Better Regulation – A Critical Assessment

Proceedings from the International Conference on Legislative Studies in Helsinki 2010

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FOREWORD

This publication consists of proceedings from the second International Conference on Legislative Studies held on 1–2 March 2010 in Helsinki. The conference was titled ‘Better Regulation – A Critical Assessment’. A multitude of different Better Regulation programs has been launched under the last decades all around the world but their success rate has varied. The aim of the conference was hereby to assess the merits and drawbacks of different Better Regulation activities and to develop new knowledge on law-drafting to improve the quality of legislation.

The conference attracted researchers from a wide variety of different disciplines, among them Economics, Law, Political Science and Sociology, just to mention a few. The diverse background of participants reflects the multidisciplinary approach characteristic to Legislative Studies. Aside of many academics, the wide participation of state officials was a true delight. They represented among others Finnish Competition Authority, Parliament of Finland, Regional State Administrative Agency and different ministries. International visitors came from such diverse places as Brazil, Germany, Italy, the Netherlands, Portugal, Russia, Spain and Sweden.

The honorable list of keynote speakers included Professor Michael Faure from the Erasmus University Rotterdam, Professor Fabrizio Cafaggi from the European University Institute, researcher Anne Meuwese from the University of Tilburg and Tuomas Pöysti, President of the National Audit Office of Finland.

In addition to the lectures there were four workshop sessions divided into different themes. This article collection follows the original division of workshops. The first chapter concerns fundamental questions on political power and the origins of legislation. Articles in the second chapter compare alternative regulatory instruments like traditional command and control regulation and self-regulation. The third chapter reviews impact assessment and measurement of administrative burden. The final chapter examines whether the goals of national competitiveness and Better Regulation can be combined at all.

The conference was mainly organized by the Legislative Studies Research Group at the National Research Institute of Legal Policy. Additional finance was acquired from the central ministerial and research organizations in the field. They included the Ministry of Employment and the Economy, Ministry of Justice, Research Centre of Empirical Legal Studies at the University of Eastern Finland, Finnish Association for Legal and Social Sciences and the research project Transformations in Law and
Power. The latter research group is financed by the Academy of Finland and hosted by the University of Turku.

The organizers are highly grateful to all financiers as well as keynote speakers, their commentators, chairs and conference participants. We would like to show our special appreciation to all the contributors involved in creating this article collection. Secretary Eira Mykkänen has been responsible for editing it.

Helsinki, August 10th 2010

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1 WHO HAS AND WHO SHOULD HAVE THE POWER TO REGULATE?
SOCIAL NORMS, CULTURE AND BETTER REGULATION

Oskari Juurikkala*

Introduction

The starting point of this paper is twofold. Firstly, theories of regulation imply theories of man and society: what human persons are; how they choose and behave; how they interact with each other; why and when they obey laws, and so on. Secondly, there is nothing more useful than a good theory. A good theory is one that is sufficiently simple, so that it can be used in practice, and sufficiently realistic, so that it does not significantly depart from the truth.\(^2\)

One of the most successful theoretical frameworks in regulatory literature has been law and economics, which combines legal and economic analysis. It is a useful approach, because it is both quite simple and quite realistic. It is not my intention to do away with it, but I will argue that it can and should be improved. There are two improvements that seem especially pertinent.

One is to challenge ‘legal centralism’ and to adopt a broader understanding of the sources of normativity in human choosing and acting. In other words, we should not limit the analysis to different types of law and their usefulness in regulation. The other is to expand our concept of motivation in human behavior, especially taking into such notions as moral character and culture. In what follows, I will firstly explain these ideas in more detail and then suggest implications for regulatory discussion.

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* I am grateful for comments to Kati Rantala, Pia Letto-Vanamo, Martti Vihanto, Matias Forss, Jason Lepojärvi, and conference participants at the International Conference on Legislative Studies in Helsinki, 1–2 March 2010.

\(^1\) I am using the word regulation in a broad sense that covers both ‘regulatory law’ properly speaking and other kinds of deliberate state influence, ranging from general legal rules to specific intervention by regulatory bodies. I do however distinguish it from other (non-state) forms of social control or influence. See Baldwin and Cave (1999: chapter 1) for different definitions of the concept of regulation.

\(^2\) This is obviously a simplistic summary of very complex set of issues.
Social and Behavioral Theory: Two Proposals

Against Legal Centralism

My first objective is to challenge the legal centralism that is implicit in most law-and-economics and regulatory theory and debate. It is assumed that law is what matters: simply put, when there is a problem, we probably need a new law. This assumption is not often said explicitly, but it is implicit in the logic of most legislative and regulatory projects. Certainly, legislators and regulators are increasingly aware of the limits of legislation and regulation: they realize that law cannot do everything. But then again, that is often where the analysis stops.

Yet much more can be said about it – and has been said. The French aristocrat, Alexis de Tocqueville once mused in his observations on the democratic experiment of the United States: ‘Laws are always unsteady when unsupported by mores; mores are the only tough and durable power in a nation’ (Tocqueville 1969: 274).

More recently, we have seen a burgeoning literature on the roles of and relationships between law, social norms, private morality, culture etc. Contributors to this discussion include several recipients of the Nobel Prize in economics. Ronald Coase (1991), for example, has frequently argued for the importance of studying the economic system empirically, especially in light of the richness of institutional arrangements. Drawing on evidence from economic history, Douglass North (1990) has studied the roles of formal and informal institutions in economic development. In her empirical work on the governance of common-pool resources, Elinor Ostrom (1990) has demonstrated the complexity and fundamental importance of non-state governance. Oliver Williamson (2000) has also underlined the role of non-state governance institutions in the transition from socialism to a market economy.

Among experts of regulation, Ayres and Braithwaite (1992: 12–14) could especially be mentioned for their stress on the role of communities and associations in understanding the institutional order of a society. And in law-and-economics literature, we have seen wide-ranging discussions on the roles and interactions between law and social norms.3 In the next section I will highlight some interesting findings of this discussion and then draw out implications for regulation.

3 Mercuro and Medema (2006: chapter 7) provide a good overview of the literature.
**Law and Social Norms**

The perspective here is not simply that there are limits to legislation. It is that law, social norms, culture, morality and so on are *parts of a complex whole* that should be analyzed as such. The argument for a more holistic perspective is that, firstly, *it is more realistic*, and secondly, *it is possible*. Although ‘social norms’ is a vague concept, it can be studied both theoretically and empirically.\(^4\) In broad terms, both social norms and law can be seen as sources of normativity for human choosing and acting – sources which may be complementary or conflicting, supportive or eroding.

Social norms and law relate to and interact with each other in various ways (see Panther, 2000). On the one hand, law and social norms may *complement* each other, as is perhaps often the case without our even noticing it. Social norms provide the broad institutional environment within which legal norms and formal institutions function and operate. The central importance of these *supportive social norms* is usually only appreciated when they begin to be eroded. The supportive function may also manifest itself the other way around: enshrining pre-existing social norms into law will give them greater strength and importance – perhaps even if such laws are difficult to enforce.\(^5\)

On the other hand, law may come into *conflict* with social norms. In such setting there are several possible scenarios. (i) It may be that, over time, *social norms adapt to legal rules*. This is likely to happen when such adaptation does not imply a loss on any significant party. But it may also be argued that generally law tends to shape social norms through its ‘expressive function’ (Sunstein, 1996a, Cooter, 2000).\(^6\) (ii) *Legal rules may adapt to social norms*. In broad terms this happens often through legal reform, given that social norms are among the main factors that influence legal and social change.\(^7\) But it may also happen that ‘law in the books’ is

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\(^4\) See Juurikkala (2009) for a review of the literature in the context of commercial relationships.

\(^5\) Cooter (2000) gives an amusing example. A new law in California required dog-walkers to clean up the poop. Before that, most people thought that was the right thing to do anyway, yet people did not complain much about dog poop; now after the new law, they do complain if someone breaks the law. It is easier to say ‘obey the law’ than ‘don't be so rude’. When a standard of behavior is included in the legal code, it has the moral backing of the legitimate public authorities of the community.

\(^6\) For example, laws relating to environmental protection, tobacco smoking or drug use can have a powerful effect on public perceptions and expectations.

\(^7\) An interesting historical example, among many others, is the formation of the Western legal concepts of criminal culpability, which emphasizes subjective intention instead of the objectivism of earlier Germanic practice; this notion of culpability was simply rooted in Christian moral theology (Berman, 1983).
supplanted by ‘law in action’ that reflects entrenched social norms in opposition to the literal meaning of the law. (iii) The two may also influence each other, one dominating from time to time and in different contexts.

Some social and legal theorists have emphasized the importance of social norms as the proper basis of legal norms. Cooter (1996) argues that English contract law was rooted in the traditional ‘law merchant’ (lex mercatoria), which was based on business customs and cooperative dispute resolution mechanisms. As the power of English common law judges grew, they began to deal with commercial disputes; but instead of trying to create a new set of rules, they sought to discover the rules already in existence among merchants, and to enforce those rules selectively so as to create a coherent and systematic body of rules.

However, placing too much emphasis on law may have an adverse effect on social norms. Pildes (1996) has warned about the possibility of destroying valuable social norms through law. Various fundamental social virtues, such as reciprocity, are learnt and acquired not through law but through life in smaller communities such as families, clubs and churches (see Tocqueville, 1969). Such social norms as reciprocity can be undermined through law-making and public policy by destroying the social conditions that enable informal reciprocity. For example, urban planning, when it pays little attention to the social context, may remove the practical opportunities for exercising reciprocity and maintaining active community life; thus the transition from busy street interaction to empty and quiet places may, paradoxically, have lead to the creation of more dangerous neighborhoods (see Jacobs, 1961). Similarly, overambitious welfare policies may crowd out pre-existing local-level and voluntary institutions that provide informal but effective remedies in unemployment, illness and old age (Beito, 2000, Putnam, 2000, Juurikkala, 2007). It may therefore be

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8 Earlier contributions include Hayek (1960, 1973) and Leoni (1991).
9 Beito (2000) is an insightful historical investigation of how so-called fraternal societies in the late nineteenth and early twentieth centuries provided extensive assistance ranging from health insurance, support in unemployment, orphanages, and homes for the elderly. Similar institutions existed in many European countries. Beito argues that such institutions died out not because they were deficient but because governments took over their role with taxpayer money, yet something important was lost in the transition. This dilemma of the welfare state has been subject to substantial discussion recently, especially in what is known as the social teaching of the Catholic Church. John Paul II (1991: 48) famously wrote that ’excesses and abuses, especially in recent years, have provoked very harsh criticisms of the Welfare State, dubbed the “Social Assistance State”. Malfunctions and defects in the Social Assistance State are the result of an inadequate understanding of the tasks proper to the State. Here again the principle of subsidiarity must be respected: a community of a higher order should not interfere in the
that sometimes law should simply provide a good, broad institutional context, but avoid unwise over-judicialization of society, as that may have complex and negative long-term consequences.

One of the central insights of the social-norms perspective is that both law and social norms have their proper role and scope. Even when they support each other, they operate very differently. For example, Bernstein (1996) observes that there are many reasons why parties to a commercial transaction may actually prefer some aspects of their agreements and relationships to be legally unenforceable. Negotiating remote contingencies may signal distrust or unusual desire to litigate, and overly detailed contracts may make things too inflexible if circumstances change; legal system costs (litigation costs, delays, risk of judicial error) are high and both parties may prefer to avoid the possibility of legal battles; and there are many factors that are known to the parties by not verifiable by in a legally enforceable way. One common strategy seems to be that commercial transactors govern their dealings through flexible, cooperative social norms when they have a mutually beneficial, long-term relationship; but they combine those norms with legally stricter contracts that can be invoked if the other party turns out to be untrustworthy.

This sensitivity to social context is reflected in some traditional legal principles such as the English doctrine that, when it comes to agreements of a domestic nature, there is a rebuttable presumption that the parties did not intend to create legal relations. The wisdom of this principle is that legal battles tend to shatter relationships, and strictly legal rights and duties cannot contain the rich and complex notions of justice and reasonableness that parties to a personal and long-term relationship have. As Lord Justice Atkin famously put it:

‘The common law does not regulate the form of agreements between spouses. Their promises are not sealed with seals and sealing wax. The consideration that really obtains for them is that natural love and affection which counts for so little in these cold Courts. The terms may be repudiated, varied or renewed as performance
proceeds or as disagreements develop, and the principles of the common law as to exoneration and discharge and accord and satisfaction are such as find no place in the domestic code.\textsuperscript{10}

Greater sensitivity to the relationship between law and social norms also enables us better to understand legal – and regulatory – practices in different cultures and societies. Each culture is a product of numerous factors working over centuries and millennia. Western legal culture cannot be properly understood without taking into account the complex ‘synthesis of Athens, Jerusalem, and Rome’ (Gregg, 2003: xiv) that gave rise to Western civilization. In such places as Africa, India or China, the history and the accompanying social norms are very different indeed. Winn (1994), for example, argues that in the context of non-Western countries like China, it is appropriate to speak of legal marginalism, because Chinese relational systems give more importance to elaborate notions of reciprocity and trustworthiness.

Last but not least, social norms can be enforced through various non-legal sanctions, which in some respects resemble legal sanctions but in other respects are quite different (Panther, 2000, Charny, 1990). On the one hand there are external sanctions of two types, (i) second-party control and (ii) third-party control. Second-party control refers to non-legal sanctions that may be used by the other party to the transaction, such as refusing to do business again or creating credible threats (Williamson, 1983). Third-party control requires the cooperation of third parties, for example in the form of gossiping, shaming, and loss of reputation. Then there is also a third type of non-legal sanction, namely (iii) internal sanctions (which may also be called first-party sanctions). They are various emotional reactions that human beings may have as a result of following or breaking social norms. On the positive side, they include such emotions as empathy, human desire for approval, honor and esteem. On the negative side, one may experience regret, remorse, shame, guilt and embarrassment. Frank (1987, 1988) proposes that the ability to undergo such emotional reactions is valuable, because it supports the establishment of mutually beneficial, cooperative relationships.

The idea here is not simply that social norms can be enforced too, but that legal and non-legal sanctions are different yet related to each other. For example, Cooter (2000) notes that, although legal enforcement of rights and duties is often necessary, it also tends to be expensive, time-consuming and uncertain. Therefore it is important that laws be

\textsuperscript{10} Balfour v Balfour [1919] 2 KB 571, at 579–580.
complemented by social norms which support reasonable behavior. On the other hand, Pildes (1996) argues that over-intrusive laws can destroy social capital by failing to see the differences between enforcing social norms and enforcing laws. Social norms are not substantive rules, but they are *dynamic wholes* which are tied to complex social structures and flexible enforcement mechanisms. The informal enforcement of social norms differs drastically from formal legal processes, and the remedies available for breach of social norms are flexible and subtle, something that is rarely the case with law. This is a reason to respect the proper realm of social norms.

**Incentives, Motivation and Moral Behavior**

I have tried to show that the legal centralism of much of regulatory debate is neither necessary nor fruitful, because better results can be obtained by looking at a broader scope of sources of normativity. My second objective is to show that we can and should do the same about our understanding of human motivation and morality. In fact, these two perspectives are closely related: for example, the notion of ‘non-legal sanctions’ necessarily takes us to the issue of *moral or internal constraints* on action. However, the motivational and ethical perspective on behavior goes beyond such constraints.11

Douglass North (1990) once said that *internal norms* are crucial to our understanding of social institutions, but we do not have any good theory of them. I agree with the first part, but I disagree with the second. We do have several good theories of human choice from an internal perspective, and even the disagreement between some of the accounts may only be apparent. In this paper I cannot delve into specific debates, but I will highlight some perspectives that are empirically strong and that support each other.

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11 Mitchell (1999: 208–209) has criticized the new ‘[social] norms jurisprudence’ for accepting too much of the behavioral and positivistic attitude of modern social science and economics: the approach may end up distorting instead of improving the explanation of norms, because the leading authors ‘generally share the same basic goal, which is to establish a non-normative theory of norms. [...] They tend to share an underlying metanorm of efficient wealth or welfare maximization, and all share the basic belief that people are motivated principally – if not solely – by self-interest. Most importantly, by limiting their inquiry to what they see, they are unable to explain, except at the most superficial level, how norms become normative – that is, how they come to tell us what we ought (or ought not) to do.’
Intrinsic motivation. It is obvious that people do many things not because they get some external benefit from it but because is an immediate source of human fulfillment (see Staw, 1976, Deci and Flaste, 1995, Frey, 1997). Children need not be paid to play, and even few adults work only for the money (this is especially true of some professions, notably academic research). Similarly, most people devote time and energy to different forms of friendship and community – especially marriage and the family – not only because of some external benefits but mainly because friendship itself is an important aspect of truly human life.

Nevertheless, mainstream economic models of human behavior tend to ignore the relevance of intrinsic reasons for action, because they treat human motivation as a ‘black box’. The problem is that this leads to too much importance being given to external compensation or punishment. Many empirical studies have shown that external incentives – sticks and carrots – do not always produce the desired results, because external interventions interact with intrinsic motivations in complex ways (Frey 1993, Kohn, 1993). Building on a wealth of psychological literature, Frey (1997) summarizes the relationships between intrinsic and extrinsic motivation as follows:

(i) Intrinsic motivation is of great importance for all human activities; it is inconceivable that people are motivated solely or even mainly by external incentives.

(ii) The use of monetary incentives crowds out intrinsic motivation under identifiable and relevant conditions (Crowding-Out Effect). The same may also be true of other external interventions such as commands or regulations.

(iii) External interventions may, on the other hand, enhance intrinsic motivation under some conditions (Crowding-In Effect).

(iv) Changes in intrinsic motivation may spill over to areas not directly affected by monetary incentives or regulations (Spill-Over Effect).

For example, when a child is paid for doing household chores, she is unlikely to contribute without compensation (crowding-out effect). Yet if her father gives her a surprise present as she has been helpful in the house, it is likely to reinforce her intrinsic willingness to help out (crowding-in effect). As a general rule, when external intervention is perceived as controlling or failing to recognize the intrinsic value of a non-instrumental relationship, it crowds out intrinsic motivation. On the other hand, when it is perceived as supportive, self-esteem is fostered and people feel they are
encouraged to act with self-determination. As will be seen shortly, these considerations have great relevance for better regulation.

**Fairness and moral emotions.** The theory of intrinsic motivation shows that rational self-interest cannot be reduced to external interests and benefits. Evidence on altruistic behavior goes further away from the narrow concept of rationality found in mainstream economic models: ordinary people often act in other-regarding ways even at the a substantial cost to themselves (see Frank, 1988). However, fairness-based behavior is usually complex and dynamic. According to Rabin (1993), the empirical evidence can be summarized in three simple principles:

(a) People are willing to sacrifice their own material well-being especially to help those who are being kind.\(^{12}\)

(b) People are willing to sacrifice their own material well-being to punish those who are being unkind.

(c) Both motivation (a) and (b) have a greater effect on behavior as the material cost of sacrificing becomes smaller.

In other words, most people care about fairness in two ways. On the one hand, they want to treat others fairly, treating them well especially when they have received good treatment. On the other hand, people tend to retaliate against those who have treated them badly. But importantly, the extent of fairness-based behavior nevertheless varies according to various criteria, such as reputation effects, amount of material loss, standards of fairness, and self-image.

**Moral character.** Yet moral behavior is not a question of emotions alone. Already the ancient Greeks thought that human persons can become morally better or worse, according to their education and their own free choices. Aristotle’s *Nicomachean Ethics* is a systematic exposition of such virtue ethics, which sees good moral character as the result of good habits, i.e. internal capabilities of acting justly, wisely, honestly, maturely etc. Through a consistent attempt to use one’s reason, to give each person their due, to overcome internal inertia, and to channel one’s various desires according to reason, one develops the cardinal virtues of prudence, justice, fortitude and temperance – habits which in turn make it easier for that person to do the right thing in concrete situations.\(^ {13}\)

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\(^{12}\) This is not to deny that people can act altruistically regardless of how the others behave; one thinks of all kinds of voluntary workers. However, that probably requires stronger internal commitment to help others, and also the positive response of those being helped is likely to reinforce one’s willingness to make sacrifices for them.

\(^{13}\) For a modern exposition of virtue ethics, see Pieper (1966).
It cannot be denied that the moral character of persons and citizens is fundamental for the well-being of communities and nations. If all men and women are just and reasonable, law has merely a marginal and supportive role to play. Yet if everyone is cruel, selfish, dishonest and irrational, there is no legal and regulatory solution in the world to deal with all the resulting social problems. Indeed, it can be argued that the optimal extent and manner of law and regulation greatly depends on the moral character of the relevant people (see George, 1993).

Strategies for Better Regulation

In this section I outline some implications of these perspectives for better regulation. They have been divided into three categories. First, there are alignment strategies, i.e. regulatory approaches that seek to align law and regulation with supportive social norms and intrinsic motivations. The second category is entitled culture-building and habit-formation strategies, which focus on influencing social norms for the better and helping persons to adopt good habits. Thirdly, enforcement strategies seek to replace or combine legal and formal enforcement with informal enforcement through internal constraints and other non-legal sanctions.

Alignment Strategies

There are various possibilities for aligning laws and regulations with positive social norms and intrinsic motivations. Here are some general guidelines and examples.

Align regulation with positive social norms. Broadly speaking, positive social norms are those that are constructive, cooperative, pro-social etc. When such norms are strong in the relevant regulatory context, the most effective strategy is likely to one that builds upon and reinforces those norms. Generally, it is likely that in such situations there is no need for heavy, top-down regulation, because a light-touch, grass-roots approach will be sufficient, less costly and more effective. This is one reason why some form of self-regulation may be advisable (see generally Ogus, 2000). This is not to say that self-regulation is the right solution to all situations, for reasons discussed later in more detail. The point is that when there are positive, pre-existing social norms, giving them a semi-formal regulatory status through self- or co-regulatory schemes is likely to reinforce those norms – and to suppress less positive social norms and attitudes.
Avoid law and regulation that corrodes valuable social norms. An interesting example in this respect is the effect of intellectual property rights (IPR) on social norms in research communities (see Menell, 2000: 144). Although it is generally agreed that some form of intervention may be necessary to provide incentives for research and development, it has been argued that IPR may undermine progress in science by promoting values that conflict with the traditional norms of collaboration, disinterestedness and the emphasis on path-breaking basic discoveries (Merton, 1973). The adverse effect of IPR may be especially strong in biomedical research, which traditionally has favored the sharing of research to promote progress and serve humanity (Eisenberg, 1987). There is no simple solution to this dilemma, but such proposals as compulsory licensing may be worth consideration – not only for economic efficiency, but also to foster a cooperative culture of research.

It is interesting to note that in countries such as the UK, law reform proposals have began to given significant weight to surveys on public opinion (which closely relates to social norms). In light of the present paper this is a step forward, because more precise knowledge of public attitudes is vital to the design of good rules. It is however important to understand that public opinion should not be seen as an automatic source of legal normativity, because public attitudes may be poorly founded or incoherent, and social norms may also be manifestly negative and harmful, as is discussed shortly in more detail.

Support positive intrinsic motivation; avoid creating a ‘culture of minimal compliance’. The theory of intrinsic motivation gives additional support to light-touch regulation in certain circumstances. Over-intrusive and formalistic regulatory approaches signal mistrust and confrontational attitudes, which are likely to weaken intrinsic motivation to do what is right. If regulatory subjects feel they are being treated mistrustfully and unfairly, they will also tend to respond with spiteful behavior, even to the point of making the job of regulatory authorities as difficult as possible just to ‘get even’ (see Bardach and Kagan, 1982). In the worse case, the regulators will in response feel their authority being undermined, and will retaliate with even worse treatment, giving rise to a spiral of hostility.

Frey (1997) advises that positive intrinsic motivation is reinforced by external intervention that is perceived as supportive. This perception can be fostered numerous ways. One way is to develop personal relationships between regulators and regulatees. Another is to give the regulatees a sense of autonomy and to provide participation opportunities; self- and co-

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14 See for example Law Commission (2006: 1.21, 5.74-77, 5.84, 7.12-17, 7.47).
regulation are clear instances of such participation, but one can think of many other possibilities too. Thirdly, the message implied by external intervention is important; for example, *rewards* may be more fruitful in some contexts than punishments and commands.

It will also be better at times to rely on *soft, non-enforceable directives* implemented by agreement instead of hard rules backed up by harsh sanctions. Building on evidence from health and safety regulation, Bardach and Kagan (1982) argue that hard regulation tends to cause crowding-out of intrinsic motivation among the better manager, who otherwise would have gone beyond the regulations. A similar argument could probably be made about environmental regulation, where too much emphasis on prices and regulations may actually have an adverse effect on intrinsic motivations to be pro-environment; the consequences will be even worse if hard regulations are poorly designed.

It is obvious that tough sanctions are sometimes needed. However, Ayres and Braithwaite (1992) argue that regulation should always start with a persuasive approach, and it should provide differentiated treatment for the ‘good guys’ (those who comply voluntarily) and the ‘bad guys’ (those prone to cheating). Punishing misbehavior is also important for the intrinsic motivation of others, because they will otherwise feel that the rules are unfair and there is a ‘law of the jungle’ in place.

Use *broad, flexible standards instead of detailed rules*. In alignment strategies, flexible and principles-based standards are likely to work better than narrow, detailed rules. The reason is simple: broad standards are similar in kind to social norms – and indeed moral principles – because they focus more on fairness and reasonableness than on formal rights and duties. They are also more flexible and adaptive, which is why many authors claim that they are the best approach in rapidly changing environments. For example, UK industrial safety legislation has been criticized for failing to create any substantial reduction in accidents, partly because the laws center too heavily on machinery accidents that are less relevant in today’s workplaces, and also because the mandated safety devices fail to take into account broader factors such as the adaptive responses of workers (Veljanovski, 2007).

Once again, the optimal strategy will depend on the details of each case. Strict rules – or at least demanding interpretation of broad standards – may be necessary when there are *strong adverse incentives* to depart from cooperative and pro-social behavior.

*Identify the proper role, scope and style of law and regulation.* The theory of social norms highlights the difference between social and legal norms: they operate differently, and this means that it is important to give
each a suitable role. In legal and regulatory design, one implication is that we should be conscious and discerning of the relevant social context. In some situations, legal categories and principles cannot adequately reflect the relevant factors that the participants themselves feel should determine the outcome of certain conduct or dispute. Family problems are the most obvious case, but the issue is relevant to all the examples discussed so far.

It is also important to be conscious of and sensitive to cultural differences. They are, for example, a fundamental factor when it comes to the success of ‘legal transplants’ (see generally Watson, 1993). Boettke (1998) argues that one cannot understand differences of economic development without taking into account the role of culture. The twist in Boettke’s argument is that on the general level, we know what kinds of institutions are necessary for economic development – institutions such as private property, sound money, and freedom of contract – but we do not know how to implement them successfully: ‘Economics may establish the properties of alternative rules, but culture and the imprint of history determine which rules can stick in certain environments. The problem is not one of private property and freedom of contract generating perverse consequences, but the fact that some social conventions and customary practices simply do not legitimate these institutions. If market transactions – which are universal – are constrained to a sub rosa existence, the commercial life and development will be limited. To move from that sub rosa existence, legal-political institutions must be adopted, but such adoption is only possible if there is a cultural fit.’ (Boettke, 1998: 13)

A topic example of the role of cultural differences is intellectual property rights (IPR) protection in China. The central government seems to be making an effort to enforce Western-style patents and copyrights, but practices in regional courts and other public bodies can be very different, because Chinese attitudes towards Western rights and privileges are influenced by many factors other than formal legal provisions alone (see Fung, 1996, and Allison and Lin, 1999). The role of culture is also relevant closer to home: the European Union consists of countries with very different histories and cultures, which is one reason why ‘one-size-fits-all’ solutions may become ‘one-size-fits-none’ regulations. Thus the social norms perspective cautions us against excessive centralization of regulation in a setting of large cultural differences.
**Culture-Building and Habit-Formation Strategies**

*Foster cooperation by combining fairness with toughness.* Most of the time social problems are caused by various kinds of destructive, anti-social and uncooperative habits and norms. Can anything be done to improve the situation? One way of looking at it is that, assuming the issue is important and persuasive regulation does not deliver results, tough sanctions are needed. The general idea here is that when people are not freely willing to act fairly and reasonably, external intervention of some type may be needed. An interesting case to consider is the UK Financial Services Authority (FSA), which has been criticized for having adopted an unduly light-touch approach to financial regulation. The criticism has been raised after serious failings and abuses in the UK financial sector, and it is based on the idea that financial market participants are often tempted by powerful monetary incentives to act less-than-completely altruistically.

But the issue is complex: not all finance professionals are selfish and greedy. How should regulation be framed in contexts that include multiple actors with different kinds of motivations and values? Ayres and Braithwaite (1992) propose an interesting strategy, called the ‘*benign big gun*’ approach. The idea is to create a regulatory system that combines persuasion – and thus recognition of positive intrinsic motivation – with severe but targeted sanctions on misbehaving persons. This approach builds on the game-theoretic notion of tit-for-tat strategies, which imply that regulators should normally treat regulatees well, but if their trust is broken, they should respond with punishments, the severity of which is measured in accordance with the seriousness of the offense. Importantly, the success of the benign-big-gun strategy hinges on the ability of regulators to play both reasonable and tough, and also on the credibility of their threat to raise the severity of punishments as the offenses get dirtier. The argument is that, in the optimal case, most actors will perceive the rules as fair and reasonable, because the ordinary approach is flexible and persuasive; and in addition, there will be no incentives to break the rules, because the punishments for violations are sufficiently tough and certain to come.

One might suppose that the benign-big-gun proposal is perfectly obvious and that is how most regulators operate. Unfortunately that is not the case. Ayres and Braithwaite (1992: 49) cite the case of the US Occupational Health and Safety Administration (OSHA), which seems to operate with the completely opposite logic: ‘They constantly nip at firms with flea-bite fines. In most encounters with OSHA inspectors, petty punitiveness is in the foreground and no big guns are in the background.'
The result of flea-biting is that cooperation is destroyed without any of the benefits that can flow from tough enforcement being secured. When scholars point to an agency like OSHA to conclude that punishment and persuasion are incompatible, they have not understood the foregrounding of cooperation and backgrounding of punishment that benign big guns can accomplish.’

Indeed, there are numerous examples regulations that fail to combine persuasion with serious sanctions. In the context of financial markets regulation, the US Securities and Exchange Commission (SEC) is famed for its tendency to churn out complex and expensive-to-comply regulations that signal a mistrust of anyone participating in financial markets; but when it comes to dirty play involving multi-million dollar pay-offs, the SEC’s punitive responses appear more symbolic than real.\textsuperscript{15} Perhaps the same could be said about Finnish competition law and its enforcement: even after a recent decision that raises punishment standards in anti-competitive agreement cases, the level of fines is arguably too low (given low probabilities of getting caught) to create a real deterrent effect.\textsuperscript{16} In light of the present discussion, such approaches to regulation are likely to fail on both counts: they cultivate both opposition and disobedience.

\textit{Use creative strategies to promote positive social norms.} The interesting question is whether other – less interventionist and less costly – strategies could be adopted to foster the formation of positive social norms. The ideas cited in this paper suggest that are various ways in which this can be done. Considered in isolation, their impact may be limited, but many of them could be combined to create a holistic solution to a specific social problem.

Frey’s (1997) strategies for encouraging intrinsic motivation were already mentioned earlier, but they are equally relevant here: developing personal relationships, giving participation opportunities, providing rewards (instead of, or in addition to, punishments), etc. Now if we are assuming that the initial situation is rather more negative than positive, such light-touch approaches alone may not be enough, but they should never be completely ignored as if some people were beyond any possibility of change. As Goethe famously said, ‘Treat a man as he is and he will remain as he is. Treat a man as he can and should be, and he will become as he can and should be.’

In the literature on social norms and law, some commentators have advocated the notion of ‘norm entrepreneurship’ (Sunstein, 1996b). The

\textsuperscript{15} See Partnoy (2003) for a series of case studies.
\textsuperscript{16} On the optimal level of fines for antitrust practices, see Wils (2006).
idea, common in sociology, is that some individuals have a special role in transforming established social norms through their words and example. The concept can be taken in a value-free sense: ‘norm entrepreneurs’ may change social norms for better or for worse.

From the viewpoint of regulation, the idea of norm entrepreneurship is highly important. It may of course be difficult for politicians and regulators to change powerful social norms (Posner, 2000). Ordinarily, the only way to change social norms is to violate them in a public and decisive way, and such behavior can be especially risky for public officials, who are so dependent on their acceptance by the public. However, law and regulation may play a role in supporting actions and role models – for example authors, artists and actors – that are committed to challenging harmful social norms. Such support may include, among others, financial and moral support, and protecting such social actors against persecution in the public square. In economic terms, we could say that such legal and regulatory strategies aim to alter the payoffs of potential norm-entrepreneurs. Such strategies obviously call for a high degree of prudence, because they may backfire, and it is difficult to predict all the unintended consequences flowing from attempts to manipulate social norms.

Use creative strategies to cultivate other-regarding behavior. It may also be possible to encourage altruistic behavior in some regulatory settings. As Frank (1987, 1988) has pointed out, personal face-to-face contact tends to advance mutual understanding and altruism. This can be illustrated by a counterexample that is familiar to most readers: car-driving. Most drivers become impatient and annoyed much more easily behind the wheel than they would in other situations. According psychologists, the explanation is that conflict situations between different drivers are faceless and non-communicative, which obstructs the development of mutual understanding.

This has at least two implications for regulatory strategy. The first is that when cooperation is needed, the enforcement of laws and regulations should be designed in such a manner that there are sufficient opportunities for personal, face-to-face contact. This strategy can also be used when the challenge is to obtain cooperation in the sense of fairness and honesty; it is simply much more difficult (even for physiological reasons) to lie face-to-face than in an impersonal letter. One can think of many potential areas of application, including the enforcement of tax and competition laws. Note however that in order to promote cooperation and fairness, the rules being

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17 Posner (2000: 30) points out that some famous ‘norm entrepreneurs’ were fabricated, Martin Luther King, Jr., being perhaps the most famous example.
enforced must also be seen as fair and reasonable; but the positive side is that personal contact and the exchange of ideas will normally help to create a more affirmative attitude toward the rules too.\footnote{For further discussion in the context of tax policy, see Cowell (1992) and Vihanto (2003).}

The second implication is that laws can be employed to frame the relevant institutional set-ups so as to reduce to need for external intervention. For example, when the aim is to reduce egoistic or greedy conduct by certain individuals, the problem may be alleviated by reducing the amount of impersonal dealings and obliging more personal, face-to-face contact between the relevant transactors. Financial markets and company law are just some potential areas of application.

These examples demonstrate the importance of taking altruistic and fairness-based behavior into account in all legislative and regulatory deliberations. However, altruism cannot always be relied on, and it is necessary to understand the influence of the context. For example, when there are powerful financial or other incentives to cheat or to be selfish, high ideals and internal constraints are more likely to be pushed aside (Rabin, 1993).

Encourage good moral habits and protect the ‘moral ecology’ of the society. Finally, it is possible to encourage good moral habits. Law has an obvious role of play in this regard in the sense of promoting basic fairness and justice: in the absence of criminal, contract and accident law, many more people would be tempted to opt for unjust modes of conduct. In light of virtue ethics, such conduct would reinforce bad habits in those persons, making them morally worse.

