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OUTSIDE THE STATE – THE SHADOW ECONOMY AND SHADOW ECONOMY LABOR FORCE

Friedrich Schneider[1]

Abstract

In this paper, the main focus lies on the shadow economy and on work in the shadow. The most influential factors on the shadow economy are tax policies and state regulation. The size of the shadow economy was decreasing over the period 1999 to 2007, from 34.0% to 31.2% for 161 countries (unweighted average). Furthermore, economic opportunities, taxes and regulations, the general situation on the labor market, and unemployment are crucial for an understanding of the dynamics of the shadow labor force. In contrast with the decrease of the shadow economy (value added figures), the shadow economy labor force increased for most countries over the period 1999 to 2007.

Keywords

Shadow Economy, Undeclared Work, Shadow Labor Force, Tax Morale, Tax Pressure, State Regulation, Labor Market

I. Introduction

Fighting tax evasion, the shadow economy and informal (illegal or shadow) employment have been important policy goals in OECD countries during recent decades. In order to meet these goals, one should have knowledge about the size and development of the shadow economy and shadow economy labor force, as well as the reasons why people are engaged in shadow economy activities. This is the content of this paper. Tax evasion is not considered in order to keep the subject of this paper tractable and because too many additional aspects would be involved[2]. Also, tax morale or experimental studies on tax compliance are beyond the scope of this paper[3].

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[2] See Andreoni, Erard and Feinstein (1998) for the authoritative survey, Feld and Frey (2007) or Kirchler (2007) for broader interdisciplinary approaches, or the papers by Kirchler, Maciejovsky and Schneider (2003), Kastlunger, Kirchler, Mittore and Pitters (2009), Kirchler, Hoelzl and Wahl (2007).

[3] The authoritative scientific work on tax morale is by Torgler (2007). See also Torgler (2002) for a survey on experimental studies and Blackwell (2010) for a meta-analysis.

My paper is organized as follows: Section 2 presents theoretical considerations about the definition and measurement of the shadow economy and also discusses the main factors determining its size. In Section 3, the empirical results of the size and development of the shadow economy are discussed. In Section 4, a discussion of the size and development of the shadow economy labor force is presented. Finally, Section 5 concludes.

II. Some theoretical considerations about the shadow economy

Defining the Shadow Economy

Up to today, authors trying to measure the shadow economy face the difficulty of a precise definition of the shadow economy.[4] According to one commonly used definition, it comprises all currently unregistered economic activities that contribute to the officially calculated Gross National Product.[5] Smith (1994, p. 18) defines it as "market-based production of goods and services, whether legal or illegal, that escapes detection in the official estimates of GDP". Put differently, one of the broadest definitions is: "... those economic activities and the income derived from them that circumvent or otherwise avoid government regulation, taxation or observation".[6]

In this paper, the following more narrow definition of the shadow economy is used.[7] The shadow economy includes all market-based legal production of goods and services that are deliberately concealed from public authorities for the following reasons:

1. to avoid payment of income, value added or other taxes,
2. to avoid payment of social security contributions,
3. to avoid having to meet certain legal labor market standards, such as minimum wages, maximum working hours, safety standards, etc., and
4. to avoid complying with certain administrative obligations, such as completing statistical questionnaires or other administrative forms.

Thus, I will not deal with typically illegal underground economic activities that fit the characteristics of classical crimes, such as burglary, robbery, drug dealing, etc. I also exclude the informal household economy, which consists of all household services and production.

[4] My paper focuses on the size and development of the shadow economy for uniform countries and not for specific regions. Recently, the first studies have been undertaken to measure the size of the shadow economy, as well as the "grey" or "shadow" labor force for urban regions or states (e.g. California). See, e.g. Marcelli, Pastor and Joassart (1999), Marcelli (2004), Chen (2004), Williams and Windebank (1998, 2001a, b), Flaming, Hayolamak, and Jossart (2005), Alderslade, Talmage and Freeman (2006), Brück, Haisten-DeNew and Zimmermann (2006). Herwartz, Schneider and Tafenau (2009) and Tafenau, Herwartz and Schneider (2010) estimate the size of the shadow economy of 234 EU-NUTS regions for the year 2004, demonstrating considerable regional variation in the size of the shadow economy.

[5] This definition is used, e.g. by Feige (1989, 1994), Schneider (1994a, 2003, 2005) and Frey and Pommerehne (1984). Do-it-yourself activities are not included. For estimates of the shadow economy and the do-it-yourself activities for Germany, see Buehn, Karmann und Schneider (2009) or Karmann (1986, 1990).

[6] This definition is taken from Dell'Anno (2003), Dell'Anno and Schneider (2004) and Feige (1989); see also Thomas (1999), Fleming, Roman and Farrell (2000) or Feld and Larsen (2005, p. 25).

[7] See also the excellent discussion of the definition of the shadow economy in Pedersen (2003, pp.13–19) and Kazemier (2005a), who uses a similar one.

Measuring the Shadow Economy[8]

The definition of the shadow economy plays an important role in assessing its size. By having a clear definition, a number of ambiguities and controversies can be avoided. In general, there are two types of shadow economic activities: illicit employment and in the household produced goods and services mostly consumed within the household.[9] The following analysis focuses on both types, but tries to exclude illegal activities, such as drug production, crime and human trafficking. The in the household produced goods and services, e.g. schooling and childcare are not part of this analysis. Thus, it only focuses on productive economic activities that would normally be included in the national accounts but which remain underground due to tax or regulatory burdens.[10] Although such legal activities contribute to the country's value added, they are not captured in the national accounts because they are produced in illicit ways (e.g. by people without proper qualifications or without a master craftsman's certificate). From the economic and social perspective, soft forms of illicit employment, such as moonlighting (e.g. construction work in private homes) and its contribution to aggregate value added can be assessed rather positively.

Although the issue of the shadow economy has been investigated for a long time, the discussion regarding the "appropriate" methodology to assess its scope has not yet come to an end.[11] There are three methods of assessment:

(1) Direct procedures at a micro level that aim to determine the size of the shadow economy at one particular point in time. An example is the survey method;
(2) Indirect procedures that make use of macroeconomic indicators in order to proxy the development of the shadow economy over time;
(3) Statistical models that use statistical tools to estimate the shadow economy as an "unobserved" variable.

Today in many cases the estimation of the shadow economy is based on a combination of the MIMIC procedure and on the currency demand method; or the use of only the currency demand method.[12] The MIMIC procedure assumes that the shadow economy remains an unobserved phenomenon (latent variable) which can be estimated using quantitatively

[8] Compare also Feld and Schneider (2010), Schneider (2011, 2014) and Schneider and Williams (2013).
[9] For a broader discussion of the definition issue, see Thomas (1992), Schneider, Volkert and Caspar (2002), Schneider and Enste (2002, 2006), Kazemier (2005a, b) and Buehn, Karmann and Schneider (2009).
[10] With this definition, the problem of having classical crime activities included could be avoided, because neither the MIMIC procedure nor the currency demand approach captures these activities: e.g. drug dealing is independent of increasing taxes, especially as the included causal variables are not linked (or causal) to classical crime activities. See, e.g. Thomas (1992), Kazemier (2005a, b) and Schneider (2005).
[11] For the strengths and weaknesses of the various methods, see Bhattacharyya (1999), Breusch (2005a, b), Dell'Anno and Schneider (2009), Dixon (1999), Feige (1989), Feld and Larsen (2005), Feld and Schneider (2010), Giles (1999a, b, c), Schneider (1986, 2001, 2003, 2005, 2006, 2011, 2014), Schneider and Enste (2000a, b, 2002, 2006), Tanzi (1999), Thomas (1992, 1999).
[12] These methods are presented in detail in Schneider (1994a, b, c, 2005, 2011), Schneider and Williams (2013), Feld and Schneider (2010) and Schneider and Enste (2000b, 2002, 2006). Furthermore, these studies discuss advantages and disadvantages of the MIMIC and money demand methods as well as other estimation methods for assessing the size of illicit employment; for a detailed discussion, see also Feld and Larsen (2005).

measurable causes of illicit employment, e.g. tax burden and regulation intensity, and indicators reflecting illicit activities, e.g. currency demand, official GDP and official working time. A disadvantage of the MIMIC procedure is the fact that it produces only relative estimates of the size and the development of the shadow economy. Thus, the currency demand method[13] is used to calibrate the relative into absolute estimates (e.g. as percentage of GDP) by using two or three absolute values (as percentage of GDP) of the size of the shadow economy.

In addition, the size of the shadow economy is estimated by using survey methods (Feld and Larsen (2005, 2008, 2009)). In order to minimize the number of respondents dishonestly replying or totally declining answers to the sensitive questions, structured interviews are undertaken (usually face-to-face) in which the respondents slowly become accustomed to the main purpose of the survey. As with the contingent valuation method (CVM) in environmental economics (Kopp et al. 1997), the first part of the questionnaire aims to shape respondents' perceptions to the issue at hand. In the second part, questions about respondents' activities in the shadow economy are asked, and the third part contains the usual socio-demographic questions.

In addition to the studies by Merz and Wolff (1993), Feld and Larsen (2005, 2008, 2009), Haigner et al. (2013) and Enste and Schneider (2006) in Germany, the survey method has been applied in the Nordic countries and Great Britain (Isachsen and Strøm, 1985, Pedersen 2003) as well as in the Netherlands (van Eck and Kazemier, 1988, Kazemier, 2006). While the questionnaires underlying these studies are broadly comparable in design, recent attempts by the European Union to provide survey results for all EU member states runs into difficulties regarding comparability (Renooy et al., 2004, European Commission, 2007): the wording of the questionnaires becomes more and more cumbersome depending on the culture of different countries with respect to the underground economy.

To summarize: Although each method has its strength and weaknesses, and biases in the estimates of the shadow economy almost certainly prevail, no better data are currently available. Clearly, there can be no exact measure of the size of the shadow economy and estimates differ widely, with an error margin of +/– 15 percent. These days, macro estimates derived from the MIMIC model, the currency demand method, or the electricity approach are seen as upper bound estimates, while micro (survey) estimates are seen as lower bound estimates.

[13] This indirect approach is based on the assumption that cash is used to make transactions within the shadow economy. By using this method, one econometrically estimates a currency demand function, including independent variables such as the tax burden, regulation, etc. which "drive" the shadow economy. This equation is used to make simulations of the amount of money that would be necessary to generate the official GDP. This amount is then compared with the actual money demand and the difference is treated as an indicator for the development of the shadow economy. On this basis, the calculated difference is multiplied by the velocity of money of the official economy and one gets a value added figure for the shadow economy. See footnote 11 for references critically discussing this method.

Theorizing about the Shadow Economy

A useful starting point for a theoretical discussion of the shadow economy is the paper by Allingham and Sandmo (1972) on income tax evasion. While the shadow economy and tax evasion are not congruent, activities in the shadow economy in most cases imply the evasion of direct or indirect taxes, such that the factors determining tax evasion will most certainly also affect the shadow economy. According to Allingham and Sandmo, tax compliance depends on its expected costs and benefits. The benefits of tax non-compliance result from the individual marginal tax rate and the true individual income. In the case of the shadow economy, the individual marginal tax rate is often roughly calculated using the overall tax burden from indirect and direct taxes including social security contributions. The expected costs of non-compliance derive from deterrence enacted by the state, i.e., the state's auditing activities raising the probability of detection and the fines individuals face when they are caught. Individual morality also plays a role for compliance and additional costs could pertain beyond the tax administration's pure punishment in the form of psychic costs like shame or regret, but also additional pecuniary costs if, for example, a reputation loss results.

Individuals are rational calculators who weigh the costs and benefits a legal status entails. Their decision to partially or completely participate in the shadow economy is a choice under uncertainty facing a trade-off between the gains if their activities are not discovered and a loss if discovered and penalized. Shadow economic activities SE thus negatively depend on the probability of detection p and potential fines f, and positively on the opportunity costs of remaining formal denoted as B. The opportunity costs are positively determined by the burden of taxation T and high labor costs W – the individual income generated in the shadow economy is usually categorized as labor income rather than capital income – due to labor market regulations. Hence, the higher the tax burden and labor costs, the more incentives individuals have to avoid those costs by working in the shadow economy. The probability of detection p itself depends on enforcement actions A taken by the tax authority and on facilitating activities F accomplished by individuals to reduce detection of shadow economic activities. This discussion suggests the following structural equation:

$$SE = SE\left[\underset{p}{-}\binom{+\ -}{A,F};\ \underset{f}{-};\ \underset{B}{+}\binom{+\ +}{T,W}\right]. \tag{1}$$

Hence, shadow economic activities may be defined as those economic activities and income earned that circumvent government regulation, taxation or observation. More narrowly, the shadow economy includes monetary and non-monetary transactions of legal nature, hence all productive economic activities that would generally be taxable were they reported to the state (tax) authorities. Those activities are deliberately concealed from public authorities to avoid payment of income, value added or other taxes and social security contributions, to avoid compliance with certain legal labor market standards, such as minimum wages, maximum working hours, or safety standards and administrative procedures. The shadow economy thus focuses on productive economic activities that would normally be included

in the national accounts but which remain underground due to tax or regulatory burdens.[14] Although such legal activities would contribute to the country's value added, they are not captured in the national accounts because they are produced in illicit ways. Informal household economic activities such as do-it-yourself activities and neighborly help are typically excluded in the analysis of the shadow economy.[15]

Kanniainen, Pääkönen and Schneider (2004) incorporate many of these insights in their model of the shadow economy. They hypothesize that tax hikes unambiguously increase the shadow economy, while the availability of public goods financed by taxes moderates participation in the shadow economy. The latter effect depends, however, on the ability to access those public goods. A shortcoming of this analysis is the neglected endogeneity of tax morale and good governance, which is addressed by Feld and Frey (2007), who argue that tax compliance is the result of a complicated interaction between tax morale and deterrence measures. It must be clear to taxpayers what the rules of the game are and, as deterrence measures serve as signals for the level of tax morale a society wants to elicit (Posner, 2000), deterrence may also crowd out the intrinsic motivation to pay taxes. Tax morale does not only increase if taxpayers perceive the public goods received in exchange for their tax payments. It may also decrease if individuals perceive political decisions for public activities or the treatment of taxpayers by the tax authorities to be unfair. Tax morale is thus not exogenously given but influenced by deterrence and the quality of state institutions. Table 2.2 presents an overview of the most important determinants influencing the shadow economy.

Table 2.1 presents an overview of the most important determinants influencing the shadow economy. Due to space reasons, there is no detailed discussion of the various determinants/causes of the shadow economy.

[14] Although classical crime activities such as drug dealing are independent of increasing taxes and the causal variables included in the empirical models are only imperfectly linked (or causal) to classical crime activities, the footprints used to indicate shadow economic activities such as currency in circulation also apply to classic crime. Hence, macroeconomic shadow economy estimates typically do not distinguish legal from illegal underground activities; rather they represent the whole informal economy spectrum.

[15] From a social perspective, maybe even from an economic one, soft forms of illicit employment, such as moonlighting (e.g. construction work in private homes) and its contribution to aggregate value added, may be assessed positively. For a discussion of these issues, see Thomas (1992) and Buehn, Karmann and Schneider (2009).

