still dominate in these large companies, or companies plan to compare actual conditions. A total of 13 companies out of 32 monitors and evaluates economic indicators, while only about 12 companies compare the actual

status of the specified plan. Third, the most commonly reported system was benchmarking, which was used by three out of 32 companies.

The simplicity and clarity of these approaches cannot be denied. The EVA indicator is taken to be the epitome of modern indicators, but again it can be shown that businesses do not use it more, because 46.9% of them said that this indicator is not tracked, but that they are possibly contemplating its use. These results are also supported by studying the annual reports by the author; the data usually mentioned are economic in nature. Many businesses also point out the way in which they met or deviated from the established plan, which is usually expressed in terms of goal-oriented sales, profits and market share.

#### **IV. Discussion**

After analysis of the trends of the performance measurement system frameworks, an attempt is made here to classify these frameworks on the basis of some broad themes according to Yadav et al. (2013).

##### **1. Classical and dominant PMM frameworks**

This theme includes those frameworks that have been very popular in literature as well as predominantly used by practitioners. Their contributions to the knowledge base are related to the incorporation of non-financial performance measures, quality, self-assessment and the inclusion of most of the stakeholders. These can be listed as follows:

- Balanced Scorecard;
- Performance Pyramid;
- EFQM – excellence model;
- Performance Prism.

##### **2. Holistic and integrated PMM frameworks**

As discussed, to fulfill the need for a holistic and integrated framework for company performance, researchers have highlighted the following developments, which primarily discuss aligning performance with the future, bringing individual performance in line with enterprise performance, and integrating operational, functional and strategic aspects of enterprise performance:

- Consistent PMS;
- Integrated dynamic performance measurement system;
- Dynamic performance measurement system;
- Integrated performance measurement framework;
- Dynamic multi-dimensional performance framework;
- Holistic performance management framework.

### **3. Frameworks updating BSC approach**

There has been a very wide discussion in the literature about incorporating and updating the BSC approach, bearing in mind the organizational view, system dynamics methodology and modelling, fuzzy cognitive maps, intellectual and social perspectives, etc. The frameworks that update the BSC approach can be listed as:

- Kanji's Business Scorecard;
- Holistic Scorecard;
- Total Performance Scorecard;
- System dynamics based BSC;
- Proactive BSC.

### **4. Context-specific PMM frameworks**

This category includes frameworks discussing the specific contexts of performance, such as economic value, social values, quantitative factors, performance value chain, etc. These PMM frameworks can be further clustered on the basis of underlying driving factors, as process-based frameworks (input-process-output-outcome framework, the performance planning value chain); financial performance drivers (shareholder value, economic value added); criticism of traditional control mechanism (beyond budgeting). Context-specific frameworks are:

- Measures for time-based competition;
- Economic value added;
- Input-process-output-outcome framework;
- Shareholder value;
- Quantitative models for performance measurement systems;
- The action-profit linkage model;
- Beyond budgeting;
- The performance planning value chain.

### **5. Recently developed PMM frameworks**

These include those frameworks developed in the last three to four years and which take into account major issues related to enterprise performance, such as:

- Flexible Strategy Game-Card;
- Sustainability performance measurement system.

The question is just when evaluating the performance of these models will be used in the activities of Czech enterprises, consistently focused as they are on classical ways of evaluating their performance.

## V. Conclusion

This paper gives a comprehensive view of existing performance management frameworks. The shift from financial measures to integrated measures, operational perspectives to strategic perspectives and consideration of a set of stakeholders to all stakeholders have been the major visible changes.

The aim of the article was to define and categorize the development of concepts of performance measurement over time. Companies are able to create a comprehensive performance evaluation system that measures more than just economic indicators and thus can assess how strong the company is overall. Complex assessment of the company is much better and more effective than individual performance measurement. The reason for this is mainly the fact that only some indicators are directly measurable and comprehensive evaluation is necessary in order to take into account both indicators of long- and short-term performance.

The sector of Information and Communication activities is dominated by classic performance measurement systems (financial evaluation) and the simplicity and clarity of these approaches cannot be denied. Important in the management of business entities are objective values, as determined by the owners of the company, but the strategic success of the entity also increasingly affects its customers and employees. It is therefore a “necessity” to also include non-financial indicators when evaluating the performance of the company, but that does not mean that conventional approaches to performance evaluation are losing their importance. It is increasingly possible to hear discussion about human capital crucial for future growth, such as sustainability and developments not only in this sector.

Researchers in the field of performance measurement and management need to look beyond the scorecard and utilize these avenues of research to develop holistic, integrated, dynamic and effective PMSs that can help an enterprise to compete and succeed in turbulent and competitive business environments.

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**RASTISLAV FUNTA, ŠTEFAN NEBESKÝ,  
FILIP JURIŠ**

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New to market for 2014 is a monograph entitled “European Union Law” by a young team of authors led by JUDr. Rastislav Funta, Ph.D., LL.M. and his two colleagues JUDr. Štefan Nebeský, Ph.D., M.E.S. and Mgr. Filip Juriš. Although this is the work of a young team of authors, it should be noted that it is an experienced team. The lead author has gained, in addition to theoretical experience, practical vocational skills thanks to activity in the German media group Bartelsmann, an Italian consultancy company, an international IT company, cooperation with the College of Europe/the European Commission, publishing and lecturing activities, and activities in the field of political lobbying. Another of the authors works for the Legal Service of the European Banking Authority in London and the third co-author is currently active in the field of legal advice, with a focus on M&A and transaction advisory.