However, virtue in the fullest sense cannot be forced from without; it must involve the free decision of the person to do the good. In this sense, law can play a limited role only. Good moral habits are fostered mainly through one’s upbringing, education, role models, example of one’s peer group etc. The main responsibility lies therefore in the various institutions of the civil society: families, schools, churches, associations and so on.

Nevertheless, the state can make important decisions in this respect too. Just like laws and regulations facilitate the activity of certain ‘norm entrepreneurs’, similarly they influence the institutional setting in which the civil society operates. Educational laws give direction to the curricula of schools and universities; laws on marriage and the family influence the stability and health of natural families; laws on religious freedom, and even tax laws, influence the ability of religious communities to take formative activities upon themselves; and through its budgetary choices, the state
makes numerous decisions that sustain certain social and cultural activities instead of others. Note also that, because of crowding-out problems, even basic social policy choices have complex but powerful consequences on the vitality and social role of various kinds of voluntary associations and charitable organizations (see Beito, 1992, and Arffman, 2008).

This perspective of moral habits is not much talked upon today, and it would be easy to dismiss it as secondary, unimportant, or simply too vague. Such skepticism is not warranted. There is a wealth of evidence supporting the view that people are significantly influenced by various educational and social factors, and that good influence can help change them for the better. Perceptions of good life – based on one’s upbringing, education, and books and movies – have an empirically measurable effect on moral attitudes. There are also encouraging results from certain programs aimed at helping prisoners avoid a criminal career.

In order to cultivate moral virtues, it is also necessary to protect what some have called the moral ecology of the society (George, 1993). This broad concept refers to the totality of moral and cultural factors which helps the upright moral development of persons and groups. The protection strategy here can mean many things, including the regulation of advertising so that the natural desire of companies to do more business will not corrupt individuals (young persons in particular) by promoting images and ideals that display materialistic and hedonistic lifestyles, fail to reflect and respect the dignity and rationality of human persons. Similarly, in such fields as entertainment, there is a danger that sales are boosted by way of resorting to the exploitation of human temptation and moral weakness, and public authorities can legitimately act to restrain such influences, especially because the logic of competition may otherwise create pressures for all market participants to engage in dubious practices. Laws might also deliberately aim to protect the public against harmful norm entrepreneurs, i.e. influential individuals that spread norms and values that are destructive of life in society.

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19 For example, economics and business education has been criticized for implicitly promoting an egoistic and materialistic ideal of life. Individual cases may differ, but empirical studies confirm that economics, finance and business students display substantially more greed in ultimatum game experiments than do control groups.

20 One study finds that Prison Fellowship’s InnerChange Freedom Initiative participants were 60 percent less likely to be re-incarcerated and 50 percent less likely to be re-arrested than the comparison group (see Johnson, 2003).
Obviously, much prudence is needed. Intrusive intervention in social life risks giving rise to moral paternalism, which may backfire in the longer term. Fundamental values such as freedom of expression are also involved; and taking a moral stand in a pluralistic society provokes the question of conflicting values. Nevertheless, these difficulties alone may not be a sufficient reason to go from one extreme to the other, from paternalism to libertinism. It is generally acknowledged that freedom of expression is not an absolute value, as it needs to be balanced against other human and fundamental rights. Similarly the mere existence of different values is not in and of itself a good reason for taking (whether actively or passively) a particular stand in the debate; and to treat all norms and values as equally laudable is also a position that calls for justification by independent reasons.

**Enforcement Strategies**

There are numerous reasons why social norms and internal constraints – either alone or supported by legal enforcement – may provide an attractive basis for enforcing socially desirable regulations. They may yield *more effective results*; they may imply *lower costs* for both regulators and regulatees; they may be *more flexible* and also more deeply rooted in *those concerns that matter* (for example, in the case of personal, long-term relationships); and they may *reduce formalistic confrontation*, which tends to corrode cooperative attitudes and positive social norms.

It is not easy to formulate any general principles or guidelines for social-norms-based enforcement strategies, and in any case the enforcement aspect of social norms has been implicit in the foregoing analysis of alignment and culture-building regulatory strategies. Here I would only like to make some additional comments.

One question concerns the conditions that make non-legal enforcement *advisable and effective*. As is clear from the previous sections, this depends on the nature and strength of the relevant social norms and moral values. For example, many aspects of business ethics (such as corporate responsibility programs) are not enforced legally, but there are reputational incentives for implementing effective ethics programs in companies. To some extent, these reputational incentives depend on institutional arrangements and social expectations, which in turn are shaped by various

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21 See George (1993: 42) for an insightful discussion of the various prudential considerations which might militate in favor of a policy of tolerating certain moral evils.
social-norm entrepreneurs. It can be argued that many aspects of corporate responsibility should not be legally enforced, because the complex and aspirational character of business ethics implies that codifying its requirements in legal enforceable codes would be likely to stultify its development and to discourage ethically-orientated businesspeople; the difficulties involved in measuring and verifying corporate responsibility variables also argues against the over-judicialization of the field.

On the other hand, the effectiveness of informal enforcement depends on many factors such as the financial incentives to violate social and moral norms. It may also be that, although the general public strongly disapproves of certain conduct, the disapproval remains mostly a private matter because it is not transformed into concrete and relevant action. These concerns seem to hold in the context of anti-competitive agreements among businesses: the expected financial gain can be significant, and the reputational penalty seems to be less significant.22

The other important question concerns the role of law and the state in the design of non-legal enforcement. For example, reputation effects can be deliberately influenced by laws and regulations. A topical example is the decision of the Estonian Ministry of Justice to publicly ‘name and shame’ parents who have failed to make maintenance payments after divorce. The reason for the decision seems to be that there have been difficulties in enforcing maintenance agreements through the court system.

More generally, law plays a supportive role even when the principal method of enforcement is non-legal. Law strengthens social norms through its expressive function and may give them necessary moral support. The specific content of social norms may also depend on laws and regulations; for example, standards of fairness can be shaped by legal rules even when they are enforced non-legally. Finally, benign-big-gun strategies of regulation require that there exists the threat of powerful legal sanctions, which to facilitate cooperation between regulators and regulatees on a more flexible basis.

22 On reputational penalties for corporate crime generally, see Alexander (1999).
Conclusion

I have argued that regulatory strategies could be improved in two ways. Firstly by looking beyond laws and regulations to the realm of social norms and other sources of normativity that govern human choosing and acting, and secondly by becoming more conscious of the role of motivations, moral character and culture. I have tried to show that these perspectives can fruitfully be translated into regulatory strategies that (i) align laws with positive social norms and motivations, (ii) seek to foster positive norms and cultivate moral habits, and (iii) rely, when appropriate, on moral and social norms for the enforcement of laws. The goal of this paper has not been to replace pre-existing wisdom, but to propose ideas that may give new insights and show directions for new initiatives. Its application in specific fields of regulation requires further discussion, experience and learning.

References


THEORETICAL REFLECTIONS ON THE PRINCIPLED REGULATORY STRATEGY
On the Conditions of Rationality in Law-Making

Hannele Isola-Miettinen

Abstract

This paper focuses the rationality assumption the legislator is presumed to have when it is using principled regulatory strategy. That is important aspect because legislation is understood to be communication. In this issue two theoretical approaches are studied more precisely: Luc Wintgens’ approach concerning the rationality of legislation activity and Ota Weinberger’s approach concerning the principle of “justice”. Wintgens approaches the issue from the perspective of legality. After that Wintgens widens the approach towards freedoms and rights of individual. On basis of the “freedom of principium” Wintgens finds some “system” principles which should guide the rationality of the legislator. Weinberger’s thinking represents non-cognitivism and the institutional legal positivism. Along Weinberger the decision-making in case of principles (“justice”) is relative question. There exist different theories on justice. There exists no stable or absolute “justice”. As a conclusion one can say that legislation is merely choices and there exist no absolute knowledge about principles. That is the reason why legitimacy is an important aspect in legislation. This paper on very general level asks, if the theoretical knowledge is possible in the legislative praxis. Namely, theoretical concepts have remarkable effect in the knowledge formation concerning the principles in legal system. One argues here, that the discussion between theory and praxis is not easy but in some extent possible. It is more possible if we understand the concepts and language we use in the communication between us.

1 Introduction

This paper is focussing principles in legislation. Paper reflects on theoretical level what and how the legislator “knows” about principles (principles like privacy, justice, human dignity or competitiveness) which it writes into the legislation. The theoretical interest of the paper is what kind of cognitive attitude the legal theory/philosophy has taken towards rationality and knowing in legislative matters and what position the
legal/philosophical theory has taken to the (legal) principles\(^1\)? The more general aim of the paper is to reflect on what conditions to combine theoretical knowledge and legislative praxis.

### 1.1 Problem of human rationality and knowing?

There exist several theories on human rationality, 1) the Kantian principled sense of rationality that believes that the possession of a capacity generating or recognizing necessary truths and \(a\ priori\) beliefs, the conception of rationality, according to which the “reason is the faculty of \(a\ priori\) principles”, 2) the Hegelian conception of holistic sense of rationality that means the possession of a capacity for systematically seeking coherence and 3) the instrumental sense of rationality that means the possession of a capacity for generating or recognising contingent rules, \(a\ postriori\) beliefs, contextually normative rules, consequentialist obligations, and hypothetical “ought” claims – the Humean concept of rationality.\(^2\) In this paper it is satisfactory to know that there exist abstract, \(a\ priori\), knowledge, that is assumed to gain by the deducing operation. In the deducing, the validity of the knowledge is based on the rationality, independently of the sense of experience. The other mean to gain the knowledge is the inductive reasoning which is generalising the truths from the single premises and from the sense experience. In the science we distinct the streams like philosophical rationalism and empiricism, in the legal theory and philosophy we talk about natural law and about positivist tradition with several emphasis.

### 1.2 Rational legislator and communication?

Van Hoecke writes “Law does not describe but prescribes reality, or, more precisely, interhuman behaviour.”\(^3\) Van Hoecke defines that “law itself essentially is based on communication: communication between legislators and citizens, between courts and litigants, between the legislator and the judiciary…”. Van Hoecke says that this communicational aspect is nowadays considered also within the frame of the legitimation of the law: a rational dialogue amongst lawyers as the ultimate safeguard for a “correct”

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\(^2\) Robert Hanna, 2006, xvii.

\(^3\) Van Hoecke, 2002, 19.
interpretation and adjudication of law.”⁴ One assumes that the legislation given by the legislator is rational communication (sender–receiver) towards the judges or civil servants or citizens. Usually the legislation that is given in the form of written language, is supposed to “mediate” some purposed “meanings” to its addressees in society. If the situation is otherwise, and the legislation is not mediating purposed meanings, the legislation given in the society by its legislator is not rational in the communicative context.

1.3 Legislation is a source of law

In modern democratic society we still agree it that, that the “statutes”⁵ given by legislator is important “source of law”. Kelsen writes “A Law – a product of the legislative process – is essentially a general norm, or complex of such norms.”⁶ Van Hoecke shows that there is in every legal culture a hard core of shared understandings that is very stable. This paradigm consist of basic views on the concept of law and legal sources, the methodology of law, legal argumentation, legitimating of law, and more generally some common values and world view. Such views may change over time, but only slowly. Legal rules may be changed from one day to the other, but the way these rules will be handled, interpreted and applied will still be governed by the, unchanged, legal culture.⁷ Sometimes the concepts “legislation” and “legislative powers” are defined to be very close relatives to the political “volition” and to the political power. Along Tuori the legislation in its normative dimension is considered to be ‘not-yet-law’, the raw material for the law, rather than ‘already-law’.⁸

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⁵ We know that in legal studies or in legal practice the terminology easily and in the long rung, without the critical reflections, begins to live its own life. The legal language differs from general language. Trying to avoid the blindness due to the special law language, it is reasonable now and then to go to origins of the traditional terms and check the balance between the special language and general language. The general language defines the term “statute”: a “law made by a legislative authority; permanent rule made by an institution or its founder; written law; Act of Parliament.” The term legislation refers in general language to “act of making laws; body of laws enacted”. The term legislator in same dictionary refers to “maker of laws”.
⁶ Kelsen, 1945, 256–257.
2 Principles⁹ – inside or outside the legislation?

Along Tuori the legal principles are various and there are found several typologies of legal principles like decision-making principles, interpretation principles, general principles, principles of sources of law, background principles of legislation or so called system principles.¹⁰

2.1 Independent or integrated principles?

Some theorists think that the principles, like the moral principles, are integrated into the legislation, some theorists see that principles are independent type of norms. Assumable Dworkin is the most popular defender of the independent legal principles. In legal theory there is no agreement on that, if the legal principles are independent norms or definite norms or one norm-type like rules, at all. Aarnio writes that he puts different norm types on the “sliding scale”, instead of typing them into some all-or-nothing categories¹¹. The discussion about rules and principles is unsettled and tension goes between the dimensions called “legal positivism” and “natural law”. On that basis there is found two kind of knowledge in law: 1) knowledge of natural law and 2) knowledge born in the decisions of the legislator. Natural law is based on idealism and the way we receive our knowledge from that natural law is the deducing. And as we well know, the knowledge based on decisions of legislator, we call positive law.

2.2 Principles based on EU –law?

Along von Bogdany the legal principles increase the rationality of the problem solving in the legal context, they create and secure the transparency and the coherence of the law. The legal principles are a kind of “framework of orientation” that is helpful in the Union’s fragmented legal order. von Bogdany writes “These principles can fulfil the function of “gateways” through which the legal order is attached to the broader public discourse. A doctrine of principles has the task to prepare and accompany

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⁹ The term principle in general language means: “general truth, doctrine or proposition, on which others are based; basic moral rule or conviction; ultimate source; elementary constituent; essence; (pl) morality.”


¹¹ Aarnio, 2006, 304.
After a quite short analysis we find in legislation objectives like:

- to promote..., to ensure...services...reasonable conditions to all telecommunication operators, to ensure opportunities...with the reasonable needs of users, to ensure that the opportunities are competitive, technologically advanced, of high quality, reliable, safe... 13.
- to ensure expressed state of affairs, like ensure the confidentiality and privacy in electronic communication, to promote some state of affairs like to promote information security in electronic communications and promote balanced development of a wide range of electronic communication services14.
- to promote the protection of privacy and other basic rights15.

Modern legislation is more or less vague aims and goals, even ideals or open values given in the form of several principles. Such goal oriented legislation is teleological, in its nature.

### 2.3 Human right principles, goal principles?

Along Garapon, in worldwide relations the form of law is regulation, on national territory the form of law is legislation and on universal level the form of law is declaration16. In the earlier versions of natural law theory with the term principle it has been referred to “something divine”. As told by Garapon, in modern legal theory the form of law of the universal human right principles is the declaration.17 Garapon defines: on national level legitimacy of law comes from its political source. On the worldwide level the legitimacy of law comes from “its necessity and efficiency”. And what legitimates the declarations given on universal level is their “values”.18

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13 Along the “Communication Market Act” (393/2003, 119/2008) and section 1.
15 The “Act on the Protection of Privacy in Working Life” (759/2004), section 1, says that “The purpose of this Act is to promote the protection of privacy and other basic rights safeguarding the protection of privacy in working life.”
16 Garapon, 2009, 73–74, the term “legislative” we in general language refer the adjective “pertaining to legislation; having the duty of law-making; enacted by legislation”. The verb to regulate in general language means “govern by rule; put in order; control by law; cause to function accurately; cause to conform to standard”.
Along Westerman next to the so-called mandatory rules of the prohibitive type we can find new kind of norms: “aspirational norms”, norms that directly prescribe the achievement of goals and “result prescribing norms”, norms that are prescribing us to obtain results. Westerman does not name aspirational norms principles, although those norms are defined that they can be realized to a larger or to a lesser extent. One can argue that principles in legislation and “principled regulatory strategy” leaves much “open”. The question is how rational legislator is when it is using this strategy? What kind of knowledge the legislator uses in its legislating strategy, when it is making its choices over the teleological kind of “state of affairs” and over their possible “consequences”?

3 Theoretical approaches to rationality of the legislator?

This paper focuses two theorists: firstly, Luc Wintgens writings on the “legisprudence”, the rational theory of legislation and secondly Ota Weinberger’s approach to rationality and knowing in law.

3.1 Wintgens and legalism?

The principle of legality is a necessary condition for the existence of rules, but it is at the same time a sufficient condition because it regulates both the unquestionable input (legislation) as well as the output (rule application) in legal reasoning. Wintgens reflects the legislative activity through lenses of this “legalism”. Wintgens tries to establish the theoretical approach that allows us to explain the absence of theoretical reflections on legislation and make some suggestions that may contribute to the theoretical study of legislation that allows us to articulate criteria for good legislation or as he names it to “legisprudence”. Legisprudence offers not

22 Wintgens, 2002, 9, traditional legal theory deals with the questions of the application of law by the judges. Wintgens refers to some writers (for example Noll) favouring the approach, which see that judges and legislators, in many respect, do the same things..
one but several theoretical approaches to that topic.\textsuperscript{24} Wintgens focuses not on the legislators’ freedom to make choices but rather on the limitations due to rules.\textsuperscript{25}

3.1.1 External and internal perspective to legislative activity?

Wintgens takes external and internal perspective to rationality. Rationality in this context means that legislative activity deals with the cognitive aspect of the rules to be followed by the legislator or, as Wintgens says, “more precisely, with the cognitive aspect of the internal point of view of the legislator”. Wintgens says that “Rationality in legislation, then, means that the legislator does more than just is promulgating, in the form of legal rules, his own subjective preferences. Legislative activity becomes more rational, in as far as the cognitive aspect of the internal point of view of the legislator is taken seriously.” Wintgens asks “How can this be analysed?"\textsuperscript{26}

One of these cognitive aspects is legal validity. It is a system-internal quality of the rule created by the legislator. Validity of legal rules can be connected to the volitional aspect of the hermeneutic point of view. It is an expression of legislators will to give legal validity to a certain proposition. External point of view refers to knowledge about reality. The legislator does not look upon the social data as raw material but such knowledge is filtered by scholarly work so that they are set up as knowledge about social reality that could be relevant for legislation. But Wintgens asks: how it is theoretically possible that the extra-legal elements can be introduced in a legal system. One instrument is the constitutional review. For example the Bundesverfassungsgericht has isolated certain criterias that are used to measure the quality of the legislation: a duty to establish the facts, 2) a duty to balance, 3) a duty of prognosis or prospective evaluation, 4) a duty to take future circumstances into the consideration and 5) a duty to correct legislation at a later stage, or retrospective evaluation.\textsuperscript{27} In the European countries there are differences in this respect of constitutional review: some countries have established constitutional courts with the capacity of

\begin{thebibliography}{9}
\bibitem{Wintgens2002a} Wintgens, 2002, 29.
\bibitem{Tuori2002} Tuori, 2002, 105–106, Tuori’s distinctions about three forms of the rationality in legislation: object rationality, internal rationality and normative rationality. Along Tuori, one explanation for the alleged decrease in the internal rationality of legislation in Finland may lie in the fact that law drafting takes place increasingly elsewhere in the state machinery than in the Ministry of Justice. Along Tuori there is the expertise required by the monitoring of internal rationality is concentrated.
\bibitem{Wintgens2002b} Wintgens, 2002, 30–32.
\end{thebibliography}
constitutional review of legislation\textsuperscript{28}. For example, in Finland, it is the Constitutional Committee inside the Parliament, which is investigating the constitutionally relevant matters, \textit{a priori} and \textit{in abstracto}.

3.1.2 \textit{Freedom as principium}

Wintgens in his later writings says that law has its own method and “the legislative” is very difficult to see through the rational theory. Wintgens elaborates further his legisprudence approach departing from the epistemological reflections concerning the freedom of the individual. Wintgens comes again to the concept of legalism and sees that legalism mainly attempts to exclude any form of theorising on the legislation. The legislation is a matter of choice. And choices are disputable, so that a theory that would take them to be the object of knowledge is condemned to failure from the very beginning. Wintgens’ solution to that problem is that Wintgens takes under the focus the knowledge and the rules that contain rights and duties.\textsuperscript{29} Wintgens sees that the freedom as \textit{principium} means that any limitation of freedom must be justified. Wintgens defines that “Legisprudence is defined as a rational theory of legislation”. It consists of an elaboration of the idea of freedom as \textit{principium}.

The justification of legislation is marked as a process of weighing and balancing the moral and political limitations of freedom. Upon the rational character of legislation, a principled framework is then required. With the help of this framework, external limitations can be justified. And the justification is part of the process of the legitimation. Rational theory of legislation, or the legisprudence, does have its basis on the principles: the principle of alternativity, the principle of normative density, the principle of temporality, and the principle of coherence. Wintgens says that “Upon the rational character of legislation, a principled framework is required”.\textsuperscript{31} The principle of alternativity requires the priority of subjects’ action. The idea is that the sovereign can only intervene on the condition that it is argued that his external limitation is preferable to an internal limitation of freedom as a reason for action, due to a failure of social interaction.\textsuperscript{32} Normative density refers to sanctions that need a special justification.

\textsuperscript{28} Wintgens, 2002, 14.
\textsuperscript{29} Wintgens, 2005, 2–6.
\textsuperscript{30} Wintgens, 2005, 11.
\textsuperscript{31} Wintgens, 2005, 11.
\textsuperscript{32} Wintgens, 2005, 11–12.
because they include a double restriction of freedom.\textsuperscript{33} The principle of temporality, the perspective of time, constrains the limitations of freedoms and the possible sanctions. The “right time” is one critical element of principle of temporality. The principle of coherence is the principle of justification of external limitations from the perspective of the legal system as a whole.\textsuperscript{34} Along Wintgens politics is matter of disagreements and here Wintgens sees that principles of legisprudence are important.\textsuperscript{35} In his conclusions Wintgens stresses the importance of human rights. Wintgens stresses the requirement to respect for individual freedom.\textsuperscript{36} What Wintgens says is “The supplementary justification on the principle of coherence underpins the connection between the concept of freedom as part of the analytical theory of the legal system and the system’s rules.”\textsuperscript{37}

Wintgens furthers the epistemological discussion with writing about jusnaturalistic and non-jusnaturalistic models of legitimation and about freedom and about the rights. Wintgens precises the substantive model and the model called procedural model in legislation. The result of procedural model is born in that legitimation programme. Substantive model demands the substantial legitimation and the substantial models basically deal with free will. Interestingly, Wintgens writes about the rights, also as political rights as participation rights and analyses theoretically the legitimacy chains. Wintgens sees that so called strong legalism goes in hand in hand with the model of the legitimation that includes the irreversibility of that legitimacy chain. Strong legalism includes a “one shot” legitimation, in that the legitimation chain is activated at the “moment” of the social contract. Reversals in the legitimation chain show some mechanisms which are built into the chain that allow subject to contribute to it in active way, in elections, in referendum or by challenging the acts of sovereign.\textsuperscript{38}

In sum, Wintgens sees that legislation as an activity is merely political issue and the issue of making choices than the rational issue. Wintgens has taken his approach to legislation through solving the critical aspect of legalism. Wintgens studied the rationality of legislation departing from the concept of freedom. Wintgens developed on that basis some principles of legislation: the most important of those rationality principles is the principle of coherence. Along Wintgens, partially the legal principles should be integrated into the legislation. Wintgens stresses the importance

\textsuperscript{33} Wintgens 2005, 12.
\textsuperscript{34} Wintgens, 2005, 15.
\textsuperscript{35} Wintgens, 2005, 22.
\textsuperscript{36} Wintgens, 2005, 22.
\textsuperscript{37} Wintgens, 2005, 22.
\textsuperscript{38} Wintgens, 2007, 39–40.
of human rights. But as we well know, all human right aspects are impossible to take into account in advance into the legislation. That is why it is often the Courts which formulate the human right principles in concrete cases.

3.2 Weinberger: what it is possible to know?

Weinbergers approach to justice is closely connected to practical philosophy, which is non-cognitivistic, legal positivistic and value-relativist, in its nature. That practical philosophy excludes every form of practical cognition in the sense of natural law theory. There is such a thing as practical thought and practical argumentation, but no such thing as practical cognition. The purpose of Weinbergers’ theory is to establish a viable analytical theory of substantive justice which on the one hand grasps the reality of human life and on the other hand emphasises the element of the moral in our individual and communal existence, without lapsing into metaphysical speculation.

Weinberger writes, legal positivism in its strong version says that it is only relative to some given system of positive norms that question of justice can arise at all. One Weinbergers’ thesis is that problems of justice stand at the crossroads between morals, law and politics. In a certain sense, these three are complementary, writes Weinberger. They are concerned with the relationships of individuals with their fellow humans and with the community. Anyhow, Weinberger writes that it is an anthropological fact that all humans and social groups of all kinds have convictions about justice which they regard as intuitively valid.

39 For example, the question what and how to know about the principle of “justice” is not irrelevant in legal praxis. The principle of justice is written into the Civil Servant Act (750/1994 sect. 2) and into the Administrative Judicial Procedure Act (586/1996, amend. 435/2003, sect. 33). Along the Administrative Judicial Procedure Act, section 1, the object of the Act is “to achieve and promote good administration and access to justice in administrative matters.” In the European Union Charter of Fundamental Rights, for example, we speak about “right to a fair trial” (art. 47). The Civil Servant Act, along the section 2, is to ensure the civil servants “just” position in relation to the employer. In Finnish language the term that is used in the Civil Servant Act is “oikeudenmukainen” (justice/fair).


42 Weinberger, 1986, 146.
the convictions about justice and judgements of what is just are always subject to analysis and are based in and developed through rational reflections.\(^{43}\) Weinberger goes on saying that, although reflections are rational processes which are in principle capable being formalised, they cannot be presented in the form of a single deductive chain moving from firmly established premise to a conclusion. Weinberger says that deliberations about justice often run along several lines, and depend on comparisons of value and judgements of preference and both rational and empirical processes of proof. The aim of such deliberations is to achieve an equilibrium between moral intuitions as shaped by tradition on the one hand and critical analyses on the other.\(^{44}\)

Weinberger reflects philosophical theories about justice that are trying to establish objectively what is to be deemed just. Those theories settle the principles of justice or set up single fundamental principles of such kind that other relevant principles are supposed to be derivable from it.\(^{45}\) As Weinberger shows, there are various attempts that try to prove the objective validity of the principles in order to justify the claim for the universal acceptance. Along Weinberger 1) justice as formal principle and the principle of formal equality is only an instrument for securing the transparent quality of substantive criteria of justice. The establishment of categories of relevant facts and of the consequential normative provisions is left open. This has to be judged evaluatively as just or unjust.\(^{46}\) 2) Justice as a material \textit{a priori} approach and the existence of substantive principles of justice is treated as a material \textit{a priori}, as Weinberger says, discoverable by intuition and/or analysis. Along Weinberger, the existence \textit{a priori} of the substantive principles of justice is a scientifically unacceptable hypothesis, scarcely serviceable in reasoning about justice. This is true without prejudice to the fact that we intuitively experience clear evaluations as to what is just. The fact that we experience something as intuitively certain by no means entails that this experience is objectively correct and unquestionable in the light of analysis and/or subsequent experience. The intuitions of justice can assuredly be turned to good account as facts to be reasoned about but they cannot justify \textit{a priori} substantive principles of justice.\(^{47}\) Weinberger says that 3) religiously inclined theorists view principles of justice as directives of God to man, and thus as also existing \textit{a priori}. According to this conception, what is to

\(^{43}\) Weinberger, 1986, 146.  
\(^{44}\) Weinberger, 1986, 146.  
\(^{45}\) Weinberger, 1986, 146.  
\(^{46}\) Weinberger, 1986, 149.  
\(^{47}\) Weinberger, 1986, 149.
count as just is determined through the belief-system which is accessible to human beings through revelation or through some other religious experience. And finally, 4) anthropologically given principles of justice deduce the principles from the essence of humankind, that determine what must objectively count as just, on the ground that these principles themselves, as implications of anthropological constants, are anthropologically necessary “ought” principles.

In Weinbergers’ analysis concerning the justice according the standard of a normative order Weinberger says, that traditional positivistic teaching reduces the problem of justice to a conformity of the conduct to rules as enacted, or at any rate to the formally equal decision of cases according to the rules in force. Such conformity of conduct to a rule can be objectively tested, without any evaluation or justification of the rule in question, which is simply taken for granted as a given feature of society. The relativisation in respect to the positive system of norms brings about the objectivisation of the problem of justice, but at the price of excluding from the considerations the very being and the substance of what lies at the core of an analysis of justice. About traditional theories of justice Weinberger says: they present judgements of justice as a form of objective cognition: either out of the conviction in favour of natural law, presupposing some kind of practical cognitive faculty or some kind of religious faith according to which the normative principles have been pre-ordained for human beings or on the ground of a purportedly objective utilian calculus or through the relativisation to a positive system of norms.

Weinbergers theory among other emphasises the element of moral in our individual and communal existence, without lapsing into the metaphysical speculation. The non-cognitivism in this case means that human beings are active beings but their thoughts and perceptions are in principle subservient to praxis. To Weinberger the thinking is a processing of information, which is an instrument for gaining knowledge and the utilisation of cognition in the context of the guidance of conduct. That is, thinking is a process which plays an essential role in the structure of deliberation determining action and its control. One sums up the idea that Weinbergers non-cognitivism excludes not only deductive justifications of practical conclusions based on purely cognitive arguments, but also every other cognitive way of supporting practical sentences. Along Weinberger
every practical justification requires some practical arguments which express an evaluative attitude, premises drawn from 1) intuition, 2) consensus, 3) explicit contractual agreement or 4) other source.\textsuperscript{53} Along Weinberger the non-cognitivism rejects both the absolute values and the validity of \textit{a priori} principles of justice and excludes every sort of the practical cognition which might purport to give a purely cognitive basis for objective values or correct normative principles.\textsuperscript{54} About complexity of justice Weinberger writes that there exists no fixed judgement about justice whose correctness is objectively guaranteed, but on the contrary always finds himself only on the search of justice. Judgements about justice are not findings of fact which could be confirmed simply by correspondence with the actions or with human attitudes or with given standards. Justice is not the fact, but a task: a task for our heads and four our harts.\textsuperscript{55}

4 Theory and practice and communication

For example, Weinberger rejects the cognitive knowledge in practical thinking. Anyhow, Weinberger stresses that thinking is information processing. And we know that thinking takes place in our minds through the certain concepts. With the concepts we have in our minds, we can also form the meanings. Las is communication, legislation is communication, in its nature. Kilpatrick in the study “International handbook on economic regulation” (2006) has focused the problem of the communication in context of regulation. In the study it has been reflected the problem of common knowledge in regulation. It is stated that the regulator is left in a state far short of the level of information assumed in several regulatory theories. In that study the problem concerns monopoly regulation. The issue is important. In the private transactions the principal bears the cost of any error in his or her assumptions. Contrast this with a regulator with responsibility for a price and quality of an essential good. If the regulator is wrong in his or her common knowledge assumption about the agent (the regulated firm), it is either consumers or the regulated firm that bear consequences.\textsuperscript{56} Is it possible that theoretical knowledge could contribute the praxis? There exist wide amount so called legislative practical

\textsuperscript{53} Weinberger, 1986, 155–156.
\textsuperscript{54} Weinberger, 1986, 162.
\textsuperscript{55} Weinberger, 1986, 169.
\textsuperscript{56} Kirkpatrick, 2006, passim.
principles, elaborated by OECD or EU. The very interesting aspect would be to analyse, what kind of theoretical starting point, if any, there has been adopted in these kind of instructions.

Conclusions

The problem of the principled regulatory strategy is taken under more effective focus in this paper because of the rationality assumption that legislator is presumed to have in its legislative activity. This aspect is important because the legislation still is one important source of law. Assumption is that the legislator mediates and communicates with its legislation the meanings to its addressees, like authorities and citizens. Principles are typical to EU-law based legislation, they have integrative and coherence creating function. Principles are various, usually they are defined to belong to the knowledge, a priori, in their nature. Principles contain goals and values. Some theorists do not count principles independent norm-types, some theorists like Dworkin argue for legal principles. This paper has studied theoretical approaches taken towards rationality of legislative activity. Along Wintgens there are found some principles which should guide the rationality of the legislator. Wintgens bases those principles on the legalism and on the “freedom of principium”. The most important legislative principle is the principle of coherence. Wintgens seems to think that the legal principles are merely the system principles. Weinberger represents the non-cognitivist attitude and the institutional legal positivism in theoretical approach concerning principle of justice. Weinberger do not accept metaphysical aspects. Weinberger does not accept cognitivism as a knowledge, a priori. To Weinberger the principles are merely structural principles. Along Weinberger the decision-making in case of legal principles (“justice”) is relative question. Weinberger shows that the formal equality is just guiding the thinking. There is no stable or absolute material “justice”. Weinbergers’ reflection shows how difficult the rationality is in case of principles.

57 Regulatory policies in OECD countries: from interventionism to regulatory governance, 2002, For example OECD –publication on regulatory policies (2002) is giving widely “instructions” to “regulatory governance” in the form of “principles” on better and good legislation, and aspects integral to democratic governance: transparency, accountability, efficiency, adaptability and coherence. Principles given in these “better regulation studies” supposed to “guide” drafters and legislative actors in legislative processes: how to cope other important (value) principles in legislative activity, in drafting, in choosing the legislative strategy, in the legislative decision-making process.
The legislation is political choices. That is the reason why modern legislator who is legislating by abstract principles, should take into the account the discourse by citizens on the societal level. That is the mean that increases legitimating rationality of legislation. Such rationality is legitimating the substance of the legislation that is important in the very problematic principled regulatory strategy. This paper on very general level also asks, if the theoretical discussion is possible in praxis. One argues here, that the discussion between theory and praxis is not easy, but possible. It is possible if we understand our language and the concepts that we use in the communication between us.

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CONFLICT AND CONSENSUS IN PARLIAMENTS
The Case of Spain 1980–2005

Xavier Coller & Andrés Santana

Abstract

Differences in legislative production hide the fact that some legislatures are more conflictive than others in passing laws. Why, then, in some parliaments some political groups are able to create consensus over legislation? This paper presents an original empirical work based on the analysis of legislation of 17 regional chambers in the period 1980–2005 in Spain. Apart from regional differences in the legislative production rate, the authors found out that some parliaments are more conflictive than others and they try to relate the consensus-conflict rate to different socio-political variables like national political climate, parliamentarians’ turnover, parliaments’ gender composition, type of majority and government.

Variations in lawmaking in regional parliaments

The main function of any parliament is to legislate. That is, to pass laws that will rule society. Certainly, parliaments can develop a wide range of activities, although the most socially relevant is the lawmaking process. There are many types of laws, but I will not get into this debate here. The content of any law is the result of a long process of negotiation and reflects the point of view of individuals or groups present in the lawmaking process as representatives, as lobbyists or as experts.

In modern politics, the legislative function is largely contingent upon the government bringing bills to parliament for their discussion among political groups and further approval. The way it works in most chambers is as follows. A bill is proposed to the chamber. Usually, the initiative is taken by the regional government, although in some rare cases, a parliamentary group or a number of deputies can also bring a bill to

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1 With the collaboration of Ana Carrillo, Alejandro Luna, Marta Paradés, Andrés Vázquez, Adrián del Río, Esther Vargas, Ángela Pérez and María José Fernández. Universidad Pablo de Olavide.
2 About the functions of legislatures see Blondel (1973), chapter 2.
parliament. Depending on the content of the law, it will be brought for discussion to any of the committees of the parliament. For instance, the bill of the budget for the government is usually brought to the economic and budget committee. A bill related to the creation of a university may be brought to the “committee of education”. And so forth. All committees reflect the exact political composition of parliament. In the committee, MPs debate the bill, amend it and produce a final bill called “dictamen”. The dictamen might have incorporated the amendments suggested by some MPs or groups or they might have been rejected. The dictamen will be discussed then into a plenary session of the regional chamber. Then, in this session, MPs may further amend the bill by retrieving the amendments that were not accepted in the works of the committee. An informed guess indicates that barely 10% of bills reach the plenary session without amendments. During the plenary session the bill may be further amended incorporating the point of view of some MPs or groups. Finally, the bill is voted, although sometimes, depending on the rules of the chamber, MPs have to vote article by article.