Table 1: The main causes determining the shadow economy

Causal variable	Theoretical reasoning	References
Tax and Social Security Contribution Burdens	The distortion of the overall tax burden affects labor-leisure choices and may stimulate labor supply in the shadow economy. The bigger the difference between the total labor cost in the official economy and after-tax earnings (from work), the greater the incentive to reduce the tax wedge and work in the shadow economy. This tax wedge depends on social security burden/payments and the overall tax burden, making them key determinants for the existence of the shadow economy.	E.g. Thomas (1992), Johnson, Kaufmann, and Zoido-Lobatón (1998a,b), Giles (1999a), Tanzi (1999), Schneider (2003, 2005), Dell'Anno (2007), Dell'Anno, Gomez-Antonio and Alanon Pardo (2007), Buehn and Schneider (2012)
Quality of Institutions	The quality of public institutions is another key factor for the development of the informal sector. The efficient and discretionary application of the tax code and regulations by the government play a crucial role in the decision to work underground, even more important than the actual burden of taxes and regulations. In particular, a bureaucracy with highly corrupt government officials seems to be associated with larger unofficial activity, while a good rule of law by securing property rights and contract enforceability increases the benefits of being formal. A certain level of taxation, mostly spent in productive public services, characterizes efficient policies. In fact, the production in the formal sector benefits from a higher provision of productive public services and is negatively affected by taxation, while the shadow economy reacts in the opposite way. An informal sector developing as a consequence of the failure of political institutions in promoting an efficient market economy, and entrepreneurs going underground, as there is an inefficient public goods provision, may reduce if institutions can be strengthened and fiscal policy comes closer to the median voter's preferences.	E.g. Johnson et al. (1998a,b), Friedman, Johnson, Kaufmann, and Zoido-Lobaton (2000), Dreher and Schneider (2009), Dreher, Kotsogiannis and Macorriston (2009), Schneider (2010), Buehn and Schneider (2012), Teobaldelli (2011), Teobaldelli and Schneider (2012), Amendola and Dell'Anno (2010), Losby et al. (2002), Schneider and Williams (2013)
Regulations	Regulations, for example labor market regulations or trade barriers, are another important factor that reduces the freedom (of choice) for individuals in the official economy. They lead to a substantial increase in labor costs in the official economy and thus provide another incentive to work in the shadow economy: countries that are more heavily regulated tend to have a higher share of the shadow economy in total GDP. Enforcement, and not the overall extent of regulation – mostly not enforced – is the key factor for the burden levied on firms and individuals, making them operate in the shadow economy.	E.g. Johnson, Kaufmann, and Shleifer (1997), Johnson, Kaufmann, and Zoido-Lobatón (1998b), Friedman, Johnson, Kaufmann, and Zoido-Lobaton (2000), Kucera and Roncolato (2008), Schneider (2011)

Continued on next page

Causal variable	Theoretical reasoning	References
Public Sector Services	An increase of the shadow economy may lead to fewer state revenues, which in turn reduces the quality and quantity of publicly provided goods and services. Ultimately, this may lead to increasing tax rates for firms and individuals, although the deterioration in the quality of the public goods (such as the public infrastructure) and of the administration continues. The consequence is an even stronger incentive to participate in the shadow economy. Countries with higher tax revenues achieved by lower tax rates, fewer laws and regulations, a better rule of law and lower corruption levels, should thus have smaller shadow economies.	E.g. Johnson, Kaufmann, and Zoido-Lobatón (1998a,b), Feld and Schneider (2010)
Tax Morale	The efficiency of the public sector also has an indirect effect on the size of the shadow economy because it affects tax morale. Tax compliance is driven by a psychological tax contract that entails rights and obligations from taxpayers and citizens on the one hand, but also from the state and its tax authorities on the other. Taxpayers are more heavily inclined to pay their taxes honestly if they get valuable public services in exchange. However, taxpayers are honest even in cases when the benefit principle of taxation does not hold, i.e. for redistributive policies, if such political decisions follow fair procedures. The treatment of taxpayers by the tax authority also plays a role. If taxpayers are treated like partners in a (tax) contract instead of subordinates in a hierarchical relationship, taxpayers will stick to their obligations of the psychological tax contract more easily. Hence, (better) tax morale and (stronger) social norms may reduce the probability of individuals working underground.	E.g. Feld and Frey (2007), Kirchler (2007), Torgler and Schneider (2009), Feld and Larsen (2005, 2009), Feld and Schneider (2010)
Deterrence	Despite the strong focus on deterrence in policies fighting the shadow economy and the unambiguous insights of the traditional economic theory of tax non-compliance, surprisingly little is known about the effects of deterrence from empirical studies. This is due to the fact that data on the legal background and the frequency of audits are not available on an international basis; even for OECD countries, such data is difficult to collect. Either the legal background is quite complicated, differentiating fines and punishment according to the severity of the offense and the true income of the non-complier, or tax authorities do not reveal how intensively auditing is taking place. The little empirical survey evidence available demonstrates that fines and punishment do not exert a negative influence on the shadow economy, while the subjectively perceived risk of detection does. However, the results are often weak and Granger causality tests show that the size of the shadow economy can impact deterrence instead of deterrence reducing the shadow economy.	E.g. Andreoni, Erard and Feinstein (1998), Pedersen (2003), Feld and Larsen (2005, 2009), Feld and Schneider (2010)

Continued on next page

Causal variable	Theoretical reasoning	References
Agricultural Sector	The importance of agriculture in the economy is included, since many studies endorse the idea that informal work is concentrated in highly segmented sectors, with clear prevalence for the agricultural and related sectors. One of the most important reasons for this is the minimum enforcement capacity of governments prevalent in rural areas. The importance of agriculture is measured as the share of agriculture as percentage of GDP. The larger the agricultural sector, the larger the expected size of the shadow economy, ceteris paribus.	E.g. Vuletin (2008), De la Roca, Hernandez, Robles, Torero and Webber (2002), Greenidge, Holder and Mayers (2005), Mootoo, Sookram and Watson (2002), Amendola and Dell'Anno (2010), Losby et al. (2002)
Development of the official economy	The development of the official economy is another key factor of the shadow economy. The higher (lower) the unemployment quota (GDP-growth), the higher the incentive to work in the shadow economy, ceteris paribus.	Schneider and Williams (2013), Feld and Schneider (2010)
Self-employment	The higher self-employment is, the more activities can be done in the shadow economy, ceteris paribus.	Schneider and Williams (2013), Feld and Schneider (2010)

III. Size of shadow economies all over the world[16]

Figure 3.1 shows the average size of the shadow economy of 162 countries over the period 1999–2007. In tables 3.1 und 3.2, the average informality (unweighted and weighted) in different regions is shown using the regions defined by the World Bank. The World Bank distinguishes eight world regions: East Asia and Pacific, Europe and Central Asia, Latin America and the Caribbean, Middle East and North Africa, High Income OECD, Other High Income, South Asia, and Sub-Saharan Africa. If we first consider table 3.1, where the average informality (unweighted) is shown, we see that Latin America and the Caribbean have the highest value shadow economies, at 41.1%, followed by Sub-Saharan Africa, at 40.2%, followed by Europe and Central Asia, with 38.9%. The High Income OECD countries have the lowest, with 17.1%. If we consider the average informality of the shadow economies of these regions weighted by total GDP in 2005, Sub-Saharan Africa has the highest, with 37.6%, followed by Europe and Central Asia, with 36.4% and Latin America and the Caribbean, with 34.7%. Again, the High Income OECD has the lowest, at 13.4%. If one considers the world mean weighted and unweighted, one sees that, if one uses the unweighted measures, the mean is 33.0% over the period 1999–2007. If we consider the world with weighted informality measures, the shadow economy takes "only" a value of 17.1% over the period 1999–2007. Weighting the values makes a considerable difference.

One general result of the size and development of the shadow economies worldwide is that there is an overall reduction in the size. In figure 3.2, the size and development of the shadow economy of various country groups (weighted averages by the official GDP of 2005) over 1999, 2003 and 2007 are shown. One clearly realizes that, for all country groups (25 OECD countries, 116 developing counties, and 25 transition countries), a decrease in the size of the shadow economy can be observed. The average size of the shadow economies of the 162 countries was 34.0% of official GDP (unweighted measure!) in 1999 and decreased to 31.2% of official GDP in 2007. This is a decrease of almost 3.0 percentage points over nine years. Growth of the official economy with reduced (increased) unemployment (employment) seems to be the most efficient means to reduce the shadow economy.

[16] Some figures are taken from Schneider, Buehn and Montenegro (2010). The econometric MIMIC estimation results are not shown here due to space reasons; see, e.g. Schneider, Buehn and Montenegro (2010).

Table 2: Average Informality (Unweighted) by World Bank's Regions

	Region	mean	median	min	max	sd
EAP	East Asia and Pacific	32.3	32.4	12.7	50.6	13.3
ECA	Europe and Central Asia	38.9	39.0	18.1	65.8	10.9
LAC	Latin America and the Caribbean	41.1	38.8	19.3	66.1	12.3
MENA	Middle East and North Africa	28.0	32.5	18.3	37.2	7.8
OECD	High Income OECD	17.1	15.8	8.5	28.0	6.1
OHIE	Other High Income	23.0	25.0	12.4	33.4	7.0
SAS	South Asia	33.2	35.3	22.2	43.9	7.0
SSA	Sub-Saharan Africa	40.2	40.6	18.4	61.8	8.3
World		33.0	33.5	8.5	66.1	12.8

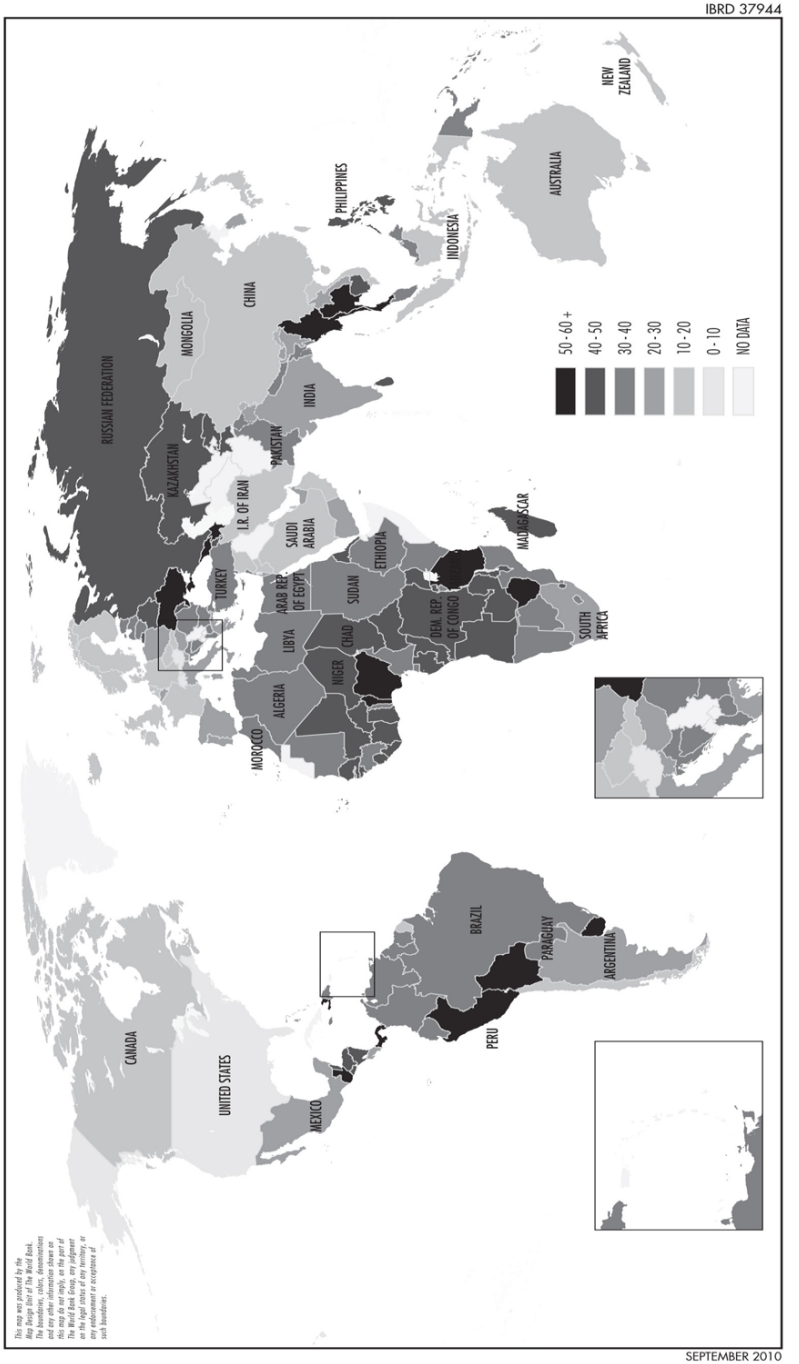
Source: Schneider, Buehn and Montenegro (2010)

Table 3: Average Informality (Weighted) by Total GDP in 2005

	Region	mean	median	min	max	sd
EAP	East Asia and Pacific	17.5	12.7	12.7	50.6	10.6
ECA	Europe and Central Asia	36.4	32.6	18.1	65.8	8.4
LAC	Latin America and the Caribbean	34.7	33.8	19.3	66.1	7.9
MENA	Middle East and North Africa	27.3	32.5	18.3	37.2	7.7
OECD	High Income OECD	13.4	11.0	8.5	28.0	5.7
OHIE	Other High Income	20.8	19.4	12.4	33.4	4.9
SAS	South Asia	25.1	22.2	22.2	43.9	5.9
SSA	Sub-Saharan Africa	37.6	33.2	18.4	61.8	11.7
World		17.1	13.2	8.5	66.1	9.9

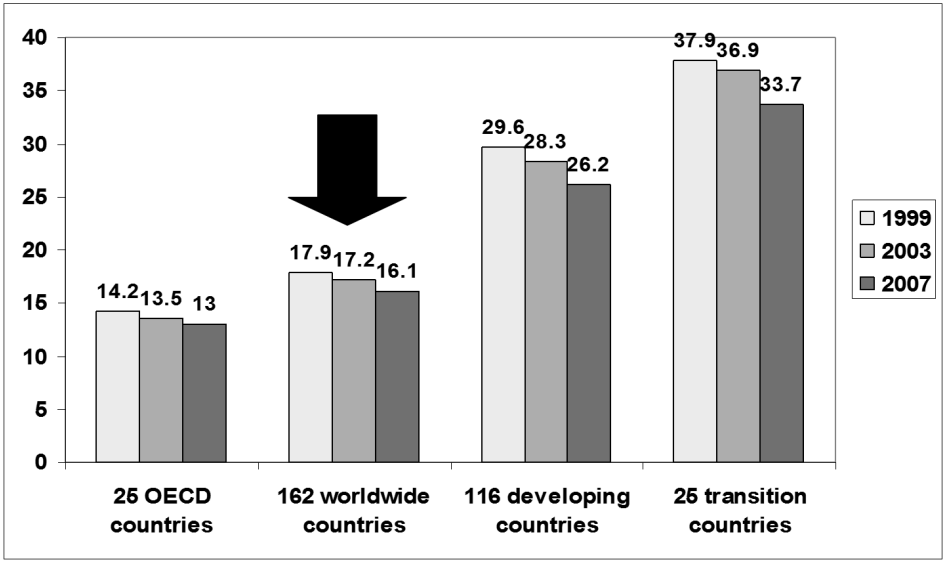
Source: Schneider, Buehn and Montenegro (2010)

Figure 1: Average Size of the Shadow Economy of 162 Countries over 1999–2007



Source: Schneider, Buehn and Montenegro (2010)

Figure 2: Size and Development of the Shadow Economy of Various Country Groups (Weighted Averages (!); as percentage of official total GDP of the respective Country Group)



Source: Schneider, Buehn and Montenegro (2010)

IV. Shadow Economy Labor Force

The following results of the shadow economy labor force are based on the OECD and World Bank database on informal employment in major cities and in rural areas, as well as on other sources mentioned in the footnotes of this chapter and the tables. The values of the shadow economy labor force are calculated in absolute terms, and as a percentage of the official labor force, under the assumption that the shadow economy in rural areas is at least as high as in the cities. This is a conservative assumption, since in reality it is likely to be even larger.[17] Survey techniques and, for some countries, the MIMIC method and the method of the discrepancy between the official and actual labor force are used for estimation.

One of the most famous studies is the OECD (2009a, b) one titled "Is informal normal?", which provides worldwide figures. This OECD study[18] concludes that, in many parts of the world and over the period 1990 to 2007, informal employment was the norm, not the exception. More than half of all jobs in the non-agricultural sectors of developing countries – over 900 million workers – can be considered informal. If agricultural workers

[17] The assumption that the shadow economy labour force is at least as high in rural areas as in major cities, is a very modest one and is supported by Lubell (1991). Some authors (e.g., Lubell (1991), Pozo (1996), and Chickering and Salahdine (1991)) argue that the illicit labour force is nearly twice as high in the countryside as in urban areas. But since no (precise) data exists on this ratio, the assumption of an equal size may be justified by arguing that such a calculation provides at least minimal figures.

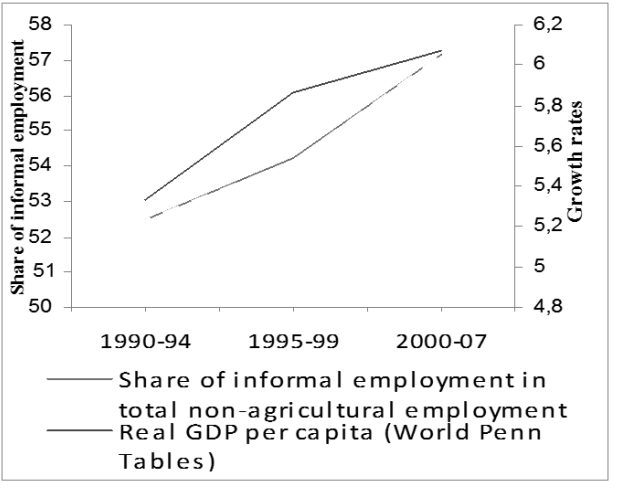
[18] The following results and figures are taken from the OECD (2009a, b), executive summary.

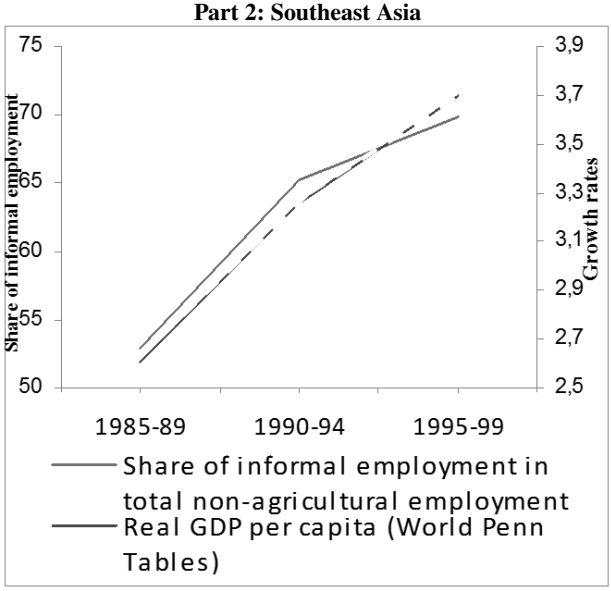
in developing countries are included, the estimates come out at roughly 2,000 million people. The share of informal employment is also shown in figure 4.1 for Latin America and South East Asia. In some regions, including Sub-Saharan Africa and South Asia, over 80% of non-agricultural jobs are informal. Most informal workers in the developing world are self-employed and work independently, or own and manage very small enterprises. According to the OECD study (2009a, b), informal employment is a result of both people being excluded from official jobs and people voluntarily opting out of formal structures, e.g. in many middle income countries, incentives drive individuals and businesses out of the formal sector.