The system of law created by the European Union (EU) is now a solid component of our political and social reality. Thousands of decisions are accepted annually on the basis of EU agreements and these significantly help to create the reality which influences Member States of the EU and its citizens. Citizens of the individual states have ceased to be only citizens of their country, their towns or municipalities, and have also become European Union citizens. It is therefore very important that they should be kept informed about the legal system which influences their lives every day. However, the structure of the EU and its system of law is not always clear to its citizens. This is often caused by the amended contracts themselves, which are very often confused and can only be understood with great difficulty. It is thus important to identify irregularities in the many terms with which these contracts attempt to react to new facts. It is also vital to attempt to make the structure of the EU and the pillars of the European system of law clear, thereby contributing to better understanding on the part of EU citizens.

On the one hand, rapid integration within the EU brought about incentives for growth, but on the other hand, it also created vulnerabilities that were, in many EU Member States, aggravated by the recession. Overcoming the consequences of the global crisis is only possible via processes of adaptation that respond to its multidimensional causation.

Europe's mission in the 21st century is primarily to ensure peace, prosperity and stability, support balanced economic and social development, face the challenges of globalization and preserve the diversity of the people of Europe and uphold the values common to all Europeans (sustainable development, respect for human rights, etc.). Globalization keeps bringing new challenges. The EU will need a wide range of competencies to be able to adapt flexibly to a rapidly changing and highly interconnected world. The Treaty of Lisbon, signed on 13 December, 2007, aims to provide the Union with the legal framework and tools necessary to meet these future challenges and fulfill the requirements of EU citizens. With it, the Union can better focus on policy challenges, including globalization and climate change. The wealth and success of Europe lies in its diversity and a fair balance between the interests of larger and smaller countries.

The European Union, as was mentioned in Judgment C-294/83, *Les Verts/Parlament*, is "the community of law". The EU differs from the classical international community of states in that the Member States have given up parts of their sovereignty in favour of the EU and they have been provided by the Union with their own rights independent from the Member States. It is necessary to mention that the EU does not have absolute power. In the exercise of its powers, the EU can issue sovereign European acts, which are, in terms of effectiveness, the same as legal acts by Member States. With the Maastricht Treaty, we have entered a new stage on the path to the political unification of Europe and begun the process of forming a closer alliance between the European nations. Other developments which have been achieved by the EU are thanks to the Amsterdam Treaty and the Treaty of Nice. While the goal of the first treaty was mainly the creation of institutional and political conditions in order to meet new challenges, the goal of the Treaty of Nice has been the increasing of the effectiveness and legitimacy of Community institutions, as well as preparation for the expansion of the EU.

A unified Europe has been built in accordance with the core concepts of values (Article 2 of the EU Treaty) by which the Member States feel bound, with the application of these values entrusted to EU executive institutions. These basic values are: securing permanent peace, unity, equality, freedom, solidarity and safety. The EU explicitly claims to respect the principles of democracy and accord a common legal status to all Member States, while also protecting fundamental human rights. These values are at the same time a foundation stone for those states which would in future like to join the EU. If a Member State seriously and persistently violates these values and rules, penalties are inevitable.

No EU citizen should be at a disadvantage, i.e. discriminated against on the basis of nationality. Moreover, all citizens of the Union are equal before the law. With regard to the Member States, the principle of equality (Chapter III Equality, the Charter of Fundamental Rights of the European Union) means that none is favored over another and that intrinsic differences such as size, population of the country or different structures can be resolved only in accordance with the principle of equality.

Solidarity (Chapter IV Solidarity, Charter of Fundamental Rights of the European Union) is also a necessary correctional freedom, because the unscrupulous exploitation of freedom is always carried out at the expense of others. With traditional international organizations, the EU has in common only that it also forms the basis for international agreements, but

the EU has become far removed from these international roots. The founding acts of the EU, which are based on international agreements, led to the establishment of a separate EU with its own sovereign rights and powers. Member States surrendered part of their sovereignty in favor of the Union.

The EU's role in economic policy is not to set and enforce European economic policy, but to coordinate the economic policies of the Member States (Article 121 TFEU) so that the economic decisions of one or more Member States do not impair the functioning of the internal market. For this purpose, the Stability and Growth Pact sets out detailed criteria according to which each Member State must make decisions on fiscal policy. If these criteria cannot be met, the Member State may give notice to the European Commission (Article 121 (4) TFEU) and the EU Council may impose excessive budget deficit procedures or impose sanctions.

In addition to economic and monetary policy, the EU plays a role in a number of other areas of economic policy. These include in particular agricultural policy and fisheries policy, transport policy, consumer policy, structural and cohesion policy, research policy and development policy on space, environmental policy, health policy, trade policy and energy policy. In the area of social policy, the EU must ensure that the benefits of economic integration not only apply to economically active subjects, but that they respect the social dimension of the internal market.

We should not forget that the Union has an institutional framework which aims to promote its values (Article 2 TEU), to achieve its objectives (Article 3 TEU), serve its interests, those of its citizens and the interests of the Member States, and ensure coherence, effectiveness and continuity in its policies and actions. The EU has an entire institutional system that allows it to provide unified Europe with new impulses and objectives and to areas falling within its powers create rights which are equally fair for all Member States. Even with all the imperfections that characterize EU law, the contribution made by the EU legal system when dealing with the political, economic and social problems of the EU Member States is priceless.

History confirms that the creation of the European Union was a key element in bringing about improvements in peace and security in anticipation of future economic development in the EU. However, there are new challenges (the ongoing crisis, uncertainty and instability in financial markets) to which it must respond.

We hope that this publication will help to explain to the general public the essence of the EU and its importance. However, its intended audience is law schools, professionals in the field of European law, economists and managers, as well as other professionals in related fields, such as political science or European Studies.



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