Although there are several indicators of parliamentary activity, law making seems to be the most relevant one since the making of laws not only requires the participation of MPs from different groups (and institutions, like the executive and high officials), but also because laws create a line in society indicating what is acceptable and what is not. Laws, thus, are a good indicator of the level of activity in a parliament. Law making in parliamentarian democracies may approach the consensus model, as opposed to the majoritarian model, delineated by Lijphart (1999:33) that “emphasizes consensus instead of opposition, that includes rather than excludes and that tries to maximize the size of the ruling majority instead of being satisfied with a bare majority.”

Some parliaments may be more active than others depending on the bills discussed and passed. Differences in the rate of lawmaking may be due to the level of competences reserved for the regions in any given federal system. For instance, if a region has the power to create universities and another lacks this capability, then the first will be able to legislate over this area increasing the proportion of laws passed vis a vis other regions. However, we’ll see soon that these differences are also due to other factors.

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3 The bill proposed by the government is called proyecto de ley (bill project). In other cases is called proposición de ley (bill proposal).
4 There are other indicators of activity such as questions to the government, law proposals, etc. See Subirats and Gallego (2002).
### Table 1: Law making in regional parliaments (1980–2007)

<table>
<thead>
<tr>
<th>Legislature</th>
<th>1</th>
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Source: Our own elaboration using information from webpages of regional parliaments and official documents.

Note: Autonomous communities have different electoral cycles. See appendix.

In an ideal world, we can expect regions having similar powers passing a similar number of laws in their parliaments. However, this is not the case as can be seen in Table 1. Take, for instance, the average of laws passed in each legislature in regions with similar powers: Aragon (51), Asturias (29), Madrid (63), and Navarre (70). Their averages are quite different and the number of laws in each legislature varies significantly. Even in regions with a higher level of powers like Catalonia, Basque Country and Andalusia there are relevant differences in the average for the period and in each legislature. Certainly, the legislative function is contingent upon different factors. The amount of bills passed in parliament is the outcome of the activity of the executive (which is related to the number of powers transferred to the region), the majority in parliament, the length of the legislature, and the ability of building pacts among parliamentary groups. This can explain why some parliaments seem to be more active than others, although further research needs to be done in order to ascertain why some legislatures are more active than others.

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5 We have obtained data of 12 regional parliaments out of 17, more than two thirds of the total.
Also, data in Table 1 indicate that there is some internal variation in the rate of laws passed in each region in different legislatures. The differences are in some cases so disproportionate that need some explanation. For some regions (Aragon, Asturias, Castile-La Mancha, Valencia, and Navarre) there is an important growth in the number of bills passed between the fourth and fifth legislatures. In part, this growth is explained by a package of powers transferred by the central government to the regions of the common system. More powers transferred means that the regional government has the capability of regulating areas that previously were in the hands of the central government. Consequently, chances are that the regional government will bring to parliament bills to be discussed, amended and, eventually, approved.

In some cases we see in Table 1 that the number of bills passed decreases dramatically. This is the case of Andalusia during the fourth legislature, and Galicia and Asturias during the third. In these cases, the low lawmaking activity of the legislature is the outcome of a deep parliamentary conflict between groups whose result was a weak government (whose parliamentary support was a simple majority stemming from an unstable pact between groups) and/or the shortening of the legislative period.

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6 The government passed a bill (December 27, 1996) restructuring the way the regions were to financed and transferring new powers.
### Table 2 Proportion of consensus (1980–2007)

<table>
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<th>Autonomous Community</th>
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Source: Our own elaboration using information from webpages of regional parliaments and official documents.

Note: Autonomous communities have different electoral cycles. See appendix.

Any law can be passed in the plenary session of a parliament by unanimity, by absolute majority or by simple majority. In general terms, it can be said that any law can be passed with or without negative votes. A negative vote means that the law is rejected by a portion of MPs although their number is not so large as to prevent the bill being approved. Given the intricacies of the legislative procedure, in this case, it means that the law approved does not reflect the point of view of a part of MPs representing a segment of a society. Thus, it can be inferred that in this case the chamber legislates against a part of a society. This is the case, say, of a bill proposed by a regional government regulating the creation and functioning of a professional association of architects. After been amended in the respective committee, the bill is brought to the plenary session of the Parliament. However, if MPs in the committee are unable to reach a consensus, when the bill is discussed in the plenary session, the opposition groups will still keep their amendments to the bill. More often than not, if the points of view of the opposition groups are not incorporated into the final bill, they will vote against it. Thus, the majority group will have created a law that is rejected by a portion of the parliament, which is to say by a portion of society. In this case, we can say confidently that there is parliamentary conflict since a consensus about a bill has not being built.
A law without negative votes means that all groups present in the chamber accept the law with more or less conviction. A consensus can be built over affirmative votes or over non-negative votes or abstention. When a group or a MP abstains, it means that they are not against the passing of the law although they do not give it full support. This might be considered “weak consensus” as opposed to “strong consensus” (unanimity) when all groups or MPs cast their affirmative votes for any given bill. This is usually the case when the majority group makes an effort to incorporate the points of view of the opposition groups into the bill being discussed either at the committee level or at the plenary session.

**Graph 2**  Average of consensus (1980–07)

Source: Our own elaboration from Table 2.
Note: Autonomous communities have different electoral cycles. See appendix.

I will not get into the debate about whether consensus is better than conflict. This is a moral issue I am not interested in as social scientist. A high level of consensus in the lawmaking process could be considered more efficient since it means that legislators take into account the needs, demands, and points of view of different social groups. A high level of parliamentary conflict might be less effective and generate conflicts in society since some groups might perceive that they are left apart, their interests not taken into account or negatively affected, and react accordingly.

Certainly, the rate of consensus is a good, solid, and clear indicator of political conflict in legislatures. A high consensus rate means that different political groups (no matter how ideologically distant they are) are able to agree and build consensus. A low rate of consensus is an indicator of political conflict and controversy, which is quite normal, especially in
polarized parliaments. A low consensus rate somehow indicates certain inability to reach pacts and build agreements, which is the bottom line of parliamentarism.

One can expect that the proportion of laws passed by consensus would be similar in all regions. There seems to be no reason for a parliament to have a proportion of laws passed with negative votes much higher or lower than other. However, we can see in Table 2 that the behavior of regional parliaments also differs. On average, it seems that there are parliaments which are more “consensualist” than others. This is the case of Catalonia and Aragon, with an average of 70 % of laws passed by consensus. Also, Madrid, Castile-La Mancha, and Navarre show and average proportion of consensualist lawmaking around 60 %. However, other parliaments show an average consensus rate quite low like Asturias (37 %) or Valencia (38 %), with barely over a third of the bills passed by agreement of all MPs.

Differences are not only found among regions. There is also internal variation over the years for each region. There are legislatures that show a high proportion of laws passed by consensus followed by others in which the consensus rate decreases dramatically. Take the case of La Rioja in the 3rd and 4th legislatures, the Basque Country in the 5th and 6th, Asturias in the 2nd and 3rd, and the like. In all of these cases, a legislature with a high proportion of bills passed by consensus is followed by a diminishing consensus rate in the next legislature. If the consensus rate varies, it is worth asking why and why should we care about it.

Consensus and conflict in parliaments

If the consensus rate is an indicator of political conflict in Parliaments and might be associated to efficiency in ruling a society, it is worth paying attention to the factors that might contribute to explain why the consensus rate varies across time and regions. Consensus rate, thus, is the dependent variable of my research. As we have seen in Table 2, the proportion of bills passed by consensus varies throughout the timeline and across regions. There are legislatures in which it is higher than in others. Also, it is different in autonomous communities and the differences are quite significant. The question, then, is what makes the consensus rate so variable? Which are the independent variables? There are several candidates I detail briefly with some statistical tests to check their role. Data refer to the following regions: Andalusia, Aragon, Asturias, Castile-La Mancha, Catalonia, Rioja, Madrid, Murcia, Navarre, Basque Country, and Valencia. This preliminary analysis
covers 12 out of 17 regions and all finished legislatures except the first one. So, the total number of cases on which this research project is based is 48 (out of 89 possible, 54 %). Further analysis will include also more legislatures and regions up to a total of 106.

**Number of groups.** Any bill that is passed with no negative votes needs to be approved by all parliamentary groups in the chamber. At first sight, it seems easier to build consensus among few groups than among many. Contrary, few political groups in parliament may help to build bridges, especially if the parliament is not polarized. In the period 1980–2006, the number of groups in regional parliaments go from 2 (socialist and populares, like in the single case of the fifth legislature in Castile-La Mancha) to 8 (like in the single case of the second legislature in Navarre) or 7 (like in most legislatures of the Basque Country). The average number of groups for the period is 4.\(^7\) However, the statistical test indicates that there is a weak, although not significant, relationship between the number of parliamentary groups and the consensus rate. The Pearson correlation coefficient is 0.200 and the probability associated is 0.173. The coefficient suggests that the more groups, the higher the rate of consensus, which is counterintuitive. This is why the original proposition needs to be qualified for further research.\(^8\)

A look at the results of Sartori’s fragmentation index indicate that there is a low but significant association between consensus and the level of fragmentation of a parliament. Correlation index is 0.201 and its associated probability is 0.063. That means that we have to introduce here a qualification.

Parliaments might be highly ideologically polarized to the extent that in some cases there are blocks of groups. In previous research I have shown that people (and that includes also political elites) perceive some groups ideologically closer to others (Coller 2003a, b). Sometimes, this closeness ends up in the integration of a political party (or a fraction of it) into another.\(^9\) It can be said that the higher the polarization, the lower the rate of

\(^7\) Actually, the average is 4.48, but there can not be half of a group.

\(^8\) It would be worth to pay attention to the index of effective number of parties developed by Laakso and Taagepera and praised by Lijphard (1999:68) as “widely used by comparativists in political science”. \(N = 1/\sum s_i^2\), where \(N = \) number of effective parties, \(s_i = \) proportion of seats in the chamber and \(i = \) party.

\(^9\) This was the case of the party Euskadiko Ezkerra, that became integrated into the Basque branch of PSOE known as Partido Socialista de Euskadi. It is also de case of Nueva Izquierda, a party founded by former members of Izquierda Unida that became integrated into the PSOE. Also, Unión del Pueblo Navarro and PP merged in Navarre.
consensus could be. Contrary, the ideologically closer the parties are, the higher the likelihood of building consensus in the chamber. This proposition relies upon the existence of “mediating” groups between two major ideological blocks. For instance, the presence of centrist parties in parliaments with a left-right divide might help to bring together distant political groups and thus help to build consensus. This is what Capo (1992) found out in his study about the Congress of Deputies in Spain. It might well be the case that my counterintuitive findings (the more groups the more consensus) is the result of the presence of mediating groups (like CDS or regionalist groups like PA in Andalusia or PAR in Aragon) that are less defined in ideological terms and can help thus building consensus.

**National political climate.** When we are dealing with federations like the case of Spain, we have to take into account the political climate at the national level. By political climate I refer to the perception that parties are willing to cooperate for the common good rather than showing their differences in basic areas like defense, terrorism, external relations, or education. If the political climate is turbulent, especially among the two major contenders, then, consensus at the regional (or even local) level might be more difficult than when the political climate is more stable. Therefore, the consensus rate might be affected as well in the regional parliament.

Among the many ways of capturing the political conflict in a society in a particular period of time, I decided to use the one involving the perceptions of qualified independent observers. In that way, we can obtain a proxy for the real political conflict. Twenty experts were asked to score the level of political conflict in Spain they observed in different legislatures of the Congress of Deputies. I offered them a scale 0–10 in which 0 is no conflict and 10 deep and intense conflict. The average for the period was 5.88 and the values ranked from the lowest 4.75 of the second legislature (absolute majority of the socialist party) to the highest 7.21 of the 8th legislature (simple majority of the socialist party) or the 7.21 of the 5th legislature (simple majority of the socialist party). The hypothesis is that, in federations in which the main contenders at the regional and national levels largely coincide, the higher the political conflict at the national level, the lower the consensus rate will be because political parties, especially the major contenders (socialists and conservative), will be unable to reach agreements in the midst of a general political conflict. Certainly, making

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10 The experts were journalists, professors, lawyers, but not politicians.
agreements with their rivals at the regional level in a moment of political turmoil at the national level could be detrimental for the parties, unless they agree on very institutional matters.

However, this does not seem to be the case. The correlation coefficient is −0.123, which means that both variables are not related at all. The coefficient is not significant (p=0.292). Therefore, political conflict at the national level seems to have no effect on the level of consensus reached by political parties in regional chambers. It could be that the variable is ill-defined or ill-built. However, the little dispersion of the measure of the variable (standard deviation is 0.8499) indicates that people tended to rank their perceptions around the mean more often than not. External independent observers largely coincide in their appreciation of political conflict, which suggests that the variable is well built.

**Absolute and simple majority.** Another candidate to explain why consensus rate varies so often is the type of majority a party has in the regional parliament. In parliamentary systems with a proportional representation model, the chamber reflects with more or less accuracy the preferences of the voters. The more votes an electoral list gets, the more seats in parliament it gets. A party can have the absolute majority of seats (half of the seats plus one) or may have a simple majority or largest plurality of seats. Since parliament elects the president of the government and supports it, and since usually parliaments legislate after the initiative of governments, then we should pay attention to different scenarios affecting the level of consensus.

When a party has the absolute majority of seats in a parliament and supports a single party government, there is no need to build any agreement with other parliamentary groups to have the bills passed. The votes of their own MPs are enough to have legislation approved. At the national level, most of González governments and the second legislature of Aznar enjoyed this situation. Similarly, there are regions where the same party has obtained a number of absolute majorities in the chamber (ie., Extremadura, Castile-La Mancha, Andalusia). Contrary, when a party gets the largest plurality of seats, but not the absolute majority of them, a multiple scenario appears. The successful party will need to build agreements with other parliamentary groups to have some legislation passed. These agreements may be built on a case by case basis or may reach the whole legislature period. In this case, it might be expected an effort to build agreements and, consequently, the rate of consensus could increase. However, this is not always the case. Depending on the number of groups, their ideological distance, and the number of seats they got after
elections, it might be the case that agreements are impossible and the
government has only a minority support. In this case, the rest of the groups
can easily vote against any initiative taken by the executive making the
task of governing certainly difficult. In this case, the rate of consensus is
expected to be low, and the government short lived.

Therefore, absolute majorities may prevent consensus while simple
majority of seats may foster it. According to data gathered on all of the 48
legislatures, there is independence between both variables. Running a
regression with the dummy variable type of majority (1=absolute,
0=simple), the results is that the regression coefficient of the explanatory
variable is \(-0.313\), which is not so much, although the coefficient and the
model are statistically significant (\(F = 9.790, p = 0.004, R^2 = 0.098\)). That
means that for the data gathered, consensus rate is not independent on the
type of majority in parliament.

There is also an attitudinal variable that can explain the variability of
the consensus rate in regional parliaments, namely the willingness of
politicians to reach agreements with their rivals. This is, though, a
psychological variable that is difficult to measure and will be discarded for
our analysis here. However, we can use a sort of a proxy to find out about
this attitudinal variable.

Taking into account that governments supported by the absolute
majority of seats controlled by a single party do not need to make
agreements with their rivals in order to pass bills by consensus, we might
have a look at whether the party controlling the government and the
majority of seats makes a difference in the rate of consensus. For the
simplicity of the analysis I will focus only on the two major contenders at
the national level (PSOE and PP), eliminating from the analysis the cases
of Catalonia and the Basque Country, which have always been governed by
regional parties. PSOE, the socialist party, held the absolute majority of
seats in Andalusia (2, 3, 5 legislatures), Asturias (5), Castile-La Mancha (2,
3, 4, 5), Valencia (3), and Murcia (2, 3). PP, the conservative party (or its
regional branch in Navarre, UPN) enjoyed absolute majorities in Rioja (4,
5), Madrid (4, 5), Valencia (4, 5), and Murcia (4, 5). With this subset of

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11 I need to check the cases of Rioja (2, 3 legislatures), and Aragon (3). Also, the third
legislature of Navarre, which began with a coalition of PSOE, CDN and EA in the
regional government, after a year split over and the government went to the hands of
UPN (PP in Navarre) for the rest of the legislature. I have considered, then the fourth
legislature of Navarre as governed by UPN but with the largest plurality of votes.
12 The exception is the 5th legislature in which the PSE-PSOE entered the regional
government.
cases we can see whether the party holding the absolute majority of seats in parliament makes a difference in the level of consensus in parliament.

A look at the consensus rate of the aforementioned legislatures in Table 2 suggests that with the exception of the fourth legislature of Madrid and the third of Castile-La Mancha, the level of consensus achieved when the PSOE holds the absolute majority of seats in regional parliaments is considerably higher on average than when the PP has the absolute majority. Actually, if we perform a simple regression analysis the result is a model like this:

\[ \text{Consensus rate} = 34.471 \times 0.606 \times \text{absolute majority} \]

Consensus rate has been defined previously as the dependent variable of this study. The variable “absolute majority” has two values. When the PSOE is the party that has the absolute majority of seats in a regional chamber in a given legislature, then the value assigned has been 1. When the PP held the absolute majority, the assigned value was 0. Note that we are dealing here with absolute majorities of a single party, not coalitions of parties to produce an absolute majority of seats to support a government. I will touch upon this issue later.

This model indicates that when the PSOE has the absolute majority of seats in a regional chamber, the level of consensus is 60% higher than when the PP controls the parliament. Additionally, the model suggests that socialist MPs make a larger effort to incorporate the points of view of other political groups in the lawmaking process (including the PP) than the conservative MPs, even when they do not need the help of other groups to have the bills passed.

The type of bills discussed in parliament might have also an impact in the rate of consensus. Bills related to the creation of universities or professional associations, those issued to help the victims of natural disasters or terrorism, are clear candidates to generate consensus. Other bills are less likely to become the ground in which parties build agreements. Further analysis will require to elaborate a classification of bills according to standard criteria.

Discontinuities. Finally, there is a last factor that can be used to explain the consensus rate in regional chambers. Every legislature, a number of

\[ \text{The Model is significant since } p=0.010. \text{ The probability associated to the regression coefficient is } p=0.010. R \text{ square is 0.368, which means that the variable “absolute majority” explains more than a third of the variability of the dependent variable “consensus rate”}. \]
candidates becomes new MPs. The proportion of newcomers in a legislature is considered here the circulation rate as opposed to the permanence rate.\(^{14}\) This rate might be higher or lower depending on a number of factors like the strategy of the party in the making of the electoral list, the position of the party in the opposition or the government, the existence of quotas, and the like. These new MPs usually come to the chamber without contacts and friendship relationships with the rivals. If they are young and inexperienced, most likely they will also be ideologically rather than pragmatically oriented. All these factors might have an effect in their performance in the regional chamber. In essence, this is the explanations that advanced Linz to explain the failure of the Spanish Second Republic. A bunch of new MPs, highly ideologized and largely lacking friendship ties to their rivals, were unable to build the necessary consensus to keep the polity stable.

Table 3 Discontinuity of political elites in regional parliaments

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Note: I have not included the first legislature because the circulation rate is 100 % since all members are new to parliament.

As data in Table 1 show, the average circulation rate for the period 1980–2005 in regional parliaments is 56.1.\(^{15}\) That means that on average, more

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\(^{14}\) The permanence rate refers to the proportion of MPs that holds a seat in any given legislature and the previous one.

\(^{15}\) To keep into account: % of newcomers in the party supporting the government can be an explanatory variable. The older the institution, the lower the circulation rate (Putnam,
than half of MPs (56%) in each legislature are new in the job. MPs tend to
circulate more in Castilla-La Mancha, Navarre and Murcia, while tend to
repeat in the chamber more often in Andalusia, Catalonia, and Asturias.
Given that there are different electoral cycles, I will not discuss variations
within regions. There are several factors that have been tested to explain
the circulation rate in parliamentary systems (Coller 2002): changes in
political leadership, growth of the parliamentary group, expectations of
winning the elections, and absolute majorities. These elements have an
effect on the rate of circulation in parliaments.

Although interesting in itself, the circulation of MPs in regional
parliaments is just an independent variable among others in this study. As
we have seen, the consensus rate varies and we try to find out a plausible
explanation for it. It is worth then to find out whether there is any
relationship between the consensus rate (dependent variable) and the
circulation rate. Previous research indicated that for the pair of cases of
Catalonia and Andalusia, and Valencia and Madrid, the relationship was
negative so that an increment in the rate of circulation meant a decrease in
the rate of consensus (Coller 2002). There I warned that more cases needed
to be added. Now, when I incorporate the 48 cases for which I could gather
information, the correlation test indicates that the relationship between
circulation and consensus is non existent. Pearson correlation coefficient is
0.007, which is to say that both variables are independent (p=0.963).

In my previous research, as well, I indicated that given that modern
parliamentarism is mainly based on the decisions of a hyperelite who tends
to control and coordinate parliamentary groups as well as becoming their
“public image” appearing constantly in the mass media, it should be
interesting to see whether circulation of this hyperelite has an effect on the
consensus reached in parliaments. The idea is that, assuming this group
makes decisions on what will finally be agreed upon with the rivals and the
final vote of parliamentary groups, insofar there is a high discontinuity in
this group, chances are that, following Linz’s hypothesis, they will have
difficulties reaching agreements with their rivals.

I run a regression using the variable “circulation in the hyperelite”. The
variable counted all members holding positions of power in each regional
parliament in each legislature. By positions of power I considered those

Loewenberg 106, Blondel 73:86). There is no optimal circulation rate (Coller 1999,
legislaturas en las que se está presente permite ver a los políticos profesionales. Factors
explaining turnover (Matthews 1985:40-1): profesionalization, less party competition,
attractiveness of parliamentary career, decisión de stepping out, pacts to substitute one
MP for another.
who preside, are vicepresidents or secretaries of legislative committees, speakers of the group, and members of the Presidency of the parliament (usually a president, two vicepresidents and two secretaries). If there are people who make decisions in parliament concerning the points to be negotiated in a proposed bill, these MPs are, no doubt, those who decide, to use a Wright Mills’ dictum. The lowest circulation rate (only 20 % of hyperelite members are new into the group) can be found in Murcia in the fifth legislature. The highest proportion of newcomers into the group with power in regional chambers (89 %) can be found in the fourth legislature of Castile-La Mancha, which is the region together with Navarre and Andalusia with the highest proportions of circulation. The average circulation rate is 71 %, with a standard deviation of 14 points. The regression model is as follows:

\[
\text{Consensus rate} = 30.956 \times 0.262 \times \text{Circulation of hyperelite group}
\]

The regression model suggests counterintuitive results. On the one hand, it indicates that the relationship between both variables is positive. That means that the higher the circulation, the higher the consensus. However, the impact of the latter in the former is low. For each 1 % that the circulation of the hyperelite grows, the consensus rate will grow as well 2.6 %. The probability associated to the regression coefficient is \(p=0.072\), \(R\) square is 0.069, which is not much. \(R\) square suggests that the contribution of the independent variable into the explanation of the variability of the dependent variable is quite low (7 %). Notwithstanding these counterintuitive results, further research is needed in order to double check them and try to find alternative explanations.

It seems that although circulation might have a very mild and counterintuitive effect in the consensus rate of regional parliaments in Spain, there are other variables that do not participate at all in the explanation of the variability of the variable. However, it seems that there is a variable that is quite important. First, the fact that a party has the absolute majority of seats in parliament, but additionally, it is very relevant whether the party is the conservative or the socialist one. It seems for these preliminary results that the socialists are more open to reach pacts with their rivals (including the PP) than their conservative rivals are.
Research agenda

No conclusion can be reached at this stage of the research process. This is a work in progress that tries to find out the associates of consensus (and conflict). We have identified a way of detecting and measuring consensus (and conflict) and, consequently, we have explored the possibility of explaining it using different variables at hand. Further variables to take into account are the electoral competition index, the type of government, the ideological polarization, and a set of social variables that account for the internal composition of the parliamentarian elite.

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## Appendix. Electoral cycles in regional elections

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WHO REGULATES THE FOOD BUSINESS – AND WHO SHOULD?

Anu Lähteenmäki-Uutela

Abstract

Food business is regulated by international organisations such as the WTO and Codex Alimentarius, parliaments, administrative agencies, food companies, and consumers. Regulation should be based on a strategy that has sustainable food consumption and food security as a goal. The decision on who regulates should be based on careful consideration of the benefits of command-and-control vs. voluntary schemes. The WTO and the UN organisations must be developed in order to better address global issues. Nation-states must work together as food chains are global. Regulatory agencies have scientific expertise, but administrative soft-law has problems relating to legal certainty and equality. Relying on companies to create self-regulation means relying on business ethics. Sometimes, business ethics is based on what the consumers want to buy. Regulation cannot therefore be trusted with businesses only. The consumer movement has its important purpose in making companies behave. However, a large part of consumers are not interested in food issues such as health or ethical questions. Sustainability of global food chains cannot be guaranteed by consumer movement only. Food regulation should be based on science (for example: food and nutrition science, economics, behavioural sciences) and ethics, and drafted jointly among all stakeholders.

1 Introduction

This paper discusses food regulation: who regulates the food business, and based on what principles and values. The substance of food regulation is undeniably important to humans both as consumers and as citizens. We use the wide concept of food regulation here, referring to rules that affect the following questions: what food is produced, how much food is produced, where food is produced, how food is produced, how food is marketed, what is the price of food sold, how food is consumed, etc. Legal questions involved in food production and marketing are often simultaneously questions of ethics. Examples are:

- How should production animals be treated?
- Should growth hormones for animals be allowed?
- What and how much chemicals should be used in farming and food production?
- Should GMOs be allowed in food?
- Does origin matter? Should Europeans favour European food?
- Who is responsible for children’s obesity?
- How much meat can we eat?
- Where to put the rubbish?

The food system is global. Likewise, food regulation is increasingly global. Food is regulated at least by global organisations, nation-states, food control authorities, companies, and consumers. The situation may suitably be called *pluralism in sources of law*. A part of regulation is mandatory, another part is voluntary. In this paper, we aim to critically evaluate various regulators in order to form an opinion on who should regulate food business.

## 2 World Trade Organisation

At the international level, the WTO regime defines boundaries for food regulation, particularly as this regulation relates to food trade. The most important agreements here are the Agreement on Agriculture and the Agreement on Sanitary and Phytosanitary Measures (the SPS Agreement). The SPS Agreement defines the rights and obligations of members with respect to application of sanitary and phytosanitary measures meaning laws and standards on food safety, animal health and plant health. Basically, the SPS agreement defines how food is to be regulated in order to maintain the goals of the more general TBT (Technical Barriers to Trade) agreement.¹ The Agreement on Agriculture of 15 December 1993 came into effect with the establishment of the WTO at the beginning of 1995. The Agreement on Agriculture has three central "pillars": market access, domestic support, and export subsidies. Market access means rules that relate to foreign products entering a country’s market: customs duties and minimum access for imports. Minimum access means import quotas by product groups.² Domestic support means national production support or subsidies to agriculture. Export subsidies are nationally granted to support a country’s agricultural exports. The goal of the Agriculture Agreement is

to liberalize food trade. This means removing barriers in order to create a market where food is produced where it can be done effectively.

Currently, the WTO negotiations go on under the Doha Development Agenda. The Doha meeting was held in 2001. As regards agriculture, the plan is to eliminate export subsidies, as well as domestic support that distorts trade. Restrictions to market access are to be “substantially reduced”. Food security, rural development, and environmental issues are listed as “non-trade concerns” that will be “taken into account”, as provided for in the Agriculture Agreement. The objective is to establish a fair and market-oriented trading system. The purpose is to correct and prevent restrictions and distortions in world agricultural markets. The Doha declaration stresses special and differential treatment for developing countries. The negotiation outcome should enable developing countries to meet their needs, particularly as regards food security and rural development. In the Hong Kong meeting in 2005, ministers affirmed the decisions and declarations accepted during the Doha conference. Agriculture subsidies were a primary matter of discussion. There were proposals that exemptions need to be phased out. Member states agreed to eliminate most of the subsidies by the end of December 2013.

The EU is pushing for the precautionary principle and the non-trade concerns to be included in the WTO trade talks. The “European model of agriculture” highlights the multifunctional role of agriculture: farming not only produces consumable commodities but also offers a whole range of services to society in terms of maintaining the environment and the countryside. According to EU negotiators, this multifunctionality must be protected by the public authorities. The EU calls for “due consideration for non-trade concerns”: social, health, cultural and environmental issues. The WTO agreements need to be clearer on “other legitimate concerns” besides science. The EC food safety risk analysis model explicitly permits consideration of these “other legitimate factors” when adopting risk regulation.

Wilkinson sees civil society and development as two key challenges facing the WTO. NGOs critique the WTO for promoting competition between companies and nations leading to suffering of employees and the environment. Simultaneously, developing countries resist putting environmental and em-

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3 WTO web page: Doha declaration explained.
http://www.wto.org/english/tratop_e/dda_e/dohaexplained_e.htm#agriculture.
4 Singh 2008, 17.
5 European Parliament Fact Sheets.
6 Johnecheck, 2008, 499.
7 Wilkinson 2000, 140.
ployee rights on the WTO agendas. This opposition stems from the fear that legislation will be used as veiled protectionism, undermining the competitiveness of the South. According to Singh, developed nations cannot support their own industries at the expense of the third world poor. Free trade and fair trade must go together. Developed nations must comply with international agreements in good faith. Developed countries cannot block imports from developing countries and at the same time expect them to pay their debts. The role of the WTO, and particularly its developed member states, is to let agriculture in developing countries grow. Principles of free trade must be accompanied by principles of global equity.

The WTO could follow the EC model, if the WTO is to address itself to global issues other than trade. Like the WTO, the European Union originally was about removing barriers to trade. Now, the EU sees other policy goals such as consumer protection as autonomous and equally important objectives. Could the WTO follow a similar path? The WTO is in its TBT and SPS Agreement referring to the FAO/WHO Codex Alimentarius standards, which means global food safety law currently exists under WTO law. This global food law under the WTO could in our opinion just as well include other standards beside safety standards, such as environmental and ethical standards. How about food security? Food safety is included in the wider concept of food security, which legally translates into right to food. If food safety is governed through the WTO, could the WTO also govern food security as a whole? It seems difficult. For creating welfare-enhancing global trade, the approach recommended by the FAO involves investing in human capital, institutions, and infrastructure, together with establishing safety nets to protect vulnerable people during the transition to freer trade. The WTO cannot force states to invest in agriculture, good governance, etc. It is more suitably a job for the FAO to coordinate policies and to influence governments. Perhaps it is the FAO that should be strengthened, instead of transferring food security governance under the WTO. Also the actions of the International Monetary Fund (IMF) affect food security. Like the WTO, the IMF has been accused of promoting globalization regardless of consequences. The IMF is at the moment rethinking its mandate in global economic policy.

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8 Wilkinson 2000, 143.
10 Johnecheck 2008, 498. European food law is often based on several Articles of the Treaty, one Article being free trade.
11 FAO 2005.
In addition to demands for developing the WTO, it has also been proposed that the global food system should be restructured by taking it outside the terrain of the WTO altogether. Rosset, for example, sees food as more than a commodity. For him, food is about farming and developing rural societies. Rosset argues for a food and agricultural system without the WTO that: provides everyone with adequate, affordable, healthy, tasty and culturally appropriate food; offers rural people the opportunity for a life with dignity, in which they earn a living wage for their labour; contributes to broad-based, inclusive economic development at the local, regional and national levels; and conserves rural environments and landscapes, and rural-based cultural and culinary traditions, based on the sustainable long-term management of productive natural resources (soil, water, genetic resources and other biodiversity) by rural people themselves. We find it unlikely that the WTO would step out of agriculture, as trade in agricultural products is financially important to all the powerful WTO members. The WTO regime might still grow into a direction where local production of basic food is favored, if such a system is proved to better guarantee the legal right to food. The legal agreements on trade must be based on economic facts and human rights.

3 Codex Alimentarius and other Standards Bodies

The food business is also regulated by the UN organisations WHO and FAO through Codex Alimentarius. Codex Alimentarius is an international organization governing foodstuffs and operating under the United Nations organizations FAO and WHO. Codex documents are global food law. Codex Alimentarius pursues to protect the health of consumers and to promote fair international food trade. Codex is similar to the EU in harmonizing food safety standards in order to facilitate trade. Codex Alimentarius Commission is the highest decision-making body, where the representatives of the approximately 180 member states meet. The Commission assembles every year. The Codex Alimentarius Commission is the most important global actor draft-

12 Rosset 2006, 14.
13 Food and Agriculture Organization.
14 World Health Organization.
15 Codex Alimentarius means food law.
ing food standards. The European Community, represented by the Commission\textsuperscript{18}, and EU Member States separately are members of Codex.

Codex documents are in the forms of standards, codes of practice, guidelines, principles, recommendations, etc. Standards often relate to product features and can be very precise setting for example MRLs (maximum residue levels) for pesticides or medicinal substances in foods. For example there is a standard for canned baby food and a standard for frozen spinach. Codes of practice guide procedure concerning production, preparation, transport and storage, including HACCP systems. Guidelines exist on nutrition and health claims\textsuperscript{19} whereas principles are more general and relate to import and export certificates. The division between different document types is not important as none of the Codex documents are directly binding on food industry operators. All of the above-mentioned document types are listed under ‘standards’ on the Codex web page\textsuperscript{20}.

Codex Alimentarius is connected to the WTO. In governing international trade, international standards are an important source of law. With foods, this means Codex Alimentarius standards. In WTO disputes, food standards that are stricter than Codex standards will be considered illegal restrictions to trade. This happened both in the Hormones case of 1998\textsuperscript{21} and the Sardines case of 2002\textsuperscript{22}. In the Hormones case, following a complaint from the USA and Canada, a WTO panel found that the EU’s ban on the import of hormone-treated meat was incompatible with the SPS Agreement. In the Sardines dispute, initiated by Peru, the WTO’s Appellate Body found that an EU regulation, which allowed only one fish species to be labeled as “sardines,” violated the WTO’s TBT Agreement. The Codex standard on sardines was used as a reference, and the EU regulation clearly contradicted the Codex standard\textsuperscript{23}.

There are also other standards organisations that affect the food business, such as the ISO. ISO is the International Organisation for Standardisation, and has published several standards related to the food industry. For example the International Standard ISO 22000:2005 is promoted in the following manner: “food safety management system meeting the requirements of the Standard

\textsuperscript{18}More precisely, its Directorate General on Health and Consumer Protection.
\textsuperscript{23}Park – Wold 2005.
could be the entry ticket to increased business in the global market and participation in cross-border food supply chains.\textsuperscript{24, 25} The TBT Agreement of the WTO requires that technical regulations and international standards are developed and implemented in a non-discriminatory manner, and without creating unnecessary obstacles to trade. The TBT Agreement recommends the recourse to international standards wherever possible while drafting technical regulations.\textsuperscript{26} ISO/IEC\textsuperscript{27} standards are particularly referred to in the TBT Agreement\textsuperscript{28}. ISO is a non-governmental organization “forming a bridge between the public and private sectors”, and a network of the national standards institutes of its 157 member countries. Many of the member institutes are part of the governmental structure of their countries, while others have been set up by national partnerships of industry associations.\textsuperscript{29} Legally describing ISO standards is difficult. They are not agreements between states as Codex standards, and they are not self-regulating because governments are involved. They are followed voluntarily, although abiding by a standard might be required in practice.