To summarize, this OECD study clearly comes to the conclusion that informal is really the norm or the normal case. 1.8 billion people work in informal jobs, compared to 1.2 billion who benefit from formal contracts and social security protection. Informal economic activity, excluding the agricultural sector, accounts for three-quarters of the jobs in Sub-Saharan Africa, for more than two-thirds in South and South East Asia, half in Latin America, the Middle East and North Africa, and nearly one-quarter in transition countries. If agriculture is included, the informal share of the economy in the abovementioned regions is even higher (e.g. more than 90% in South Asia). Also, this OECD study arrives at the result that more than 700 million informal workers "survive" on less than $1.25 a day and some 1.2 billion on less than $2 a day. The study also concludes that the share of informal employment tends to increase during economic turmoil. For example, during the Argentine economic crisis (1999–2002), the country's "official" economy shrank as by almost one-fifth while the share of informal employment expanded from 48 to 52 percent. One can clearly see that, even under conditions of strong economic growth, the share of non-agricultural employment and the share of informal employment is strongly rising.

Figure 3: Informal Employment and GDP in Latin America and Southeast Asia

Part 1: Latin America





Source: OECD, Is Informal Normal, Paris, 2009a, b.

In table 4.1, the share of informal employment in total non-agricultural employment over a five-year period and by region is presented. From the table, one clearly sees that in all regions the share of informal employment has remarkably increased over time. The share of informal employment in South- and Middle-American countries in the period 1985–1989 was 32.4% and increased in the period 2000–2007 to 50.1%. In 34 Asian countries, informal employment rose in the period 1985–1989 from 55.9% to 70.2% from 2000 to 2007. In the 42 African countries, the share of informal employment (as a percentage of total non-agricultural employment) was 40.3% from 1985–1989, and increased to 60.5% in 2000–2007. Table 4.1 clearly demonstrates that there is a very strong positive trend in the share of informal employment (as a percentage of total non-agricultural employment).

Table 4: Share of Informal Employment in Total Non-Agricultural Employment by five-year period in %

Region	Average Share of Informal Employment in % of Local Non Agricultural Employment over			
	1985–89	**1990–94**	**1995–99**	**2000–07**
22 South- and Middle American Countries	32.4	35.4	40.3	50.1
34 Asian Countries	55.9	60.4	65.4	70.2
42 African Countries	40.3	47.1	52.4	60.5
21 Transition Countries	30.9	32.3	35.4	40.2

Source: OECD 2009a, b, pages 34–35; and Charmes (2002, 2007, 2008) for the ILO Women and Men in the Informal Economy, 2002. Note: For the most recent period: Heintz and Chang (2007) for the ILO, and for West Asia: Charmes (2007 and 2008).

V. Conclusion

In this paper, some of the most recent developments in research on the shadow economy and undeclared work in highly developed OECD, developing and transition countries are shown. The discussion of the recent literature shows that economic opportunities for employees, the overall situation on the labor market, not least unemployment, are crucial for an understanding of the dynamics of the shadow economy. Individuals look for ways to improve their economic situation and thus contribute productively to the aggregate income of a country. This holds regardless of whether they are active in the official or the unofficial economy.

A further question is: What type of policy conclusions can I draw? One conclusion may be that – besides the indirect tax and personal income tax burden, which the government can directly influence by policy actions – self-employment and unemployment are two very important driving forces of the shadow economy. Unemployment may be controllable by the government through economic policy in a traditional Keynesian sense; alternatively, the government can try to improve the country's competitiveness to increase foreign demand. The impact of self-employment on the shadow economy is less or only partly controllable by the government and may be ambiguous from a welfare perspective. A government can deregulate the economy or incentivize "be your own entrepreneur", which would make self-employment easier, potentially reducing unemployment and positively contributing to efforts aimed at controlling the size of the shadow economy. Such actions, however, need to be accompanied by a strengthening of institutions and tax morale to reduce the probability that the self-employed shift reasonable proportions of their economic activities into the shadow economy, which, if it happened, would make government policies incentivizing self-employment less effective. This paper clearly shows that a reduction in the shadow economy can be achieved using various channels the government can influence. The main challenge is still to bring shadow economic activities into the official economy in such a way that goods and services previously produced in the shadow economy are still produced and provided, but rather in the official economy. Only then can the government get additional taxes and social security contributions.

Finally, if I ask myself what we know about the shadow economy and work in the shadow, I clearly realize that we have some knowledge about the size and development of the shadow economy and the size and development of the shadow economy labor force. For developing countries, the shadow economy labor force has reached a remarkable size, according to OECD (2009 a, b) estimates, which is that, in most developing countries, the shadow economy labor force is greater than the official labor force. What we do not know are the exact motives, why people work in the shadow economy and what is their relation and feeling if a government undertakes reforms in order to bring them back into the official economy. Hence, many more micro studies are needed to obtain more detailed knowledge about people's motivation to work in either the shadow economy and/or in the official one.

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EUROPEAN ASSOCIATION COMENIUS

Protecting Human Rights Through Fundamental Principles of Administrative Procedures in Eastern Europe

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Abstract

Administrative procedures (APs) are tools to protect fundamental human rights in state-citizen relations. As the modernization of public administration regulation is undergoing a transformation in the direction of reducing detailed rules on APs and, by the same token, emphasizing fundamental or general principles, research on the development and the state of the art of administrative principles in the general administrative procedure acts (APAs) of selected Eastern Europe countries with a common heritage of Austrian law dating back to 1925 (Slovenia, Croatia, Macedonia and the Czech Republic) was carried out. The normative-comparative analysis reveals differences in approaches to and the pace of APAs reform and content; some countries are taking a more radical approach, mainly by following good governance dimensions. Convergence based on Council of Europe and EU initiatives is also evident. Classical guarantees against the misuse of power (principles of legality, equality, proportionality, rights of defense, etc.) are therefore crucial. The most progress seems to have been made by Croatia and the Czech Republic; by focusing on partnerships in administrative-legal relations in the sense of good administration, these two countries have, among other things, set a trend for other countries to follow.

Keywords

Administrative Procedures, Eastern Europe, Good Governance, Human Rights, Principles, Rule of Law

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I. Introduction

Human Rights Protection in Administrative Relations

The historical conflict between the interests of the state and the citizen has led to an ever-evolving process of human rights protection in law and practice. In the time of absolute monarchies, the authority executed its powers *ex imperio* with no acknowledgment of individual rights, as the latter were unilaterally subordinate to the state. The existing regulations were intended to support the state apparatus and the execution of its powers. These trends changed with the rise of the bourgeoisie, wherein the French revolution (1789–1799) was a milestone. This was a very important event for the development of administrative law and the origins of individual rights. One result of the French Revolution was the codification of human rights in the Declaration of the Rights of Man and of the Citizen. The Declaration codified basic principles that established new approaches to the state-citizen relation as a fundamental administrative relation, for example: *"The Law has the right to forbid only those actions that are injurious to society."*[4] The precondition for the rule of law and the freedom of the individual and his/her human rights and fundamental freedoms is the separation of powers; this was already recognized by Montesquieu (1689 to 1755).[5]

As a counterweight to absolutism and a police state (*Polizeistaat*), a conception of the rule of law (*Rechtsstaat*) rooted in the Age of Enlightenment was also outlined by nineteenth-century German writers. Initially (up to the twentieth century), the idea concentrated on legal formalism and was linked to a bureaucratic apparatus which guaranteed the functioning of the system. But with World War II and the Nazi regime, which abused the law by adopting tyrannical rules, the idea of *Rechtsstaat* had to be significantly changed to include not only formal legality (which is important for procedural safeguards) but also the constitutionally recognized protection of human rights under the supervision of the constitutional court and furthermore good (public) governance.[6] This doctrine is of major importance within the research presented in this paper since most of the states in the area of Eastern Europe were once under German and Austrian influence in the administrative field (Slovenia, the Czech Republic, and Croatia). The German understanding of the rule of law is more closely related to the separation of powers and to administration being bound by law than the American one, for example[7]. *Rechtsstaat* implies the elimination of arbitrary authority and is the ideal of the democratic state. Yet in order to implement the concept of the rule of law, a legalistic approach (e.g. the constitutional provision on the independence of judges) does not suffice and it is necessary to examine and act appropriately in the implementation of legal norms in practice. In this framework the administrative procedures in most of Eastern Europe are understood as concrete decision-making in individual matters

[4] And: *"Nothing that is not forbidden by Law may be hindered, and no one may be compelled to do what the Law does not ordain"* (Article 5). Furthermore, Article 12: *"To guarantee the Rights of Man and of the Citizen a public force is necessary; this force is therefore established for the benefit of all, and not for the particular use of those to whom it is entrusted."* English version source available at Britannica Academic (2014).

[5] Kerševan (2008).

[6] Ziller (2009, cop. 2007), cf. Pollitt and Bouckaert (2011).

[7] Cf. Künnecke (2007), Pavčnik (2009).

only (so-called *adjudication* or *Verwaltungsverfahren*, as opposed to general policies decision-making)[8]. The core of administrative constitutional and supranational law is due process or fair trial. Administrative procedural law was historically developed in the individual states primarily to protect the fundamental human rights of parties in relation to the (mis)use of power by administrative authorities (as *constitutional law in action*[9]).
The authors have put forth the hypothesis that administrative procedural law principles are a tool for making operational the basic constitutional safeguards for the protection of individual human rights from the abuse of power when deciding on administrative matters. Fundamental principles, such as the principles of legality, proportionality and equality, are the product of societal development over time and are inextricably linked to the promotion and protection of human rights. Principles therefore represent the fundamental values valid for a certain space and time in society. The mutual influence of the legal orders of different national systems is evident throughout history and becomes even more evident after World War II, when international organizations to promote the protection of human rights, such as the United Nations and the Council of Europe, were established. Fundamental principles are the core interpretative instrument of legal rules and as such they are a source of and guideline for human rights protection. The corpus of fundamental principles is not a status quo, but an ever-evolving process that is also linked to technological progress. In the last century, the technological progress that made the most visible impact on society has been the Internet, which enabled many different kinds of e-communication and necessitated the regulation thereof and with it the promotion of principles of participation, transparency, efficiency, removing administrative burdens, i.e. principles of good administration. With the overall globalization process taking part in different segments of society, including law, and on the basis of the similar historical background of the selected Eastern European states, we defend the idea that a convergence of administrative procedure regulation is taking place and promoting those same values which are enshrined in fundamental principles.

Research Question and Research Methodology

Administrative procedure (AP) is one of the most important instruments through which parties can receive substantive rights in relation to the state. One of the goals of its codification is to ensure procedural standards for the parties and protect their rights (procedural as well as substantive). Fundamental principles as a guideline on the interpretation of legal rules are important and common to all legal branches (principles of legality such as proportionality and equality are already commonly recognized by constitutions). Furthermore, administrative law, with its sub and supra position of party and authority, demands certain "special" (or with certain modifications for the executive branch) principles, such as substantive truth, the protection of public interest, independence, etc.
The central research question is whether fundamental principles of APs are important for the protection of human rights. Therefore we studied the following research sub-questions: firstly, the setting up of a model of fundamental principles of good administration and

[8] Cf. Rusch (2009), Galligan, Langan, and Constance (1998).
[9] See Künnecke (2007).

good governance as deriving from different international documents, presenting basic pool of values to be followed by APs' regulation. Secondly, the identification of existing fundamental principles in APs' codification in selected states, and thirdly, the assessment of their relevance for human rights protection. The authors investigated the level of human rights protection in APs regulation of Croatia, the Czech Republic, Slovenia and the Former Yugoslav Republic of Macedonia (hereinafter referred to as Macedonia), focusing on variations and similarities/differences among the states and pace of progress achieved after the downfall of communist regimes in the 1990s with the influence of joining (or being in the process of joining) the supranational authority of EU, and the promoting of modern approaches.

The sample of countries was chosen based on the facts as follows. The selected states are similar – compared to the majority of Western European states – in terms of size (they are relatively small), political culture, politicization, macro-economic criteria, etc. They all belong to the so-called continental Europe state tradition, in which state dominates society and the understanding of public administration has its roots in public law – this understanding emphasizes the role of the state and parliamentary legislation in defining policy over and above society.[10] One of the reasons for these similarities is a common historical background. Croatia, the Czech Republic and Slovenia were all part of the Austro-Hungarian empire, which bequeathed a certain level of common legacy to all three states. Furthermore, in 1925, Austria was regarded as the first country to successfully codify AP (after a Spanish attempt to codify it in 1889). Selected countries in its geographical neighborhood and with a previous common legacy, took over the Austrian model of APs regulation (Czechoslovakia in 1928 and Yugoslavia in 1930). There was a consequent Austrian influence also on Macedonia, whose territory became part of the Kingdom of Yugoslavia in 1929. Later, the sample of countries was identified by all four countries being influenced by communist government after the World War II, with Czechoslovakia having been under Soviet influence, while the other three were under the common Yugoslavian socialist system. Since the 1990s, these countries have been aiming at the modernization of their regulation and development of democracy, being also influenced by efforts to join the EU and its demands for the modernization of legal order, the signing of the European Convention on Human Rights, etc. All four countries are therefore "New Democracies" and part of a convergence wave. However, the research question is to what extent the abovementioned circumstances have influenced the regulation of fundamental principles of APs as human rights promoters and identifying commonalities and divergences among the compared states.

In order to identify the latter, an analysis of general laws on administrative procedures in four selected states was carried out, with the research focusing on the introductory provisions that regulate fundamental principles. They are as follows:

- *Zakon o splošnem upravnem postopku*, Slovene APA (Official Gazette No. 80/99 and amendments);

[10] Loughlin, Hendriks and Lindström (eds.) (2011).

- *Zakon o opštem upravnom postupku*, Macedonian APA (Official Gazette No. 38/05 and amendments);
- *Zákon č. 500/2004 Sb., správní řád* (Act. No. 500/2004 Coll., Administrative Procedure Code);
- *Zakon o općem upravnom postupku*, Croatian APA (Official Gazette No. 47/09).

For the purposes of the performed research, different methodologies were applied. In the introductory chapters, we used descriptive methodology giving an overview of the idea of the rule of law and the origins of human rights protection, with a short historical introduction and the notion of the Germanic and Anglo-Saxon system, placing administrative procedural law in the role of human rights guardian in relation to administrative authorities. Using the historical method, we analyzed the development of generations of human rights over time with defining types of human rights relevant for each generation. Subsequently, a comprehensive overview of good governance and good administration concepts is given by means of a normative-analytical as well as historical method. Using a systematic approach, the authors analyzed major international documents over time and, by means of methods of deduction and synthesis, drew up a set of principles as a model for the setting up of fundamental principles of APs. From the set of most common principles distinctive for each concept, classical constitutional safeguards and managerial and modern principles were identified by typological method. Based on legal theory, the authors explained the basic characteristics of principles and their relation to rules. In the second part of the article, the authors used a historical and normative-analytical as well as comparative method to analyze AP regulation in selected states, using a macro approach to first define AP codifications in general and their extent of use. Furthermore, the fundamental principles of APs were analyzed on a micro level. With the use of the deductive method, normative analysis and analysis of content fundamental principles were identified of a classical and managerial/modern nature, as deriving from APs of selected states. Their content was compared and interpreted, using methods of analogy and deduction as well as typology. Finally, using the axiological-deontological method, principles as promoters of human rights protection in APs were defined. In the conclusion a synthesis of the findings was performed.

II. Protection of Human Rights and Public Interest in Administrative Procedures

An authority in a given time and space defines the public interest to be followed in a certain state. As a precondition for a democratic state, public interest should be justified on the basis of commonly recognized values and the needs of the society in question. Protection of human rights should be a component of this interest. In theory, different generations of human rights can be distinguished, in line with changes in the development of society over time. The protection of citizen and political rights (such as freedom of movement, personal dignity, the inviolability of human life) is typical of the first generation.[11] These so-called

[11] The main relevant international document is the International Covenant on Civil and Political Rights (1966, UN General Assembly).

rights of negative status demand *negative status duties* of the state, meaning that the state should suspend its intervention in the field of the beneficiaries of these rights. Nevertheless, a certain degree of state action (and, to this extent, also positive duties) is expected for effectively ensuring these rights. The second generation of human rights is characterized by social and economic rights.[12] These are rights of positive status, meaning that active action is expected of the state. The state should establish actual and legal conditions for individuals to be able to enjoy and execute these rights. Theory further delineates a third generation of collective rights deriving from the collective right to self-determination, and a fourth generation, which was the result of the development of post-industrial features (for example, the right to a healthy living environment). The last two groups are often acknowledged in administrative procedures.[13]

Administrative procedures are a means for providing principles of good administration and as such they establish an important part of the quality of public administration.[14] The latter is a prerequisite for political and economic performance.[15] Furthermore, administrative procedure is nowadays the fundamental business process of public administration and aims to improve the rationality of its functioning through the alteration of statutes regulating administrative procedure, among other things in the sense of eliminating administrative barriers to the increased effectiveness of public policies.[16] Despite tendencies towards a more partner-oriented relationship between the state and citizens (for example, mediation, administrative contracts, public-private partnership, etc.), the main, distinctive feature of state-citizen relations still remains the superiority of public interest over private interests. The functioning of the state and especially of its executive powers is regulated by administrative law (substantive and adjective). As part of its formal aspect, administrative procedure is a tool for the creation and implementation of public policies in the development of states. The trend goes from strict authoritative functioning to the modernization of administrative procedures, i.e. partnership. The modern state is therefore more oriented towards the user of public services and being a partner with the individual party[17] within the framework of the protection of public interest and the interest of third parties. At the end of the 1980s, several private-sector principles and methods were introduced in the public sector as a result of the evolution of new public management (NPM) which emphasized the efficiency of management, democracy and user orientation. NPM principles were put into force to a different extent in states and include privatization, decentralization, deregulation, new forms of responsibility and efficiency measurement.