4 National Legislators

Above, we discussed the international framework for food law. Food business is naturally also regulated by states in the form of national legislation, which is binding and enforceable by national courts. Besides sovereign states, European food business is regulated by the EU. In fact, the EU is responsible for most of European food legislation, the role of the member states being limited. The US and China, for example, have their own food legislation. National rules are in reality copies or modifications of rules in other countries. Above, we stated that the food system is global. For example in Finland, the food on the tables is from

\textsuperscript{25} ISO 22000 is the standard on food safety management systems, including requirements for any operator in the food chain. Other important standards related to the food industry are: ISO/TS 22003:2007, which includes requirements for bodies that provide audits and certification of food safety management systems, ISO 22005:2007, which is about traceability in the feed and food chain, and ISO 24276:2006, which standardizes methods of analysis for detecting GMOs. ISO web page. http://www.iso.org/iso/catalogue_detail?csnumber=35466.
\textsuperscript{26} Commission Communication on Standards 2004, 7.
\textsuperscript{27} “The International Electrotechnical Commission is the international standards and conformity assessment body for all fields of electrotechnology.” http://www.iec.ch/.
\textsuperscript{28} Annex 1 of the Agreement.
\textsuperscript{29} ISO web page. http://www.iso.org/iso/about.htm.
all over the world. Likewise, Finnish food is exported into several countries. Raw materials in a single food product may come from all continents.

In regulating global business, global rules are considered necessary. The main goal of global harmonization of rules is to facilitate trade. National rules are often creating obstacles to trade. Sometimes this is the very goal of regulation, sometimes its by-product. With agricultural subsidies and export support, the goal is to further national interests. In other situations, national rules may be related to traditional products, for example. In international trade law, national rules that create obstacles to trade are justified only if they are based on national protection of citizen’s lawful interests. Likewise in the EU, a member state may refrain from implementing EU regulations if an exception is needed to serve a national interest, which is for example related to public health.

We will not go further into the details of national food law here. National law, that is rules made by national parliaments, is still relevant in regulating food. For example, the US and the EU have different rules on GM foods, pill-form foods, and food advertising. A part of national food law may be classified as hard law, another part consists of administrative soft law discussed in the next chapter. Food companies must adjust to different national requirements, making it impossible to launch global products using single formats for contents and labels. Even in the EU, member states interpret the same directives differently. For example, some countries consider a health-related product a medicine, while other countries consider the same product a food. The national food law will not seize to exist. Still, the development is towards harmonization. This is because harmonized rules benefit large companies and developed countries, and they are eager to defend their interests.

5 Administrative Agencies

Today, a large part of regulatory activities lies within the food agencies. They give their various guidelines, recommendations, and scientific opinions. Even though non-binding in principle, this administrative soft law is followed by food companies just as hard law norms. As law-makers are typically not experts of food science, many questions are left for the implementers to decide upon. For example, the European Food Safety Authority decides on what type of scientific evidence it requires before it lets food marketers use a certain health claim. In Europe, there are also dozens of national food control authorities that implement food law in practice. The United States Food and Drug
Administration has created volumes of soft law guidelines. Also in China, the role of administrative organs, such as the Ministry of Health and the State Food and Drug Administration, is very important in determining the content of food regulation in practice.

Often, hard law norms are fairly general, whereas details are given by administrative instruments. The reasons for this division of work are the need for scientific expertise, the need for great regulatory detail, and, following the two other reasons, the need for constant changes. This means that a large part of food regulation is given by the administrators, not the legislators. More importantly, this is also the detailed part that is particularly relevant from the entrepreneur’s perspective. The binding nature of ‘guidelines’, ‘notifications’, ‘procedures’, etc. varies. In Europe, soft law guidelines are typically attached with statements of the type “this is not binding; only the laws are binding”. This leaves entrepreneurs legally insecure: the agencies presume that soft law guidelines are followed, but guidelines can suddenly be abolished or changed, or not be adhered to in individual cases.

According to Koulu, the area of soft law will likely broaden in the future. Soft law is favoured by actors who produce it because it is fast and inexpensive as there is no need to find a political compromise. The experts can merely draft soft law and publish it. Koulu points out that scientific expertise of law-makers will not automatically lead to high quality laws. Calls for better soft regulation have not emerged, although better regulation as regards hard law has received much attention. Soft law is beyond quality control, as the producer of soft law can revert to the fact that soft law is non-binding. Problems of legislative competence, legal coherence, legal interpretation, or legal protections for regulation targets can similarly be avoided.30 Simultaneously, normative terms are used perhaps to make regulation targets overlook the non-binding nature of soft law31. We are of the view that if a document comes from a regulatory agency, an average citizen will understand it being the law. Legal certainty reasons support giving legal weight to guidelines by regulatory agencies.

Non-binding guidelines are a part of an implementation strategy where agencies have a lot of power and implementation is based on co-operation, flexibility, and negotiation. Guidance by guidelines is supplemented by individual guidance given by agencies to targets of regulation. Implementation happens through constant interaction between entrepreneurs and the implementing agencies. Business operators often ask the foodstuff and medicine

30 Koulu 2009, 119–120.
31 Koulu 2009, 121.
agencies for information on how to fulfill their legal requirements, and the agencies explain – and create – the law as best they can. Persuading the regulation targets to follow the rules is often cheaper and faster than forcing them to follow the rules. Using sanctions might spoil the cooperation spirit.

The cooperation strategy has its limits, though. First, this kind of implementation strategy can only work when regulation targets are motivated to follow the rules. Getting caught selling products that are hazardous to health will have a strong impact on company image for years. For this reason, most food and medicine companies are completely willing to try their best to avoid this. ‘Normal’ food industry operators and pharmaceutical companies are responsible, or at least interested in their responsible image. However, sometimes business operators will not listen to any non-binding guidance or persuasion. All kinds of ‘magic’ foods and food supplements marketed for weight loss both in Europe and China can be mentioned as examples. These products are continuously marketed with false and misleading claims, and the agencies must use sanctions to get them off the markets. For these companies, short-term financial gains are more important than long-term credibility.

Secondly, there is the risk of so-called regulatory capture, where the objects of regulation push their demands so far that they actually get to decide how they are regulated. Agencies must be careful of not giving too much weight on the industry opinion only. Cooperation and mutual understanding does not mean that the agencies must always please the industry. It merely means that, if possible, industry efforts are recognized, and overly burdensome measures are avoided. The third important challenge of the strategy is treating entrepreneurs equally. The use of non-binding guidelines and case-by-case information guidance means that implementation is flexible in a certain meaning. This brings the negotiation element into the picture. The information and negotiation strategy is based on trust, and it will lose its foundation if implementation takes place on unequal terms. Flexibility cannot mean that companies with similar risks are treated in a different manner. Equal treatment is the responsibility of the agencies. Ethical rules and implementation principles must be discussed among agency staff. In the supranational context, the decision-making rules are even more important.

Scientific risk assessments and scientific guidelines are the most suitable tasks for food agencies. If we want impartial risk assessments based on science, we must guarantee independence of the agencies from political actors. This is because in political reality, it is tempting to pursue local short-term interests.

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32 Tala 2001, 271.
instead of common good. Creating total independence of an agency, on the other hand, creates a control problem. The agency might develop a will of its own. The control problem can be avoided by setting substantive decision-making criteria by law, in which case it is possible to subject decisions of regulatory agencies to review by courts. This is what Krapohl suggests. This means the political actors must set the legal principles under which an agency acts. Only after this can implementation be trusted within the regulatory agency.

6 Self-Regulation

Self-regulation also has its role in the food business. Self-regulation is performed by business organisations such as the CIAA, and by single food businesses themselves. Food companies and their representatives do use various ethics guidelines. Compared to law, food companies prefer self-regulation and focus on business ethics. Law is often mentioned merely as a side note in an ethics report. The U.S. legal system leaves more room to business ethics and relies on the civil society to resolve ethical issues, whereas the European legal system traditionally focuses on binding legislation.

In Europe, food legislation is getting increasingly complicated, and also stricter as more areas are covered. The European food industry has attempted to hold back the tide of legislation, and instead favours self-regulation. The most important actor speaking for self-regulation is the CIAA, Confederation of the Food and Drink Industries in the EU. CIAA calls for simpler, clearer legislation and shorter, less burdensome legal procedures. According to the CIAA, the food and drink industry is one of the most regulated sectors in Europe. They claim “better regulation, including industry self-regulation, can deliver benefits to European consumers faster and help to promote higher growth and employment”. They are working for “a better functioning single market, fewer administrative burdens, and a more supportive business environment”. According to the CIAA, this is needed particularly to help small and medium-sized companies.

33 Krapohl 2004.
34 Confédération des industries agro-alimentaires de l'UE – Confederation of the food and drink industries of the EU.
35 CIAA membership is made up of 25 National Federations, including 3 observers, 30 EU sector associations representing different food industry sectors, and 20 major food and drink companies.
The CIAA considers that “many of the problems faced by the food and drink industry with existing legislation should be solved through a better, simpler, more proportionate and a more competitive EU regulatory framework”. They recommend the following principles on food law:

- Legislation must be clear to prevent diverging interpretation,
- Legal requirements must be practically achievable and enforceable,
- Legislation must be based on science,
- Procedures must be clear and predictable, including precise timetables,
- Sufficient lead-in times, where possible, are needed to minimize implementation costs.37

To support their argument that self-regulation is a viable alternative, the CIAA has indeed drafted numerous documents that can be classified as soft law. The CIAA for example created a voluntary nutrition labelling scheme. The food industry’s concerns and suggestions need to be taken seriously by the European Commission. In particular, the regulatory procedures should be transparent and not waste the efforts of all the parties involved. However, the food industry might not actually want to understand all the substantial laws as some of the complicated and inconveniently strict laws are burdensome. By demanding ‘simple’, we suspect that they simultaneously wish for ‘less restrictive’.

ElAmin urges the industry to take self-regulation much more seriously if they want the legislators to step aside. The industry organizations are giving vague promises that they will follow a common line over issues such as advertising, obesity, health claims and nutritional content. If they really believe their own codes could be used instead of EU legislation, they should take up the challenge and actually draft these codes.38 Irresponsible companies cannot be given the responsibility of people’s health. General problems with self-regulation relate to unclear responsibilities, free riders, implementation and control, and restricting competition39. Interests of dominant companies might overweight public and societal interests.40 Future business regulation might increasingly be in the form of co-regulation, combining the benefits of law and self-regulation.41 According to Parker and Braithwaite, it is necessary to

38 ElAmin 2006.
40 Tala 2009, 330.
41 See Tala 2009, 331–332 on benefits and problems of co-regulation.
understand how law connects with other sources of normative ordering\textsuperscript{42}. Regulation is pluralized and decentralized, where the new role of states is to steer public-private partnerships\textsuperscript{43}.

7 Consumers as Regulators

Consumers and their organisations can also be seen as regulators as consumer activism may force companies to change their products and behaviour. We see self-regulation and consumer activism closely connected. This relates to a basic question of business law vs. business ethics. Either businesses are: 1) forced to act in a sustainable manner, or 2) trusted to do it by themselves. The latter option of trusting companies in practice means leaving it to consumers to force businesses to act responsibly, presumably through the price mechanism and boycotts. This means that self-regulation relies on active consumerism. Few people believe that businesses will act responsibly merely because they want to do the right thing: they do it for their reputation and image as these affect sales. In our opinion, the question of why companies are responsible is not particularly significant. If the consumer movement is strong enough, companies will presumably stay responsible and business laws are not needed. Consumer demands in product safety and marketing information are in practice always opposite to the industry propositions. Perhaps consumers are trying to get more than they actually want in order to get at least something. Consumers often ask for things that they don’t actually need, and certainly don’t want if there is a cost to it. They also ask for things that are certainly not good for them. Consumers are often ignorant, indifferent, or even self-destructive. These human traits and habits need to be examined before leaving regulation to consumers only.

In practice, law has often been stricter than food company codes. Focus on business ethics might be used to block binding legislation or to blur consumers. Consumers do not always have adequate information on agricultural trade, food politics, or nutrition. Often, they are not even interested on these issues. The irrational part of human brain will probably not feel as responsible over producers in third-world countries as it should. Neither will the irrational person start eating healthy. This is because the primitive part of human brain is still concerned over avoiding starvation, and feeding the family. Therefore, we

\textsuperscript{42} Parker & Braithwaite 2005, 137.
\textsuperscript{43} Parker & Braithwaite 2005, 129.
need to carefully consider before letting consumers take responsibility over
global food chains. Regulators need to focus on the ultimate goals of food law,
and ethics and sustainable development need to be at the top of the list. Gov-
ernments need to consider alternatives to legislation, such as co-regulation,
self-regulation or information guidance. If consumers lack necessary expertise
or interest in ethical issues, legislators might be wise not to let markets decide.
This means governments might need to enact laws that will make all food
business fair trade. The scientific community is responsible for providing the
necessary information for decision-making, including information on con-
sumer behaviour and future trends. Guiding consumer minds through taxation
might be considered necessary, and is already done in several countries.

8 Conclusions

8.1 Who should regulate food?

We are of the view that food should be regulated by everyone involved: the
stakeholders should regulate the food business together. A consumer cannot
be presumed to have adequate time and resources for long-time planning of
food chain sustainability. Above, we concluded that we cannot leave food
regulation to food companies and rely on business ethics only. Self-regulation
should not exist just because the legislator is too busy to react on some issue,
the legislator wants to get the easy way out, or just because the industry claims
that legislation is not welcome. However, both businesses and consumers need
to be heard and closely connected to regulatory procedures.

International cooperation between public and private actors is needed, en-
gaging governments, NGOs, companies, and consumers. NGOs promoting
human rights and environmental issues are increasingly active. In practice, the
most powerful players tend to get the last word on regulation. This means
powerful companies and industry groups that act through lobbying govern-
ments and food control authorities. Governments, on the other hand, look out
for their interests. For example, the EU is willing to diffuse European stan-
dards internationally, particularly to neighboring countries.\footnote{Commission Communication on Standards 2004, 3–4.} It is beneficial to
European companies if European standards are diffused into other markets, as
the need to modify processes and products gets smaller. The lead for countries
in developing globally accepted standards is seen as a lead for companies to accessing markets. A shift of balance in international negotiation powers will affect the negotiation result on food regulation.

Codex Alimentarius is where international food standards are currently drafted. Codex is important particularly because Codex standards are acknowledged by the WTO agreements as a source of international food law. The power struggles inside Codex are crucial to global food regulation, and further developing Codex Alimentarius mechanisms is needed. The WTO regime includes the dispute resolution mechanism, which makes WTO agreements more binding and stronger than for example UN resolutions. UN organizations govern food safety and also the wider issue of food security issues but are not as powerful as the WTO.

In between command-and-control regulation and self-regulation, there is a third approach to regulation that combines government involvement and company involvement. This is called co-regulation. The European Union calls it the New Approach. Several researchers are of the view that the concept of law needs to be redefined, as it is no longer a question of command and control, or state vs. citizen. In the future, law might mean a means to organise the cooperation between government and citizens, between public and private. Law would mean guaranteeing the legitimacy of the process of creating rules: hearing all parties concerned. With European food regulation, the EFSA could for example reform its panel structure so as to allow representation of all stakeholders. In global scale, it is the Codex panels that need to be reformulated in order to hear various interests.

8.2 The scientific base of food regulation

Above, we discussed on who should regulate food and the process of deciding on food regulation. In this last chapter, we touch upon the science that these decisions should be based upon. Firstly, regulation must be based on a certain need. It must solve a problem in a society or correct an unethical situation, rather both. For example, we might consider regulation that somehow tackles the problem of juvenile obesity. There are different modes of regulation, and the choice of a regulatory instrument should be a conscious decision. Food regulation should be consistent with other regulation, such as the environmental standards. We will not go further into the discussion of criteria for bet-
ter regulation here\textsuperscript{45}. Food regulation is sometimes seen as “technical” standards rather than “law”. Even though economists, epidemiologists, and nutritionists, etc. are important in making food regulation, the expertise of lawyers is still needed. In addition to legal science, we are of the view that food regulation should be based on food and nutrition science, economics, behavioural science, and ethics.

Nutrition science is needed to determine how certain chemicals react in a human body. For example, it is needed for determining health effects of components such as fatty acids, fibres, minerals such as calcium, and vitamins such as riboflavin. We need to know about the amounts of pesticides and residues that cause health risks too great, and on what causes allergies. On additives, flavourings, and enzymes, we need scientific research. Health claims on foods need to be scientifically substantiated. In Europe, these kinds of scientific evaluations are the task of the European Food Safety Authority (EFSA).

Economics in connection with the law is called law and economics. Research on law and economics is a part of a wider scientific field of institutional economics. Economics in connection with the food chain is called agricultural economics. Economic science is needed in determining how regulation affects location, methods, processes, and profitability of farming and food businesses in the global food chains. The understanding of economic consequences of certain regulation is a basis for conscious evaluation of regulation goals and their fulfilment. Of course, economic considerations are seldom the only factor when deciding on a piece of food regulation.

By behavioural science, we mean sociology and psychology. Sociology focuses on human behaviour of groups of people, where psychology focuses on individuals. Evolutionary psychology, for example, is gaining interest in understanding economic behaviour\textsuperscript{46}. It could also have a role in understanding regulation, particularly its making and implementation. For example, compliance and non-compliance of rules is probably related to evolutionary mechanisms where sometimes the human brain sees it fit to abide by the rules. Sometimes the brain figures it wiser to break a rule. Consumer behaviour related to food is for an important part related to evolutionary mechanisms which guide consumers towards diets that have kept us alive through the Stone Age and further. In practice, this means that the brain decides what tastes good to us. Regulators need to be aware of psychological factors in selecting food, as regulation is supposed to guide human behaviour. Rational thought is one of the mechanisms

\textsuperscript{45} See Tala 2005.
\textsuperscript{46} Cohen 2005.
going on in the human brain, but not the only one. Therefore, regulation should not be entirely based on an assumption of rational market actors.

Our attitudes towards ethical questions are also partly inherited through our brain structure and brain activities. The instinct-part of our brain often seems to guide ethical action, and this part of the brain is old. The oldest part of the human brain is also called “monkey brain”. In the beginning of humanity, humans lived in rather small societies, tribes. There was no need for morale extending beyond familiar people. We suspect this is the reason for our incapability to resolve global problems related to poverty and hunger, for example. Our brain simply does not see the connection between our actions and global problems. Our indifference towards animal suffering might be related to similar disregard of our brain for anything that is not related to keeping our own species alive.

It is fairly easy to agree that food regulation should be based on ethics. Ethics means that besides being profitable, food business should be sustainable in social and ecological sense. However, opinions on what is ethical vary greatly. Natural science related to chemicals or non-human biological material is seen as more objective than science on emotions such as suspicion or fear of something that is considered wrong. For example with genetically modified organisms, the “rational” side often calls the arguments of the GMO-suspicious side irrational. International human rights should serve as a lead to what is ethical. Worker’s rights according to ILO standards should be guaranteed in the food chain. The right to food was recognized already in Article 25 of the Universal Declaration of Human Rights in 1948. More comprehensively it is defined in the International Covenant on Economic, Social and Cultural Rights. The health and safety of consumers and the environment must be fulfilled, and animal rights also need to be acknowledged.

Besides science, food regulation should also be based on politics, if politics is understood as negotiation and compromises between stakeholder interests. These stakeholders include farmers, food producers, marketers, consumers, the environment, states, and societies. States have their interests in supporting national economy, national health, and employment. Societal values such as tradition and culture cannot directly be measured in money. “Other legitimate factors” besides pure science are officially given weight in food regulation, and perhaps even more in the future. These other factors include economics, traditional food cultures, and rural development. Food is a con-

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47 Cohen 2005.
48 See Mechlem 2004 on right to food.
sumer issue but also a trade issue, a cultural issue, and an environmental issue. Food is more than just a commodity, and regulating food will be more complicated than regulating less emotion-provoking, less culture-bound commodities, such as mobile phones.

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SELF-REGULATION IN GLOBAL VALUE CHAIN – A TRADE BARRIER OR AN OPPORTUNITY FOR PUBLIC-PRIVATE CO-OPERATION?

Kaisa Sorsa

Abstract

The aim of this paper is to address and analyze the use of different self-regulation systems in the global value chains by asking why companies voluntarily co-operate by self-regulating, even though they compete, also with each other, in the market. Secondly, it is argued that the lawmaker should take self-regulation more seriously as a regulatory strategy because of its benefits and feasibility in the dynamic, global business environment. First, the use of self-regulation in value chain is analysed based on empirical evidence as presented in international and Finnish research papers. Secondly, the results are reflected on with more theoretical arguments.

1 Introduction

Regulatory policy is critical to the welfare of a country. On the positive side, regulations have an essential role to play in protecting the environment, assuring a safe workplace, providing protection to consumers and in other ways addressing the needs of the people. Since the 1990s, however, it has become increasingly evident that national and supranational rules and regulations are not sufficient when it comes to achieving social, environmental and competitive objectives within the framework of the global economic and trade system (Sherman & Pitts 2008, 6; Usher & Newitt 2009, 11). In many cases the slow process of developing government policy and accompanying regulations does not satisfy the market's need for clarity and communication (Codron, Sirieix and Reardon 2006). In order to fill the gap, civil society actors such as NGOs or in other cases the private sector has stepped in. Both have resulted in voluntary standards and codes of conduct which have been developed to complement legal rules. The challenges companies face cannot wait the slow movement of the lawmakers who use to react to the problems. Regulation is also usually seen more as a risk management tool than as a tool to promote good business practices (as an opportunity management tool). It is argued, that the lawmakers should move to a more proactive law approach strategy, learning from the good
practices developed by private regulation and encouraging the use of self-regulation instead of keeping in the reactive, command and control regulation road.

This article addresses the role of self-regulation in global value chain. Firms generally do not become competitive on their own, i.e. without a supportive environment of related suppliers and service providers as well as customers which are both reliable and demanding. All firms are more or less embedded in networks of firms that provide externalities such as easy access to information, material inputs, specialized business services and a skilled workforce. The more developed these complementary networks are, the more can an individual enterprise specialize in certain core capabilities, which in turn tend to raise the competitiveness of the network which the firm is embedded in. (Altenburg 2007, 6; Schmitz 2005, 7). Value chain analysis helps the policymaker find out where the bottlenecks are. Which part of the chain holds up progress in others? Which deserve the priority in government attention? Which can be expected to be resolved by the private sector and which require public-private partnership? (Schmitz 2005, 11).

Value chains are one of the most important elements of these networks or production systems. Value chains can be defined as the full range of activities (primary and supportive activities) that are required to bring a product from its conception to its end use. These include design, production, marketing, distribution, and support to deliver the product to the final user. The activities that comprise a value chain may be contained within a single firm or may embrace many firms, NGOs and civil society organisations. They can be limited to a single country or stretch across national boundaries. (Porter 2004, 33–35; Altenburg 2007, 6).

This article focuses mainly on the use of self-regulation tools in the field of business to business (B2B) and business to consumer (B2C) relationships in global value chains in different industry sectors in order to show, how private actors aim not only to manage risks but also to create a competitive advantage by using self-regulation. Self-regulation is understood here as regulation of the conduct of individual organisations, or groups of organisations by themselves. Regulatory rules are self-specified, conduct is self-monitored and the rules are self-enforced. There is also usually a sanction system in use. (Tala 2007a, 9). The content of the rules is also relevant in this research. (Sorsa 2009b, 1–2). It varies from the definition of quality of actions and processes to the quality of management of stakeholder relationships. Recent years have seen a substantial growth in private self-regulation schemes. Regardless of their exact number (appr. 400), based on the date of their establishment, it is evident that the period from 1990 until today has seen a dramatic increase in the number of for
example Food Quality Certification Schemes at the business-to-consumer (B2C) level in EU, some of them are competing self-regulation systems.\textsuperscript{1}

Decision-making processes in global value chains can be considered analogous to the legislative, executive and judicial functions of public government. These roles correspond to the authority to set, implement and verify compliance with the rules for value chain participation. Voluntary standards institute new rules and rule-making processes for value chain participation. In other words, they alter legislative governance conventions, the rules that less-powerful actors must comply with to participate in the value chain and to have access to the end market. Legislative power is typically formalized through the operations of an implementing organization’s board of directors, standards development committees or implementation secretariat. (Sexsmith & Potts 2009, 7–8).

2 Self-regulation in value chain – reviewing retail, food, clothing and chemical industry

2.1 Aims and objectives

Self-regulation includes a host of options available to address specific problems and objectives, including codes of conduct, industry service charters, guidelines and standards, as well as industry-based accreditation and complaint handling schemes. This research distinguishes between individual self-regulation (where an entity regulates itself, independently from others) and self-regulation by groups (corporations, professional communities, trade associations etc.) focusing primarily on the latter.

This article is mainly based on the research conducted in 2009 (Sorsa 2009b). The research had two main aims. The most important was to understand 1) how and why businesses co-operate by using self-regulation methods in order to resolve challenges or the problems related to their business. The other aim was 2) to find out when and under which conditions trade associations and other entities engage in self-regulation. Within this research I am concerned with self-regulation that becomes binding those who formally adhere to the self-regulation system and also with those who are bound to the rules by contracts.\textsuperscript{2}

Answering to the ‘how’ question reveals the different kind of self-regulation tools which are in use (codes of conduct, standards, certification


\textsuperscript{2} E.g. Caffagi has focused on private regulation with general or ultra partes effects in his paper “Private Regulation in European Private Law” 2009.
tion-, verification – and accreditation schemes). Answers to the ‘why’ question bring into the light the drivers of self-regulation, and also the object of self-regulation. When self-regulation takes place highlights the market conditions which enable or restrict the use of self-regulation. As one can distinguish between different forms of self-regulation by the degree of government involvement ranging from pure self-regulation to mandated self-regulation, the rich variety of different self-regulation tools and methods were highlighted in sector specific examples.

2.2 Theoretical insights

Understanding how and why, when and under which conditions trade associations and other networks see self-regulation relevant and reasonable to them provides insights into the role of private regulation and legislation in business. The explanations have so far applied both the theory of new institutional economics and transaction cost theory, but less the theories known in the field of strategic management.

The Value Chain3 framework of Michael Porter – a model that helps to analyze specific activities through which firms can create value and competitive advantage – was used as a contextual framework. Porter strongly underpins the argument that competitiveness at the firm’s level decisively depends on its local embeddedness. While management sciences have always dealt with firm strategy and inter-firm linkages, it is Porter’s merit to have attracted attention to additional location-specific factors as local demand and rivalry.

The traditional way of explaining the reasons and motives of self-regulation assumes the following order: avoidance of regulation (Héritier & Eckert 2008, 116; King & Toffel 2007; Kyttä & Tala 2008, 88), response to global social activism (Vogel 2006, 8; Giovannucci & Potts 2009; Nadgrodkiewicz 2009, 2–5; Kyttä & Tala 2008, 94 and Héritier & Eckert 2008, 116–117), protection of self-interests and protection of the company’s reputation and brands (Vogel 2006, 7). These explanations seem to be based on a single or a couple of self-regulation schemes or focused only on one industry sector.

The theoretical analysis model was developed combining the earlier research results. Four dimensions were used as hypothetical explanations for the drivers of self-regulatory regimes: market failure -dimension, opinion – responsive -dimension (ethical issues), interest-driven -dimension and

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3 In some of the EU official documents the chain perspective is also taken into account, see the “agricultural product quality policy: impact assessment”.
competitive advantage -dimension. (Sorsa 2009b, 6). The potential sources of competitive advantages on the company level can be: 1) product differentiation in the marketplace, 2) quality signals, 3) reduced insurance premiums, and 4) maintenance of standards along the supply chain (Bondy et al. 2004). These sources are here taken as a starting point for the development of self-regulation schemes in industry level. Opinion responsive dimension represents the idea that the self-regulation initiative is created in order to promote ethical values. Market failure describes conditions under which market outcomes are not guaranteed to serve the public interest. Market failure often generates regulation.

![Diagram](image)

**Figure 1** Forces which influence the self-regulatory system (Bartle & Vass 2005)

This model was challenged and reflected in sector specific value chain analysis. Examples from retail business, food industry, clothing industry and chemical industry are under a more detailed analysis. From the policy maker’s viewpoint the idea of a value chain becomes useful for analytical and policy purposes, once three features are included: first, the activities are often carried out in different parts of the world; second, some activities add more value and are more lucrative than others (the policy maker’s concern is to help local enterprises move into the lucrative activities); third, some actors in the chain have power over the others. (Schmitz 2005, 4).

Reacting to market failures or to the public opinion is argued to be the main reason for self-regulation. They both represent the reactive way of action. On the other hand, creation or promotion of competitive advantage or the interests of one interest group like trade association, are more proactive ways of action. (Sorsa 2009b).

Usually the research related to self-regulation is focused on one single self-regulation system analysing its strengths and weaknesses. There are however rare exceptions (Dankers 2003; Kirk-Wilson 2008). This research
started from a different viewpoint: the aim was to capture the reality of the business context where the different self-regulation rules are embedded, where they compete with each others or with the legal rules or supplement them. The retail business, food industry, clothing industry and agriculture were in focus.

2.3 Methodology

This article is mainly based on the research conducted and published by the writer in 2009: “Self-regulation and co-regulation in value chain – reviewing retail, food and chemical industry examples” (Sorsa 2009b). It was based on a literature review and the materials of different self-regulation schemes. The self-regulation schemes were selected based on their global or broad local coverage and the fact that most of them are relevant also from the Finnish companies’ viewpoint and in the Finnish markets. The research data included books, articles and studies related to self- and co-regulation. This secondary data used in the research covered approximately 200 scientific research reports and articles published during 2000–2009. Important criteria selecting from the materials was the use of the empirical research methods. The material covered research based on quantitative, qualitative or case methods in order to capture the diversity and reality of the phenomenon in business. The preliminary explanations were reflected during the analysis of industry related examples. (Sorsa 2009b, 34–85 and 101–119).

The different self-regulation schemes which were under a more thorough analysis are listed in the appendix 1. During the research process it was found out that the self-regulation schemes had some differences depending on the level they operate. The schemes are divided into two different groups according to the level on which they operate: 1) business to business (B2B) level and 2) business to consumer (B2C) level schemes. Base on some earlier research findings this division seemed to have some significance from the motivation viewpoint.
3 Self-regulation in business to business relationships

3.1 Self-regulation as a way of co-operation in the global network

The preliminary theoretical analysis model was extended by the theoretical ideas related to the relevance of stakeholder relationships in the value creation of business. Looking at stakeholder relations either from an ethical point of view or from a business point of view is not enough; these issues are inextricably linked. Stakeholders other than customers and owners are also important in the value creation process, which has usually been defined through the lenses of customer-firm relationships or from the viewpoint of creating value to owners. (Myllykangas 2009). Globalisation of production has accelerated demand for greater control over quality assurance in production processes. This is especially significant where suppliers are located at a great distance from their customers.

Voluntary standards and codes of conduct are seen as a tool to manage these challenges. The networks required to define complex standards often come about because the resources required to formulate the standard, and to make it credible, are distributed amongst a variety of actors. Moreover, there is an element of interdependence amongst such actors because they have specific core competencies but they also need each other in order to make a standard reliable, transparent, efficient, and legitimate (Nadvi & Wältring 2004; Abbott & Snidal 2008, 3).

In the present-day global business environment, it is not enough to concentrate only on the customers in order to create value and in order to have sustainable competitiveness. Rather, it is necessary to take the broader stakeholder view because the value is created with the broader stakeholder network than before. It is no longer enough to concentrate only to one’s own company and its shareholders. The whole value chain and its possibilities need to be taken into account. (Sorsa 2009b, 127–137).

Business firms have started to engage in activities that traditionally have been regarded as genuine governmental activities. The private ac-

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4 E.g. in the UK, Section 172 of the 2006 UK Companies Act embraces a concept of enlightened shareholder value by requiring UK companies to “have regard” for the social impact of their decisions on such stakeholders as the company’s employees, the need to foster the company’s business relationships with suppliers, customers, and others, the impact of the company’s operations on the community and the environment, and the desirability of maintaining a reputation for high standards of business conduct. (Sherman & Pitts 2008, 8).
tors are willing to take responsibility of the social issues which have traditionally been on the responsibility of the government. Many business firms have started to assume social and political responsibilities that go beyond legal requirements and fill the regulatory vacuum in global governance. Especially transnational corporations (TNC) engage in public health, education, social security, and protection of human rights while operating in countries with failed state agencies, they define ethic codes and engage in self-regulation to fill global gaps in legal regulation and moral orientation (Vogel 2008, 268–269; KOM (2009) 215; Nadgrodkiewicz 2009, 2–5; Porter & Kramer 2006). From a practical point in global business, a principal driving force for the self-regulation is the preference of individuals in importing countries for sustainable practices in exporting countries. In many situations those preferences cannot be exercised effectively by civic behaviour (voting, public commentary directed at government, etc.). Instead individuals act on those preferences through their private market behaviour (as consumers or investors) or through their behaviour as employees and managers of firms. (Vadenbergh 2007, 8).

3.2 Competitive advantage as a motive to self-regulation

3.2.1 Self-regulation as a tool for cost efficiency and differentiation

The principal explanation to self-regulation seemed to be the desire to proactively develop and sustain the companies’ competitive advantage and the threat of future regulation did not seem to be as important an explanatory factor as the earlier research had suggested. (Sorsa 2009b, 127–137; Sorsa 2010b, 17–19 and 61–64).

According to the empirical research conducted in Australia consumer market, a common reason for self-regulation, often in conjunction with other reasons, is the desire to raise industry standards. Self-regulation is a means to exceed minimum legal requirements and can also enhance understanding and compliance with regulations. In a competitive environment there is a strong incentive for businesses to continually improve standards and exceed the benchmark service levels in order to gain market share. Various forms of self-regulation can set a benchmark for minimum service levels, and allow businesses flexibility in how these services are to be met and exceeded Raising industry standards often refers to the ability to deal with rogue players or poor reputation. The role of reputation can be very important to a business, particularly when the business is operating in a competitive environment. (Australian Government, Treasury 1999, Chapter 3).
The sources of competitive advantage were in most cases *cost efficiency* or *differentiation* based on corporate social responsibility issues and the motivation of self-regulation seemed to rise from this foundation (Sorsa 2009b, 127–137). Ponte and Gibbon have found out in their research that e.g. food consumption is increasingly characterized by food and/or user safety awareness, the parallel processes of globalization and localization of consumer tastes, and social and environmental concerns (Ponte & Gibbon 2005, 2). Under such process, the agro-food production system has drastically transformed to attain economic efficiency through applying uniform criteria for product to take advantage on integration of production system across the borders while accommodating diverse market preferences through differentiations. In this context, the use of global standards has increased and transformed from conventional ways of ensuring minimum standards for food safety and quality at national level to the coordination tool for global food production system as well as the means of product differentiation (such as organic, fair trade, socially responsible to name a few).

In retail business the BSCI standard aims to avoid multiple and redundant auditing systems. There are several platforms where supplier social audits can be shared by buyers and brands in order to minimise “audit fatigue”. These include Sedex\(^5\) and the Fair factories Clearing House\(^6\). (Sorsa 2010b, 25–26 and 61–64).

The different value chains were *either buyer driven or producer driven*\(^7\) and the methods and tools of self-regulation varied depending on the value chain model. Also, differences between the self-regulation methods were dependent on the relationship type. In business to business (B2B) -relation-

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5 Sedex is a not-for-profit organisation based in London, UK, open for membership to any company anywhere in the world. Sedex will be the knowledge management provider of choice for measuring and improving ethical and responsible business practices in global supply chains. Sedex focuses on four pillars: Labour Standards, Health & Safety, Environment and Business Integrity. www.sedex.org

6 Reebok International Ltd., the National Retail Federation, Retail Council of Canada and World Monitors joined forces and created a not-for-profit organisation, the Fair Factories Clearinghouse in late 2004. The FFC was established to use technology to lower the cost of entry for those seeking to manage compliance programs and to improve the availability, comprehensiveness, and standardization of compliance standards and audits through the use of a global management system to track workplace conditions. www.fairfactories.org

7 An earlier, but still very active body of research on Global Commodity Chains (GCCs) developed a key distinction between global chains that are "driven" by two kinds of lead firms: buyers and producers. Today, global-scale networks of legally independent firms no longer make only simple items, but technology- and capital-intensive goods and services as well. The GVC framework specifies a more elaborate set of governance forms and crucially provides a method to explain changes in governance patterns over time. As a starting-point, however, we can say that buyer-driven chains tend to be coordinated via market, modular, or relational governance, and producer-driven chains tend to be coordinated via captive or hierarchical governance.
ships mainly different product or process standards (ISO 9000, ISO 22 000) and codes of conduct (ETI\(^8\)) were in use in order to guarantee the quality, product safety, environmental aspects, ethical or social aspects (ISO 14000, SA8000, BSCI\(^9\), OHSAS 18000) of the production to the buyer. In these self-regulation schemes the approach to self-regulate seems to be preventive, minimisation of the own risks. (Sorsa 2009b,128; Sorsa 2010b, 76–86)). All these standards and codes of conduct were in use in buyer driven value chains. In business-to-consumer relationships, instead, different labelling schemes (e.g. Utz Certified, Fair Trade, Swan, Eco-Flower) played a relevant role. (Sorsa 2009b; 2010b, 88–98).

### 3.2.2 Self-regulation as a tool for setting process standards

The importance and role of the process standards instead of product standards seemed to be growing. This finding is congruent with the findings of several researchers (Nadvi & Wältring 2004; Broberg 2009, 11). The process standards refer to management practices (quality management or management of environmental issues) of the company (Sorsa 2010b, 64–70). In some cases, these include clearly defined and measurable benchmarks, allowing firms to gauge how well they perform in reaching particular targets. According to Josling et al. research related to food regulation and trade (2004, 104) with the increased focus upon food safety has come a shift toward process requirements and away from product requirements.

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\(^8\) Ethical Trading Initiative (ETI) is a multi stakeholder initiative (brand companies, NGOs, trade unions). The initiative started in the late nineties, when companies selling food and clothing to UK consumers were coming under increasing pressure to ensure decent working conditions for the people who produce the goods they sell. ETI was set up in 1998 to bring the combined knowledge and influence of relevant NGOs and the international trade union movement to work alongside. van Yperen 2006, 31. According to Motlala (2006, 20–21), when companies import products from outside the EU the assurance of the product quality comes more and more important to them.

\(^9\) The Business Social Compliance Initiative (BSCI) is an industry-led platform, an initiative of European retail companies initiated by the Brussels based Foreign Trade Association (FTA). In 2002 a common platform was established for the various different European Codes of Conduct and monitoring systems and to lay the groundwork for a common European monitoring system for social compliance. In 2002 and 2003, retail companies and associations held several workshops to determine the framework for such a system. In March 2003 the FTA formally founded the Business Social Compliance Initiative (BSCI). Audited suppliers are registered in the BSCI Database so that there is no need for other BSCI members to assess the same supplier. This decreases the costs for the supplier and enhances the efficiency of the improvement process.
What comes to the quality management standards, the ISO 9000 is the most popular of global process standards. It provides assurance that the firm or service provider has in place appropriate quality management procedures. The standard is seen as promoting better, and more assured, control of quality within international supply chains, improving market transparency of suppliers, and reducing transaction costs related to quality management. The standard is generic, and can be applied to manufacturing, service, and public sectors. Within the private sector many companies use it as a filtering mechanism to assess the process competencies of their suppliers; those without ISO 9000 certification are often excluded from the supply chain in various sectors and markets. The standard is seen by many developing country firms as key to obtaining access, and enhancing competitiveness, in global markets (Nadvi & Wältring 2002, 12–13).

The content of process standards has extended to cover environmental, social and economic aspects. The aim is to balance shareholder interests against the interest of the wider community and to respond positively to emerging societal priorities and expectations. This phenomenon illustrates that the business of business is no longer only profit seeking. Instead broader aspects are also important to the companies. With self-regulation companies are able to address these challenges faster than lawmakers.

The main emphasis of most sustainability standards is ensuring that a product has been brought to market using sustainable production and trading methods. Conventional value chain relationships, by contract, specify the physical attributes of a product upon its delivery. Sustainability standards represent a unique, explicit effort to establish non-product-related rules for production and processing. When such rules apply exclusively to producers, the implementation of standards can reduce the relative authority of producers in decisions about their production practices. (Sexsmith & Potts 2009, 8).

### 3.2.3 Social standards for general and sector specific use

#### 3.2.3.1 Business and multi-stakeholder initiatives tackling same problems

Self-regulation schemes focusing on labour rights and social aspects are diverse and also geographically fragmented. Social Accountability

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10 The distinction between product and process standards, while widely used, is becoming hazy. Some standards, such as those for organic food for example, reflect both product and process characteristics, and thus more hybrid in nature. (Nadvi & Wältring 2004).
(SA8000), Business Social Compliance Initiative (BSCI) and OHSAS schemes are focused on social aspects of sustainability. SA8000 is a multi-stakeholder initiative, in operation since 1997, a voluntary standard for workplaces. SA 8000 is a factory certification model. It is a uniform, auditable standard for a third party verification system on social issues. The rationale for creating SA8000 was to provide a unifying framework for various workplace codes of conduct and verification methodologies. (Nadgrodkiewicz 2009, 4). While there are several other widely applied multi-stakeholder initiatives codes of labour practice in the field (such as the ETI Base Code, textile industry codes: Fair Labour Association (FLA) and Fair Wear Foundation), SA8000 has a relatively long history and high level of international recognition. Any changes to it may be seen as a barometer of the evolution of private labour standards, their methods of monitoring and implementation. In the US market SA competes with the FLA. Compared to SA, FLA seems to put more emphasis on involving local NGOs in the monitoring process than other code initiatives by capacity building. FLA has been at the forefront of efforts to develop initiatives beyond monitoring to address labour right issues. (FLA 2009, 3–5; Usher & Newitt 2009, 21–25; Abbott & Duncan 2008, 5–6, 10).

Social Accountability International (SAI) has produced a new version SA8000:2008. The definition of a child now goes beyond ILO Conventions in excluding the allowance of work by 14 year olds in developing countries. SA8000:2008 defines a child as anyone below the age of 15 in all countries. All in all, the tone of voice is different – empowerment, dignity, respect, dialogue and stakeholders all receive much more prominence, reflecting the zeitgeist. There is more onus on companies to take certain actions and record and demonstrate them. There are explicit statements of workers rights, beyond referencing relevant conventions. There is more mention of tackling root causes and taking prompt and preventative action, not just action when they are ready. These changes take SA8000 in some important new directions.

The BSCI is a European business initiative to improve the social performance in supplier countries through a uniform social standards monitoring solution for retail, industry and importers. BSCI is not a verification or certification system and therefore does not issue a certificate. Certification is

11 OHSAS 18000 is an international occupational health and safety management system. It helps companies to control occupational health and safety risks. OHSAS 18001 was created via a concerted effort from a number of the worlds leading national standards bodies, certification bodies, and specialist consultancies. This was outside of the ISO process, owing to decisions by ISO not to enter into this field of activity at that time. van Yperen 2006, 39.
possible via SA8000. (van Yperen 2006, 21, 25). BSCI focuses also increasingly on capacity building to raise the awareness of suppliers, to empower workers and ensure sustainable change in the factory and/or farm. (Usher & Newitt 2009, 26).

OHSAS 18000 is a multi-stakeholder initiative, applicable to all sectors, a typical management system, focusing on the management of health and safety issues. Companies can obtain certification by an external accredited organisation. Since its publication 1999, OHSAS 18001 has become the de facto international standard for the certification of (occupational) health & safety management systems, and is being adopted as a national standard by a constantly increasing number of national standards bodies.

**Case Retail business – buyers’ perspective to BSCI**

Social standards have entered the Finnish retail business during the last ten years (Sorsa 2010b, 25–26 and 54–59). According to the company reports all the major retail companies covering 86% market share of Finnish retail markets are committed to the BSCI initiative. This means that the companies exporting to Finnish retail markets have to comply with the BSCI standard. At present, members have to commit themselves to audit and integrate 2/3 of their suppliers or 2/3 of their buying volume in defined risk countries into the compliance programme. This auditing and integrating must be carried out within a timeframe of 3 1/2 years. Kesko Group has progressed well with its auditing effort even though it has not reached its goals in 2008 (Kesko 2008, 55–56).

The BSCI is becoming an important EU market access requirement. BSCI members include big retailers such as C&A, HEMA, WE and Wehkamp (Netherlands), Karstadt, Metro Group, Quelle and Neckermann (Germany), Kesko and Stockmann (Finland), Lindex, KappAhl and Unibrands (Sweden), Inditex (Spain), Vögele, Calida and Coop (Switzerland), The Cotton Group (Belgium) and Celio (France). (See also Sorsa 2010, 27–30).

**Case Ningbo in China – sellers’ perspective**

The fact that textile and apparel enterprises often take the lead in Corporate Social Responsibility initiatives is not an aggregation of many coincidences; instead, there are some deep-rooted reasons. First, from a micro point of view, among industries close to consumers, the textile and apparel industry is the most market-oriented one, while most of the CSR concerns are from consumers. Another reason lies in the international trade relations. The worldwide transfer of production capacity started from labor-intensive
industries, while textile and apparel industry is the first to bear the brunt. Multinational corporations move their production, especially labor-intensive textile and apparel production to developing countries where cheap labor is often accompanied with labour, environment and corruption issues.\(^\text{12}\) (Sorsa 2010b, 103–106).

Social process standards has become an issue of increasing importance in regard to outsourcing by developed countries of low-tech, labor intensive production to developing countries. China’s manufacture industry is deeply embedded in the global production networks (GPN). Ningbo city, the biggest clothing industrial cluster in China, accounting approximately 1/9 of total domestic garment production, specializes in knitting wear, man’s suits and shirts, kids’ wear and casual wear. Most products in Ningbo apparel firms are exported to EU, USA and Japan.

<table>
<thead>
<tr>
<th>The Kind of Certifications</th>
<th>Frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>ISO9000</td>
<td>53</td>
<td>58.2</td>
</tr>
<tr>
<td>ISO14000</td>
<td>23</td>
<td>25.3</td>
</tr>
<tr>
<td>OHSAS18000</td>
<td>2</td>
<td>2.2</td>
</tr>
<tr>
<td>SA8000</td>
<td>1</td>
<td>1.1</td>
</tr>
<tr>
<td>CSC9000T</td>
<td>3</td>
<td>3.3</td>
</tr>
<tr>
<td>COC</td>
<td>24</td>
<td>26.4</td>
</tr>
<tr>
<td>Others</td>
<td>5</td>
<td>5.5</td>
</tr>
<tr>
<td>None</td>
<td>30</td>
<td>33.0</td>
</tr>
</tbody>
</table>

CSC9000T = China Social Compliance 9000 for Textile Industry
COC = Code of Conduct

Ningbo clothing industry presents a good case to reflect the current situation of China apparel industry in GPN and the status of CSR in China’s

\(^{12}\) Annual Report on Social Responsibility of China Textile and Apparel Industry 2006, 8. China National Textile and Apparel Council (CNTAC) invited delegates inside and outside China to conference discuss issues of strategic significance on building a responsible global supply chain for the industry in 2006. The conference passed “Declaration on the Social Compliance by China Textile and Apparel Industry”. Chinese textile and apparel enterprises will persevere with the self-discipline of CSR on a voluntary basis. In 2005 China social Compliance for textile and Apparel Industry (CSC9000T) – Principles and Guidelines was released. CNTAC begun to provide guidance to Chinese textile and clothing businesses and encourages to take more active measures to addressing CSR related issues by the implementation of CSC9000T. Responsible Supply Chain Association (RSCA) is an industry-wide and professional body for the promotion of social responsibilities, which is directly under the administration of CNTAC. RSCA Through pooling efforts and resources, RSCA members are promoting a common monitoring and factory development system with BSCI.

garment industry and to investigate the performance of CSR. The clothing industry is labour intensive in character and quite market oriented and privatized. Nearly 2/3 firms’ 90% production are exported, and the export mostly concentrates on the EU, USA & Japan. It verifies that as a typical buyer-driven chain, the leading companies in developed countries control the apparel chain (branding and marketing) and gain high value-added, and the apparel firms in developing countries stay in the low value-added processing and manufacturing segments. More firms nowadays pay attention to the management of quality, environment and social responsibility. The state of the certifications of every kind of standards can be seen in Table 1. According to the survey, the pressure of certification also comes from the buyers, whose orders, more or less, force 80% firms of the samples to fulfil the social responsibility standard. (Linfei & Qingliang 2009, 218–222).

3.2.3.2 International Framework Agreements as a new instrument

The lack of enforcement of national labour laws and the limited protection of workers’ rights in developing countries have led workers’ rights representatives to attempt to establish transnational industrial relations systems to complement existing national systems. In practice, these attempts have mainly been operationalised in codes of conduct and recently international framework agreements (IFAs) have been proposed as an alternative. International (or global) Framework Agreements are agreements negotiated between a multinational company and an international or global union federation concerning the international activities of that company. Their main purpose is to establish a formal ongoing relationship between the multinational company and the global union federation which can solve problems and work in the interests of both parties. (Sorsa 2010b, 44–52).

Codes of conduct and IFAs serve the same purpose, namely, to improve workers’ rights, but represent different ways of governing workers’ rights transnationally. (Egels-Zandén 2009, 530) Although codes commonly include requirements on worker representation and freedom of association, many companies’ experience of working with suppliers indicates that communication between management and workers is often very poor. This is also an area where problems remain undetected by auditing. (Usher & Newitt 2009, 24).

Why IFAs were borne can be explained referring to the criticism which the Global Union Federations (GUFs) have presented about the monitoring of the codes of conduct. GUFs are very sceptical towards the so-called “independent monitoring” of codes of conduct performed by external auditing
and accounting companies. The main points of criticism are: 1) due to the complexity of the supply chain, it is not possible for external auditors to monitor each of the company’s suppliers on a continuous basis; 2) external auditing and accounting companies often do not have much experience in dealing with fundamental trade union rights, such as freedom of association and the right to free collective bargaining in particular; 3) where external auditing and accounting companies are engaged, trade unions are often excluded from the monitoring and verification process; and 4) by engaging external auditors on a contractual basis, the company essentially retains control over the whole process (Telljohan et al. 2009, 55). IFAs are developed as a response to these deficits and in order to establish an ongoing dialogue with the transnational organisations through the conclusion of an IFA.

Spanish fashion retailer Inditex has made its partnership with global trade union ITGWLF a cornerstone of its strategy for implementing its code of conduct and addressing labour standards issue in the supply chain. As the first for the garment industry, Inditex signed a Global Framework Agreement (GFA) with ITGWLF\(^\text{13}\) in 2007, establishing a formal framework for dialogue and cooperation. Inditex signed the GFA to co-operate on tackling workers’ rights throughout the company's supply chain. The partnership enables Inditex to take a more preventative approach to worker issues, rather than a solely reactive approach, by responding to problems before they have been flagged by auditors or escalated into a dispute. (Usher & Newitt 2009, 24). Inditex’s alliance with the global garment union has started to bear fruit. In the case of one of Inditex's Cambodian suppliers, River Rich, GFA provided a framework for a rapid, collective response to the breach of workers rights in 2007. There have been ‘hard’ business benefits too, in the shape of a 30 percent increase in productivity and an increase in orders from Inditex from 9 million to 11 million garments annually. (www.ethicaltrading.org, 21 May 2009).

According to Egels-Zandén’s recent research why corporations adopt IFAs, the explanation he found to be the desire to retain a trusting relationship with the labour union movement especially at the enterprise level (Egel-Zandén 2009, 540). Prior research, instead, has identified four main plausible reasons why corporations adopt IFAs: (i) to retain, restore, and/or improve legitimacy, (ii) to avoid governmental interference, (iii) for ethical reasons, and (iv) to achieve competitive advantage. The legitimacy explanation is the one best supported in previous research (Egel-Zandén 2009, 538). Egels-Zandén’s research result can be compared with the model I have presented in this article. In figure 1, it is

\(^{13}\) International Textile, Garment and Leather Workers' Federation.
suggested four reasons why self-regulation schemes are created and one of them is the desire to promote the interests of “professional interest groups”. Egels-Zandén found out that the IFA was driven by a stakeholder pressure from inside the company, from the enterprise level union which is an integral part of the company. In such firm, stakeholder relationships, the relationship itself can be seen by the firm as a valuable resource. Several EuroCorp managers claimed that the trusting relationship was seen as a source of competitive advantage vis-à-vis EuroCorp’s competitors. (Egel-Zandén 2009, 543).

3.2.4 Self-regulating environmental issues in different phases of value chain

The motives behind the creation of self-regulation schemes can be shed light on also by focusing on the problems they aim to resolve. Self-regulation schemes can be categorised according to the level of the value chain they are applied. Food industry self-regulation schemes can be divided to pre-farm gate, post-farm gate and to whole chain self-regulation schemes. (Sorsa 2010, 30–38).

Food assurance schemes (pre-farm gate and whole chain)

So far the primary producers are not obliged to put into place a HACCP system in EU, but only have to comply with some less farreaching hygiene provisions. In order to give retailers and consumers assurance about product safety and certain aspects of production methods, “food assurance schemes” at the farm level, and sometimes covering the whole food supply chain, were developed. The most prominent example in this category is GlobalGAP (formerly EurepGAP). According to the Agri 238 report, these schemes often do not add any particular characteristic to the product or its production method but assure that all legal requirements have been complied with. (Agri 238, 6). This may be true in Europe but when the requirements of GlobalGAP are applied in the farms or packaging processes in developing countries, the situation is totally different. Compared to the developing countries legislation, these requirements go far beyond the requirements of the local legislation.

Where for example a large European supermarket chain imports food products into the European Community, this will be done under a contract specifying matters e.g. the quality of the product including food safety. In general these food safety requirements go further than what is required by 14 Regulation 852/2004, supra note 35, Article 5(3), Annex I.
law, for example laying down stricter maximum limit value of a pesticide in certain crops, by requiring certification, or by requiring that the food is subject to full traceability (or other additional process requirements). Often the private standards are not established by the individual food importer, but instead by private associations that cover substantial parts of the distributors in the European Community. These private food safety requirements impose an additional burden on the food businesses in the developing countries; and sometimes this burden may be much heavier than the one imposed by public food safety legislation. (Broberg 2009, 24).

Food safety and liability schemes (post-farm gate)
In principle, these schemes allow for efficiency gains for suppliers that should lead to improved supply conditions (HACCP\textsuperscript{15}, ISO 22 000, ISO 9000, ISO 14 000). These schemes operate almost exclusively at the business-to-business level for post-farm gate food processing. Their foremost concerns are food safety issues. HACCP is a preventative risk based approach to food safety which seeks to minimize risks but cannot eliminate them. \textit{They are not normally communicated to the final consumer by means of logo or label} and therefore certification does not result in a price premium. However, most retailers demand certification from their suppliers, thereby making it \textit{a de-facto requirement for market access}. (Agri 238, 2009, 4).

The use of these standards and code of conduct has become relevant in international value chains. In some EU Member States they are accepted as a sign of due diligence.\textsuperscript{16}

\textsuperscript{15} Hazard Analysis and Critical Control Point (HACCP) is a systemic preventive approach that is set up to identify potential food safety hazard being realised. It is the food business operators who must analyse their own processes in order to themselves put into place a HACCP system.

\textsuperscript{16} Many different retailer control schemes in UK were designed to meet the legal obligation of UK 1990 Food Safety Act, the basis of food law changed from one of strict liability to a recognition that problematic incidents can and do happen no matter how diligent a manufacturer is. Since then, if a manufacturer can show that all reasonable precautions have been taken and all due diligence applied so as to prevent a food law offence occurring, then the courts will accept that as a sufficient defence. (Agri 238, 2009, 4).
4 Self-regulation in business to consumer relationships

4.1 Self-regulation of marketing – number of motives to self-regulate

The achievement of acceptable advertising through self-regulatory systems is a topic that has been debated in the leading marketing journals for over twenty years. This extant literature can be classified into two key areas.

The first provides a significant, body of knowledge of advertising self-regulation in general and examines, for example, how various schemes function around the world and the second area is more prescriptive and provides normative guides for regulators and advertisers to develop effective advertising self-regulation programs.

The core question in this article is why companies self-regulate and in this case, why do they self-regulate marketing activities? The Consolidated ICC Code for Advertising and Marketing Communication Practice (CAMCP 2007\textsuperscript{17}) adopted by the International Chamber of Commerce (first issued in 1937) was as an example and some industry specific self-regulation schemes as well. The ICC Code of marketing\textsuperscript{18} aims to demonstrate responsibility and good practice in advertising and marketing communications by promoting high standards of ethics in marketing across the world and to enhance overall public confidence in marketing communication. It also aims to provide practical guidance for companies (CAMCP 2007, 9). According to the European Advertising Standards Alliance’s the advertising must enjoy a high level of consumer trust and confidence (Blue Book 2007, 13).

The motive behind the CAMCP seems to be congruent with a common reason for self-regulation, which is the desire to raise industry standards. Self-regulation is often used as a means to exceed minimum legal requirements and also as a means to enhance understanding and compliance with regulations. This is mentioned also in CAMCP. In a competitive environment there is a strong incentive for businesses to continually improve stan-

\textsuperscript{17} The eighth revision of ICC’s Code of Advertising Practice.

\textsuperscript{18} The Consolidated International Chamber of Commerce’s Code was drawn up by a specific task force of ICC’s Commission on Marketing and Advertising, the Task Force on Code Revision, composed of advertising practitioners (advertisers, agencies and media) and self-regulation experts. The ICC’s Task Force on Code Revision will regularly review the Code’s provisions, to ensure that they continue to reflect the latest developments in technology, marketing practice and society. ICC has been a major rule-setter in the field of international marketing and advertising since 1937 when the first ICC code on advertising practice was issued.
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...ards and exceed the benchmark service levels in order to gain market share. Various forms of self-regulation can set a benchmark for minimum service levels, and allow businesses flexibility in how these services are to be met and exceeded (e.g. in GlobalGAP). Raising industry standards often refers to the ability to deal with rogue players or poor reputation.

The role of reputation can be very important to a business, particularly when the business is operating in a competitive environment. Using self-regulation as a marketing tool is another reason why self-regulation has been developed by industry. Membership of a recognised form of self-regulation (e.g. code of conduct) can often constitute an important selling point for businesses to attract new customers, and may increase the bargaining power of the business when entering new arrangements with other parties (OFT964). This is highlighted with the examples of next chapter.

Increasing the level of information on products and services is a further reason for self-regulation (e.g. CIAA Guideline Daily Amount). By enhancing information flows like traceability in food industry, businesses can boost consumer confidence in products. The actual or perceived 'threat' of government regulation, or a 'push' by government because of poor industry practices was found to be a further reason for industry to self-regulate. This was the case when time-share industry started its self-regulation efforts in 1980s. (Sorsa 2003). Often there will be a number of reasons to self-regulate.

4.2 Self-regulation tools to promote competitive advantage

Many self-regulation systems use the ethical issues as a source of differentiation and aim to distinguish certified products from others by highlighting certain product or process attributes (e.g., observance of strict environmental requirements; social standards; animal welfare; organic farming; origin; etc.). (Sorsa 2009b, 58–65).

Utz Certified highlights the all dimensions of corporate social responsibility (ecological, social and economical) as well as the trace-

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19 The UK consumer authority Office of Fair Trading (OFT) encourages businesses to higher standards when using tools other than enforcement, such as guidance and training, and in particular through Consumer Codes Approval Scheme (CCAS). The CCAS rewards those who adopt best practice, giving them a competitive edge in attracting and retaining customers. What is exceptional when providing advice and guidance, OFT distinguishes between what is necessary to meet statutory obligations and what is desirable for the purposes of achieving improvements above the minimum required by law. (OFT964). See more in Sorsa 2010.

20 Confederation of the Food and Drink Industries in the EU.
ability. It is market-oriented sustainability program which is open to farms of all sizes. Rainforest Alliance focuses more on the biodiversity and social aspects. It awards certification to farms that meet a set of standards developed by the Sustainable Agriculture Network (SAN), a coalition of conservation and sustainable development NGOs with origins in Latin America. Fair Trade focuses mainly on social and economical dimensions. It aims at fair access to markets with a focus on sustainable production and improved living conditions for small scale producers or farmers.

In the business to consumer relationship different origin labels (The Key Flag) or eco-labels (The Swan\textsuperscript{21}, Eco-Flower) were developed in order to offer consumers the possibility to make better choices as regards the product and process characteristics of their purchases and in order to raise the trust and image of the business in general (Sorsa 2009b, 44–51; Agri 238, 7).

The Key Flag is issued by the Association for Finnish Work, and it is a registered collective trade mark that proves a product or service is Finnish-made. The right to use the Key Flag symbol is issued upon application to the origin mark committee of the Association for Finnish Work. The Key Flag may be used for brand marketing and corporate profiling, with some reservations. The right to use the Key Flag is issued for a maximum period of three years at a time. Key Flag products and services must be produced in Finland. Furthermore, at least 50 percent of their production must be of Finnish origin, in terms of cost value. The use of the Key Flag is regulated by the Association for Finnish Work, that has been promoting Finnish know-how already for over 95 years.

Eco-labels which are based on self-regulatory systems play a relevant role in all sectors as well. There is however, also ecolabels which are based on the EU regulations\textsuperscript{22}. In Nordic countries the two eco-labels, one based on self-regulation, and another based on EU regulation, are competing with each other. There is a revision process going on with the EU Ecolabel. The Swan is better known in Nordic countries that the EU Ecolabel. The aim of the revision process is that the Ecolabel will be well harmonised with other labels, nationally and globally and that the Ecolabel can be attained by

\textsuperscript{21} The Swan is the official Nordic eco-label, introduced by the Nordic Council of Ministers. The green symbol is available for around 60 product groups for which it is felt that eco-labelling is needed and will be beneficial. http://www.ymparistomerkki.fi/en

\textsuperscript{22} The European Ecolabel is a voluntary scheme, established in 1992 to encourage businesses to market products and services that are kinder to the environment. Products and services awarded the Ecolabel carry the flower logo, allowing consumers – including public and private purchasers – to identify them easily. The voluntary nature of the scheme means that it does not create barriers to trade. On the contrary – many producers find that it gives them a competitive advantage.
companies with limited costs and efforts for them while still maintaining a high ambition\textsuperscript{23}. From the consumer viewpoint one could ask that do we need so many different ecolabel systems? From the consumer’s viewpoint the large number of standards and the diversity between them can lead to confusion.\textsuperscript{24}

From the retail business viewpoint different labels are a source of differentiation, as it is to the food industry. The retailers choose different labels in order to create the image for the company. On the other hand, in retail sector the labels produced in self-regulation systems face more and more competition from the so called private labels which the big retail companies have produced. From the consumer viewpoint this trend is welcomed because usually it means lower prices for the consumers. In food value chain these self-regulation tools are used in order to guarantee the quality or safety of food products or production and also in order to communicate this to the final consumer by means of a logo or label. (Sorsa 2009b, 127. See also Sexsmith & Potts 2009, 47 – 59).

5 Self-regulation as a response to the threat or pressure

Self-regulation is often explained to be born as a consequence of the threat from the lawmakers reaction to market failures or the threat from public opinion. This explanation did not seem to get much support in this research. It seems that only the chemical industry self-regulation system, Responsible Care, was born as a reaction to the threat from lawmakers as well as the self-regulation of pharmaceutical industry (Kyttä & Tala 2008), which is a sub category of chemical industry. In the chemical industry business operators wanted to raise the trustworthiness of the sector after the serious accidents in different part of the world in chemical plants. Nowadays, however, it seems that the Responsible care programme is more based on the desire of the industry to show to the public that it wants to take responsibility of the environment and its workers. (Sorsa 2009b, 77–85).

ISO 14000 is a most well known standard for environmental management. According to Nadvi & Wältring, in contrast to ISO 9000, whose introduction is based on the needs of business for quality assured supply chain management, ISO 14000 has evolved under different pressures. Its

\begin{itemize}
\item[24] Same conclusion was received in Agri 238, 7; van Yperen 2006, 59 and Nadgrodkiewicz 2009, 4.
\end{itemize}
emergence has to be seen as a response by industry to the growing environmental consciousness of the 1980s and 1990s, and the demands of NGOs and multilateral bodies for environmentally sustainable practices in production. It is generally believed however that, the ISO 14000 series emerged as a result of both the Uruguay round of the General Agreement on Trade and Tariff (GATT) negotiations and the UN Rio Summit on the environment held in 1992 (Navdi & Wältring 2004; Hewitt and Gary, 1998). According to the standardisation organisation’s information in ISO (1996), the main purpose of the standard is to “provide a systematic, documented, consistent procedure that provides clear evidence of the relationship between organizations’ publicly stated environmental policy and the implementation of this policy in practice”.

## 6 Self-regulation in the context of better regulation

It is evident that from 1990 until today there has been a dramatic increase in the number of self-regulation schemes not only in the food industry at the business-to-consumer level in the EU but also in other industries. As a consequence, it is argued that the lawmakers should take self-regulation more seriously as a regulatory strategy because of its benefits and feasibility in dynamic, global business environment (Sorsa 2009b, 52–55).

The aim of this article was to find out why do companies voluntarily cooperate by self-regulating with their competitors and with the members of civil society and NGOs and to find out when and under which conditions trade associations and other entities engage in self-regulation. The most important motive for self-regulation seemed to be the desire to promote or to create competitive advantage. It was shown also that sustainable development has framed the development of different self-regulation schemes. This seems to serve a public regulatory function in the global environmental arena. Self-regulation networks fill the regulatory gaps that are created when global trade increases the exploitation of global commons resources and shifts production to exporting countries with lax environmental or social standards. Public responses are often inadequate to address the attendant environmental harms, especially since most of them are regionally restricted.

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25 According to Caffaggi public and private regulation (e.g. self-regulation) complement rather than substitute one another, although in many contexts, private law-making has anticipated public regulation (e.g. HACCP) or, in de-regulatory ages, has substituted public legislation. Caffaggi 2009, 9.
The reason why companies try to tackle problems related to social and environmental aspects is because these are seen on the one hand as opportunities for growth and competitive advantage (e.g. Nadgrodkiewicz 2009, 2–3) and on the other hand ethical issues are an integral part of the business without emphasis to competitive issues. That is reflected as a growing number or self-regulation schemes focusing on social or environmental issues.

This research on self-regulatory mechanisms breaks down the classical orthodoxy that regulation only occurs through a mechanism of deterrence that works via commands against misconduct spelled out in legal rules, monitoring of compliance by a state regulatory agency, and application of punitive sanctions for breach. In self-regulation informal sanctions (negative publicity, public criticism, shame) have a greater motivating impact than formal legal sanctions. These questions are part of the implementation and compliance issues which are raised high in the BR agenda. Regulatory effects always depends on the extent to which regulatory norms are incorporated into informal and self-regulation, whether at the level of a corporation’s management, an industry or a local community. It is also illustrated in this research like in Schmitz’s report that the entrepreneurs are reluctant to comply with the command and control rules and they are sceptical of the advice they receive from government agencies. Instead, they listen to their customers. If policy-makers would start with this fact, they can be more productively engage with the private sector (Schmitz 2005, 15).

It came up in this research that we live in a buyer-driven world (Sorsa 2009b; Sorsa 2010b, 100–116). As market become more differentiated and complex, and as buyers become more demanding, the policy-makers, in order to be effective, need to learn to work with these drivers of change. (Shmitz 2005, 21). The UK Government has taken this already seriously. It believes that by engaging better with business, and developing a better understanding of supply chains, a more complete understanding of the costs and opportunities created by policy choices would be achievable. In particular, the UK Government is keen to understand how better supply chain analysis can help policy-makers identify economic opportunities that might flow from certain policy choices. Understanding supply chains as part of the policy-making process can be a useful approach to identify where and how to act within markets for the benefit of the economy and to capture business opportunities. (Thinking Business in Policy 2009, 4–5).

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26 Supply chain analysis is the systematic mapping and analysis of the physical commercial and cost linkages that exist between businesses. It aims to identify the opportunities and barriers created by Government policy decisions or actions connected to a particular policy. These chains can be confined to a particular sector in a specific geographic location or divided between different sectors spanning across different regions.
These findings highlight the relevance of information in all phases of law drafting and the role of impact assessment. The information should come from different sources (Tala 2007b, 9; Sorsa 2010b, 117–119) and not only from political science researchers. It was found out in this research that the way of analysing the same issues varied a lot depending on the scientific discipline the writer came from. Management sciences can be a rich source of information for law makers because it approaches the issues from more business oriented perspective than do the political scientists.

This research should wake up the law makers to realise that self-regulation as an alternative option\(^\text{27}\) to command and control regulation can be taken seriously. The purpose was to show how innovatively businesses, NGOs and civil society actors find solutions to the problems (concerns about quality assurance, health and safety, as well as ethical, social and environmental aspects of production) which seem to be insuperable to the EU lawmaker or the international public organisations like WTO, ILO or OECD. The rules of international conventions are packed to manageable code of conducts or IFAs and implemented to business practices by contracts. The serious problems of non-compliance of legal rules are translated to self-regulation rules integrated to company cultures of multinational companies and their suppliers. Customers, NGOs, civil society actors and researchers take care of the monitoring of the compliance of the self-regulation rules. The number of the reports available about the pros and cons, efficiency and effectiveness of the different self-regulation schemes is tremendous. There is more and more scientific research which aims to develop instruments to measure the impacts of different self-regulation schemes (Lloyd et al. 2008; Nadgrodkiewicz 2009; Giovannucci & Potts 2008; Telljohan et al. 2009). From the law maker’s viewpoint it is a question of negligence that this information is not better used in law making.