[12] The main relevant international document relevant is the International Covenant on Economic, Social and Cultural Rights (1966).

[13] Lampe (2010).

[14] According to Rusch (2011), the current principles of good administration are reliability and predictability (respecting the rule of law, also by discretion decision-making; also decision-making in a reasonable timeframe); openness and transparency (use of simple, clear language; encouragement of participation of everyone affected by a decision; right to be heard); accountability (supervision by other branches of authority; possibility of legal remedies; giving reasons for a decision; access to files, etc.); judicial control system and effectiveness and efficiency.

[15] *Ibid*.

[16] Kovač (2011).

[17] Schuppert (2000).

New trajectories have been identified in terms of: 1) NPM (with elements such as a shift from internal towards external orientation towards meeting citizens' needs, performance indicators and market type mechanisms, decentralization and privatization, etc.); and 2) the Neo-Weberian state (NWS, with elements such as the reaffirmation of the state and representative democracy, preserving basic principles of administrative law, impartiality and hierarchy in the public service as a distinctive function in society) – even as a global convergence.[18] As a theory and practice, NPM in particular and NWS were a key source for the *doctrine of good governance* or New Public Governance (NPG) concept. According to this doctrine, the state should only ensure authority and the protection of general social benefit, but the state itself is not the only holder of this authority (development from the authoritative, centralized to the service, decentralized function of state, partnerships and networks). The good governance concept derived mainly from the private sector; it was introduced in 1990 by the World Bank and the emphasis at the time was on economic aspects (the connection between the quality of the system of state rule and the capacity to achieve sustainable economic and social development), while democratic aspects were not involved. Later, the concept was taken up by different international organizations and came to include democratic aspects.[19]

A trend of change from the top-down, unilateral behavior of public authorities in their relation to citizens to a more horizontal relationship with characteristics of a client relationship[20] (as in the private sector) and new values in administrative decision-making/the regulation of administrative services, such as transparency, simplicity, clarity, participation, responsiveness and towards citizen-oriented performance[21] can be detected in recent decades. Another attempt at a less top-down approach was the adoption of the European Commission's White Paper on European Governance[22], which concerns the way in which the EU uses the powers given to it by its citizens and establishes five principles of good governance: openness, participation, accountability, effectiveness and coherence. The main goal was the greater involvement of citizens/organizations in EU policy making. As stated in the white paper, these five principles are important for establishing more democratic governance and supporting democracy and the rule of law in member states; furthermore, they apply to all levels of government (global, European, national, regional and local).[23] According to SIGMA[24], the key components of good governance are: rule of law; the principles of reliability, predictability, accountability and transparency; technical and managerial competence; organizational capacity and citizen participation. *Principles of public administration* were derived from these key components; they were

[18] Pollitt and Bouckaert (2011).
[19] Venice Commission (2011), cf. Pollitt and Bouckaert (2011).
[20] The development of partner-oriented public administration was also a result of a critique of Weber's more or less rigid model of hierarchically organized and legally bound public administration.
[21] Rusch (2011).
[22] European Commission (2001). The definition given in the White Paper: *"Governance means rules, processes and behaviour that affect the way in which powers are exercised at European level, particularly as regards openness, participation, accountability, effectiveness and coherence."*
[23] *Ibid*.
[24] SIGMA (1999, hereinafter referred to as SIGMA). Specifically on transparency on openness in Savino (2010).

further defined through the jurisprudence of national courts and the European Court of Justice and are now seen as *public administration standards*. According to SIGMA[25], the main administrative principles common to Western European countries can be divided into four groups: legal certainty; openness and transparency; accountability; efficiency and effectiveness. Especially recently, increasing emphasis was also placed on the rationality and efficiency of administrative procedures in Eastern Europe, either in terms of implementing public interest or the mission of administrative bodies or in terms of, e.g. economic development, mitigation of economic crisis, improving investment capacities, etc.[26] Therefore, a good administration as a well-functioning bureaucracy is one with the capacity to support the government and its partners in steering the society and the economy toward collective goals, being democratic, pursuing the rule of law and accountability in the broadest sense.

The right to good administration as a narrower, legal concept based on procedural rights is part of good governance doctrine.[27] The concept of good administration can already be detected in Resolution (77)[28] on the Protection of the Individual in Relation to the Acts of Administrative Authorities[29], which regulated the right to be heard, access to information, assistance and representation, statement of reasons and indication of remedies. In 2007, on the basis of the European Code of Good Administrative Behaviour (2001) and Resolution (77)31, Recommendation CM/Rec(2007)7 of the Committee of Ministers to member states on good administration was adopted. The Recommendation contains a Code of Good Administration (Code); it takes the view that good administration is one of the aspects of good governance and instructs member states (not just the EU, but the wider circle) to promote good administration within the principles of rule of law and democracy. The Code sets rules regarding the issuing of administrative decisions, appeals and compensation and promotes nine principles of good administration: lawfulness, equality, impartiality, proportionality, legal certainty, taking action within a reasonable time limit, participation, respect of privacy and transparency.[30]

Furthermore, the Charter of Fundamental Rights of the European Union was adopted in December 2000, initially as a Recommendation and later, in 2010, as an obligatory primary law.[31] In Article 41, it regulates the right to good administration as one of citizens' fundamental rights. The right originally derived from the case-law of the Court of Justice of the European Union and the General Court and was initially binding as a fundamental legal principle.31 According to Article 41, it demands the impartial, fair handling of affairs within a reasonable timeframe and includes the right to be heard, the right to have access to files, the obligation to give reasons for a decision, the right to use official EU

[25] *Ibid*.
[26] Rusch (2009).
[27] Venice Commission (2011).
[28] Mendes (2009).
[29] Adopted by the Committee of Ministers on 28.9.1977.
[30] In Continental Europe, the principle of transparency was initially implemented only by means of APAs (thus as "procedural" transparency), during the last two decades; however, procedural transparency has been complemented with the spread, all over Europe, of Freedom of Information Acts (Savino (2010)).
[31] OJ C 83/389, 30.3.2010.

languages and the right to compensation for damages caused by institutions/their servants while performing their duties. To explain the meaning of the right to good administration in practice, the European Code of Good Administrative Behaviour (European Code) was adopted in 2001 through a resolution of the European Parliament. The right to good administration is today a fundamental right consisting of a set of individual rights and obligations aimed at preventing arbitrary administrative behavior in the European Union. The European Code represents the concretization of these individual rights and obligations.[32]

In Table 1, some of the main international documents that provide guidelines on public administration (PA) for national systems' performance are analyzed, with a focus on the concepts of good governance (GG) and good administration (GA). From the elements included in the concept of GG, we can confirm the assertion that this concept is of a broader nature and also includes political dimensions linked to economic growth and social resources.[33] The basic principles included in GG are more abstract and general (coherence, for example) and contain not only procedural requirements, but also substantive requirements explicitly demanding human rights protection. Furthermore, this concept involves more managerial principles; besides transparency, participation, effectiveness and efficiency, which are common to both concepts, technical and managerial competence, organizational capacity, accountability, simplification of procedures and responsiveness to people's needs are addressed. On the other hand, the concept of GA promotes the procedural aspects of PA performance to a greater extent, i.e. use of language, the right to be heard, assistance and representation, reasoning and indication of legal remedies. It also includes compensation for damages, which partly overlaps with ethical behavior, combating corruption and accountability, all of which are typical of GG.

Naturally, the concept of GA is more orientated towards human rights protection than the concept of GG, since the former notion derives from the *Rechtsstaat* doctrine while the latter promotes effective policy-making as well. However, the Venice Commission research[34] of 2011 explicitly included in the GG concept the presumption that GG also encompasses GA as a narrower, legal concept, with the protection of human rights as one of its typical independent elements. As indicated in Table 1, certain key principles overlap and are basically the same, for example, rule of law includes the principles of lawfulness, impartiality, proportionality and certainty; equity is connected to equality, fairness and non-discrimination. Furthermore, both concepts promote participation and decision-making in a reasonable timeframe, and these are inextricably connected to the principles of efficiency and effectiveness included in both GG and GA. There is, however, no one-way definition of either concept, meaning that their content can vary between different stakeholders. Nonetheless, the data presented in Table 1 include a set of the most common contents of the concepts of GG and GA and should serve as a model for setting up fundamental principles of administrative procedures.

[32] Mendes (2009), Hirsch-Ziembińska (2007).
[33] Venice Commission (2011).
[34] *Ibid.*

Table 1: Good Administration & Governance Concepts as a Basis for establishing Principles of Administrative Procedures

Concept	Selected Documents	Issuer Year	Principles: a) Classical constitutional safeguards b) *Managerial and modern NPM and NPG/GG/GA principles*
Good Administration	European Convention on Human Rights	Council of Europe 1950	a) 1. Principle of lawfulness; 2. Equality, fairness, non-discrimination; 3. Impartiality, proportionality, certainty, 4. The right to be heard, access to information, respecting privacy; 5. Use of language; 6. Assistance and representation; 7. Reasoning and indication of remedies; 8. Compensation of damages. b) 1. Participation; 2. Transparency; 3. Effectiveness, efficiency, taking action within a reasonable time limit.
Good Administration	Resolution (77)31 on the Protection of the Individual in Relation to the Acts of Adm. Authorities	Council of Europe 1977	
Good Administration	European Code of Good Administrative Behaviour	European ombudsman (EU) 2001, 2005	
Good Administration	Recommendation CM/Rec(2007)7 to member states on good administration	Council of Europe 2007	
Good Governance	European Principles for Public Administration (Paper No. 27)	SIGMA (OECD) 1999	a) 1. Human rights protection; 2. Rule of law; 3. Reliability and predictability; 4. Coherence; 5. Equity; 6. Ethical behavior; 7. Combating corruption; 8. Decision-making in reasonable time. b) *1. Transparency, openness, participation; 2. Technical and managerial competence; 3. Organizational capacity; 4. Accountability, effectiveness, efficiency; 5. Simplification of procedures; 6. Responsiveness to people's needs.*
Good Governance	White Paper on European Governance	European Commission (EU) 2001	
Good Governance and Good Administration	Stocktaking on the Notions of GG and GA (Study no. 470/2008, CDL-AD(2001)009)	Venice Commission (Council of Europe) 2011	*Combining all GG & GA principles.*

Source: selected documents as deriving from Table 1

The rights to be exercised in administrative procedures are typified by their positive status, meaning certain activity is also expected of the parties (for example, to receive social assistance in cash, the party needs to submit an application to the respective public authority). Parties are bound to and dependent on the state/local authorities in enforcing their rights and also when authorities impose obligations upon them; consequently, respect for human rights is of great importance in these procedures as well. Most countries (Austria (1925), Yugoslavia (1956), Poland (1960), Hungary (1957), Czech Republic (1967,

2004), Germany (1976), Italy (1990), Slovenia (1999), Croatia (2009), Macedonia (2005)) adopted a statute governing administrative procedure, and this serves as a tool for the self-limitation of authority.[35] Others developed rules on administrative procedure through case law and different parts of legislation without having a statute explicitly regulating administrative procedure (e.g. Belgium, France, United Kingdom, Ireland).[36] Regulation is aimed at protecting parties from the abuse of power in decision-making about administrative and other public matters. Regulation of this kind is a sign of a democratic regime and is extremely important for the protection of the individual's position, since it enables the predictability of public authorities' conduct. By means of administrative procedures, parties have several procedural safeguards which guarantee democratic procedures and the implementation of constitutionally ensured safeguards against the abuse of power. The main principles for enabling the protection of human rights and fundamental freedoms in administrative procedures are the separation of powers, legality, and equality before the law and proportionality.[37] These principles are usually already enshrined in the constitution. In general, legal principles are of great importance for all branches of law, administrative law being no exception. They present value-based criteria on how to behave in different legal relations, including administrative-legal ones. Principles give decision-makers the possibility of evaluating and estimating the relevance and use of legal rules in concrete case situations.[38] Rules define ways of behaving and acting, in contrast to principles, which do not have such a distinctive one-way definition of behavior.[39] In accordance with the principle of legality, the authorities are strictly bound to the legislation in force, which is abstract and general so as to achieve the widest possible circle of addressees. It would be irrational to expect all life situations to be covered by legislation; additionally, within the existing legal rules, decision-makers often come across situations where the applicability of a certain rule is not clearly defined. Fundamental principles are the core interpretative instrument to be used in such cases.[40] Although legal principles are in a sense "blank concepts" and, as such, somewhat elusive, theory and practice recognize them as being very important for lawmaking and enforcement.[41] Theoreticians like Dworkin and Esser see in principles not just an instrument to be applied when we need to define the use of a certain legal rule, but also legal guidance which operates on the same level as legal rules and has a direct impact on everyday judicial decision-making.[42] Principles are no longer viewed as being of subsidiary relevance, but must be used by judges simultaneously with rules.[43]

[35] Statskontoret (2005).
[36] Cf. Rusch (2009), Statskontoret (2005).
[37] Grafenauer and Breznik (2009).
[38] Pavčnik (1997).
[39] For more about theory on principles, see Ávila (2007).
[40] More in Pavčnik (1997).
[41] SIGMA (1999).
[42] Novak (2010).
[43] Cf. ibid.

III. Regulation of AP in selected Eastern European States

The Enactment and Scope of AP in Selected States

Taking into account their common historical background and geographical position, we decided to compare the regulations on administrative procedures in the Republic of Slovenia, the Republic of Croatia, the Former Yugoslav Republic of Macedonia and the Czech Republic. These states represent a very interesting combination of legal systems influenced by both western and eastern approaches. They were all influenced by the Germanic legal system, particularly the Austrian legal model,[44] and also by the socialist regime following World War II. We could say that history partly repeats itself, in the sense that these states were all part of some kind of federation in the past, strived for independence in the 1990s, and are now coming "back together" under the wings of the European Union: Slovenia and the Czech Republic have been members since 2004, Croatia joined in July 2013 and Macedonia is a candidate country. All these states are (being) Europeanized in a sense as they adopt certain European features.[45] National reactions to EU "pressures"[46] resulted *inter alia* in changes of the administrative systems of these states (so-called administrative Europeanization)[47]. Organization of national administration is in principle not part of *acquis* but the White Paper of 1995[48] stressed the importance of administrative capacity for implementing the *acquis*. As a result, several reforms of the administrative system of these states took place. Individual reforms in Slovene public administration and the whole series of activities carried out in this regard may be considered successful if the criteria for assessment are the objectives set in the reform documents and comparative indicators in the EU or other countries based on good administration and governance concepts. However, reforms were designed and carried out rather legalistically, with no functional analysis and a lack of political coordination.[49] In Croatia, public administration reform has gone through numerous reforms; nevertheless, the main priority at all levels has always been the decentralization of tasks and structures. Major progress has been made in the area of legislation in order to improve public administration efficiency.[50] Macedonia has gone through a period of complex economic, political and administrative development since gaining independence in 1991. As a result, a number of strategic and action plans have been adopted and implemented. One of the greatest concerns has been the high "politicization of the public service". In December 2010, the new Strategy on Public Administration Reform (2010–2015) was adopted and the main results are expected to be in

[44] According to Schwarze (1992), Ziller (2009, cop. 2007) and Statskontoret (2005), in terms of good administration four traditions of administrative law may be identified in Europe (and more broadly): 1) the administration-centered tradition, as in France, 2) the individual-centered tradition, as in the UK, Ireland, and the US, 3) the German-Austrian legislator-centered Rechtsstaat, and 4) the ombudsman-centered tradition, as in Scandinavia.

[45] Petrov and Kalinichenko (2011). See also Olson (2002), and Radaelli and Featherstone (eds.) (2003).

[46] Iancu (2012).

[47] Hadjiisky (2009).

[48] European Commission (1995).

[49] Kovač (2013).

[50] Nikolov (2013).

the areas of public finances, HRM, e-government and management and corruption.[51] The reform of public administration in the Czech Republic started immediately after the Velvet Revolution of November 1989. The central state administration reform started many years after the public administration reform on local and regional tiers was completed and the reform processes and goals were not only because of the admission of the Czech Republic to the EU.[52] The reform process is far from being completed and many of the important reforms introducing modern approaches to public administration have been started only recently.[53]

As far as administrative procedure is concerned, all four states have an Austrian administrative procedure regulation model in common. Namely, Austria adopted its law on administrative procedure at an early date, in 1925, and was followed by Czechoslovakia in 1928 and the Kingdom of Yugoslavia in 1930. The beginnings of the administrative procedure regime in the territory of Slovenia date back even further, to 1923. In 1946, the first law on general administrative procedure in Yugoslavia was abolished, and a new federal law was enacted in 1956.[54] In the interim period, procedural provisions of different laws, and partly also of sectoral laws, were applied. During the over 40 years it was in force, the federal law was amended only four times (in 1965, 1977, 1978 and 1986).

The Republic of Slovenia became independent in 1991 and succeeded the legal order of the former Yugoslavia to an extent which was in accordance with the new state regime. The General Administrative Procedure Act (GAPA) was therefore taken over as a "Slovenian law". Only in 1999 did the Republic of Slovenia adopt a new act (which entered into force in 2000); it was still based on the Yugoslavian one but introduced certain changes (the use of APA also for public service providers when deciding on rights/obligations; the subsidiarity principle; redefinition of legal principles; reduction of legal remedies, etc.)[55] with the aim of adapting the regulation to the new organization of the state and the new market-driven societal environment. In just 14 years, the Slovenian GAPA has already been amended nine times (see Table 2) with a focus on the need to reduce administrative burdens and the introduction of new technologies (the exchange of data from official records by civil servants, e-communication, renunciation of the right to appeal, the right to access to files and access to public information, etc.). Its volume is still extensive, with 325 articles. With a view to reducing administrative burdens, a new amendment entered into force in March 2014. The main anticipated change is the demand that officials fill out a form instead of parties. The authors are slightly skeptical about the actual need for and benefits of such changes and also feel that they bring up questions of the liability of officials, in the sense that new disputes could arise between the authorities and parties.

[51] *Ibid*.
[52] Vidláková (2006).
[53] Hladík, Kopecký (2013).
[54] Koprić (2005).
[55] More in Kovač (2011).

The Republic of Croatia also became independent in 1991 and took over the Yugoslav GAPA. In April 2009, a new GAPA was adopted, and it entered into force on 1 January, 2010.[56] To date (in the last three years) there have been no amendments. Croatia certainly took longer than Slovenia to enact a new GAPA, but this "delay" resulted in far more new, modern approaches and half the articles. Some of the novelties are the introduction of new or certain amendments of existing principles; the regulation of administrative contracts; the "silence means consent" institute (if explicitly foreseen by the law); the amendment of the legal remedy system (the introduction of objection for administrative contract disputes and actions of public authorities and public service providers); e-communication, etc. In view of the APA's novelties, the amendment of sectoral regulation is now needed as an alignment process, especially since the new APA does not explicitly define its subsidiary application.[57] The Croatian GAPA definitely took an interesting approach, combining traditional regulation (such as the Yugoslavian GAPA) and modern approaches.

The Former Yugoslav Republic of Macedonia became independent in 1991 and also took over the Yugoslavian GAPA of 1956. In 2005, the Macedonian Law on General Administrative Procedure (LGAP) was enacted; it has since been amended twice, in 2008 and 2011. The LGAP of 2005 was more or less the continuation of the Yugoslavian GAPA with a few minor changes, such as new principles and delivery methods.[58] The main novelties introduced through the 2008 amendments were the shortening of deadlines for decisions in administrative matters (15 days for simple matter (previously one month) and 30 days for complex cases (previously 60 days)) and the removal of the two-level decision rule; the right to an appeal became a possibility that can be prescribed by the GAPA or substantive laws[59] and the "silence means consent" mechanism was introduced.[60] The 2011 amendment further developed this mechanism and defined civil servants' obligation to gather all documents from official records. To introduce the "silence means consent" principle, the Macedonian Parliament amended over 130 laws. However, the complex appeals system still undermines the application of this principle.[61] One of the priorities of the Macedonian government is the modernization of the public administration system, within which administrative procedure reform is one of the most important parts. Administrative procedures are still seen as too lengthy and unnecessary.[62] In 2010, the "Public Administration Reform Strategy 2010–2015" was adopted, and in March 2012 the European Commission and Macedonian government launched the High Level Accession

[56] The first draft of the new GAPA was prepared as a result of the CARDS 2003 project: Support to the Public Administration and Civil Service Reform.

[57] Hus and Katić Bubaš (2011).

[58] Davitkovski and Pavlovska-Daneva (2009). Public Administration Reform Strategy 2010–2015, Republic of Macedonia, 2010, hereinafter referred to as Public Administration Reform Strategy 2010–2015.

[59] Public Administration Reform Strategy 2010–2015. This amendment was made to implement constitutional change, which allowed an appeal or *other legal protection* against first-instance administrative acts, meaning that a direct administrative dispute against first-instance decision was possible (Davitkovski and Pavlovska-Daneva (2009)).

[60] Todevski (2011).

[61] European Commission (2012). For the functioning of the "silence means consent" mechanism, see Todevski (2011), Davitkovski and Pavlovska-Daneva (2009).

[62] Todevski (2011).

Dialogue (HLAD), which is aimed at promoting the EU accession reform process, with public administration reform being one of five priority policy areas. One of the results of the first HLAD session was the government's decision to elaborate a new Law on General Administrative Procedure (LGAP), since a good LGAP is a precondition for quality and legally correct administrative decisions; administrative procedures are in turn important for good administrative behavior, serving the community, promoting social trust in the executive branch, political stability, social wealth and economic development.[63]

The disintegration of Yugoslavia was followed in 1993 by the splitting-up of the Czechoslovak Federal Republic, whereby the Czech Republic became independent and adopted a new constitution (already in December 1992). Part of Czech constitutional law[64] is the Charter of Fundamental Rights and Basic Freedoms, which was taken over from the former legal order. Since 2004, the Czech Republic has been a member of the European Union. Similarly to the ex-Yugoslav states, the development of public law in the Czech Republic was strongly influenced by Austrian law and after 1950 also by the Soviet system. After 1989, important changes were initiated, with an emphasis on fundamental human rights and freedoms.[65] Administrative procedure was codified in Czechoslovakia in 1928, also following the Austrian codification of 1925. Administrative procedure was enacted in 1967, and was amended several times, especially during the 1990s.[66] In 2004, a new Administrative Procedure Code was enacted (it entered into force in January 2006) with the aim of simplification.[67] The nature of the code is subsidiary, and it was followed by more than one hundred special regulations. As can be seen below in Tables 2 and 3, the Code takes certain modern approaches, such us public contract regulation, issuance of measures of a general nature, complaints against inappropriate conduct of persons in authority, etc.

From the comparison shown in Table 2, we can conclude that there are certainly commonalities among the APAs of all the selected states. Typical of all four is the scope of APAs for issuing individual concrete administrative acts when public authorities (state, local/regional authorities and other subjects when partaking in authoritative decision-making) decide in the field of administrative law. Moreover, it is directly evident that more recent laws (even when it is a matter of just a couple of years) incorporate more modern approaches with a broader scope, including agreements and administrative contracts and the general design and implementation of administrative acts; Croatia and the Czech Republic are role models for this approach. The APAs compared here also simultaneously regulate these procedures on a more abstract level and seek to provide principles for (overly)

[63] SIGMA (2012).
[64] Having the same force as the constitution (see Pouperová, 2014).
[65] Staša and Tomášek (2012).
[66] Statskontoret (2005).
[67] Besides this Code, there is also other legal regulation on administrative processes that deals with different activities of administrative bodies. For more on these activities and about particular regulation of administrative procedure, see Staša and Tomášek (2012). Furthermore, the tax and charges regulation is completely autonomous, meaning the administrative procedure code does not apply. Slovenia, on the other hand, enacted a special Act on Tax Procedure in 2006, which has been amended several times and has a total of 424 articles; nevertheless, the General APA is still applied in accordance with the principle of subsidiarity.

detailed operational rules. Such a flexible approach allows for the greater incorporation of a broader spectrum of life events under the regulation and does not require constant amendment, which could decrease legal certainty and the transparency of the regulation.

Table 2: The Enforcement and Scope of APAs in Selected States

State	Enforcement /Codification	No. of Art.	Scope of Application/Regulation
Slovenia	2000 / 1999 Am.: 2000, 2002, 2004, 2005, 2006, 2007, 2008, 2010, 2013	325	Issuing individual administrative acts (deciding about concrete administrative-legal relations); use of GAPA when deciding on other public matters for which special procedures have not been enacted[68] (Art. 1–4).
Macedonia	2005 / 2005 Am.: 2008, 2011	302	Issuing individual administrative acts in administrative matters (i.e. all acts and activities through which public administration authorities are represented and executed) (Art. 1 and 2).
Czech Republic	2006 / 2004	184	The process of administrative authorities[69] when issuing decisions to constitute, alter or cancel rights and/or duties of particular persons in particular cases/issuing decisions declaring that a person does not have rights/duties in a particular case (Sec. 9). Contentious proceedings, disputes arising from public contracts, disputes arising from civil, labor, family or business legal relations (only when provided by special statute) (Sec. 141). Proceedings to determine a legal relationship (Sec. 142). Issuing statements, certificates, notifications (Sec. 154–158). Public contracts (Sec. 159–170). Issuing measure of general character (Sec. 171–174).[70]
Croatia	2010 / 2009	171	Issuing individual administrative acts; administrative contracts; for the protection of the rights/legal interests of parties when public service providers decide on their rights/obligations/legal interests[71]; any other activity of public administration bodies in the field of administrative law that directly affects the rights, obligations or legal interests of parties (Art. 1–3).

Source: APAs of compared states

[68] Minimal procedural safeguards should be ensured also in these matters (e.g. misdemeanors, disciplinary procedures, etc.).

[69] Authorities of the executive branch of the government, of regional self-governing units and other authorities when performing competences in the field of public administration (see Section 1).

[70] In general, the APA does not apply to civil, business, or labor legal actions performed by administrative authorities, etc. (Section 1/3). For the scope of application of the Czech APA, see also Staša and Tomášek (2012): the current concept of administrative procedure regulation in the Czech Republic is focused on *activities of the administrative body* and not on the persons to whom the conduct is directed. The issuing of measures of a general character is only one instance of procedure; the measure can be subject to judicial review by administrative courts (Staša and Tomášek (2012)).

[71] If no judicial or other legal protection is prescribed by law (see Hus and Katić Bubaš (2011): a school's decision on children's diet, a doctor prescribing incorrect treatment to a patient).

Notions of European convergence in Eastern Europe

Over the course of history, each country has developed its own administrative system within its legal tradition, which is why the EU allowed differences in the administrative legal systems of its member states. Convergence developed through different acts (conventions, recommendations, declarations, and directives) that prescribe general principles, standards of public administration (reliability, predictability, openness, transparency, responsibility, efficiency, economy, effectiveness, participation of citizens, etc.)[72], based, among other things, on the common legal tradition and democracy of member states. Therefore it is not surprising that to date there has not been a coherent codification of administrative law for the EU, but only some fragmented regulation. A special role in the field of shaping (European) administrative law has been given to the case law of the Court of Justice. From it, legal principles governing administrative activity in European Union law have been derived. In its case law, the court relied on the unwritten general principles common to the constitutional/administrative traditions of member states.[73] However, "European administrative law" is a relatively new branch of law; in a narrow sense it represents administrative law for the EU, and in a broader sense the approximation of the administrative laws of member states on the one hand and of the EU on the other.[74] The core of European administrative law is a combination of principles of legality, proportionality, and legal certainty, protection of legitimate expectations, non-discrimination and fair administrative process and effective judicial review.[75]

The comparative overview of the selected regulations revealed that the administrative procedures share a large number of common institutes. This is to be expected, since in all four states the codification of administrative procedures has Austrian roots (the law of 1925 being a model) and since they all fall under civil system law and the Germanic continental legal space. Furthermore, all the states decided to join the European Union, with Slovenia and the Czech Republic joining in 2004, Croatia joining in 2013 and Macedonia being a candidate country. The harmonization of a national legal system with the EU *acquis communautaire* is one of the preconditions for successful accession to the EU.

In comparison to other EU countries, all four states examined here have a very long tradition and history of administrative procedure codification. Namely, most EU member states enacted (or modified) administrative procedure only after the 1990s.[76] This is definitely a result of societal changes and not only reflects the fundamental need for the protection of the public interest and the protection of individual rights, but also pronounced partnership tendencies which require greater flexibility in public decision-making. Administrative procedure is especially important for different segments of business processes (such as establishing a company, taxes, public-private partnership, etc.); this is particularly true of the EU, where members' free market rights also influence countries' economic growth. Although this long tradition of AP codification is a sign of a democratic approach to

[72] Davitkovski and Pavlovska-Daneva (2010).
[73] Schwarze (2011).
[74] *Ibid*.
[75] Schwarze (2011).
[76] Statskontoret (2005).

regulation and the rule of law, it can also lead to some rigidity and inflexibility. That is not entirely bad, since only copying ideas and solutions from other (especially western) countries' legal systems is not necessarily the most effective approach to change. A country's legal tradition and history is a very important part of its "legal identity" and intrusive, alien interventions can produce even less effective conduct or become mere nice-looking legal institutes on paper that are never used. Both are ultimately unproductive. Each change in regulation should therefore be carefully thought through and multidisciplinary research (from at least a legal and economic perspective) should be conducted beforehand. It does seem – from a subjective standpoint, of course – that most Eastern European countries are rushing headlong into the European Union, taking over its legal order without much resistance for the sake of successful accession. Most of these countries are still young democracies in terms of the length of the period in which they have been independent; thus certain deviations in the effectiveness of public administration activities are normal. Namely, the process of evolving a legal order is also affected by society itself, especially by its values and "ripeness". Therefore the enhancement of the public administration system is an ever-evolving process in each country, and as such requires its own time and space. The Croatian and Czech APAs are definitely already taking modern approaches with new institutes, such as public contracts, the regulation of abstract acts, etc. With the new APA it is preparing, Macedonia has a great opportunity to enhance its regulation. Until now, Slovenia was satisfied with the APA of 1999, although there has been a tendency to patch it up every few years with certain novelties. Yet there are murmurings of the adoption of a completely new law which could possibly take the simplification approach (a shorter law with less formalistic regulation and greater flexibility), although the questions to be asked here are how much discretion will be given to public administration and is society, in light of its low degree of trust in the rule of law, ready to put a greater degree of trust in public authorities. In the authors' view, one of the main guidelines for possible changes in any kind of regulation in any state in the future should be to enact clear regulation that is understandable to the average population (keeping in mind the simplicity of procedures) and marked by continuation (i.e. not subject to change with each change of government – this applies especially to sectoral regulation).

IV. Principles in Administrative Procedure Acts as a Way to Ensure Human Rights

Principles are the fundamental value base of any legal regulation to be followed in its design and interpretation in any legal procedure. Administrative procedure is the main process of public administration and an instrument of democracy aimed at protecting (interested) parties in their interactions with authoritative decision-making. Administrative procedural law principles are a traditional tool of democracy whose purpose is to make operational the basic constitutional safeguards for the protection of individuals from the abuse of power. Procedural guarantees are therefore important for the protection of fundamental rights and freedoms. Furthermore, the protection of fundamental, constitutional rights is inextricably linked to correct administrative procedure.[77] A basic guideline for the regulation of

[77] Schwarze (2004).

administrative procedures was given in 2005 by SIGMA, which stated *general principles of administrative activity* (such as legality, impartiality, procedural fairness with timeliness, openness and transparency, accountability and liability, scope of the law and interested parties) and *principles governing administrative procedure*: definition of administrative activity, form of AP (general and special regulations of AP), the commencement of AP, language, evidence, hearing of the interested parties, time limits and reinstatement, termination, administrative silence and retrial. However, certain fundamental principles are usually already defined by the constitution and not always repeated in GAPA. The latter of course does not diminish their legal validity.[78] The overview of the APAs compared here showed that the majority of the abovementioned (general) administrative principles as set by SIGMA in 2005 are present, some as fundamental principles, others as rules.

Regulation of fundamental administrative principles is typically part of the introductory provisions of APAs, which apply to administrative procedure as a whole. APAs or sectoral regulation can also define certain special principles which are used in certain parts/types of procedure. With the exception of the Croatian APA, the APAs examined here explicitly recognize the "principle" of subsidiarity (Czech APA: Section 1/2; Macedonian APA: Article 3; Slovene APA: Article 3), meaning provisions of the General APA, including principles, are also applied in special administrative procedures.[79] Article 3/1 of the Croatian APA, on the other hand, explicitly requires the use of the GAPA in all administrative matters except in certain individual questions of administrative procedure which can be regulated differently in other statutes if this is necessary for certain administrative fields and not in contradiction with the GAPA (it provides no direct ordinance for the subsidiary use of GAPA).[80] Despite the lack of a direct ordinance, such a rule can still be derived from a substantive definition of administrative matters that requires the use of GAPA whenever the authority decides on a right/obligation or legal benefit of a party in a field of administrative law where the actual or at least potential existence of a conflict between the public and private interest may occur.