There are some EU policy documents which already note the development of private trade-related sustainability assurance schemes, and their relevance in relation to sustainable development objectives (e.g. COM (2009) 215; COM(2008) 641). EU Commission has also considered its role related in this process and highlights that regulating criteria and standards would limit a dynamic element of private initiatives in this field and could stand in the way of the further development of Fair Trade and other private schemes and their standards. It is however important for good market functioning that consumers and producers should have access to reliable information on the schemes, standards and criteria should be objective and non-discriminatory to avoid any negative impact on e.g. small and medium size companies and producers of developing countries. There should be also

\(^27\) Paremman sääntelyn toimintaohjelma, 168–169.
independent monitoring to guarantee that the products are the result of practices carried out according to a specific set of criteria balancing ecological, economic and social considerations. The nature and results of the auditing process should be available for inspection. (COM(2009) 215).

These elements of assessing good practice of the private sector operators are mentioned in several other research papers and public documents as well. The important question today and in future is, to what extent could the drafting, implementation and control of different marketing standards (or parts of them) or other self-regulation schemes be left to self-regulation? (Sorsa 2010a) What role should the EU or national law makers play in this process?

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2 ALTERNATIVES TO REGULATION
COULD EU-LEVEL REGULATORY PRIVATE INTEREST ORGANISATIONS PROMOTE OR DISCOURAGE HARMONISATION OF CONSUMER LAW IN EU?

Ellinoora Peltonen

1 Introduction

In the recent years the European legislature and, particularly, European Commission have experimented with self- and co-regulatory solutions as a part of EU consumer policy. Several consumer protection Directives implicitly or explicitly allow for or promote complementary self- and co-regulatory schemes to be implemented by regulatory private interest organisations (hereinafter RePIOs). Most commonly the Directives merely acknowledge or promote RePIOs’ role in complementing implementation of EU’s consumer policy at the Member State (MS) level. This is an approach that could increase the flexibility, but also the heterogeneity of EU law implementation. On the other hand, there is also limited number of Directives, which promote EU wide self- or co-regulatory schemes. The

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1 Directive 2006/114/EC of the European Parliament and of the Council of 12 December 2006 concerning misleading and comparative advertising (codified version), Article 6, stipulates that Directive does not exclude the MS level voluntary control of misleading or comparative advertising by means of regulation by RePIOs.

Directive 2008/122/EC of the European Parliament and of the Council of 14 January 2009 on the protection of consumers in respect of certain aspects of timeshare, long-term holiday product, resale and exchange contracts, Article 14, stipulates that MS may encourage RePIOs to inform consumers of their codes of conducts and the setting up or development of out-of-court complaints and redress procedures.

European Commission’s (2009) proposal for a Directive of the European Parliament and of the Council on the coordination of certain provisions laid down by law, regulation or administrative action in MSs concerning the provision of audiovisual media services (Audiovisual Media Services Directive), COM(2009)185 final: Article 3.3, stipulates that MSs are obliged encourage RePIOs’ work at MS level to the extent permitted by their legal systems.

However, the European Commission’s (2008) proposal for a Directive of the European parliament and of the Council on consumer rights, COM(2008) 614 final, seems to envisage a more modest role for MS level RePIOs than the Directives, which it will replace. The proposed Article 44 encourages traders and code owners (e.g. RePIOs) to inform consumers of their codes of conduct.

2 To name few consumer policy Directives promoting private regulatory schemes by RePIOs at EU level: Directive 2006/123/EC of the European Parliament and of the
existence of such provisions in special field of consumer policy indicates that, in that particular regulatory field of consumer policy the European legislature has aspired for a more harmonised and, at the same time, flexible implementation of consumer policy.

This study demonstrates that only modest progress has been made in view of furthering harmonisation of EU’s consumer policy by means of RePIOs assisted self-or co-regulatory implementation at the EU level. At current state many EU level RePIOs lack in their effective organisation and in their mandate, which makes it difficult for them to contribute to the more harmonised implementation of EU’s consumer policy. In particular, the European legislature has not standardised procedures by which it could better engage the EU level RePIOs in consumer policy implementation.

However, the study also demonstrates that within some specific old and new policy fields the European legislature and European Commission have managed to effectively trigger an increasingly harmonised EU wide implementation of consumer policy with the help of EU level RePIOs.

Council of 12 December 2006 on services in the internal market: It is stated in paragraph 115 of the Directive that “Codes of conduct at Community level ... do not preclude MSs, in accordance with Community law, from taking more stringent measures in law or national professional bodies from providing for greater protection in their national codes of conduct.” Furthermore, Article 22.2c and Article 27.4 recognise, indirectly, that MSs may allow for the use of codes of conduct as what comes to regulating, monitoring and enforcing professional services.

Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council (‘Unfair Commercial Practices Directive’) states in its recital that at MS and EU levels, “[i]t is appropriate to provide a role for codes of conduct, which enable traders to apply the principles of this Directive effectively in specific economic fields ...” Furthermore, the Article 3.8 states that “This Directive is without prejudice to any conditions of establishment or of authorisation regimes, or to the deontological codes of conduct or other specific rules governing regulated professions in order to uphold high standards of integrity on the part of the professional, which MSs may, in conformity with Community law, impose on professionals.

Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (‘Directive on electronic commerce’) in its Article 8.2, stipulates that the MSs and the European Commission are obliged to encourage professional RePIOs to establish codes of conduct at the EU level. Also, Article 16 stipulates that for implementation purposes MSs and the European Commission are obliged encourage the drawing up of EU level codes of conduct.

In the Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, Article 27 encourages the drawing up of MS and EU level RePIOs’ schemes to contribute to the proper implementation of the data protection provisions. Furthermore, the Article 17 encourages complementary out-of-court dispute settlement systems to be organised by RePIOs.
These EU level RePIOs possess, not only sufficient determination, but also organisational capacities and mandate for EU wide implementation of particular consumer protection stipulations. The regulatory powers of these RePIOs transcend the MS borders, which makes it possible for them to oversee and enforce their private regulatory schemes, directly, across the MSs – at the business-specific level. These RePIOs also openly aim for further harmonisation of single market and their tasks are intended to fully support EU’s consumer policy. New Approach to Standardisation (hereinafter NA) is one of the promising examples of (now, already “old school”) consumer safety policy utilising EU level RePIOs – European standardisation organisations – in harmonising European product standards. Recently, the NA was freshened up also to include formally recognised EU level RePIO-run oversight organisation – European co-ordination for Accreditation (EA). The EA is now mandated to oversee private contract agents, Notified Bodies, that verify individual business compliance to NA standards; and to oversee (predominantly private) national accreditation bodies that accredit the contract agents. This is in contrast to previous policy within NA, where overseeing the Notified Bodies and accreditation bodies was largely left for the MSs’ discretion.

In addition to NA, there are promising and, on the other hand, discouraging case studies of EU wide RePIOs, which attempt to contribute to the more harmonised EU consumer policy by means of EU level RePIO-led frameworks that include private implementing measures. The most promising case studies can be found in the “new” regulatory fields, such as e-commerce (Marsden, C. & Simmons, S. & Brow, I. & Woods, L. & Peake, A. & Robinson, N. & Hoorens, S. & Klautzer, L., 2008, p. xxi, 171–181).

The case studies indicate that some EU-level RePIOs have been able to implement their self- and co-regulatory codes of conduct so that they do appear to support the harmonisation of EU’s consumer policy. However, these cases are often found only in very specific consumer policy fields: In sectors, where the product or service markets are already close in finding their way of being genuinely integrated across the MSs. In fact, in these sectors the EU level RePIO-assisted harmonised implementation of EU’s

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3 The so called Notified Bodies: Notified Bodies and their accreditation is an integral part of checks and balances related to NA to Standardisation Directives that allow for manufacturing businesses to demonstrate that the products conform to principles-based standards. Sometimes, product conformity is demonstrated by means of external verification services provided by Notified Bodies.

consumer policy should improve the functioning of the business-sector as a whole and, therewith, provide genuine advantages for consumers. However, more generally applicable EU level RePIO-led self- and co-regulatory schemes that intend to assist in implementation and harmonisation of EU’s consumer policy remain challenging.

2 RePIOs may exert soft control at EU level

2.1 Introduction

As noted in the introduction, occasionally the EU legislation provides possibilities to use EU wide RePIOs in implementing consumer policy: Some Directives do encourage self-regulation; self-monitoring and enforcement to be drawn up by professional- and industry-RePIOs at the EU level. The Directive 2006/123/EC concerning services, Article 37, provides for RePIOs’ codes of conduct at the EU level. Also Unfair Commercial Practices Directive 2005/29/EC recital 20 makes reference to EU level codes. Furthermore, Directive 2008/122/EC on the protection of consumers in respect of certain aspects of timeshare contracts Article 14; Data protection Directive 95/46/EC Article 27.3; and Directive on electronic commerce 2000/31/EC in its Articles 8.3 and 16 promote codes of conduct at EU level.

However, there appears only few case studies in which European Commission and/or legislature have successfully delegated, either informally or formally, significant implementing tasks to certain recognised EU wide RePIOs in the field of consumer protection. This is due to the fact that powerful RePIOs operational at the EU level are lacking: Many of the EU level industry or professional confederations simply are not able to carry out implementing tasks as they lack mandates and sufficient organisational and financial resources. Acquiring mandates from member organisation would be even impossible due to differing legal traditions that the RePIOs operating at the MS level face (Zeijden (van der), Paul & Horst (van der), Rob, 2008; European Commission, Directorate General for Internal Market, 2007; Hans-Bredow-Institut and the Institute of European Media Law, 2006).

In addition, it is noteworthy that harmonisation of the consumer law in EU via EU wide RePIOs is not often even a policy objective. This is demonstrated, for example, in that the MS level self- or co-regulation is often promoted instead of EU level self- or co-regulation. In addition, MS level self- or co-regulation is always optional, considered as mere
supplementary to legislative implementing measures. Thus, the Directives granting a possibility for self- and co-regulation at MS level are actually promoting or, at least, accepting regulatory plurality. In fact, self- and co-regulation is often encouraged, because in several fields MSs already do have legal traditions that rely partly on self- or co-regulation implemented by national RePIOs, and the European legislature has not dared to provoke this delicate balance between legislation and self- or co-regulation.

The next Chapters will primarily scrutinise case studies, where EU level industry- and professional-RePIOs operate self- or co-regulatory schemes that are supported or influenced by either European Commission and/or legislature. The study made an effort to find case studies in which the EU level RePIOs are able or, at least, intending to exert tangible, continuous and uniform control over individual business compliance across the MSs. Under such circumstances the RePIOs should have real capabilities to improve the implementation and, therewith, also the harmonisation of consumer policy in EU. On the other hand, if there is an evident lack of tangible, continuous and uniform business-specific control as what comes to EU wide RePIO-led self-and co-regulatory schemes, this could be seen as an indication that EU level RePIOs are not able to provide for further harmonisation of the EU consumer policy – beyond that of the legislative harmonisation.

Therefore, the primary interest of the study is on RePIO-led self- and co-regulatory schemes that entail a permanent and organisationally independent entity responsible for compliance monitoring and enforcement of individual business compliance across several MSs.

However, even if the number of case studies of such EU level self- and co-regulatory schemes was found to be very limited, the more heterogeneous schemes – strategies that depend on various policies at MS level in monitoring and enforcing individual business compliance to EU level codes of conduct – did not seem to be totally insignificant in terms of EU consumer policy harmonisation.

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5 This tendency to foster national path-dependency is particularly visible in the Directive 2006/123/EC concerning the services in the internal market; the unfair commercial practices Directive 2005/29/EC; Directive 2006/114/EC concerning misleading and comparative advertising; and the proposed codified version of the Audiovisual Media Services Directive, which even states in its recital 45: “Directive encourages the use of ... [self- and co-regulation]. This neither obliges MSs to set up co- and/or self-regulatory regimes nor disrupts or jeopardises current co- or self-regulatory initiatives which are already in place within MSs and which are working effectively.”
2.2 Case: Advertising self-regulation by EASA

Permanent and uniform control and enforcement at business-specific level across several MSs by an EU-wide RePIO is a rarity. However, “soft” control and enforcement strategies of EU-wide RePIO are more common. These strategies are particularly well demonstrated on the account of 

advertising self-regulation. Currently, advertising self- and co-regulation is overseen by European Advertising Standards Alliance (EASA), which is an EU level RePIO.

Followed by a political pressure from the European Commission (European Advertising Standards Alliance, 2005)6 EASA brought together representatives from all sectors of the advertising industry for a Self-Regulatory Summit in 2004. In the presence of representatives of the European Commission a Self-Regulatory Charter was signed. The Charter commits advertising industry and individual self-and co-regulatory organisations operational at the MS level to efficient self-regulatory systems across Europe. What is perceived as efficient is elaborated by EASA (European Advertising Standards Alliance, 2004)7.

In fact, the European Commission has viewed EASA as an active controller of the self-and co-regulatory organisations operational at the MS level. The EASA dedicates substantial resources to encourage best practice adoption of self- and co-regulatory organisations at MS level. It also periodically updates its reference documents and engages all MS-level self- or co-regulatory RePIOs to EU level deliberations. For example, it periodically publishes a report, called Blue Book (European Advertising Standards Alliance, 2007), where all the national self- and co-regulatory – approaches in advertising sector are represented (European Commission, Health and Consumers Directorate General, 2006). Thus, even if EASA does not exert business-specific self-regulatory monitoring, it exerts sector-

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6 In October 2003, Commissioner Byrne challenged the advertising industry to “show that self-regulation can have comprehensive coverage and can be made to work”, asserting that “if greater reliance is to be placed on self-regulation then substantial further efforts will be required”, in particular with regard to: lacking European-wide coverage in terms of the use of codes, levels of compliance, and the application of sanctions; hard-to-control advertising methods, including rogue direct marketing and claims published on traders’ own websites.

Thus, this indicates that the EASA self-regulatory measures were perceived as having potential in providing for more harmonised EU consumer policy.


7 The Charter builds upon the EASA’s Statement of Common Principles and Operating Standards of Best Practice and EASA’s Best Practice Self-Regulatory Model. The Charter also recognises that self-regulation should be based on the universally-accepted ICC Codes of Marketing and Advertising Practice. Source: European Advertising Standards Alliance, 2004.
specific monitoring and compliance improving by actively overseeing and softly re-steering its national member organisations.

Currently, the advertising sector’s self-and co-regulatory traditions are different across MSs. This cuts short the aspirations of the harmonised self-regulatory rules and centralised organisation of monitoring and enforcement at business-specific level across MSs. On the other hand, currently, it also seems that there is no political pressure to move towards more uniform EU level self- or co-regulatory (or legislative) framework8 – the soft sector-specific control suffices.

2.3 Case: Advertising self-regulation by EFRD

There are also other EU level advertising industry-RePIOs than EASA that represent specific advertising fields. They normally co-operate and co-ordinate their self-regulatory activities with EASA, however, having their own codes of conduct and associated monitoring strategy. For example, the alcohol industry’s European Forum for Responsible Drinking (EFRD) has agreed on the Common Standards for Commercial Communications (CSCC) (European Forum for Responsible Drinking, 2006).

One can detect a level of political pressure that has contributed to the development of CSCC, thus, indicating that the CSCC is perceived as providing for the EU consumer policy9. Nevertheless, the current EFRDs formal commitment of implementing, monitoring compliance and enforcement of the CSCC at the EU level seems to be weak. The CSCC states on the account of monitoring and imposing sanctions: “The general aim of these Common Standards is not to replace existing national systems, but rather to provide general criteria that should be met by national self-regulatory mechanisms, sector and company codes. Complaints based on/concerning an infraction of the Common Standards are dealt with by the member organizations of the European Advertising Standards Alliance (EASA) ... at national level. These national organizations are best placed

8 This is particular demonstrated in the proposed Audiovisual Media Services Directive, recital 45. Source: COM(2009)185 final.
9 The CSCC reflects many of the issues addressed by the European Council of Ministers in the 2001: Council Recommendation of 5 June 2001 on the drinking of alcohol by young people, in particular children and adolescents. The CSCCs is also based in the Guidelines for Commercial Communications on Alcoholic Beverages developed in 1994 by the Amsterdam Group (TAG). The European Commission also encourages the self-regulatory approach in its 2006 Communication: “Actors in the alcohol beverage chain have been actively engaged in most MSs in enforcement of national regulations, and have declared their willingness to become more proactive in enforcing regulatory and self-regulatory measures.” Source: COM(2006) 625 final, p. 9.
to deal with complaints, as only they will be able to assess and understand fully the national context and local sensitivities (European Forum for Responsible Drinking, 2006).” Thus, implementation is left entirely to the member organisations of the EFRD at MS-level. On the other hand, the MS-level approaches of the member organisations vary considerably: from command-and-control to virtually no visible action as what comes to self-monitoring and self-enforcing compliance10.

Despite of the apparent EFRD’s disengagement to EU level compliance monitoring and enforcement of the CSCC scheme, the general compliance levels of the industry in view of the CSCC has been monitored by means of relatively comprehensive (independent) compliance monitoring report on yearly basis, commissioned by the EFRD (Bouis, Lucien, 2008). In addition to this, EU has funded project called Enforcement of national Laws and Self-regulation on advertising and marketing of Alcohol (ELSA) has gathered compliance data from the MSs, industry-REPIOs and businesses that have signed in to the CSCC (ELSA, 2009) 11. Thus, quite significant work is done in view of sector-specific control by the EFRD itself and also by the EU institutions: The learning processes generated by the ELSA-project and independent reports commissioned on yearly basis by the EFDR can be perceived as a strategy to softly steer and harmonise the alcohol industry’s advertising practices across the EU.

Therefore, it appears that even if implementation of a EU wide RePIO scheme is not uniform – exerting control at business-specific level by a permanent and independent EU level entity – this does not necessarily equal to a failed policy harmonisation. The primary added value of the EU level codes and their subsequent sector-specific monitoring is that they

10 In France, for example, the CSCC is monitored by means of pre-launch advice provided by Bureau de Vérification de la Publicité (BVP). This is an NGO composed by the TV advertisers and financed by the industry. In the UK there are several self-and co-regulatory bodies that monitor issues related to CSCC. In television advertisements, a pre-launch advice is provided by co-regulatory Broadcast Advertising Clearance Centre (BACC) funded by commercial broadcasters. On the other hand, the search for violations is done by self-regulatory Advertising Standards Authority ASA (Broadcasting) and co-regulatory Broadcast Committee of Advertising Practice (BCAP). In Finland, the marketing of alcohol is limited by legal Act and supervised by public authorities. Therefore, there is not much scope for self- or co-regulatory initiatives. However, there is Council of Ethics in Advertising (MEN) which deals mainly with complaints from consumers and with issues that are deemed to have public significance. The MEN handles complaints from consumers and advertisers regarding commercial communications in all media. There is no right of appeal. No sanctions are available to the Council if its decisions are ignored because its statements are recommendations. Sources: National Foundation for Alcohol Prevention, 2007, p. 59, 66–68, 193–207.

11 The main objective of the ELSA project is to examine the degree of implementation of the Council recommendation on responsible drinking. The project is co-financed by the European Commission.
render self-and co-regulatory (MS level) member organisations and individual business industry members more aware, responsive and responsible of their legal and private regulatory obligations; and also expectations laid on them by the European legislature. Thus, even if harmonised monitoring and enforcement strategy is lacking at EU level, there is a potential significance in EU level codes of conducts, which is embedded in their reflexivity: Subscription to EU level codes of conduct and (even a minimum level of) oversight and policy deliberation may encourage industry’s and individual business’ willingness to learn and to implement more harmonised policies across EU.

2.4 Case: Distance selling Directive and EMOTA

The Distance selling Directive 1997/712 that is destined to cease to exist after introduction of Consumer rights Directive, entails provision that encourages compliance control to be executed by RePIOs in its Article 11(4)13. Despite that only MS-level self-regulatory and monitoring initiatives are promoted in the Directive, the recent study commissioned by the European Commission found (Zeijden (van der), Paul – Horst (van der), Rob,2008.) that – on its own initiative – the EU level RePIO, European e-commerce and Mail order Association (EMOTA), is assisting in implementation of the Distance Selling Directive. This is done by means of European Convention on Cross Border Mail Order and Distance Selling (CBMO-DS) (European e-commerce and Mail order Association,2002.)

In the CBMO-DS the 17 signatories of national member associations of EMOTA “pledge to abide” by the rules set in the Convention “respecting international and European legislation, regulations and conventions as well as national legislation and deontological regulations the national Associations and their member companies”. The Article 12 stipulates that provisions of the CBMO-DS are implemented by the national member associations within their existing national deontological framework and by the individual businesses according to the conditions specified by the national member associations. Thus, the CBMO-DS does not envisage EU level entity for monitoring business-specific compliance or enforcement. It

13 “MSs may provide for voluntary supervision by self-regulatory bodies of compliance with the provisions of this Directive and recourse to such bodies for the settlement of disputes to be added to the means which MSs must provided to ensure compliance with the provisions of this Directive.“
simply implements a system of referral, where consumers may receive information on the dispute resolution possibilities provided by EMOTA member associations in the other MSs.

The CBMO-DS is intended to be implemented, for example, by Finnish and French member associations of EMOTA. However, they compliance monitoring and dispute resolution services that the Finnish and French RePIOs provide for differ considerably.\textsuperscript{14}

Generally, as what comes to EMOTA and its convention, it seems to be suffering from a very common problem amongst many self-regulators: There is a lack of transparency and visibility on the account of its self-regulatory code of conduct and/or its implementation at MS level. Despite, after several years of signing the CBMO-MD that is supposedly implemented across several MSs, several of the MSs’ authorities have either had no knowledge of, or interest in, the existence of such self-regulatory code of conduct. This is demonstrated in a recent comparative study noting that majority of the MSs’ authorities reported they had chosen not to implement Article 11(4) of the \textit{Distance Selling Directive} (Schulte-Nölke, Hans & Twigg-Flesner, Christian & Ebers, Martin (eds.), 2008). This signifies that the majority of the MSs have had no contact to or information on their national RePIOs that have implemented the EU level CBMO-MD. Alternatively, the MS authorities consider that the existence of such national code of conduct has had no significance to the implementation of the Directive.

One can question the significance of such EU level code of conduct for the harmonisation of EU’s consumer policy, as it is not uniformly

\textsuperscript{14} The Finnish RePIO, Asiakkuusmarkkinointiliitto, does not even make a reference to this EMOTA convention in its Internet pages nor does its code: The Finnish Direct Selling Industry Code of Conduct of the Finnish Direct Marketing Association (FDMA). As what comes to the handling of complaints it is stipulated in FDMA that: “\textit{The Code Administrator shall monitor Companies’ and Direct Sellers’ observance of the Code and, when necessary, take the appropriate actions in accordance with the regulations pertaining to an ethical Code Administrator. In addition, the Code Administrator shall prepare an annual Code report. The FDMA shall establish procedures for handling complaints.}” However, in the www-pages of the DMA there is no reference to published annual Code reports; and no information on whether or how the complaints could be handled by the FDMA. In addition, the provision concerning FDMA’s engagement to provide assistance in cross-border disputes stipulated in the CBMO-MD is not to be found from the Finnish code. On the other hand, in France, Fédération des Entreprises de Vente à Distance (FEVAD) has also code for professional conduct for the distance selling, where the complaints handling procedures are clearly delineated. Separation of powers has also been taken into account as the complaint handling body is independent from the FEVAD and its member organisations. In addition, the FEVAD has taken EMOTA convention as an Annex to the FEVAD code of professional conduct (Suomen Asiakkuusmarkkinointiliitto, 2009; Suomen Asiakkuusmarkkinointiliitto, 2005; Fédération des Entreprises de Vente à Distance, 2009).
implemented at business-specific level, it is clearly not well advertised and promoted by member associations at MS level, and as EMOTA does not publicise (and probably even does not even periodically conduct) sector-specific control and deliberation measures at the EU level.

3 Hardening the soft-spots

3.1 How to support EU level RePIOs?

It appears from the previous Chapter that the European legislature and Commission have accepted that many industry- and professional-RePIO confederations operational at the EU level are merely possessing “soft means for control”. Their control is not exerted directly towards (self- or co-)regulated businesses, but they exercise secondary sector-specific control over their member associations that, in turn, implement the EU level self- or co-regulation at the MS level. This renders the EU-level RePIO confederations’ influence to be based on deliberation and not on fixed institution and uniform commands.

In the above discussed case studies the EU-wide RePIOs did not have EU-level monitoring and enforcement entities or uniform rules and strategies for monitoring and enforcing individual business non-compliance. Nevertheless, two of the cases presented aimed for relatively established and uniform processes of sector-specific control over their national member associations, which implement (monitor and enforce) the EU level self-regulations vis-a-vis the individual member businesses. This approach appears to be working for EASA, in particular.

However, even if there were well-functioning strategies of “soft means of control” in place at the EU-level, for example, insufficient coverage (e.g. RePIOs lacking in some MSs) may render such EU-wide self-regulatory implementation totally inconvenient.

In addition, it should also be noted that the above Chapters 2.2 and 2.3 presented cases were amongst the few stronger ones in terms of sector-specific control over member associations and subsequent deliberation by the EU level RePIO. Generally, informal dialogue between European RePIO confederations and the European legislature and the Commission, in particular, has led to a plurality of non-binding collaborations and memorandums of understandings signed between industry-REPIOs, professional-REPIOs and the European Commission, for example,
European wide recommended *codes of conduct* (Vever, Bruno, 2005). However, such dialogue has *not* generally led to EU level self-regulation that is in any way concerned with compliance monitoring and enforcement at individual business-specific or at sector-specific (MS) levels. They merely declare the aspirations and common goals towards which the signatories agree to progress.

The reasons for no-show of the EU-wide RePIO codes of conduct can not solely be explained by irresolvable differences in MSs’ legal and self-regulatory traditions, and weak EU level RePIOs, as suggested in the Chapter above. The EU legislature and the Commission are also partly culpable for the lack of institutionalised and uniform self- and co-regulatory schemes at the EU-level.

The Treaty and, consecutively, the European legislation do not stipulate whether it is possible to formally recognise and to delegate regulatory tasks to EU wide RePIOs. However, in the 2003 *Inter-institutional agreement on better law making* it is recognised that European legislature can resort to formal delegation by means of legislative act.

Nevertheless, the problem-solving capacity seems to be weak and heterogeneous in view of how to effectively promote or to formally delegate self- and co-regulatory tasks to EU-wide RePIOs. The lack of effective and efficient tools and procedures to assist and encourage RePIO’s work towards more harmonised European consumer policy is well demonstrated in a recent study (Zeijden (van der), Paul & Horst (van der),

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15 “Self-regulation in the professions has developed at European level in the last twenty years in a very broad range of activities, not least within the liberal professions, which had already been widely self-regulating at national level for a long time... These examples of self-regulation, generally based on codes of conduct, supported where appropriate by the social partners of the sector, have helped to establish codes of ethics and common practices, thereby facilitating the implementation of the principle of mutual recognition. We can refer in this context to European self-regulation in the following professions: engineers (1982), lawyers (1988), perfusion nurses (1991), advertising agencies and consultants (1992), restaurateurs (1993), solicitors (1995), travel agents (1996), Internet service providers, hairdressers, asset managers, estate agents (2001), hoteliers (2003).” Source: Vever, Bruno, 2005.


17 See: European Parliament, Council, Commission (2003): Inter-institutional Agreement on Better Law-Making. Co-regulation is seen as possibility under the paragraph 21. Under co-regulation a legislative act must serve as the basis of private regulatory action. The delegating act indicates the extent of co-regulation in the area concerned, and the relevant measures in case of non-compliance by one or more parties, or if the co-regulatory agreement fails. Relevant measures may provide, for example, for the regular supply of information by the Commission to the legislative authority on follow-up to application; or for a revision clause under which the Commission will report at the end of a specific period and, if necessary, propose an amendment to the legislative act or other appropriate legislative measure.
Rob, 2008, p. 43.), which scrutinised the present EU-wide self-and co-regulatory schemes in the field of consumer policy sector. The study suggested that there is a special model of European level co-regulation named as co-regulation with final agreement by the Commission (hereinafter CoReFAC). This “CoReFAC-approach” seems to be similar to the Commission’s ex post recognition procedure, which was originally designed for voluntary environmental agreements\(^\text{18}\). However, unfortunately this “CoReFAC-approach” is a non-binding to the signatories: the European Commission and the RePIO: Therefore, it brings in no powers besides those of persuasion.

Currently, the legislature and the Commission appear to be on the view that, if specific tasks need to be mandated to a particular EU wide RePIO, this RePIO must be recognised and its tasks need to be approved by each individual MSs and by the EU legislature. Such MS-level approval procedure has recently been used on the account of EA, which is an organisation relevant the NA to Standardisation discussed in more detail in the coming Chapter.

Thus, the next Chapters discuss some potentially promising strategies in which the European legislator and the Commission have surpassed their deficient and uncertain powers to “delegate” regulatory tasks to EU level RePIOs.

3.2 Case: Co-regulatory policy making – self-regulatory implementation in the Internet environment

The case studies discussed above viewed traditional sectors of self- and co-regulation. However there is some evidence that the new regulatory sectors could surpass the burden of differing legal traditions at the MS level. Particularly, in the field of Internet self-regulation, there have been recent attempts for the European legislature and Commission to encourage European wide self-regulatory schemes. Special case studies bring light into the nature of co-operation between the European legislature, Commission and the RePIOs in this sector and the deliverables.

In 1999–2000, the European Commission launched a special dialogue between stakeholders, which later became known as the “e-Confidence initiative” aiming to promote consumer confidence in electronic commerce through flexible regulatory approaches, i.e. thorough codes of conduct

\(^{18}\) On the procedure, see for example: Schnabl, G., 2005, p.93.
and/or trust marks\(^\text{19}\) negotiated and implemented by industry- and/or consumer-RePIOs or other private entity (COM(1999)687, p. 9).

This preference to private (self-)regulatory approach is not surprising in view of the Directive on Electronic Commerce 2000/31/EC\(^\text{20}\), where in the Article 16 the drafting of codes of conduct for the purpose of electronic commerce (to enhance implementation of Articles 5–15) at Community level is encouraged, by trade, professional and consumer associations or other organisations. The Directive also promotes the voluntary transmission of draft codes of conduct at national or EU level to the Commission; the accessibility of these codes of conduct in the EU languages by electronic means; communication between RePIOs and authorities as what comes to assessment of codes of conduct and their impact upon business practices, habits or customs relating to electronic commerce; and the drawing up of codes of conduct regarding the protection of minors and human dignity. In connection to this, the Article 17 promotes out-of-court dispute settlement in electronic commerce.

The Commission’s strategy for promoting European wide RePIO-led regulatory approach in e-commerce actually resembles some other strategies promoting the work of RePIOs: To some extent it approaches the process of negotiating voluntary environmental agreements in the field of environmental policy and, on the other hand, the social dialogue process of the social policy sector.

In environmental policy, the European Commission generally validates voluntary environmental agreements, ex post, through recommendations (COM(96)561 final, p. 20–21). Similar type of Commission recommendation was also foreseen in the initial rounds of e-Confidence initiative negotiations between stakeholders (SEC(2004) 1390, p. 8.). The Commission also used the same threats in its e-Confidence initiative as on the account of environmental agreements (COM(2002)412 final) noting that “a lack of success in this area [e-Confidence initiative] would augur badly for the concept of self-regulation, resulting in a need for greater reliance on legislation to adequately protect consumers’ interests (SEC(2004) 1390, p. 8).”

The e-Confidence initiative also has some elements of social dialogue in its aspirations to build a regulatory framework together with all the stakeholders. However, the e-Confidence initiative surfaced some the

\(^{19}\) A trustmark is similar to a “quality seal”. It conveys the message that a certain business has agreed to adhere to a set of common good practices, principles or guidelines and, possibly, to provide redress mechanisms for a customer. The trustmark may involve a third party assessment (verification) of the business practices prior to granting the mark.

teething problems related to transferring “social dialogue” – approach from one sector to another. Initially, the Commission set up for the purpose of e-Confidence initiative a group consisting of several RePIOs and businesses. At the time, the Commission took the position that they would follow-up on work of the stakeholders, possibly, backing it up with a Commission Recommendation (SEC(2004) 1390, p. 6). The Commission also acted as a secretariat to the core group: convening and hosting meetings, preparing the minutes of the meetings, maintaining website created for the purpose of e-Confidence initiative (UNICE, 2002, p. 7).

However, the process towards codes of conduct or trust marks between the stakeholders did not progress according to the Commission’s initial plans. At the final stage, the group of negotiators diminished to only two: European Consumers Organisation (BEUC), and Union of Industrial and Employers’ Confederation of Europe (UNICE) finally agreed to take on bilateral negotiations, which resulted to a draft of European Trustmark Agreement setting voluntary codes of conduct “European Trustmark Requirements” for e-commerce businesses who wish to display a special European trust mark in their e-commerce Internet-pages. The agreement foresaw a system of independent third party verification and ex post compliance monitoring and dispute settlement. The agreement was a result of several rounds of deliberations, at first, between several participants and, at later stage, only between the BEUC and UNICE (UNICE, 2002, p. 7–12).

In particular, the European Trustmark Agreement anticipated a special European level e-Confidence Committee that would have had the task to oversee e-commerce businesses that displayed European trust marks in accordance with the requirements set in the European Trustmark Agreement. The e-Confidence Committee would have been composed of equal number of persons proposed and appointed by common accord between industry- and consumer-REPIOs: UNICE and BEUC. Furthermore, BEUC would have also had the task to appoint by common accord an independent chairman in consultation with the European Commission.

The e-Confidence Committee would have had the task of: dealing with complaints (regarding to non-compliance by participating e-businesses) and elaborating its internal rules of procedure in view of complaints handling, including a possible appeal mechanism via arbitration; elaborating the content of “declaration of compliance” and “annual compliance report” of participating e-businesses that were foreseen in the European Trustmark Agreement; and organizing the modalities of the validation processes of the participating e-businesses. In the case of dispute arising from the interpretation of the European Trustmark Requirements,
the Committee would have made the final decision. It would have also reviewed the whole e-Confidence scheme; and managed the e-Confidence website (European Consumers’ Organisation, BEUC, 2001). In short, the European Trustmark Agreement would have set up special permanent institutions and processes for implementing, compliance monitoring and follow-up by the social partners (BEUC and UNICE) at European level and, in addition, the scheme was designed to be adopted at business-specific level.

Despite the BEUC and UNICE were able to agree on main aspects and modalities of the Trustmark-scheme, they found it difficult to reach consensus on few minor points. Therefore, UNICE and BEUC agreed to invite the Commission to play a role as mediator to resolve the remaining points of dispute. However, the Commission did not take a role of a negotiator nor did it issue Recommendation in support for European Trustmark Agreement. Finally, no agreement could be reached between the UNICE and BEUC (Zeijden (van der), Paul – Horst (van der), Rob, 2008, p. 34).

The European Commission seemed to back away from the Trustmark scheme specially, because the formal role in compliance monitoring the UNICE and BEUC had foreseen for the Commission. It perceived that Commission’s “role does not include involvement in the oversight of an organisation which is aimed at policing the application of what is essentially a self-regulatory code of best practice (SEC(2004) 1390, p. 6).”