In Table 3, we identified two groups of principles: 1) classical, such as the notion of human rights protection and 2) managerial and modern, such as indicators of concepts of NPM, GG and GA. Such a classification is based on overall public management and governance features, types of reforms and politico-administrative regimes, setting a framework for administrative procedures as well. Namely, the trends of reforms are focusing, in different countries and time periods, on: 1) classical, *Rechtsstaat* and public interest protection based reforms, and 2) reforms, prioritizing NPM/NPG principles, such as effectiveness, performance orientation, transparency, accountability, etc.[81] However, some of these principles are rather difficult to categorize as such, since they emerge in different perspectives and legal or policy frameworks and papers as a classical safeguard or/and modern standard – typically the principle of transparency or openness.[82]

[78] Cardona (2005), Statskontoret (2005).
[79] Cf. Statskontoret (2005).
[80] Hus and Katić Bubaš (2011).
[81] Pollitt and Bouckaert (2011).
[82] Savino (2010).

Nevertheless, for the purpose of this study we identified a total of 13 principles in the classical group. Number one was the principle of legality, which in its broadest sense also includes principles of predictability, finality, impartiality and proportionality (see numbers 1–4 in Table 3). These principles are an essential part of the rule of law and a precondition of any democratic state, as they constitute a procedural presumption for human rights protection. Continuing, classical principles ensuring participation of the interested parties are included in the first group, i.e. protection of affected persons' rights, assistance, hearing and right to defense, use of language, data access and protection and the right to legal remedy. Within these principles, only one duty is imposed upon the interested parties: the duty to speak the truth and the fair use of rights. Otherwise they impose obligations upon the authority so as to ensure the (human) rights protection of parties, which are in an a priori weaker, subordinate position and as such need to be protected (for example, substantive truth and the timeliness of decision-making, see numbers 8, 10 and 12 in Table 3).

In restructuring the vision of the authorial state and its functions, the need to introduce managerial practices into public administration has been an important objective in Eastern European countries since the 1990s – most often because of external supranational incentives (EU, OECD, and World Bank). Given the specific socio-political and economic circumstances of that time, the primary goal of introducing NPM in those countries was in fact quite different from those pursued in older democracies, since the latter primarily see NPM as a tool for upgrading democratic system making, while the former mostly applied it as a tool for stimulating effective and efficient ways of a democratic system in general, and only later on for modernization and adaptation purposes. Hence, we identified a total of only four principles of a managerial and modern nature in the Macedonian and Czech regulations. Both of these regulations promote public administration as a service to the public, demanding polite behavior and the satisfaction of the needs of the affected persons when possible. The Macedonian APA also explicitly mentions the accountability of the authorities. The Czech APA goes even further, including the right to complaint about the inappropriate conduct of persons in authority or against the proceeding of an administrative authority (Section 175) and introducing the principle of the mutual cooperation of administrative authorities in the interest of good administration (Section 8/2). In theory, some of the basic principles of the Czech APA are seen as the projection of general legal principles onto positive law.[83] Some principles are derived from the Constitution and the Charter of Fundamental Rights and Freedoms, such as the principle of Section 2/4 ("the adopted solution should be in accordance with public interest, administrative authority complies with circumstances of the particular case and there should be no groundless differences when deciding factually identical/comparable cases"), which introduces the principles of predictability and stability in decision-making. Czech jurisprudence understands them as the principle of (protection of) legitimate expectations (predictability of a decision) or as the principle of justified confidence in the procedures of public administrative authorities; they are also understood as the equality of addressees, the prohibition of the abuse

[83] Staša and Tomášek (2012).

of discretion and the requirement to reason a decision.[84] The principle of equality also derives from Section 7, which states the equal status of affected persons' procedural rights and demands the performance of procedural duties in the same manner from all affected persons. The principles of activities of administrative authorities as enshrined in Sections 2–8 correspond to a considerable degree to the principles of good governance.[85]

Based on the normative analysis in Table 3, a number of similarities in all four APAs can be detected; on the other hand, there are also some differences. The principles identified as common to all four states are the principles of legality, equality, impartiality, objectivity/independence, proportionality, protection of public interest, protection of parties' rights, protection of the economy/effectiveness of procedures, ascertaining the case without reasonable doubt/substantive truth and the right to legal remedy (appeal).

Table 3: Principles in APAs of Selected States[86]

No.	**Principles:** **1–13 Classical (protection of HR)** ***14–17 Managerial and modern (GG and GA)***	**Slovene** (Art. 6–14)	**Macedonian** (Art. 4–19)	**Czech** (Sec. 2–8, 81–, 175)	**Croatian** (Art. 5–14)
1	Legality	**x**	**x**	**x**	**x**
2	Predictability and stability of decision-making/ Protecting rights attained by the parties/ Finality/ Legal effectiveness of the decision		**x**	**x**	**x**
3	Equality, impartiality and objectivity/ Independence	**x**	**x**	**x**	**x**
4	Proportionality in protection of parties' rights and public interest	**x**	**x**	**x**	**x**
5	Protection of affected persons' rights/ Assistance/ Equality	**x**[87]	**x**	**x**	**x**
6	Notification of the affected persons and right of defense/ Hearing	**x**	**x**	**x**	
7	Official use of languages and scripts / Alphabet		**x**		**x**
8	Ascertaining the case without reasonable doubt/ Substantive truth	**x**	**x**	**x**	**x**
9	Data access and protection				**x**
10	Independence/discretionary evaluation in assessing evidence	**x**	**x**		**x**
11	Duty to speak the truth and fair use of rights/ Notify administrative authorities about on-going public procedures	**x**		**x**	
12	Bringing decisions without unnecessary delays/ Economy and urgency of the procedure/ Efficiency	**x**	**x**	**x**	**x**

Continued on next page

[84] Skulová, Husseini, Vrbová, and Prokopová (2011).

[85] *Ibid*.

[86] The content of the table focused on the introductory provisions of APAs that regulate fundamental principles of administrative procedures. Although some of the principles are not strictly mentioned in these provisions and may therefore not be marked in Table 3, they might be defined in later APAs provisions or other regulation (like the constitution, the Public Administration Act, the Law on Free Access to Information of Public Sector, etc.). Table 3 does not include certain Slovene and Macedonian APA institutes regulated in the basic principles chapter, such as the definition of administrative matter, authorities' obligation to use the APA, definitions of authority/civil servant and subsidiary application of law. (Cf. also Hus and Katić Bubaš (2011), and Skulová, Husseini, Vrbová, and Prokopová (2011)).

No.	**Principles:** **1–13 Classical (protection of HR)** ***14–17 Managerial and modern (GG and GA)***	**Slovene** (Art. 6–14)	**Macedonian** (Art. 4–19)	**Czech** (Sec. 2–8, 81–, 175)	**Croatian** (Art. 5–14)
13	Usually two-instance administrative procedure when issuing individual decisions/ Right to appeal/Legal remedy[88]	**x**	**x**[89]	**x**	**x**
14	*Accountability*		**x**		
15	*Mutual cooperation of administrative authorities in the interest of good administration*			**x**	
16	*Public administration is a service to public/ Service orientation*		**x**	**x**[90]	
17	*Right to complaint against inappropriate conduct of persons in authority or against the proceeding of administrative authority*			**x**	

Source: APAs of compared states

Most of the common principles in the Slovenian, Croatian and Macedonian APAs can be viewed as a consequence of the previous Yugoslavian APA (see Table 3). Macedonia also kept some principles which the Slovene and Croatian APAs excluded, such as accountability, final decision and the legal effectiveness of the decision. These institutes are not defined as general principles in the other countries' APAs, but they are derived from other provisions or other systemic regulation (for example, the Slovenian Civil Servants Act, Public Administration Act, etc.) or are already defined by the constitution (i.e. liability for damages, legal effectiveness (Articles 26 and 158 of Slovenian Constitution)). Croatia introduced some new principles in 2009, such as the principle of the right of parties to legal remedy (which includes multiple remedies: complaint, objection against public contracts or other activities of a public body/public service provider and administrative dispute) and the principle of data access[91] and protection, which gives parties the right to access data, Internet pages, forms and professional advice/help. The principle of the hearing of the party (or any affected person with a legal interest) is no longer explicitly expressed in general provisions, although it can still be derived from later APA provisions (for example Articles 30, 52). The Czech APA sets it as the right of defense (Section 4/3 and 4/4). The Slovene (Article 9) and Macedonian (Article 10) APAs took over the Yugoslavian principle of parties' right to express themselves before a decision is issued. Another important dimension of parties' participation rights is the use of languages/alphabets/scripts, which is defined in all the regulations: in Macedonia and Croatia as part of the introductory provisions, in the Czech (Section 16) and Slovenian (Article 62) APAs as rules of procedure.

[87] Part of the principle of protection of parties' rights and public interest (Article 7).

[88] Final decision is subject to judicial review in all four states (cf. Staša and Tomášek (2012)).

[89] With the 2008 amendment, the right to appeal became only an option, not a necessity – being regulated by law, meaning a two-instance rule is not basic principle of APA, although still enshrined in the chapter on Basic Principles (Davitkovski and Pavlovska-Daneva (2009)).

[90] The requirement of polite behaviour (see Section 4/1).

[91] Right of access to documents in an administrative procedure is an essential part of transparency regime. In all European legal orders, a person participating in an administrative procedure has the right of access to documents on which the decision of the administration is (or will be) based (Savino (2010)) – but not in all legal orders is this technically speaking formulated as a general principle of APA.

Taking into account the subordinate position of the party, which puts the administrative procedure in the role of major protector of parties' rights when interacting with the authorities, the following set of fundamental principles as a major interpretative instrument of rules were identified as an expression of parties' (human) rights protection: the principles of legality (in the broadest sense), equality, participation; protection of the parties' rights; the right to legal remedy (appeal); reaching decisions without unnecessary delays; and the principle of protecting rights attained by the parties (*res iudicata*). Together with the obligations imposed on the authorities (such as the principle of independence, establishing substantive truth, mutual cooperation of authorities in the interest of good administration, accountability, impartiality and objectivity), these provisions are also a procedural safeguard and guarantee for the protection of human rights in administrative procedures, and in this respect they constitute administrative law as *materia constitutionis*.

Finally, the data collected in the survey (Table 3) confirm the initial hypothesis on the importance of administrative procedural law principles for the protection of human rights in the sense that these principles implement the operational safeguards already defined in the constitution. Namely, we have to bear in mind the importance of procedure for executing substantive rights of a constitutional nature. For the authoritative acts governing these rights to be lawful, both formal and substantive legality has to be ensured. This means that the procedure itself has to be performed in accordance with legality so as to properly ensure substantive (human) rights. With their core interpretative function and constitutional background, fundamental principles are therefore of great importance for the protection of human rights and ensure legality and legal certainty also when deciding on administrative matters.

V. Conclusion

The research we conducted led us to conclude that AP regulation in the selected Eastern European states is still of a classical (administrative law oriented) nature; it arises from a subordinate citizen-authority relationship and protects the weaker party by prohibiting the arbitrariness of authoritative decision-making on the basis of the principle of separation of powers (two-instance procedures, administrative decisions being subject to judicial review). Therefore the purpose of APs and content deriving from analyzed principles confirms the hypothesis of APs' relevance and importance for the protection of human rights in administrative decision-making. Furthermore, comparative normative analysis of the APAs shows that the prevailing legal tradition has the Austrian APA as its basis, with certain new modern approaches such as public contracts, issuance of general acts, the institute of "silence means approval", public service providers' obligation to apply the APA when deciding about citizens' rights/obligations, e-communication, etc. Despite the shared historical heritage, differences appeared in the last decade, as Croatia and the Czech Republic introduced more managerial and modern institutes alongside classical approaches to AP regulation. However, on the basis of the three generations definition of administrative procedures[92], we can conclude that regulation in all four countries still belongs to

[92] Barnes (2010).

the first generation of AP regulation, although certain citizen-state partnership elements can be noted. New or NPM/NPG-driven AP principles such as the mutual cooperation of authorities, accountability, the service orientation of authorities, etc., have been defined, and this reflects good administration approaches. Furthermore, all four countries' APAs include other main elements reflecting good governance (and also good administration), such as transparency, responsiveness, rule of law, effectiveness and efficiency.[93] Performance and respect for these principles of good administration as part of good governance are also a prerequisite for the protection of human rights in practice, when implementing the regulation set. Finally, the greater a country's awareness of the importance of AP for the protection of constitutional (human) rights, the greater its emphasis on building a democratic state also through administrative procedure that introduces good governance and good administration principles. As a result of (future) EU accession/membership (influencing the regulation also by funding different projects to encourage reforms, such as CARDS 2003 and similar projects), membership in the Council of Europe and overall globalization, we will probably continue to experience the trend of convergence in the future, bearing in mind the importance of quality regulation of administrative procedure as the main decision process for states' economic growth and the effectiveness of public administration activities.

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[93] Cf. Apelblat (2011).

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DISCOUNTS AND THEIR EFFECTS – ECONOMIC AND LEGAL APPROACH

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Abstract

The present article discusses the economic and legal effects of single-product loyalty discounts. It is clear that arguments concerning the "pro-competitive" effects of such discounts must be judged with skepticism. This applies in particular to the assumed effects of loyalty discounts resulting from double profit surcharges or falling average costs, as well as in the context of price discrimination. I argue that many of the alleged effects could also be achieved with discount forms where the risk of restrictive effects on competition should be lower. Also, the assumed anti-competitive effects of loyalty discounts must be better justified economically. This article suggests using a form-based approach for the assessment of discount schemes. However, this should not amount to a restrictive assessment of certain discount schemes. For the development of such a form-based approach, it is necessary to review the theories about pro-competitive and anti-competitive effects. Therefore, this article attempts to identify which positive effects are more likely to be achieved by means of which discount forms and under which circumstances.

Keywords

Discounts, Economies of Scale, Predatory Competition, Pro-competitive Effects

I. Introduction

When discussing Article 102 TFEU (Svoboda, 2010; Kallaugher, Sher, 2004), the focus of attention is, along with other abusive practices by dominant undertakings, primarily on the abuse of some discount schemes. One of the problematic forms of discount is the so-called loyalty discount. These are discounts that will lead to a situation where a customer has to cover its needs for one or more products as a whole or to a large extent from the manufacturer or dealer who granted the discount. In the literature we can find reference to "loyalty discounts" and "fidelity rebates" (Funta, 2011a, b). There is a distinction between "loyalty discounts" and "loyalty rebates" (Elhauge, Geradin, 2007), where in the first

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case the price to be paid is lowered, i.e. the customer pays less, while in the second case, the customer pays the full price, but receives a check for the amount saved. Unlike in the English literature, in the U.S. the literature uses the term "first-dollar discount" (Crane, 2013). A simple example can allow us to distinguish between them. In the case of loyalty discounts, if a "supplier's nominal price for its product is 100, the supplier might offer customers a discount of 15 on all units in excess of 50 percent of the customer's requirements. In this example, a customer whose total requirements are 100 units would pay the supplier 7,550 for 80 units, saving 450 from the nominal price (15 a piece on the incremental 30 units). The same supplier using this sort of discount would offer the 15 price break on all units purchased provided that the customer obtains at least 50 percent of its requirements from the supplier. Using the same example, the customer buying 80 units would pay 6,800. The loyalty devices that most frequently encounter antitrust scrutiny are these "first-dollar" discounts, and the discussion below will focus on them" (Jacobson, 2010).

Anti-competitive effects may occur if such discounts evolve strong "pull" effects which result in a situation where other suppliers or potential competitors have no chance to make an attractive and cost-covering offer. The fear that loyalty discounts have such displacement and market foreclosure effects means that loyalty discounts, if they are offered by undertakings in a dominant position, will be judged very strictly by courts. This approach has been criticized in recent years, especially from an economic perspective. Many economic, but also legal papers refer to the positive aspects of loyalty discounts (Kobayashi, 2005). They constitute a "classical form of price competition, an effective commercial tool" (Faella, 2008). Loyalty discounts reduce efficiency losses that occur due to so-called "double profit surcharges", or allow more efficient pricing in the case of decreasing unit costs. In this article, we will confine ourselves to situations in which loyalty discounts are given to undertakings and not to end users. This seems justified in view of the case law (e.g. Michelin II, British Airways/Virgin or Tomra). The arguments relating to the pro-competitive aspects of fidelity discounts must therefore be assessed with healthy skepticism. A critical view makes economic analysis relevant for antitrust practice, because only a sufficiently differentiated examination allows the elaboration of a catalog of circumstances under which certain forms of discounts can deploy the alleged pro-competitive effects. But the supposedly restrictive effects of loyalty discounts must also be subject to critical examination, as there is often a lack of a convincing theoretical economic basis. Although we can undertake only a short critical analysis, due to the limited space of the paper, this ultimately allows for a more differentiated assessment of discounts.