The above negotiations represented a novel and unprecedented example of cooperation between interest organisations and the European Commission specifically aiming to establish a new RePIO based on balanced interest representation. As a result of the e-Confidence initiative, UNICE has stated that it “encourages public authorities to promote and to act as a ‘facilitator’ of more dialogue between stakeholders at EU level (UNICE, 2002).” However, the Commission’s role in the negotiations and final deliverables fell short from the initial aspirations. In fact, if this type of “social dialogue” in aiming for tangible results in terms of self- or co-regulatory solutions is to be promoted by the European Commission, on the basis of the experience gained from the e-Confidence initiative, some essential aspects need to be taken into account. As UNICE has positioned it: Objectives of the initiative, criteria for participation and procedural criteria need to be clear from the outset; role and the possible final endorsement by the Commission need to be identified from the beginning; clear and adequate timetable for the proceedings needs to be established;

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21 The points of disagreement were: definition of the e-business; how the e-Commerce order should be acknowledged by the e-business; and the available payment options. Source: European Consumers’ Organisation, BEUC, 2001.
transparency throughout the process is essential for stakeholders to make informed decisions; and the right to initiate such proceedings should be open to all stakeholders as well as the autonomy to participate to the process (Zeijden (van der), Paul – Horst (van der), Rob, 2008, p. 34). This is without a doubt a voice of reason coming from an experienced participant to European social dialogue.

There is also another EU level RePIO-led code of conduct that deserves closer scrutiny: Pan European Game Information System (PEGI) created by Interactive Software Federation of Europe. PEGI issues age-ratings (labels) for entertainment software and ensures that these ratings are used according to PEGI’s code of conduct. The code reflects the industry’s commitment and concern that information is provided to the public in a responsible manner about the content of its products. The industry’s contribution is intended to complement existing national laws, regulations and enforcement mechanisms. What is different in PEGI from the above discussed case studies concerning EASA and the EFRD is that the PEGI is engaging the game-industry businesses directly – at business-specific level – to its self-regulatory scheme, i.e. not through national member organisations as, for example, on the account of advertising sector discussed above (Interactive Software Federation of Europe, 2009).

In fact, Interactive Software Federation of Europe has implemented PEGI by means of relatively comprehensive monitoring and enforcement organisation and strategy that is targeted to ensure individual business compliance. The PEGI Code of conduct for the European interactive software industry regarding age rating labeling, promotion and advertising of interactive software products sets: An Advisory Board (PAB), a Complaints Board (PCB), and an Enforcement Committee (PEC). The PAB and PCB include representatives from chief stakeholders (parents, consumers associations, child psychology experts, academics, media experts and the interactive software industry)\(^\text{22}\). The PEC is in charge of implementing the recommendations of the PAB and, more generally, of seeing to the enforcement of the rules and sanctions included in the present Code, including decisions of the PCB (Interactive Software Federation of Europe, 2009).

\(^{22}\) PAB has the task of continuing adjustment of the Code to social, legal and technological developments. The PCB also includes representatives from stakeholders similarly to the PAB. It is entrusted with the tasks to: handle possible complaints; and handle conflicts about the PEGI age ratings including any publisher or consumer complaints about those ratings.
An addition to PEGI, another scheme, *PEGI Online*\(^\text{23}\), was implemented by Interactive Software Federation of Europe in 2007 after to the growth of interactive games in the Internet and after some political pressure and stimulus was exerted on online gaming industry on the side of the European legislature. In fact, PEGI Online was launched by Commissioner Reding in June 2007. Its coordination has been viewed as a type of “co-regulatory policy making with self-regulatory implementation (Marsden, C. & Simmons, S. & Brow, I. & Woods, L. & Peake, A. & Robinson, N. & Hoorens, S. & Klautzer, L., 2008, p. 21, 173)”\(^\text{24}\): Which probably points to the fact that PEGI Online was created as a result of successful, co-operation, persuasion and/or legislative threat on the side of European legislature.

Furthermore, the PEGI online scheme was co-funded by EU’s *Safer Internet Action Plan* (COM(2003)776 final). On the other hand, the PEGI Online is also said to be stemming from Council 2002 Resolution on the protection of consumers, in particular young people, through the labeling of certain video games and computer games according to age group; and Council 2006 Recommendation on the protection of minors and human dignity and on the right of reply in relation to the competitiveness of the European audiovisual and on-line information services industry.

*PEGI Online safety code* (Interactive Software Federation of Europe, 2007) is a code of conduct for the European interactive software industry. The code reflects the interactive software industry’s commitment and concern that information provided to the public in a responsible manner about the content of interactive software products. The industry’s contribution is intended to complement existing national laws, regulations and enforcement mechanisms. Monitoring and enforcement of the code is conducted mainly by the same private regulatory bodies created in PEGI *Code of conduct*, i.e. PAB, PCB, and PEC (Interactive Software Federation of Europe, 2009). The bodies operate along the same lines and have similar regulatory powers towards the businesses that have subscribed to the code(s) as based on *PEGI Code of conduct*.

The PEGI and PEGI Online schemes have been generally considered as success stories of EU level RePIO-led Internet self-regulation in the

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\(^{23}\) The *PEGI Online* project is a supplement to the *Pan European Game Information system* (PEGI) to cover online electronic games. Started by the *Interactive Software Federation of Europe* (ISFE) in 2003 with a view to help European parents and gatekeepers to make more informed decisions when it comes to buying offline and online games, the PEGI system provides pointers, in the form of age logos and content descriptors, pertaining to the age suitability of the games concerned. It later included also *Netherlands Institute for the Classification of Audio-visual Media* (NICAM). However, despite of its pan-European nature, also PEGI relies on monitoring that is executed by national member organisations. Source: Marsden, C. & Simmons, S. & Brow, I. & Woods, L. & Peake, A. & Robinson, N. & Hoorens, S. & Klautzer, L., 2008, p. xxi, 171–181.
independent reports that have reviewed them (Marsden, C. & Simmons, S. & Brow, I. & Woods, L. & Peake, A. & Robinson, N. & Hoorens, S. & Klautzer, L., 2008)\(^{24}\).

### 3.3 Case: Formal mandates under Standardisation

The *New Approach (NA) to Standardisation*\(^{25}\) is often perceived as particularly meaningful tool for EU level RePIO-led process of setting product standards aiming for truly harmonised single market in view of products. The NA to Standardisation was originally designed to the field of technical harmonisation of products. Since the mid-1980s, the EC made an increasing use of standards in support of its policies and legislation (*hence it is the “New Approach”*). Recently, NA is also perceived as having potential to move for new regulatory fields, e.g. to standardisation of services. Since 1998, approximately 25 new legislative acts and projects in which standards play a supportive role have been developed and implemented. The future prospects for using the NA to standardisation across several sectors have been viewed promising by the Commission (Verheugen, Günter, 2005).

Innovative features of the NA technique include, of course, the RePIO-led standard drafting process; but also the setting up of appropriate *conformity assessment procedures* (CAs) to demonstrate compliance with the NA Directives that set **essential requirements** (ERs); and the introduction of CE marking to those products that conform to the ERs (European Commission, electronic source, 2009)

Thus, the NA to standardisation relies on *Directives* that define ERs – a kind of principles-based standards for products produced and distributed in the European market. Thus, the ERs are laid down in a normal legislative process. Thereafter, three European standardisation organisations\(^{26}\) have the task to specify how these ERs can be fulfilled through the path of

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\(^{24}\) The only points of criticism have been the fact that online game providers in Germany have decided to exclude themselves from the PEGI Online scheme, because Germany already has its own national self-regulatory scheme in place. The other point of critique has been that the enforcement board does not include lay members


\(^{26}\) CEN (European Committee for Standardisation), CENELEC (European Committee for Electrotechnical Standardisation) and ETSI (European Telecommunications Standards Institute)
harmonised European standards. These technical specifications are drawn up on the basis of the *Council Resolution of 7 May 1985*; and the *Directive 98/34/EC* Drafting the harmonised standards is a voluntary process based on consensus amongst different economic actors: industry-RePIOs, SMEs, consumer-RePIOs, labour-RePIOs, environmental-RePIOs, public authorities, etc.

The implementation of NA, particularly, the *monitoring* of business-specific and general market compliance to NA Directives is a multilayer exercise consisting of several private and public actors and organisations: private contract agents, *Notified Bodies*, check the conformity of products at individual business-specific level; (private) *accreditation bodies* accredit the contract agents; the EU level *standardisation related RePIO*, EA, oversees the accreditation bodies and the accredited contract agents; and, the MS’s and European authorities monitor the general compliance levels within the market and issue notifications and monitor the accredited contract agents.

The *private contract agents*, e.g. Notified Bodies, used under NA are normally private organisations or individuals that have been accredited to carry out CAs to check product conformity to ERs. After accreditation the Notified Bodies are approved and notified by MSs. They operate *in an area of public interest*. Generally, accreditation bodies that accredit

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28 Council Resolution of 7 May 1985 setting out a New Approach to technical harmonisation and to standardisation.
30 Recently the rules and procedures for accreditation and verification of Notified Bodies are harmonised and defined with aim to address the uneven implementation in individual MSs that often undermines the credibility of schemes by Regulation (EC) No 765/2008. NA Directives establish different *procedures* for CAs of ERs according to the categories of products covered. The NA Directive may leave businesses no choice or give them a wide freedom of choice for demonstrating product conformity. The procedures are categorized to special *modules*. However, a relatively recent Decision No 768/2008/EC sets common: definitions; more uniform modules outlining the different common conformity assessment procedures; obligations for businesses (manufacturers, importers and distributors); specific rules for the use of the EC marking; notification criteria for the conformity assessment bodies (Notified Bodies); and specific safeguard procedures concerning market monitoring by public authorities. In essence, it re-introduces a more unified the common framework for future sectoral NA Directives.
Notified Bodies are private entities. However, accrediting bodies are considered as executing public authority activity and, thus, their accreditation activities must be based on a formal recognition by the MSs (European Commission, 2003, Chapter 6.4.; Regulation (EC) No 765/2008. Article 4.5).32

Recently, the NA experienced some changes. Product’s CA procedures; Notified Bodies’ qualifications; and criteria for Notified Body accreditation were renewed and further harmonised. New legislative framework was adopted by Council Regulation (EC) No 765/2008. Furthermore, a recent Decision No 768/2008/EC also establishes a common legal framework that can be used for any industrial product that would benefit from European harmonised standards: The Decision is a kind of template to be used when drafting NA Directives. It therefore introduces common definitions and procedures for future sectoral legislation relying on NA to become more consistent and easier to implement.

What is particularly interesting is that, in this context, the Regulation 765/2008 also reinforces and solidifies the role of European co-operation for accreditation (EA), which was originally a private body providing European network of nationally recognised accreditation bodies. Thus, the EA is now one of the few EU wide RePIOs that currently enjoy the privilege (or burden) of having a formal authorisation of the EU to conduct certain monitoring tasks, which it carries out as a service of general interest with a public authority status.

In the absence of clear Treaty provisions that would allow for regulatory tasks for such private institutions, the European legislature and authorities saw it necessary that EA also acquires this formal status from the MSs individually. As part of the process of formal recognition of the EA: European Commission, MSs and the EA have signed General Guidelines for cooperation between the EA and the European Commission, the European Free Trade Association and the competent national authorities in April 2009 (European Commission, EA, competent national authorities, 2009). In fact, the 765/2008 Regulation, Article 14, had already provided for this agreement to take place by stating that: “The Commission shall .... recognize a body ... which ... shall conclude an agreement with the Commission ... The first body recognised under this Regulation shall be the European cooperation for accreditation, provided that it has concluded an agreement as specified in paragraph 2.” The Article 14 also necessitates that the agreement specifies detailed tasks for the EA, funding

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32Article 4.5. “Where accreditation is not operated directly by the public authorities themselves, a MS shall entrust its national accreditation body with the operation of accreditation as a public authority activity and grant it formal recognition.”
provisions and provisions for its supervision. Therefore, relying on the definition of the inter-institutional agreement (European Parliament, Council, Commission, 2003), the EA can be seen as a co-regulatory body operating at the EU level.

According to the General Guidelines for cooperation the EA “serves as the last and authoritative level of control of conformity assessment activities with regard to technical competence and professional integrity of conformity assessment bodies, in order to create mutual confidence.” In compliance with the Regulation 765/2008, the EA members, i.e. the accreditation bodies, develop and monitor accreditation services.

Thus, the EA – as the newly recognised EU level RePIO – certainly has the obligation and the means (the mandate and financial resources) to steer and to control the accreditation of Notified Bodies and their CA procedures. Thus, it is providing for a more harmonised consumer (safety) policy across EU.

4 Conclusions

In very specific areas of EU consumer policy there are self- and co-regulatory schemes that do provide for an increasingly harmonised consumer policy at EU level. These schemes may be operating under formal regulatory mandate (co-regulation) or have been induced with right combination of incentives or deterrence by the European legislature (self-regulation).

The case studies indicate that EU level RePIOs transcending the MS borders by implementing their self- or co-regulation directly and uniformly at business-specific level are most often found in very specific consumer policy fields: In sectors where the product or service markets are already close in finding their way of being genuinely integrated across the MSs. This market integration may have been induced by limited number of

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33 The Annex I of the Regulation (EC) No 765/2008 stipulates that the body (EA) must be established within the Community, and under the its constitution, national accreditation bodies from within the Community shall be entitled to be members of it, provided that they comply with the rules and objectives of the EA and with the other conditions set out herein and as agreed with the Commission in the framework agreement. The EA must consult all relevant stakeholders and provide its members with peer evaluation services satisfying the requirements of Articles 10 and 11. The EA must also cooperate with the Commission in accordance with the Regulation.

34 Regulation (EC) No 765/2008, Article 5.3. states that “National accreditation bodies shall monitor the conformity assessment bodies to which they have issued an accreditation certificate.”

business-operators and/or specificity of products or services produced (e.g. as demonstrated above in view of accreditation services and EA or gaming industry and PEGI).

In some consumer policy fields (e.g. in advertising) it would be difficult to envisage a uniform self- or co-regulatory scheme across the EU due to particularities of self- and co-regulatory traditions at the MS level and the plurality of business-operators. However, some case studies detected that heterogenous implementation at MS level and sector-specific monitoring combined with reflexive negotiation strategies by EU level RePIOs could, nevertheless, provide for an increasingly harmonised consumer policy across EU.

Finally, it is recognised that one particular EU level RePIO-led implementing strategy for self- or co-regulation does not fit all the private regulatory fields, but considerable lessons could be learned from one field to another.

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HOW ARE THE ECONOMIC RIGHTS OF COHABITANTS BEST PROTECTED?  
Law or Contract?

Viola Boström

1 Introduction

Compared to other areas of law, family law develops rather slowly. It is easy to find traces of ideas from the French Revolution and even the Middle Ages in the regulation of e.g. inheritance law. Family law has had something inherently slow or sluggish about it, and the reforms have often been well founded and launched only after long periods of economic, social, demographic and other changes.

One of the major changes during the last 40 years is the decline of the marriage rate and the increasing number of cohabitant families. Both in Finland and Sweden, as elsewhere in Europe, this is a clear trend. The question is; what strategy should the legislator apply to this change? The question can surely not be answered without knowledge of what the legislator seeks to accomplish, but some of the key elements to the answer can, according to my opinion, be phrased with the following questions:

- What are the Svenssons and the Virtanens doing?
- What is the legislator doing?
- In what way are the doings of the Svenssons and the Virtanens and the legislator interfering and interacting with each other?

It seems clear that there is some kind of interaction between the cohabitants and the legislator. But how does it work? To what extent, if any, are the actions of the legislator determining the actions of the Svenssons and the Virtanens? And vice versa? The assumed relation can be described with the following illustration, which will be further discussed later on.
Demographic Changes

Marriage has ever since the Christianizing of the Nordic countries been the family form promoted by the church, the legislator and, in time, also the society as a whole. Cohabitation has however always existed alongside marriage, but to a rather small extent. (SOU 1978:55, p. 33–34) For a long period of time, about 10 % of the children in Sweden were born by unmarried women, including both cohabiting mothers and single mothers. (SOU 1981:85, p. 518) At the end of the 1960’s, there was a change. The number of children born out of wedlock rose quickly, and the reason was the increasing number of cohabitants. Today, almost 50 % of the children in Sweden are born by cohabiting mothers. Although there is no reliable statistics in Sweden, the cohabiting couples are estimated to about 29 % of all couples living together, and about 71 % of the couples living together are married. (Walleng, 2009)

The development in Finland is similar, although not as early or far-reaching. In 1985 about 12 % of all couples living together were cohabitants. Since then the rate has steadily increased, and today about 24 % of all couples living together are cohabitants, and about 76 % are married. About 33 % of all children in Finland are born by mothers living as cohabitants. (www.stat.fi)
These statistics clearly show that cohabiting couples as well as children living in families with cohabiting couples is no longer a minor issue. It is a social reality. The normative function of the law implies that the legislator is obliged to address such questions. (Wahlgren, 2008) If this is accepted, it is reasonable to argue that the legislator, whether in Sweden or in Finland, must have an opinion on the regulation of cohabiting couples. The demographic change does however not infer anything about the content of the legislator’s opinion. The legislator can decide to refrain from regulating the issue – like in Finland, so far, or decide to regulate the issue – as in Sweden. The content of the regulation may be – whichever, depending on what the legislator wants to accomplish.

The regulation on marriage in both Sweden and Finland includes rules on property division in case of divorce or death as well as rules on inheritance and alimony. Is it therefore also reasonable to argue that the legislator should address all these questions regarding cohabiting couples? Well, if the statistics indicate that these situations – separation, death and economic cooperation leading to economic dependence after a separation – frequently occur among cohabiting couples, it would seem reasonable.
There is reason to believe that the economic cooperation in a long term cohabitation relationship often leads to economic dependence. However, even claims for alimony after a divorce are very rare in Sweden. Based on the fact that Finnish women are professionally very active, it may be assumed that the same is true for Finland. It is therefore not likely that the legislator will ever expand the possibilities to receive alimony, neither for spouses, nor for cohabitants. The issue of alimony is therefore, on political grounds, a non-issue, and will be left out of the further discussions.

Separation is, however, certainly a social reality for cohabitants. Although many cohabitation relationships end when the couple gets married, it is also true that many end by separation. In 2008 more than 23,000 children in Sweden experienced that their cohabiting parents separated. (www.scb.se) In Finland about 4,000 children experience that their cohabiting parents separate every year. (Kangas, 2009) A cohabitation relationship is more likely to end in separation than a marriage to end in a divorce. However, it is difficult to argue that a typical cohabitation relationship is so short that the legislator can ignore the question of property division. The only available recent Nordic statistics is from Iceland, and it indicates that although about half of the cohabitation relationships are ended within two years, about 12% of the relations last ten years or longer. (Walleng, 2009)

Cohabitant relationships ending by the death of one of the cohabitants are not as usual as those ending in separation. In a Swedish public investigation from 1981, it was assumed that cohabitation relationships ending with the death of one of the cohabitants, more seldom occurred. (SOU 1981:85, p. 110 and 115) Present statistics from Sweden and Finland is, to my knowledge, not available. Statistics from Sweden published in 1990 shows that only about 2,000 cohabitant relationships a year ended by death of one of the cohabitants. (SCB, 1990, p. 9) Although it might be assumed that this number has increased, it is still far from the number of marriages ended by death of one of the spouses. However, death of one of the members in a family leads to substantial changes, both economic and social, and this indicates that these family dissolutions, however not that many in absolute figures, should be taken seriously.

A conclusion of the demographic changes is that the normative function of the law requires the legislator both in Finland and in Sweden to form an opinion on whether to regulate or not. This is true at least for the question of property division in case of separation and death, and for the question of the cohabitants’ right to inherit.
3 Legal Development

In both Sweden and Finland, the first reforms to place cohabitants on an equal footing with spouses were launched within tax law and social security law. Sometimes spouses were treated like cohabiting couples, sometimes cohabitants were treated as spouses. The reason was inter alia to achieve fairness between different types of families regardless of whether they were married or not. (SOU 1972:41 p. 92)

The first Swedish law regulating the mutual rights and responsibilities for cohabitants was the law (1973:651) on the common dwelling of unmarried cohabitants. In case of separation, the cohabitant in better need of the joint dwelling could claim the right to keep it. If the cohabitants had never had common children the cohabitant in better need had to present particular reasons for his or her right to keep the dwelling. However, the law was not applicable to real estate and did not grant the cohabitants any economic rights. If one cohabitant was given the right to stay in the other cohabitant’s condominium, he or she would have to pay the full price. The law offered the cohabitants a social security rather than an economic security.

About twenty years ago, in 1987, the Swedish (1987:232) Cohabitees Act was adopted. The cohabitants, whether heterosexual or homosexual, were given a minimum protection in case of separation or death. In case of separation, a property division can be required by either of the cohabitants. In case one of the cohabitants has died, the right to ask for a property division is only granted the surviving cohabitant. The property division includes the joint dwelling and the joint household-goods that has been acquired for joint use. Any debts connected to this property, should be deducted, and the net value should be divided equally between the two. The cohabitants have no right to inherit, but if the property division does not grant the surviving cohabitant at least about 8 000 Euro, he or she can ask for a bigger part in the property division. The right to keep the joint dwelling, if in bigger need, still prevails.

In Finland there has been no family law regulation on the mutual rights and responsibilities of cohabitants. If one of the cohabitants dies, the surviving cohabitant has no right to ask for a property division, nor any right to inherit. Both in case of separation or death, there may however be reasons to divide some of the property. If the cohabitants own e.g. a house together, it may be sold, and the purchase sum will be divided between the cohabitants or the heirs of the deceased and the surviving cohabitant. This follows from the fact that the cohabitants had a joint ownership, and does

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1 The law (1987:813) on Homosexual Cohabitees was adopted at the same time.
2 The two laws were replaced in 2003 by the (2003:376) Cohabitees Act.
not grant the cohabitant any right to receive a bigger part than he or she had acquired with ownership. There is however also some relevant case law in Finland. One example is that a cohabitant after a separation was granted a reasonable compensation for her contribution to the purchase of the house in which the family had been living, although she had no part in it as a formal owner. (HD 1993:168) In another case, a car had been bought for the joint use of the cohabitants, although formally only the man was the owner. The woman managed to show that the car had been bought with the intention that it should be jointly owned, and that they had both contributed financially. The court found that they both owned the car, and that the man had to pay her compensation. (HD 1992:48)

If the cohabitants are living together in a rented flat when one of them dies, the surviving cohabitant has a right to take over the lease. This is a social right rather than an economic right. Other than that the surviving cohabitant has no specific rights according to Finnish law – so far.

4 Legislative Policy

As one of the previous chapters shows, the demographic changes in Sweden and Finland are similar. What conclusion has the legislator drawn from these changes? What legislative policies has the legislator adopted, and what underlying assumptions are the policies based upon?

In Sweden, the principle of neutrality was adopted at an early stage. The idea was launched by the minister of justice in 1969. It indicated that the legislator should be neutral toward different forms of family life and different moral opinions. (Agell, 2004, p. 228–229) Two possible interpretations were suggested.

- The same rules should apply to couples regardless of whether they are married or cohabiting – the same rules policy.
- The rules that apply to married couples should not apply to the couples that are cohabiting – the different rules policy.

As mentioned earlier, the legislator had to some extent already chosen the same rules policy for the tax law and social security law area, in order to achieve a fair system that would not discriminate either spouses or cohabitants. When it came to the mutual rights and responsibilities of the cohabitants, the choice was trickier. The same rules policy would imply that the same rules as for married couples should apply. The different rules policy would – probably – imply that no specific rules should be made for cohabitants. That would have meant that the cohabitants would have had to
make their own individual arrangements or that they would have had to rely on other applicable regulation from e.g. the area of law of property. The legislator chose none of the two policies.

In addition to adopting the neutrality principle, the legislator decided to carry out an empirical study of married couples and cohabiting couples. This was done in 1974 and the result of the inquiry was presented in 1978. It became clear that cohabiting couples began to cooperate financially when living together and when building their home. This has also been argued by scholars from other Nordic countries. (Sverdrup, 2009, p. 25.) In short, the legislator came to the conclusion that many cohabitants were in need of at least basic protective rules in case of separation or death.

The Finnish legislator on the other hand, has been reluctant to accept this view. It has been argued that the legislator should not interfere with the mutual rights and responsibilities of the cohabitants. If the cohabitants want protection, they can always get married or regulate it in some other way. And if they do not want protection it should be possible to refrain from it. It is seen as a question of freedom for the cohabitants – the freedom of contract as well as the freedom to refrain from contract.

5 Possible Effects of the Legal Policy

The Swedish legislator has assumed that there is little possibility to influence the inclination to marry by using family law regulation. This was one of the outcomes of the interview study mentioned earlier. However, there are some well known examples of new regulation inspiring people to get married. In 1989, the marriage rate in Sweden rose from 39 300 the year before until 106 500 in 1989. The reason was a change in the social security system; the widower pension was abolished. (Agell, 1998, p. 23)

Economic incentives seem to have a great influence on people’s behaviour. Is it possible that the feeling of security may also influence people’s behaviour? Will a false sense of security make people refrain from regulating the ownership of their assets or setting up a will? Is there a risk that the Swedish Cohabitees Act, with its minimum protection, has led to a sense of false security for some cohabitants? Is there a risk that Swedish cohabitants are less protected than the Finnish cohabitants, although the Swedish legislator has regulated the mutual rights of cohabitants, and the Finnish legislator has not?

It seems reasonable to assume that the legal policy and the regulation or non-regulation it leads to, at least to some extent influence the individual regulation of the cohabitants. In order to evaluate the overall protection of
cohabitants, both the legislative regulation and the individual regulation would have to be taken into account. It can be described in the following manner.

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<td>Legal policy</td>
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6 What are the Svenssons and the Virtanens Doing?

So the question is; what are the Svenssons and the Virtanens doing? And to what extent are their actions influenced by the actions of the legislator? In order to receive some insight into the reasoning of the Svenssons and the Virtanens, an interview study is going to be made. The empirical study will consist of interviews with five cohabiting couples in Finland, and interviews with five cohabiting couples in Sweden. The interviews will be conducted with one cohabitant at the time, since the presence of the partner might make it more difficult to receive frank answers to some of the questions, e.g. regarding their individual knowledge and opinion on the regulation as well as their strategies regarding distribution of assets and debts and legal transactions. A test interview has been performed in order to adjust the questionnaire and on the basis of the discussion with these persons it was decided that the rest of the interviews, if possible, should be conducted with each cohabitant separately.

The couples will be chosen with three different categories in mind; age, parenthood and persons who have previously been married or cohabiting, and now have started a new family, since it can be assumed that these factors influence their knowledge of and their interest in the regulation, as well as the likelihood to act in order to regulate their mutual rights and responsibilities.

So far, only four interviews have been conducted, in Finland with two young couples in their 20s, one of which are still students, and one of which have recently started working. In Sweden, the interviews were conducted with two couples in their mid 30s. One of the couples had a child, and one had no children. Both these couples were homosexual.
Although there is no reason to predict what the outcome of the interviews will be, a few preliminary points will be made.

- Finland is described as a rather traditional society, where marriage is expected, and people more inclined to marry. “There is a cultural pressure to make a public declaration of love, and put the ring on the finger…”
- The banks seem to be key informants where legal issues are concerned. “All the banks we went to discuss a house loan with have mentioned that…they all wanted us to protect ourselves.”
- Specific events, such as the buying of a house or the raising of a loan, rather than the time, seem to influence the actions of the cohabitants. “When we were raising this loan… that is when I, or we both, felt that we have to regulate this in some way.”
- Family law is not the only area of law influencing the inclination to marry or to regulate ownership or loans etc. Examples such as tax law, bankruptcy law and the regulation of housing loans were mentioned both in Finland and in Sweden. “It is as if the society has decided that one should be married.” “I understand that we have to make maximum use of the tax deduction possibilities.”

These preliminary results have led to an adjustment of the project. Since other areas of law seem to be so influential as to the actions of the cohabitants, I have decided to include a basic investigation of the rules on taxation, and the rules involved in buying and owning a home. Hopefully, this will cover most of the relevant regulation that influence the cohabitants in this respect.

I will also include three interviews with bank personnel and three interviews with real estate agents in each country, in order to get a broader picture of how cohabitants regulate, and how the banks and the real estate agents influence this regulation.

7 Conclusions

So far, there are no final conclusions of this project. However, the first picture of the assumed relation between the actions of the legislator and the cohabitants will be shown again. This time, it obtains some of the different stages in the regulation and contract cycle. It also shows the assumed impact of the legislator, of the cohabitants and of other actors, such as banks and real estate agents. Hopefully, at the end of this project, it will give a reasonable description of some examples of how cohabitants and legislators interact.
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TOWARDS AN ANALYSIS OF THE PROBLEM OF EXCESSIVE PRICING

Maria Pakarinen

Abstract

The aim of this paper is to examine the paradox between the theory and practice of the regulation of excessive pricing. Discrepancy arises since the competition authorities are reluctant to intervene in unfair prices although excessive pricing is one of the most noticeable forms of abuse of the dominant position. Since ex post regulation does not seem to be an adequate means to resolve the problem of excessive pricing, attention should be focused more on proactive measures. This paper examines the problems concerning the ex post regulation of excessive pricing as well as considers the proactive approach as a means of controlling unfairly high prices.

1 Introduction

The abuse of the dominant position may consist in “directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions”. A price is considered excessive when it has no reasonable relation to the economic value of the service or product supplied. Excessive pricing can be ex-

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1 The abuse of the dominant position is prohibited under the EU competition rules and equivalently under the national provisions of the most EU member states; see Article 102 (a) of the Treaty on the Functioning of the European Union (TFEU) and e.g. Article 6 (1) of the Finnish Act on Competition Restrictions (480/1992). It should be noted that the Article 102 of the TFEU was known as Article 82 of the EC Treaty until the Treaty of Lisbon was entered into force on 1 December 2009. However, the first remarkable change in the application of the EU competition rules took place already when the Council Regulation (EC) No 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty had come into force on 1 May 2004. E.g. the Finnish Act on the Amendment of the Competition Restrictions (318/2004) was entered into force at the same time. Hereby the national competition regulation was harmonised with the EU competition rules. At the moment, the new Finnish Competition Act is in preparation (see the report of the Competition Act 2010 Working Group); nevertheless, any direct changes for the regulation of excessive pricing are not expected to come.

2 See e.g. case 26/75, General Motors Continental NV v Commission of the European Communities 1975, para 12, and case 27/76, United Brands Company and United Brands Continentaal BV v Commission of the European Communities 1978, para 250.
ploitative abuse which is direct exploitation of customers, or it can be exclusionary abuse which seeks to strengthen the market position at rivals’ expense. This paper analyses excessive pricing as an exploitative abuse since its controversial nature raises questions for a more detailed analysis.

Undertakings with a dominant position may have an incentive to utilise the lack of competition by strengthening their market position and charging excessive prices without acceptable justification. Therefore, undertakings have been imposed a special responsibility not to allow their conduct to impair genuine undistorted competition. Although competition authorities have focused more attention to anti-competitive behaviour aiming to foreclose competitors rather than to direct exploitation of consumers, excessive pricing is an issue that should not be shrugged off. Despite the subsidiary role excessive pricing has in the case law, there has been a relatively vigorous policy debate on it during the past few years. The growing interest in this topic is at least partly due to the dissatisfaction with the outcome of the liberalisation process in deregulated fields as well as to the European Commission’s forthcoming review of the enforcement priorities for Article 102 of the TFEU with regard to exploitative abuses. The price level has importance also in general since it has been recognised that a price rise can be detrimental to consumers and to the economy although the prices would not be so clearly unfair that intervention would take place. However, it is unarguable that intervention against excessive pricing by means of ex ante price regulation or ex post price control is not usually reasonable when a competitive market situation is desirable. There is also a wide consensus that competition authorities should not regulate prices which is a task more suitable for sector-specific regulators.

Interestingly, while excessive pricing is considered as an abuse of the dominant position in the European Union, it is not regulated as such in the United States. However, the difference is not as significant as it may at first appear. Even though exploitative excessive pricing is considered as an abuse of the dominant position in the European Union, the ex post intervention is largely exceptional in practice.

The aim of this paper is to give an overview of excessive pricing and analyse the paradox between the theory and practice of its regulation. Firstly, the

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3 However, the term ‘excessive pricing’ is usually understood by exploitative nature. After this, ‘excessive pricing’ is used to refer to exploitative abuse.
4 OJ C 45/02, 24.2.2009, para 1.
6 HE 243/1997 vp.
theory of regulation is examined, secondly the problems concerning *ex post* regulation are analysed, thirdly a few alternative regulatory strategies are discussed, and fourthly the proactive approach is introduced as a means of controlling exploitative conduct. Finally, the main findings are summarised in the last chapter.

2 Perspectives on the theory of regulation

The theory of regulation deals with the fundamental question of the market functioning: whether the market is able to correct its failures itself or is government intervention needed? Either way, in a situation where the costs of the regulation would be higher than the benefits followed from the rules imposed, law-making is often considered undesirable.7

The regulation theory can be divided into two parts: the normative and positive theory of regulation. The normative theory of regulation discusses which alternative regulation measure is the most expedient for reaching a certain political goal – if the regulation is considered necessary in the first place. Conversely, the positive theory of regulation analyses the underlying motives that are actually affecting the legislators’ decisions. Although both the normative and positive theory of regulation can be distinguished, they are not completely separate approaches. On the contrary, those approaches are closely interconnected and both are necessary in the critical analysis of the legislation as well as in the research work on law-drafting.8

The regulation of market power is considered necessary since the markets can never work perfectly and imperfect competition leads to market failures. Market failures may result in allocative, productive and dynamic inefficiencies. Moreover, asymmetric information, public goods and externalities can often be seen as a justification for the regulation of market power. Externalities can be small-group externalities or mass externalities according to the amount of the parties that have been affected; in the case of the small-group externalities, there are only a few parties affected, while the mass externalities involve a large group of people. The Coase theorem is considered to fit well in a situation characterised by the small-group externalities, while the Pigouvian approach applies better if there are mass externalities involved. According to

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7 See e.g. Määttä 2005a, p. 19.
8 See e.g. Määttä 2004, pp.195–198.
the Coase theorem, the lower the transaction costs, the more efficiently scarce resources can be allocated without government intervention.⁹

The assessment of costs is important since imperfect markets are characterised by high transaction costs. Transaction costs can be divided into ex ante and ex post costs, according to the stage when the costs are born. The ex ante transaction costs cover costs such as search costs, bargaining costs and enforcement costs, whereas the ex post transaction costs involve maladaptation costs which occur when a given performance does not realise, haggling costs which occur when parties strive together to fix or minimise the effects of maladaptation, system costs which stem from the mechanisms that assist to solve the disputes, and implementation costs which are followed from the enforcement of monitoring and precautionary measures.¹⁰

According to the Coasian approach, market actors can bargain an efficient outcome if there are zero transaction costs and the property rights are well-defined. The Pigouvian approach instead emphasizes the necessity of government intervention in correcting the market failures.¹¹ Excessive prices are likely to be mass externalities since there is rather a large group of people involved; however, the Pigouvian interventionist approach is unlikely to be the most appropriate measure to correct the market failure if the market entry is free. In that case, parties can, as Coase’s model suggests, negotiate and agree on an efficient outcome without government intervention. If the market situation is not self-corrective, the intervention comes to be considered as an alternative means to correct the unhealthy market situation.