II. Discount schemes and their effects

With a few exceptions, the first economic analyses (McGee, 1958) of discount schemes were made in connection with the Robinson-Patman Act[2] of 1936 prohibiting price

[2] The aim of the Robinson-Patman Act is to protect only those price discriminations made "to meet an equally low price of a competitor".

discrimination. A basic distinction can be made between discounts that are granted when buying just one product, and those that are granted in the case of the purchase of several different products. Thus, when discussing the case of a single-product discount, the problem is mostly seen in the displacement of a competitor who is already present on the market or when it will make market access more difficult for a potential competitor. Multi-product discounts will be not considered in the following. However, although the term "discount" or "rebate" are used as synonyms, we have to distinguish between the term "discount" in the case of individual transactions, versus rebates in the case of deductions or cash payments made to customers. With fidelity rebates ("loyalty" or "fidelity discounts" or "rebates"), it is about quantity discounts, which are based on the total amount taken off within a period, and which take effect when a certain predetermined amount is exceeded (Harris, 2001). Our interest in the following is especially focused on the distinction between incremental (or "classical") discounts and non-incremental discounts that are simply referred to as fidelity discounts. The competitive effects of loyalty discounts will be discussed below, using the market structure in which the pro-competitive effects may appear. This is a vertical structure with three levels, where on the top level there are one or several manufacturers selling the product to one or more distributors, who are ultimately selling it to end users. In the following we will first discuss the alleged pro-competitive effects before we discuss theories about the fraudulent use of discounts.

III. Possible pro-competitive effects

The possible pro-competitive effects of discounts will be presented and criticized in the following sections. Moreover, when assessing the possible pro-competitive effects, we will focus our discussion on the role of buyer power. Especially when market power is present both for the manufacturer and the dealer, a minimum level of coordination between various levels of the value chain is necessary in order to optimize overall performance.

Efficiency increase by selecting a suitable discount system

Double mark-ups ("double marginalization")

Quantity-independent prices at the wholesale level can lead to inefficiencies which are minimized by the choice of a suitable discount system. This applies for example in the case of so-called "double marginalization". This phenomenon always occurs when there is only imperfect competition on the relevant market, i.e. if oligopolistic or monopolistic market structures are present at the various stages of the value chain. As mentioned above, the problem of "double marginalization" occurs only if the customers possess market power on the downstream level. Otherwise, competition prevents a situation in which a surcharge may be charged on the additional incurred marginal costs. Of course, the problem of "double marginalization" can also be eliminated by means of non-incremental discounts. Since a strong price reduction will be made from a particular volume, the manufacturer is in fact providing the quantity (specifically, the minimum quantity), which has to be taken off by the buyer.

Falling average costs

Regardless of whether the consumer is the final customer or is only an interstage in the value chain, there may be inefficiencies in quantity-independent prices if the manufacturer produces on a basis of falling average costs. This is the case, for example, with high fixed costs. For constant costs, unit price must, in order to cover these fixed costs or higher incremental costs because of small quantities, be strictly above the marginal costs of the last discharged unit. If the manufacturer has the option of choosing quantity-dependent unit prices, he can deliver the last unit at a price equal to his marginal cost, but fully cover, by means of higher prices for small quantities, its fixed and variable costs and even make a profit. It should be noted that, even in this case, an efficient solution can be achieved through incremental discounts. These discounts must reflect only the steadily falling average costs of the manufacturer. For loyalty discounts, due to efficiency reasons, there is no special justification.

Economies of scale[3] at downstream levels

By choosing suitable discounts, the manufacturer can specify minimum purchasing volumes and thereby limit the number of retailers supplied. By this means he can save on distribution costs. However, it is highly controversial as to whether efficiency can be achieved. Moreover, intra-brand competition between dealers is thereby significantly limited, which leads to higher retail prices. But with regard to the form of discounts used, it is not clear why any economies of scale (Funta, 2011a, b), which rest on the dealer, cannot be achieved through incremental discounts. Thus the importance or even the necessity for discounts is highly questionable.

Loyalty discounts as incentives for the downstream levels

There is the view that loyalty discounts, especially in trade, reflect the bonus structure, as undertakings use them for the remuneration of their field staff. We can illustrate this with the following example. The dealer pays the manufacturer with a fixed franchise fee and can buy the respective goods for the (incremental) costs of the manufacturer. Consequently, the manufacturer generates a positive profit by means of the fixed fee. The dealer may affect the sales volume, by choosing the retail price, but also by means of his personal effort. Since the products are delivered to the dealer at the (incremental) costs of the manufacturer, it is also ensured that the dealer has the best incentives to maximize the total profit in the value chain. The goal of an efficient discount system should be to "delegate" the sale and therefore the provision of additional services to the dealer so that the decisions taken by the distributor, including the choice of the retail price, will maximize the entire gain in the value chain. From the need to give adequate incentive to the distributor, there is no need to provide the dealer with an additional "bonus" from a certain sales threshold, as would be the case for a loyalty discount. Establishing certain quantities or sales targets can therefore lead to inefficiencies, in particular with regard to uncertainty about future

[3] The opposite of economies of scale is when the average unit costs of production increase beyond a certain level of output.

demand. To better understand the role of discounts in optimal incentive systems, it is necessary to briefly explain the principal-agent model. In the economic literature on incentive systems, non-incremental bonus payments may be optimal if the incentive system serves not only for an agent to maximize the profit, but at the same time to absorb the income by the principal. In the principal-agent theory, relationships are characterized by the asymmetric distribution of information between the parties involved. The agent has an information advantage versus the principal. In order not to perform tasks alone, the principal is transferring tasks and decision-making powers (Kalesná, Hruškovič, Ďuriš, 2012) to the agent. The actions of the agent are thus affecting not only its own utility level, but also the level of the principal. The aim of the approach is to move the agent to deal in the interest of his principal.

Effective incentives for upstream level

Loyalty discounts secure fixed volumes for the manufacturer unless they have a "binding" effect. This applies at least proportionately, provided that the additional discount is based on the proportion of the total turnover of the distributor. Overall, the manufacturer protects himself against opportunistic behavior on the part of customers and other manufacturers that use the same distribution channels. The promotional activities of the manufacturer can serve as an example of how dealers and other manufacturers benefit if this also increases sales of their products. The indirect determination of minimum revenue through loyalty discounts guarantees the manufacturer that he receives an adequate return for his "specific investment" in the dealer. In particular, this avoids the possibility that the dealer will focus on another product. In this case, an efficiency-boosting incentive will be created in order to make it difficult for the dealer to engage in opportunistic behavior.

IV. Discount systems as pro-competitive price discrimination

Even if all consumers have access to the same discount system, we can discriminate between individual customers according to their size. To illustrate this, we can assume that an undertaking supplies two different types of consumers, but cannot directly distinguish between these two. A group of consumers wants to purchase only one unit of the good. The second group of consumers has a positive, but lower, willingness to pay for a second unit. If the undertaking can choose only a single, independent quantity price, it may be profit-maximizing to choose a price so high that the second group of consumers purchase only one unit. As a result, sales will be reduced, but the undertaking will overall achieve greater profit. If the undertaking can grant a discount, it may give the second unit at a lower price, provided that it will be prevented that customers will carry out arbitrage transactions with each other. As a result, consumers pay different unit prices in the two groups, where in this case the price discrimination (Karas, Králik, 2012) increases the total quantity sold and welfare increases. So far, the optimality of certain discount forms, from the perspective of the manufacturer, has been considered. In the discussion about the possible pro-competitive effects of certain discount schemes, it is noted that manufacturers offer these only at the request of buyers with considerable power. In fact, economic theory

shows that buyers benefit not only from the discount gained, but may have preferences for certain forms of discounts.

There are several reasons why pro-competitive effects do not necessarily occur when it comes to relationships between undertakings. First, in those cases where there is already a long supply relationship, it should be assumed that the manufacturer knows the customer type, i.e. the average amount ordered by each customer. Manufacturers could deliberately choose the same discount frame for all buyers in order to prevent antitrust complaints due to abusive price discrimination. We can distinguish between three levels of price discrimination. In the case of the first level, price discrimination, an individual price is required from each consumer, i.e. the maximum price the customer is willing to pay. First-level price discrimination is also called perfect price discrimination. Second-level discrimination refers to cases when the price depends on the quantity purchased, but not on the buyer, and is also called quantity discrimination. Third-level price discrimination means that the price depends on the group of buyers to which the buyer belongs, but is at the same level for each member of the group. The question of the distribution of bargaining power entails criticism of the application of the theory of price discrimination in contractual relationships between undertakings that are not end-users. The theory of price discrimination in retail markets assumes that the price-setting undertaking unilaterally submits a proposal and thereby tries to maximize its own profit. In principle, price discrimination is more successful when the freedom of choice is lower.

V. Abusive effects of loyalty discounts

As noted in the introduction, antitrust enforcement practice means that there is the possibility of displacement and market foreclosure, although there are claims (Hovenkamp, 2005), that loyalty discounts should be considered pro-competitive if the price is above the discounted cost. In the following, we will focus on exclusionary conduct against competitors on the same market level. A discussion about the theories of the abusive effects of discount schemes cannot be avoided for the following reasons. First, it is clear that the analysis of the abusive effects of various discount schemes needs a significantly better economic basis. Furthermore, it is necessary to develop manageable rules for antitrust enforcement practice in the context of both pro-competitive as well as restrictive effects.

Theories of market foreclosure effects and predatory competition

Market foreclosure

A fundamental objection to all theories of exclusionary abuses through market foreclosure has been raised by the “Chicago School” (Posner, 1976). It cannot be in the interest of distributors to simply exclude manufacturers with better or cheaper products wholly or partially from the market. The new industrial economic literature (“post-Chicago”) has, however, shown that, contrary to this “fundamental criticism”, there may still be situations in which the (incumbent) undertaking in the market can, at the expense of at least some manufacturers and of course customers, close market entry. This is one of the most influential theories pointing to the possible coordination problem between manufacturers.

In the "post-Chicago" literature we find the concept of the incumbent having a monopoly position. This is because the incumbent has a so-called first-mover advantage (being the first to enter a new market) when drawing up contracts. If a potential competitor were already present, it could participate in the competition (Škrinár, Nevolná, 2012) for the market. However, that ability may be disabled by the dominant undertaking. From antitrust cases dealing with discount issues, especially loyalty discounts, we can find that competitors hindered by the dominant undertaking are already active in the market. It should be examined why the already active competitors cannot equally compete for the entire market (Funta, 2007). One possible explanation could be insufficient capacity and inadequate financial resources for the investments necessary to operate on a larger part of the market. If the quality of a product and the manufacturer reputation is of high importance to the end customer, it is often too risky for the dealer to rely fully on the new product and the new manufacturer. High loyalty discounts can thus hinder market entry. On the other hand, one might ask where the incumbent advantage comes from. These considerations already surrendered a number of market characteristics in which an exclusionary abuse is to be expected. These include capacity constraints at smaller competitors, uncertainty about product quality and overall performance, especially for new competitors, existing discount schemes with long and possibly overlapping reference periods for each merchant, as well as strong end-customer loyalty in a sufficiently large part of the market.

Predatory competition

In its extreme form, predatory competition (Funta, Nebeský, Juriš, 2014) tends to achieve a monopoly which must be defended by the establishment by means of increased barriers to entry. The standard case of predatory competition comprises the setting of predatory prices. Competitors who do not have sufficient financial resources, because of financing problems, can be forced to exit the market. If the market can be sufficiently closed to new entrants, the remaining undertaking can generate supra-competitive profits through which any losses caused by predatory pricing will be compensated (recoupment). However, it should be noted that often neither market foreclosure nor predatory pricing in their pure form can be identified by means of discounts. In many cases, there are number of small manufacturers that operate for many years alongside a dominant undertaking, but may be hindered by its discount system in generating growth (barrier to expansion). In these cases, the market is neither completely closed nor is systematic predatory competition in place. Instead, a certain market division will be created by the dominant undertaking. In this case, the dominant undertaking (Procházka, Čorba, 2006) benefits from the disruption caused by such competitors and not only during the recoupment phase. Unlike during the predatory pricing phase, the dominant undertaking (Munková, Kindl, Svoboda, 2012) has no losses in the displacement phase, since usually only a small part of the total volume is sold at a price (after discounts) below cost.

VI. Some preliminary observations on the effectiveness of discounts in case of abuse

In order to drive out a competitor from the market, both loyalty discounts as well as incremental discounts, such as quantity discounts, can be used. However, the practical relevance of this type of abuse, in connection with discounts, is of little importance. Far more important is the case of a possible complete or partial foreclosure of the market. The possible anti-competitive effects of certain forms of discounts can both weaken as well as strengthen demand-side uncertainty. If a dealer has to set his own retail price in the long term and with great uncertainty, it is (if not impossible) not only difficult but also more expensive for him to reach a certain fixed volume. From the ex-ante perspective (from the perspective of the dealer), this leads to uncertainty about the final demand to the consolidation of the price-quantity scheme offered by the manufacturer: A more competitive offer towards end users always leads to an incremental increase of the probability through which the discount threshold is achieved. A pure ex-post evaluation of the discount system cannot, therefore, adequately capture the optimization calculus of the dealer in its own price-quantity choice.

VII. Conclusion

This article is intended to focus on discounts and their effects from an economic and legal perspective. With regard to pro-competitive effects, we arrived at the judgment that loyalty discounts are, because of demand uncertainty, not necessarily effective in solving incentive problems. Instead, these discount forms can, under high levels of uncertainty, lead to high losses in efficiency. Only in the absence of market power at a downstream level should some of the pro-competitive theories be reflected. The application of a form-based approach by the assessment of discount schemes should not lead to a restrictive assessment of certain discount schemes. For the development of such a form-based approach, we reviewed theories about pro-competitive and anti-competitive effects. As mentioned above, this article attempted to identify which positive effects are more likely to be achieved by means of which discount forms and under which circumstances. We identified the role of market power on the customer side and showed that some of the pro-competitive theories should be considered only in the absence of market power in the downstream level. This finding is somewhat unusual because demand power is normally used (e.g. in merger control procedures between manufacturers) as a defense argument. But because of market power on the other side, some of the theories concerning pro-competitive effects should have less importance. In summary, it seems that, on the basis of the current state of knowledge in economics, there is no robust relationship between demand uncertainty and the abusive use and effects of certain discount schemes. The further development and application of discount schemes will not stand in the way of competition law economization in the sense of the so-called new economic approach. The objective of the use of economic thinking should be the development of justiciable rules for the practice. Such rules are economically meaningful, methodologically justified and are more appropriate for practical application.

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Expenditures on Collective and Individual Services: Discussion on the Classification of Government Expenditures with Regard to their Inclusion into Growth Models

Zuzana Machová[1] **& Igor Kotlán**[2]

Abstract

The aim of this paper is to examine the effects of government expenditures on long-run economic growth in developed countries using their different breakdown. Empirical analysis is performed for a panel of 34 OECD countries in the period 2000–2012. Above all, the results support the idea that conclusions of previous studies on this topic may be strongly distorted by inappropriate classification of expenditures, typically in the case of expenditures on education and health. These are usually considered productive and thus growth enhancing, but if their part of R&D expenditures is detached, their effect on growth is in fact negative. In general, it is concluded that government expenditures on individual services have negative effects on growth, while the impact of expenditures on collective services is positive.

Keywords

Government Expenditures, Economic Growth, Collective Services, Individual Services

I. Introduction

The recent period has given rise to a body of literature concerning the influence of fiscal policy on economic growth. This development is natural, as the professional economic public tries to answer the research questions that have appeared in connection with economic, financial or debt crises.[3] Economists analyze either the influence of different types of taxes, or the influence of different types of government expenditure on economic growth,

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[3] For more on this topic from several interesting points of view, see e.g. Funta, 2011; Kačaljak, 2011; Endovitskiy and Lomsadze, 2012; Aiginger, Horvath and Mahringer, 2012; Fleichuk and Hnat, 2012; Ziyadin, 2012; Cheng, Choong and Leong, 2012; Caba, 2013; Olteanu, 2013; or Šišková, 2013.

but nowadays the aggregate influence of all the fiscal variables on growth is studied above all. In the analyses, in accordance with contemporary literature, direct and indirect taxes are usually distinguished, as well as productive and unproductive government expenditures. The explanation of the categorization of taxes is that direct taxes have higher distortionary effects on the economy and thus harm economic growth more. In the case of government expenditures, there is an assumption that productive government expenditures are investment expenditures that support economic growth, while unproductive, consumption expenditures do not. However, the conclusions of empirical studies are contradictory. It has been neither significantly confirmed what the effects of separate types of taxes are, nor what the effects of particular types of expenditures are.

While the issues of the influence of taxes on growth were examined in several recent papers (Kotlán and Machová, 2012a, 2013; Machová and Kotlán, 2013a) and are not of interest in this paper, the effects of government expenditures seems a rather unexplored area. Starting from economic theory, there are also doubts about the accuracy of the classification of expenditure into productive and unproductive parts, or rather about the accuracy of the assignment of specific types of expenditures to productive or unproductive parts. There appears to be a question as to whether another classification would be better, with respect to the analysis of government expenditures effects on growth. One possibility is to study the separate effects of expenditures on individual, and on collective services including expenditures on R&D.

Thus the aim of this paper is to examine the effects of government expenditures on economic growth in developed countries, using their standard breakdown into productive and unproductive parts, along with alternative categorization. Empirical analysis is performed for a panel of 34 OECD countries in the period 2000–2012.

II. Theoretical and empirical background

Current growth theory is based on the model of Solow (1956) and its extension towards the endogenization of technological progress (Lucas, 1988; Romer, 1986). In the original Sollow model, fiscal policy could not influence economic growth in a steady-state, i.e. the growth of developed economies. But later work, e.g. Barro and Sala-i-Martin (2004), shows that fiscal policy may affect particular growth variables (physical and human capital accumulation above all), and thus also the growth. According to Barro (1990) or Rebelo (1991), the growth rate of an economy (γ) in a steady state is equal to the growth rate of physical capital (k), human capital (h), and the growth rate of consumption (c) of households, and depends on intertemporal elasticity of substitution in consumption ($1/\theta$) adjusted to time preference rate (ρ), and net marginal rate of return on capital (both human and physical):

$$\gamma = \frac{\dot{k}}{k} = \frac{\dot{h}}{h} = \frac{\dot{c}}{c} = \frac{1}{\theta}(r - \rho). \tag{1}$$

In the basic model (1), taxes may affect the growth rate through their effect on the net marginal rate of return on capital. The channels are described in Mendoza, Milesi-Ferreti and Asea (1997), or Denaux (2007) in detail.

According to Barro (1990), government expenditures may be considered an input to private production in the event that they are of investment character (expenditures on infrastructure above all). In that case, government expenditures have a positive effect on economic growth, as they raise the net marginal rate of return on capital. Many empirical studies have been based on Barro's assumption, and this type of government expenditures has become labelled productive (see e.g Kneller, Bleaney and Gemmell, 1999; Gemmell, Kneller and Sanz, 2011; Denaux, 2007). However, the studies differ in what type of real government expenditures they include into the productive part.

For simplicity, Barro (1990) assumes the broad concept of capital that includes both physical and human capital (consistently with Rebelo (1991) and his AK model). With constant returns to scale, the production (Y) function thus shall be as follows:

$$Y = AK\left(\frac{G}{K}\right)^{\alpha} = K\phi\left(\frac{G}{K}\right), \tag{2}$$

where A is the technology level, K is capital, G is productive government expenditure, α is technological coefficient, and ϕ expresses a positive decreasing marginal product (i.e. $\phi' > 0$ and $\phi'' < 0$). For the purposes of expressing the relationship between government expenditure and economic growth, it is possible to assume the existence of a flat tax rate on income τ, which is used to fund government expenditure: $G = \tau Y = \tau K\phi(G/K)$, in the case of a balanced budget. For simplicity, different rates for different types of taxes are not considered.[4] The net marginal return on capital is then equal to:

$$r = (1-\tau)\phi\left(\frac{G}{K}\right)\left(1-\phi'\frac{G}{Y}\right) = (1-\tau)\phi\left(\frac{G}{K}\right)(1-\eta), \tag{3}$$

where η is the sensitivity of Y to changes in G for a given K, and the growth rate of an economy is modified from the equation (1) to:

$$\gamma = \frac{1}{\theta}\left[(1-\tau)\phi\left(\frac{G}{K}\right)(1-\eta) - \rho\right]. \tag{4}$$

As already stated, the growth rate of the economy is thus positively affected by productive government expenditure, but the sensitivity of production to changes in government expenditure has, on the other hand, a negative influence on growth.

The most important study by Kneller, Bleaney and Gemmell (1999) uses the standard Classification of the Functions of Government (COFOG), but distinguishes only between a group of productive expenditures (including general public services, defense, educational, health, housing, and transport and communication expenditures), and a group of unproductive expenditures (including social security and welfare expenditures, expenditures

[4] The influence of different types of taxes is taken into account e.g. in Kotlán and Machová (2013). They show the channels through which the taxes affect the growth variables. They also point out that some economic and legal aspects of labor markets must be considered in the analyses. For these aspects, see e.g. Horvath, 2012; Simonovits, 2012; Serban, 2012; Zvonar, 2012; Samosyonok, 2012; Huber and Bock-Schappelwein, 2013; Simonovits, 2013; Schovánková, 2013; Birčiaková, Stávková and Antošová, 2013; or Nagy and Való, 2013.

on recreation, and on economic services). The authors show that the group of productive expenditures really positively affect growth, while unproductive ones do not.

Among similar studies, Denaux (2007) must also be mentioned. He uses the breakdown of expenditures on government expenditures to physical capital accumulation (approximated by stock of roads per cap.), and expenditures to human capital accumulation (approximated by government spending on schooling). He finds no significant effect of spending on physical capital, but he confirms the positive effect of spending on human capital, i.e. on higher education on economic growth.

However, as already stated within the introduction, the results of empirical analyses are not consistent, especially when a more detailed level of classification of expenditures is used. For example, Drobiszová and Machová (2014) also use the COFOG, but they include all the main types of expenditures into their analysis. They show that only spending on defense, education, health, and general public services have a positive effect on economic growth. Unlike the abovementioned studies, the positive effects of expenditures on infrastructure were not confirmed.

Recent experience from OECD countries shows that public wages, interest payments, subsidies and government consumption are less growth enhancing, while spending on education and health boosts growth (Afonso and Jalles, 2014). It is also interesting to realize the consequences of the fact that Bhattacharya and Mukherjee (2013) confirm that households in the OECD move from non-Ricardian to Ricardian behaviour as government debt reaches high levels and as uncertainty about future taxes increases.

At first glance it may seem that expenditures on, e.g. education and health, i.e. human capital, are provably supporting economic growth, while the effects of expenditures on, e.g. infrastructure are questionable. But it is very important to realize that, according to the methodology of COFOG 98, all of the main categories of government expenditures also include corresponding expenditures on R&D. This may significantly distort the analyses. One of the ways to avoid this problem is to distinguish between expenditures on collective services, and individual services, which should be closer to Barro's approach above, assuming that expenditures on collective services have positive effects on growth, while expenditures on individual services do not. The classification and further explanation are described in following part.

III. Methodology and data

According to the OECD and Eurostat (2012), individual services are the services that general government provides to specific identifiable households. That is, services such as health and education, which are consumed by households individually. Collective services are those that the general government provides simultaneously to all members of the community. That is, services such as defense and public order and safety, which are consumed by households collectively. Because they are considered as part of gross fixed capital formation[5], the R&D for individual services are also included, which is the most important point of the classification. Collective services also include the overall policy-making,

[5] According to the SNA 2008, and ESA 2010.

planning, regulatory, budgetary, coordinating and monitoring responsibilities of ministries overseeing individual services. These activities, unlike the services to which they relate, cannot be identified with specific individual households and are considered to benefit households collectively. Based on the COFOG 98, individual services (IS) include expenditures on:

- Health (category 7),
- Recreation, culture and religion (8),
- Education (9),
- Social protection (10),

except for categories including R&D (7.5, 8.4, 8.5, 9.7, 10.8), and n.e.c. categories (7.6, 8.6, 9.8, 10.9).
The excepted categories as well as categories:

- General public services (1),
- Defense (2),
- Public order and safety (3),
- Economic affairs (4),
- Environment protection (5)[6],
- Housing and community amenities (6), make up the group of collective services (CS).

From a methodological point of view, the analysis was based on a dynamic panel model which used data for 34 OECD countries in the period 2000–2012. Potential output per worker in PPP (Y) was dependent variable. Independent variables included control growth variables, i.e. gross fixed capital formation as a percentage of GDP (K), and total factor productivity expressed as GDP per worked hour (L).
The second group of independent variables was formed by fiscal variables. The model included both the revenue and expenditure side of the budget; fiscal balance was omitted to avoid perfect collinearity of the variables. Regression coefficients of the fiscal variables may thus be interpreted as a change of the potential output in the case that the corresponding variable as well as the fiscal balance in opposite direction is changed by unit, ceteris paribus. Fiscal variables included direct taxes (DT), indirect taxes (IT), both expressed as corresponding tax quota, i.e. tax revenue-to-GDP ratio[7], and finally government expenditures. At first, productive (PE) and unproductive (UE) expenditure in accordance with Kneller, Bleaney and Gemmell (1999) were included, and secondly expenditures on individual services (IS) and collective services (CS), all of them expressed as a percentage of GDP.

[6] The extend of all the expenditure types is involved by national and international laws. However, in the case of environmental protection, the impact of laws is very strong (for more on the legal aspects, see e.g. Černič, 2012; Bogataj, 2012; Škrk, 2012; or Gaberščik, 2012).
[7] Alternative indices could be also used, e.g. the World Tax Index (Kotlán and Machová, 2012b; Machová and Kotlán, 2013b).

The data was gained from OECD iLibrary, specifically the OECD Tax Database, and the database of national accounts.

As the estimation technique, a generalized method of moments (GMM) was used, which included the method of instrumental variables. This method uses the Arellano-Bond estimator (Arellano, Bond, 1991), and the transformation method of first difference of each variable in the regression, which prevents potential problems with the stacionarity of the time series. Using a robust estimator in calculating the covariance matrices (White Period method) ensured that the estimation results of standard deviations of parameters and hypothesis tests were correct with regard to a possible occurrence of autocorrelation and heteroscedasticity. This estimation type ensures that the appropriate transformation process and using appropriate instruments eliminates the risk of endogeneity of the lagged values of the dependent variable and the independent variables with a random component. In the analyses below, the lagged values of the dependent variable were used as the instruments, starting from a lag of two. A Sargan test (see the J-statistics in the tables below) confirmed the validity of the instruments in both estimated models.

Assuming a lagged effect of fiscal policy on economic growth, a lag of one period designed with (-1) was used in the case of fiscal variables. For better interpretation of the regression coefficients, all the variables were used in logarithmic form.

IV. Empirical analysis and results

This part of the paper is devoted to the impact of government expenditures on long-run economic growth, expressed by the estimates of the potential output for each OECD country. Table (1) shows the results of the estimation of the model including productive and unproductive government spending according to Kneller, Bleaney and Gemmell (1999). Table (2) shows the results from the model where government expenditures were divided on expenditures on collective services, and on individual services.

Table 1: Effects of productive and unproductive expenditures on growth

Variable	Coefficient	Std. Error	t-Statistic
$GDP(-1)$	0.895393	0.001923	465.5316***
K	0.009173	0.000908	10.10532***
L	0.032129	0.001090	29.46243***
$DT(-1)$	−0.030982	0.001878	−16.49942***
$IT(-1)$	−0.017438	0.001042	−16.73826***
$PE(-1)$	−0.000802	0.000625	−1.284099
$UE(-1)$	−0.014670	0.000574	−25.54178***
Instrument rank	35		
J-statistic	34.20847		

*Notes: all variables are expressed in logarithmic form; t-statistics are adjusted for heteroskedasticity and autocorrelation; standard deviations are calculated using robust estimates; *, **, *** indicate significance levels of 10%, 5%, and 1%, respectively.*

Source: own calculations

In both models, a statistically significant positive effect of control growth variables was confirmed, with total factor productivity having a quantitatively stronger impact on long-run growth, which corresponds to economic theory for developed countries. Also, in both models, a statistically significant negative effect of taxes was confirmed, and the negative effect of direct taxes is quantitatively higher than the effect of indirect taxes. This supports the conclusions of most empirical studies on this topic, e.g. Kotlán and Machová (2012a, 2013), or Machová and Kotlán (2013a).

Table 2: Effects of expenditures on collective and individual services on growth

Variable	Coefficient	Std. Error	t-Statistic
$GDP(-1)$	0.897221	0.003321	270.1565***
K	0.013152	0.001260	10.44037***
L	0.036305	0.001601	22.67938***
$DT(-1)$	−0.026248	0.002000	−13.12116***
$IT(-1)$	−0.020497	0.000642	−31.93569***
$CS(-1)$	0.005908	0.001002	5.897708***
$IS(-1)$	−0.015145	0.000911	−16.63241***
Instrument rank	35		
J-statistic	35.69204		

*Notes: all variables are expressed in logarithmic form; t-statistics are adjusted for heteroskedasticity and autocorrelation; standard deviations are calculated using robust estimates; *, **, *** indicate significance levels of 10%, 5%, and 1%, respectively.*
Source: own calculations

With regard to the aim of the paper, the results concerning government expenditures are, nevertheless, the most important. Table (1) shows, that the influence of both productive and unproductive expenditures, classified according to Kneller, Bleaney and Gemmell (1999), on economic growth is negative, although the effect of productive expenditures is quantitatively lower.
On the other hand, if the expenditures are examined in categorization on expenditures on collective and individual services (table 2), it is shown that the impact of expenditures on collective services is positive, while the effect of expenditures on individual services on growth is negative and quantitatively corresponds to the effect of unproductive expenditures.

V. Conclusion

The topic of fiscal policy and its impact on economic growth is very current, especially with regard to research questions that have arisen with the recent economic, financial and debt crises. Fiscal consolidation is inevitable in many countries, and their fiscal authorities are forced to make budget cuts, which is in direct conflict with the standard Keynesian approach. Furthermore, many empirical papers have confirmed the negative effects of most types of taxes on economic growth. Improving fiscal balance by raising taxes could thus be counterproductive. On the other hand, there also exist theoretical as well as empirical studies showing that certain types of government expenditures may

have significant positive effects on economic growth. Restructuring the expenditures side of a budget could thus improve the performance of the economy without any negative effects on fiscal balance.

Most of the previous studies distinguish between the effect of so-called productive and unproductive government spending. However, unproductive expenditures also include expenditures on R&D in those studies, as well as expenditures on education and health which are of an individual character. These methodological discrepancies may be easily avoided using a classification distinguishing between expenditures on collective services, and expenditures on individual services, which is also in accordance with new national accounting methodology SNA 2008 and ESA 2010.

This approach was also used in this paper, where a dynamic panel model for 34 OECD countries in the period 2000–2012 was estimated, using a GMM and instrumental variables method. Two models were estimated – the first included government expenditures classified as productive and unproductive in accordance with the literature, while the second included expenditures on collective, and on individual services. In the first model, both types of government expenditures have a negative effect on growth, which only supports the inconsistency of the results in the case of the breakdown of expenditures used in the analysis. On the other hand, in the second model, it is shown that, in accordance with the assumptions, expenditures on collective services, including all the expenditures on R&D, positively affect long-run economic growth, while the expenditures on individual services, including individual expenditures on education and health, affect growth negatively.

The results support the idea that the conclusions of previous studies on this topic may be strongly distorted by the inappropriate classification of expenditures, typically in the case of expenditures on education and health. These are usually considered productive, but if their part of R&D expenditures is detached, their effect on growth is in fact negative.

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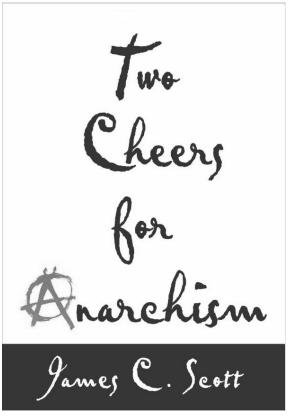

JAMES C. SCOTT

Two Cheers for Anarchism:
Six Easy Pieces on Autonomy, Dignity, and Meaningful Work and Play

Princeton University Press, 2012

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Impelled towards anarchism from an unusual direction by his experience studying agrarian communities in Southeast Asia, in *Two Cheers for Anarchism*, Scott presents an informal perspective on autonomy, dignity, work, play, organisation, and related ideas. He is not driven by theory, or by any large-scale political project, and takes a pragmatic approach, accepting that states may now be unavoidable.

Made up of twenty-nine "fragments" which could mostly stand in isolation, the six "pieces" in *Two Cheers for Anarchism* are themselves somewhat anarchic in organisation.

The first piece begins with blind obedience to red lights by East German pedestrians, considers the importance of small, anonymous acts of insubordination and law-breaking more generally, and works up to the role of massive, spontaneous militancy, outside the co-option of unions or political parties, in key historical and political events. It also contains a fragment on the importance of crowd feedback in the workings of some kinds of charisma.

In the second piece, Scott contrasts vernacular and official order. Some of this draws on examples from his own speciality, agriculture, comparing the problems of monoculture plantations with a Guatemalan peasant garden which is apparently disordered but actually highly efficient. He also contrasts informal names and so forth with international homogenization in language, culture, political forms, and modes of sensibility.

Piece three, on "The Production of Human Beings", starts with an adventure playground in Emdrup, Denmark and the Vietnam Memorial in Washington, considers notions of efficiency and alternative approaches to a Gross Human Product, touches on the authoritarianism of convalescent homes and other pathologies of the institutional life, and ends with the removal of red lights and street signs in Drachten, the Netherlands.

Piece four is a defence of that much maligned class, the petty bourgeoisie (in which Scott includes peasants). A key feature of the class is that members are largely in control of their work; Scott highlights the attraction of the autonomy and self-respect and freedom that brings. He also warns of the co-option of this by businesses that attempt to provide workers with the illusion of autonomy while denying them any real freedom.

The fifth piece turns to the misuse of quantification in measurements of scholastic and academic performance, notably in SAT tests and citation indices. These approaches pretend to avoid politics while concealing their agenda in the structure of the system imposed.
And the short final piece, "Particularity and Flux", begins with how the town of Le Chambon-sur-Lignon sheltered Jews in the Second World War, then looks more broadly at the rewriting of messy, contingent events as neat history and at how states misrepresent historical events in the service of theatrical bluster and symbolic pageantry.
Occasionally, traces of academic style and terminology come through in Scott's prose. For example: "The order, rationality, abstractness, and synoptic legibility of certain kinds of schemes of naming, landscape, architecture, and work processes lend themselves to hierarchical power." But mostly he achieves a clear, accessible language, and the pieces in *Two Cheers for Anarchism* should attract a broader audience than his scholarly books. One hopes they will bring people to think again about some of the assumptions of both ordinary life and political culture.

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