3 Problems of ex post regulation of excessive prices

The EU competition rules as well as the member states’ national competition laws are mostly based on ex post regulation. However, the competition policy with regard to excessive pricing has also features of ex ante regulation which occurs through the sector-specific regulation. Sector-specific regulation complements the regulation carried out by competition law. With special legislation, it is possible to provide stricter rules than by competition law. Special

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⁹ See e.g. Pigou 1920 and Coase 1960.
¹⁰ See e.g. Kanniainen et al. 1996, p. 27 and Cooter and Ulen 2004, p. 92.
¹¹ See e.g. Pigou 1920 and Coase 1960.
legislation is usual especially in those fields where legislation or natural monopoly prevents the existence of competition.\textsuperscript{12}

\textit{Ex ante} regulation is used in sectors where competition law by itself is inadequate in creating and maintaining effective competition. In infrastructure sectors with constant market failures, such as the telecommunications and energy, competition law is considered insufficient to create competition. Nevertheless, even if sector-specific regulation was suitable for promoting competition on such market opened up for competition, it should be employed with extreme caution. \textit{Ex ante} sectoral regulation should not be used in general as it creates higher administrative costs in the form of implementation of legislation, monitoring of markets and sanctioning of infringements. Moreover, special legislation may distort incentives on the market as well as encourage regulated firms to allocate their resources in order to circumvent regulation.\textsuperscript{13} To determine whether to regulate in the electronic communications sector, the Commission has identified a ‘three criteria test’ in which all the three criteria have to be cumulatively met before regulation can take place. First, there should be high and non-transitory barriers to entry, second, the market structure is not able to create effective competition and third, the competition law is insufficient to deal with the market failures. In addition to these criteria, significant market power is also required.\textsuperscript{14} Anyhow, the problem situation that competition authorities have to encounter, relates to \textit{ex post} regulation; thus, \textit{ex ante} control is not covered in this paper.

Excessive pricing is a controversial type of abuse of the dominant position: it is one of the most blatant forms of abuse, and still at the same time government intervention is highly exceptional. Price intervention is not considered desirable if the market situation is self-corrective: when the market entry is free and the goods are valuable to consumers, it is likely that new entrants appear and prices decline without intervention.\textsuperscript{15} High prices and excessive profits may act as market signals to attract new competitors into the market, and if there are no remarkable barriers to entry, therefore, any intervention that reduces the profits of an incumbent could just prolong the monopoly situation by preventing market signals which could attract the potential entrants into the market.\textsuperscript{16} From this point of view, confining the freedom of pricing is detri-

\textsuperscript{13} See e.g. Report from the Nordic competition authorities 2004, pp. 33–34 and Kroes 2009.
\textsuperscript{15} See e.g. Motta 2004, p. 25.
\textsuperscript{16} See e.g. Motta and de Streel 2007, pp. 17–18 and Williams 2007, p. 144.
mental to market functioning because intervention might only increase inefficiency and reduce competition on the market although these would have been the underlying motives for the intervention in the first place. There is consequently a broad consensus that price intervention should be limited to exceptional cases.

It is thought that various problems are likely to arise due to intervention. Nevertheless, it has been noticed that under certain circumstances problems may also arise if intervention against high prices does not take place. Although excessive prices may harm consumers in the short run, pricing may be reasonable in a longer period of time, providing that there are no barriers to entry keeping the entrants off the market. Thus, pricing should always be looked at from a long time perspective. The existence of barriers to entry is commonly seen as a reason for intervention. If the market is characterised by high or insuperable barriers to entry, intervention might be the only means to achieve the competitive market structure. On the contrary, if the market has free entry, it is likely that new entrants will come and the market structure will normalise without intervention.

It is essential to regulate monopolies since a monopoly is likely to involve welfare losses. A monopoly produces less output and charges a higher price than a competitive market. This will result in a deadweight loss of the monopoly because some consumers who would have bought the monopoly product at the competitive price will substitute other products. The welfare loss is a result from the fact that the substitute product is more expensive to produce and thus its price is higher than the price of the monopoly product would be if it was sold at its competitive price. Therefore, the monopoly causes some consumers to switch to substitute products that cost society more to produce than the production of the monopoly products. Meeting the needs of society is thus far more expensive than would actually be necessary. Allocative inefficiency is not, however, the only source of welfare loss, since productive inefficiency as well as dynamic inefficiency may also increase the welfare loss due to monopoly power. Productive inefficiency exists when a monopoly firm has higher costs than it would have if acting in a competitive market. The reason behind this is that a monopoly has less incentive to cut its costs since it does not face any competition, and thus, adopts a less efficient technology than the firms operat-

17 See e.g. Vihanto 2000, p. 45.
18 See also e.g. Lowe 2003, Motta and de Streel 2007 and Paulis 2008.
19 See e.g. Posner 1998, p. 301.
20 See e.g. Kuoppamäki 2006, p. 12.
ing under competition. A monopoly might also result in dynamic inefficiency because it might not have incentives to innovate either; albeit the role of the market power in creating innovations is actually somewhat controversial.21

When excessive prices are considered to attract new entrants into the market, there should be no intervention since that may result in a decrease in competition. On the other hand, intervention against excessive pricing can also be detrimental for it may discourage the investments and innovations of the dominant firms. Because high prices and profits can be seen as rewards for firms’ efforts, then if no benefits are expected from investments, the incentive to invest disappears.22 There is also the risk of misjudgements and the costs of these errors are likely to rise high. Type I error implies false condemnation, i.e. intervention where it should not have taken place, whereas type II error means false acquittal, i.e. failure of intervention where involvement would actually have been needed. The false condemnations create costs especially by decreased incentives to invest and innovate which could have led to higher consumer welfare. Thus the costs of type I errors in the form of dynamic inefficiency are higher than the costs of type II errors in the form of allocative inefficiency.23 In addition, it is extremely difficult to define whether the prices charged are excessive. There is no generally accepted definition of an excessive price and, furthermore, it is impossible to argue what exactly constitutes an excessive price — prices can certainly be high without being anti-competitive. The problem thus arises as how to distinct unfairly high prices from competitive high prices.

Although there are many reasons why intervention against excessive pricing is not reasonable except for certain rare cases, the non-interventionist approach may include drawbacks too. The non-interventionist approach by the competition authorities can be harmful for it can encourage firms with a dominant position to price excessively without a fear of getting condemned.

In addition, the non-interventionist approach may set an undesirable signal to firms which wish to co-operate with each other on pricing for higher profits. Since a cartel is an unsure arrangement prohibited by competition law, firms may be more tempted to merge and raise the price level after the market power has been acquired. However, although a merger may be a more enticing alternative than a cartel, it can be generally more detrimental due to the permanent

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21 See e.g. Motta 2004, pp. 45–64. See also Arrow 1962 and Schumpeter 1943 on different views on the interaction between market power and innovations.
22 See e.g. Motta and de Streel 2007, p. 18.
23 Ibid., p. 20 and Evans and Padilla 2005, p. 113.
nature of the agreement, provided that the merger has taken place with the intention to restrain competition.\textsuperscript{24} The \textit{ex post} regulation of abuse of dominant position is not sufficient to eliminate all harmful effects, such as a price rise brought about by a merger which is the reason why merger control should be paid attention to.\textsuperscript{25}

Although the competition authorities usually favour the non-interventionist approach, there are situations where intervention needs to take place. Exploitative conduct may be intervened in, especially where the protection of consumers and the competent functioning of the internal market cannot be adequately ensured by any other means.\textsuperscript{26} If a firm’s dominant position is due to a natural monopoly, competition is considered socially undesirable and thus cannot be increased in the market. That is due to the economies of scale which imply that a firm operating under a natural monopoly produces more efficiently than two or more firms together. The flip side of this efficiency benefit emerges since a natural monopoly, while being the only actor in the market, has the incentive to exploit its dominant position in order to maximise the profits. Therefore, the intervention situation often occurs with natural monopolies.

Although the aim of this paper is to deal only with exploitative pricing, it should be noted that if excessive pricing is of exclusionary type, the need for intervention is clearer. Exclusionary abuse is aimed to foreclose competitors and restrict competition in the market. For example, a price squeeze emerges when a vertically integrated firm charges an excess price of a wholesale product from its competitors in the upstream market, and thus weakens their opportunities to compete in the production of downstream products. The size of the margin between the firm’s wholesale price and retail price indicates a price squeeze when the margin is insufficient to allow a reasonably efficient competitor to obtain a regular profit on the market.\textsuperscript{27} Price squeeze is an exclusionary type of abuse as it harms the competitors directly and the consumers only indirectly. Therefore, the need for intervention is more obvious since the conduct impairs undistorted competition and the market is not able to correct the failure itself.

Although excessive pricing is regarded as an abuse of the dominant position in the European Union, there is no such regulation in the antitrust law of the United States. The belief in market functioning diverges, which can be seen in a form of non-interventionist approach to excessive pricing under Sec-

\textsuperscript{24} See e.g. Kuoppamäki 2006, p. 243.
\textsuperscript{25} See e.g. HE 243/1997 vp.
\textsuperscript{26} See OJ C 45/02, 24.2.2009, para 7.
\textsuperscript{27} See OJ C 265/02, 22.8.1998.
tion 2 of the Sherman Act. The charging of monopoly prices in the United States is considered not only lawful, but it is also seen as an important element of a free-market system. The opportunity to charge monopoly prices at least for a short period attracts business acumen; it induces risk taking that produces innovation and economic growth. As it has already been noted, the difference between the two sides of the Atlantic is not that significant as one may think on the grounds of the legislation. Hence, after all, it can be stated that although the legal states of the United States and the European Union differ in theory from each other regarding the prohibition of excessive pricing, the difference rarely exists in practice. Moreover, those times when pricing has been considered as an abuse of the dominant position in the European Union, the price has had to be outstandingly excessive and other circumstances have clearly favoured the judgment too. Because the competition authorities do not want to be price regulators, they have not, however, addressed what the reasonable price would be, but they have left it for firms to assess it themselves.

4 Alternatives to the regulation of excessive pricing

The alternatives to regulation range from a pure legal regulation to a situation where no regulation exists. The alternatives should be understood widely. The traditional legislation is based on a command-and-control regulation; however, there are various means that do not require legal regulation, such as information and education, self-regulation or threatening with regulatory actions. The form of regulation to be chosen derives from the objectives of the law.

The main objective of Article 102 is the protection of competition as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. If competition is effective, it may bring benefits to consumers in the form of low prices, high quality products, a wide selection of goods and services, and innovation. Therefore an important concern is to prevent the exclusionary conduct of the dominant firm which is likely to limit the remaining competitive constraints on the dominant company, including the entry of new competitors, so as to avoid consumers are harmed. Thus, the main objective of

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the competition policy is the protection of competition, not the protection of competitors.\textsuperscript{30} National competition law is neither primarily supposed to protect the undertaking from unfair actions performed by rivals unless that is at the same time an action necessary to examine for ensuring healthy and well-functioning competition in the market. As concerns the objectives of the competition law, it is important that the competition authorities can handle matters with sufficient efficiency and speed.\textsuperscript{31} This can be understood also in the meaning of not to intervene in excessive pricing since it is often a time-consuming, expensive and rather unnecessary task to perform.

Determining the best possible means to reach the pursued objectives of the law requires a careful assessment of alternative regulatory strategies. Even if the need for a clearer legal state was recognised, the legal regulation is not often what should be altered. Instead, various non-legal strategies may come to be considered. At the moment, the European Commission reconsiders its policy on Article 102. The commission has already finished the first stage of the review and published a guidance paper on its enforcement priorities in applying Article 82 of the EC Treaty (present Article 102 of the TFEU) to abusive exclusionary conduct by dominant undertakings.\textsuperscript{32} The ultimate aim of the article is to protect consumers.\textsuperscript{33} Thus the guidance indicates that the Commission’s priority is in cases where the exclusionary conduct is liable to have harmful effects on consumers. The review of the enforcement priorities for Article 102 with regard to exploitative abuses is still in preparation and will be published in due course. The guidance Commission will provide on exploitative abuses will denote largely needed directions to market actors and the national competition law enforcers on how the Commission uses its economic and effects-based approach in applying Article 102 to abusive exploitative conduct.

The generality of legal rules is characteristic of competition law. In this regard, it is possible to refer to the delegation of legislative power. That is due to the fact that by flexible rules, legislative power is shifted to courts and other enforcers of the law.\textsuperscript{34} Since legal competition rules are general by nature, intervention is to a large degree feasible when needed. On the other hand, general rules may lead to a misinterpretation and non-uniformity in applying the law. Therefore, even if the general rules are practical in the sense that they en-

\textsuperscript{30} See European Commission 2005, paras 4 and 54.
\textsuperscript{32} See OJ C 45/02, 24.2.2009.
\textsuperscript{33} Kroes 2005.
\textsuperscript{34} See e.g. Määttä 2005b, p. 51.
able flexible intervention, they also create uncertainty. For example, it is difficult for undertakings to determine whether their pricing is excessive since the defining of an excessive price is impossible by legal competition rules. According to the opinion of the EESC, legal certainty comes actually with the basics of a well functioning society; the law can work if the users of the law know and understand it. However, although the legal state is to some extent unclear, there is still no need to regulate the competition rules more exactly. The legal certainty can instead be enhanced with other means, such as guidance and counselling. For example, the Finnish Competition Authority has published its evaluation criteria it uses when it assesses the possibility of a price squeeze in the broadband market. The memorandum is published as it is expected to assist companies offering broadband services in the fixed network to evaluate the fairness of their pricing from the viewpoint of competition law. Likewise, guidance on the Commission’s enforcement priorities in applying Article 102 of the TFEU to abusive exclusionary conduct by the dominant undertakings can be seen as a means of a better non-legal regulation. The Commission’s forthcoming guidance on exploitative conduct is also likely to increase the legal certainty with regard to excessive pricing.

5 Proactive approach as a means of controlling excessive pricing

The regulation of abuse of the dominant position is **ex post facto**. The **ex post** regulation of excessive pricing is challenging in more than one way. Since there are many problems involved, the prevention of excessive pricing is likely to be less complicated and less costly than **ex post** intervention. Because the **ex post** control of abuse of the dominant position is not adequate to prevent excessive pricing, the competition policy should focus more on **ex ante** intervention. This is the course which the EU Commission has already taken. The Commission “does not normally control or condemn the high level of prices as such. Rather it examines the behaviour of the dominant company designed to preserve its dominance, usually directly against competitors or new entrants who would normally bring about effective competition and the price level as-

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35 OJ C 175/05, 28.7.2009, para 2.1.
36 FCA 3 September 2009.
sociated with it". Priority should thus be given to exclusionary abuses since exclusion is often the ground for later exploitation of customers. This is the same approach the national competition authorities have followed in their own decision-making practice.

Price regulation is not always the most appropriate remedy to handle excessive prices. Because excessive pricing echoes more a problem in the market structure rather than in the behaviour of the dominant firm, the appropriate remedy should change the market structure for the future instead of only punishing the dominant firm for its past actions. Excessive pricing is a form of abuse, where *ex post* regulation has proved to be unworkable too. This is where the proactive law approach comes in useful. While the *ex post* approach becomes often expensive in the form of the costs of time and money, proactive law approach aims to prevent the possibilities to price excessively in the first place.

To be precise, the word proactive implies acting in anticipation, taking control and self-initiation. The proactive law approach also differentiates two further aspects of proactivity. The first aspect is a promotive dimension and the other one is a preventive dimension. The promotive dimension implies promoting desirable outcomes and encouraging good behaviour, whereas the preventive dimension implies preventing undesirable outcomes and keeping legal risks from materializing. Consequently, the focus of the proactive approach is on success rather than on failure which implies taking the initiative to promote and strengthen factors that aim to success. The proactive approach to excessive pricing should thus be understood in a broad sense: not only in the preventive manner, but also promotive measures should be pursued.

Since the emphasis of the legal field has traditionally been on the past, the legal research has been mainly concerned with failures too. Contrary to this kind of reactive approach to the law, proactive law approach looks forward and seeks to promote desirable goals and maximise opportunities in advance, while minimizing problems and risks. This approach can be useful as a means to solve the problem of excessive pricing. After all, it is better to prevent than to cure. The costs of *ex post* intervention are likely to rise high; however, by predicting the problems, those costs can be prevented.

37 European Commission 1994, para 207.
38 Kroes 2005.
40 OJ C 175/05, 28.7.2009, paras 5.3. and 5.4.
41 Ibid., paras 1.3., 1.4., 2.1. and 5.1.
In applying Article 102 to exclusionary conduct by the dominant undertakings, the Commission’s focus lies on the types of conduct that are the most harmful to consumers. The enforcement will therefore be directed to ensuring that markets function correctly and that consumers benefit from the efficiency and productivity which is a consequence of effective competition. Exclusionary conduct impairs the effective competition by foreclosing rivals in the anti-competitive way. Exclusionary conduct by a dominant undertaking is harmful since by weakening the position of its competitors, the dominant firm strives for increasing its own market power which might eventually give rise to the opportunity to price significantly above the competitive level.

Preventing the artificial increase in market power is thus in the key position in the fight against excessive pricing. That is because, at the same time, the opportunities to price excessively can indirectly be decreased. However, a rise of market power is not necessarily bad. The dominant position often involves efficiency benefits that it would not have if acting under competition. It is not illegal to be in a dominant position; a dominant firm is entitled to compete on its merits, but it is not allowed to succeed because of abusive conduct.

6 Conclusions

This study has concentrated on excessive pricing as an exploitative abuse. Although excessive pricing is prohibited under the EU competition rules as well as under the national provisions of the most EU member states, the competition authorities have repeatedly refused to intervene in excessive pricing. There are, however, many reasons for this inconsistency. First and most importantly, high prices tend to attract new entrants into the market which will result in a decrease in price level without government intervention. It has also been noticed that intervention may discourage the dominant firms’ investments and innovations, and it is remarkably difficult to define whether a certain price is excessive. In addition, there is a high risk of false condemnation which can become very expensive. For the reasons above, intervention is considered necessary only in cases where other means have proved to be inadequate.

The aim of this paper was to give an overview of excessive pricing and analyse the paradox between the theory and practice of its regulation. Because *ex post* regulation is an inadequate means to resolve the problem of excessive

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42 See OJ C 45/02, 24.2.2009, para 5.
pricing, the focus should be more on preventive measures. The essential role should be in the prevention of the creation of artificial barriers to competition. Although the emphasis of the legal field has traditionally been on the past, it can often be better to look forward. While *ex post* intervention is often a time-consuming and expensive means, *ex ante* intervention may prevent those drawbacks from arising. Therefore, the proactive approach to the law can be considered as a means of controlling excessive pricing. Preventive measures should not, though, be understood as alternatives to traditional *ex post* regulation, but more as complements to each other. Moreover, it is worth bearing in mind that a price rise can occur — besides in the form of excessive pricing — with cartels and mergers or exclusionary abuses which are often at the basis of later exploitation of consumers. Thus, the merger control, cartel control and control of abuse of dominant position should be seen equally since each division has importance in the fight against excessively high prices.

It has been shown that the problem of excessive pricing does exist and the legal state cannot be seen very successful in this respect. However, the *ex post* regulation of excessive pricing forms at least a token deterrent for not to overprice although the deterrent has not worked well in practice. Therefore, the rule can be useful as a last resort as it gives an opportunity to intervene in prices totally over the top. After all, consumers should be protected from the clearly unfair exploitation of market power.

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LEGISLATIVE TECHNIQUES AND ICT
In the Wake of Law Keeping Pace with Technology

John Ubena

Abstract

This article explores Legislative Techniques and ICT. Often the legislator bears a blame for overlegislating as a price for its failure to pay attention to legislative techniques.\(^1\) Overlegislation is a result of enacting a new law for every change and or convergence of technologies. Additionally, the legislator is seen to be guilty of legislating laws which are not sustainable as the laws become obsolete after a short while.\(^2\) The aforesaid reactive tendency increases unpredictability of the laws which in turn hampers ICT innovation. The problem is worsened by the internationalization nature of ICT.\(^3\) The legislator is often left unguided and consequently does not know what to do in the transition from one regulatory phase to another. The question this article seeks to answer is whether the change and convergence of ICT can be overcome by revisiting legislative techniques. The author argues that, legislative techniques being the determinants of legislative process and implementation or enforcement of legislation are good means to eliminate problems occasioned by ICT change and convergence.

1 Introduction

The importance of mechanisms of legislative techniques is seen in both developed and developing countries as one of the pillars of a legal system. The vitality increases now because of the change and convergence of Information Communication Technologies (ICTs) which leaves legislation

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\(^1\) Enacting of too many laws than citizen's ability to handle and comprehend them. See foot note 3


obsolete. The legislator ought to deal with this problem in a visionary way. Nowadays it is the order of the day that any change or convergence of ICT triggers the legislator to enact new law. Indeed this is done regardless of the citizens’ inability to comprehend such voluminous and scattered pieces of legislation. Without guidance the legislators are stranded as to what legislative techniques should be adopted to curb these problems. However, before proceeding further in this discussion, it is worthwhile to elaborate some key concepts such as ICT and legislative techniques which are central to the article.

ICT embody technical and application standards. It is admitted that such distinction is fundamental to any designing and determination of ICT regulation. It is emphasized, though, that this article being an inventory is not exploring that distinction in details. ICT includes, among other things, Telecommunications, Broadcasting, Internet and Multimedia. ICT is a fast growing field of technology. The rapid advancement of ICT leaves many laws redundant. The attempt to develop sustainable laws is weakened by the legislator’s tendency to enact technology specific legislation. ICT is changing and converging at an amazing pace. The article focuses on ICT as a case study and because of its far reaching economic, legal, political and social impacts. ICT being a sub set of field of technologies implies that the conclusion drawn will be relevant to other technologies.

In this article legislative technique is defined as an approach or methodology which legislators employ in the process of enacting and implementing legislation to achieve a specified goal(s) in a particular country depending on the socio economic need, cultural background and general legal and constitutional heritage of that country. The legislative technique chosen depends on the rationale of the legislation and overall need of the society in which is to be implemented and for what period of

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5 There is no universally accepted meaning of the concept ‘legislative techniques,’ thus it is used in different senses and contexts. In Common Law legal system this concept is linked with legislative drafting, while in Civil Law legal system some scholars have pointed out that the concept is more than legislative drafting. See: Wahlgren, P. (2008), infra note 9; Willem van der Velden (1987). Infra note 8 at p. 53; For Common Law legal system uses of this concept, see: Francis Benion, Statute Law; Michael Zender, Law Making Process; Sir William Dale (1977). Legislative Drafting-A New Approach, London: Butterworths.

6 The fact that a country is a civil law or common law legal system/jurisdiction has a role or bearing on legislative techniques employed. It must also be noted that legislative techniques is broader than legislative drafting, thus legislative drafting is a subset of legislative techniques.
time. The assumption is that the legislators adopt an approach to legislative techniques which guarantees that the legislation suits technological changes and the convergence of technologies. But in practice that is not the case. The article explores that in detail.

In order to appreciate why there are such a variety of legislative techniques one has to know the philosophies underlying them. The approaches to legislation are employed as tools to achieve a certain goal. Meaning that, legislative techniques are means to achieve legislation’s goal(s). This is called law operative perspectives. It assumes law to be an instrument. The said law constitutes an independent variable and the goals are the dependent variables. Since such philosophy considers law a tool, the society has no influence upon the law. The law is made independent of the society. Consequently the law is imposed upon the society. Hence the interests of the society are subordinate to the interests of legislator. Therefore, the law will be made regardless of the society’s protest against the said law. A good example is the Instrumental Approach. However, other approaches exhibit different features rendering them somewhat non instrumental. Evolutionary approach for example, considers law as the mirror of the will of society. The law must therefore reflect the interests of the society. This is typical law generic perspectives. In this respect law is a dependent variable. Thus the society shapes the law and in turn, the law preserves values in the society.

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7 Willem van der Velden (1987). *The value-and goal-dependency of legislation and its methodology*. In Åke Frändberg and Mark Van Hoecke, eds., *The Structure of Law*, Uppsala: Iustus Förslag, at pp. 55. Although a term ‘method’ or technics’ of legislation is used to mean legislative techniques. He defines the said term as a set of ordered and specified activities to achieve a certain goal (or goals) in relation to certain domain and certain conditions. See also: Wahlgren P. (2008), infra note 9.


9 See: Willem van der Velden, supra note 8 at pp. 56, 75–76; Koen Van Aeken infra note 68.

10 Ibid.


14 Law as a social system i.e. the social concept of law; law consists of non formulated conceptual elements, thus besides consisting elements of a non-conceptual nature is also brought forth by other social units than sovereign or government agencies; see: Willem van der Velden, supra note 8, at pp 62–68.

15 The values like privacy (data protection), and not subjecting human beings to
This article therefore, is divided into three parts. The first part covers introduction, background and problem description. The second part is devoted at elucidating approaches to legislative techniques and rationale of the approaches in addressing ICT problems. And finally part three will entail a brief concluding remark of the entire discussion.

1.1 Background

Adoption of a particular legislative technique is dictated by an area to be regulated. If the area to be regulated is characterized by constant change like ICT, regulating such area becomes difficult. ICT is evolving; from telegraphy to voice over Internet protocol (VoIP)\textsuperscript{16}, from broadcasting to podcasting and webcasting.\textsuperscript{17} As if that is not enough, the technologies are converging at a rapid pace. Similarly, there is convergence of sound, image, text, data, voice, wireless, public networks and private networks. Of importance is the convergence of broadcasting, telecommunication and Internet.\textsuperscript{18} Nowadays one can have these technologies in a single device. Although these changes were not contemplated years ago, they have been created and are here to stay.

The changes challenge legislators and the legislative techniques adopted in designing and drafting ICT legislation. To remedy the situation the legislator adopted the traditional or piecemeal approach. This approach entails the legislating of a new law for every change and convergence of ICTs. This culture proves to be a fallacy as legislation is increasingly becoming obsolete\textsuperscript{19} and in other instances lacunae in the legislation are

\textsuperscript{16} For legal challenges of VoIP see: Wessner, C. W., infra note 19 at pp. 8–9.
\textsuperscript{17} For more about convergence of ICT, Telecommunication and media sector see: Joachim Benno Why the Use of ICT Engenders Legal Problems-in Search of a Common Denominator in SOU 2002:112 at pp 44–54.
\textsuperscript{19} See also: Lyria Bennett Moses in her Recurring Dilemmas: The Law’s Race to Keep up with Technological Change have identified four reasons of change of law following technological change, they include the need for special laws, uncertainty, Over-inclusiveness and Under-inclusiveness and obsolescence.
observed. On top of that legislation is voluminous and of poor quality\(^{20}\) which in turn makes it incomprehensible.

As a reaction to sporadic and constant change and convergence of ICT, the EU introduced the New Regulatory Framework (NRF).\(^ {21}\) This is Electronic Communications Regulatory Framework constituted of six Directives. Given this casuistic approach one may warn that the legislators are yet to overcome the changes. To justify this, the EU has introduced another approach. This approach is called the “Better Regulation Approach”. The approach was introduced as a result of Lisbon Strategy.\(^ {22}\) It is thus worth stressing that despite adopting these ambitious efforts to address the challenges posed by evolving ICTs, the efforts are short of success.

Since quite a few legislators if any, have offered serious attention to legislative techniques,\(^ {23}\) the author claim that there is a clear oversight of legislative techniques.\(^ {24}\) Certainly, such techniques are important in the wake of law keeping pace with ICT.

As stated earlier on, the purpose of this article is to explore the relation between legislative techniques\(^ {25}\) and ICT. Thus phenomenon of legislative techniques is revisited to uncover whether these approaches can be employed to guarantees the sustainability of law in the evolving technologies.


\(^{22}\) For details about better regulation http://ec.europa.eu/governance/better_regulation/index_en.htm

\(^{23}\) The EU and OECD have set precedent on the initiatives to improve quality of legislation. They did that by introducing Regulatory Impact Assessment (RIA). The same was endorsed by UK and USA since long ago. As for Sweden, there is a Legislative Council ‘lagrådet’ to scrutinize legislative bills hence improving quality of legislation. Furthermore, Sweden is embracing Better Regulation through RIA, see: Magnus Erlandsson, _Regelförenkling genom konsekvensutredningar_ Rapport (Sieps 2010:1); see also: Swedish Better Regulation Council ‘Regelradet’ at http://www.regelradet.se/Bazment/regelradet-eng/sv/startpage.aspx. Further see: Alfred Kellermann at el (1998). Improving Quality of Legislation in Europe. The Hague: TCM Asser. However, it must be stated that none of these initiatives thoroughly covered legislative techniques.

\(^{24}\) Joachim Benno supra note 18, is of the view that Legislative Techniques are the ones to handle the problem of change and convergence of ICTs.

\(^{25}\) Similar views on importance of Legislative Techniques are offered by Wahlgren, P. (2004), supra note 4; Wahlgren, P. (2008) supra note 9; Lessig, L., infra note 53, Lessig appeal for the regulation of architecture of the code by the legislator; Joachim Benno, supra note 18.
1.2 Problem description

The legislators both in developed and developing countries have a tradition of enacting legislation in various compartments and in a piecemeal approach. But now they are facing a dilemma as a result of the technological changes and convergence of technologies. Such changes and convergence are posing a challenge to the legislators, who must decide which legislative techniques should be adopted in order to address the said changes and convergence. The serious impact of such changes and convergence is that of legislation becoming obsolete, while in other instances lacuna in the law are observed. This brings in a difficulty not only in legal interpretation of ICT legislation but also in the administration and enforcement of the law as the legislation is voluminous and too scattered to be comprehended.\textsuperscript{26}

As stated herein, the article albeit briefly explores the legislative techniques in a changing world of ICT. In particular, the focus is on the impacts the chosen legislative technique will have on technological innovation on the one hand and enforcement of such legislation on the other. In connection to that the sustainability of that legislation is also an area of interest considering the fact that ICT is evolving.

It is worthwhile to state that, the theoretical foundation of this article is partially founded on the theory of legislation, popularly known as legisprudence as postulated by Luc Wintgens. Wintgens is credited for reiterating inter alia the overwhelming complaints about volume and poor quality of legislation.\textsuperscript{27} As a theory, legisprudence places emphasis on structure and function of legal systems, particularly the theoretical reflection on legislation.

Admittedly, problems such as poor quality and obsolete legislation have tempted scholars to blame legislators. Arguably, the scholars are equally blameworthy. This is confirmed by Wintgen’s argument that, for a long time legal theory focused on interpretation and systematisation of law; thus, there are few studies on creation of law.\textsuperscript{28} Such gap necessitated development of legisprudence as a rational theory of legislation aimed at theoretical reflection of law.

\textsuperscript{26} Supra note 3
While endorsing democratic credibility of alternatives to legal regulations and based on the concept of freedom as principium, Wintgens reminds legal scholars that there is want of research on the principles of legislation. Wintgens further appeals for ways of assessing and striking the necessary balance in developing legislation that is sound on the one hand and that secures an equilibrium or coherence in the legal system on the other. Although this makes legisprudence a field in which legislative techniques is destined to be propagated, approaches to legislative techniques focus on the creation and application of law in the fast changing and converging technologies.

Despite legislation being a nucleus of any legal system it is surprising to find that there are quite a few scholars who have explored legislative techniques. The majority of scholars have not covered legislative techniques hence leaving legislators with little knowledge of that phenomenon. This explains why the legislator has resorted to the traditional approach [see part 2.0]. Presumably that is the only approach which the legislator is well acquainted with.

The scholars have done little to assist the legislator in this respect. There is a clear confusion between legislative techniques and legislative drafting. Moreover, there is confusion between legislative techniques (form) and legislative politics (content). The literature does not provide any guidance as to what techniques the legislator should adopt in rapidly changing or developing sectors like ICT. The legislator’s neglect of legislative techniques has resulted into a lack of clear established elements of legislative techniques to be employed in a particular sector.

In the light of foregoing background and the problem statement it is pertinent to explore the phenomenon of legislative techniques. By so doing the interaction between the approaches to legislative techniques and the impact of such approaches on ICT will be pinpointed. This forms a thesis of discussion hereunder.

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29 Ibid pp. 11–25
30 Ibid; see also: http://www.cwrl.be/eng/legisprud_journal.htm; legisprudence journal online at http://www.ingentaconnect.com/content/hart/legis
31 Scholars whose works appear to have somehow covered legislative techniques include Jeremy Bentham, Savigny, Hans Kelsen; Willem van der Velden supra note 8; Wahlgren, P. (2004), supra note 4; Wahlgren, P. (2008), supra note 9; just to mention a few. On the other hand, there are others like Francis Benion, Statute law book; Michel Zender, Law Making Process; Sir William Dale, Legislative drafting-A New Approach, have covered legislative drafting techniques.
32 Scholars who have indirectly covered legislative techniques include among others; Lessig,L., Bert-Jaap Koops, Biegel,S., Brownsword, R., Wintgens,L.J., etc.
33 See also: Willem van der Velden supra note 8 at p. 73.
34 Ibid at p. 89, general conditions to be considered in developing methods of legislation.
2.0 Legislative Techniques

Legislative techniques are like a toolbox in the hands of legislators designed to serve different purposes or goals. Since legal problems are complex issues that cannot be addressed by one technique. The legislator with such a toolbox is capable of addressing technology problems without retarding its innovation. The legislative techniques investigated in this article have been divided into five major approaches namely; Traditional Approach, Technological or Embedded Approach, Utopian Approach, Instrumental Approach and Evolutionary Approach. The said approaches are addressed under a separate heading in the sections below.

2.1 Traditional Approach

It must be stated that, no matter the nomenclature one uses in describing the traditional approach to legislative techniques, this approach remains to be the most preferred approach in many legal systems. The approach has three subdivisions that define its features. The subdivisions include the quantitative approach, the hands off approach and qualitative approach as indicated below.

2.1.1 Quantitative Strategy

Quantitative strategy depicts a legislator who reacts to new problem by enacting new law. Therefore, more problems imply more legislation. Admittedly, society generally believes that problems exist because there is insufficient legislation. This must be seen in the light of the fact that a politician’s popularity usually grows with his or her ability to address problems in the society. As a result the legislator is accustomed to enacting new law for every new problem without caring about the quality of the legislation and citizens’ inability to comprehend the legislation.

Ironically, the quantitative approach is increasingly becoming a favourite of the legislator as a deployment of ICT in legislative process has lessened the task which would have otherwise remained burdensome. ICT is rescuing the traditional approach; the said approach is overwhelmed with complex legislative problems which keep on piling up. ICT makes the

36 Ibid
37 See Eng, S. supra note 21, see also: Susskind, R. Supra note 5.
legislation manageable no matter how voluminous it could be. A quick glance at this move though, reveals that basic problems such as unsustainability and poor quality of legislation are likely to be obscured.38

2.1.2 Hands – off strategy “legal free zones”

The hands off strategy, is an approach that is inclined towards deregulation and self regulation of some sectors like ICT. The argument put forward is that government interference hampers the development of ICT. Examples of self regulation in the ICT sector include domain names disputes resolution and fixing of ICT Standards. However, currently, government is increasingly involved in standards regulation.

Although the merit of employing self regulation is acknowledged the same has several flaws e.g. there is a lack of penal sanctions. Since the role of the law is to balance interests in the society,39 such balance cannot be secured with this strategy.40 Furthermore, crimes involving ICTs as intermediary are redressed by penal sanctions.41 Self regulation mostly involves self reporting.42 Thus a framework for self regulation ought to be set by legislation. Self regulation is not necessarily a no legislation approach.

2.1.3 Qualitative Strategy

Although the traditional approach has many flaws, attempts have been made to reform it. Currently many legislators are improving the quality of legislation by reforming the drafting of legislation. The use of general technology neutral provisions has been suggested.43 Efforts are further being made to improve the language of legislation.44 At the EU level some

38 Wahlgren, P. (2004), supra note 4; see also p. 605.
39 Interests like, Privacy, Intellectual Property Rights, fair competition and other consumers’ rights.
41 Wahlgren, P. (2004), supra note 4, p. 607
43 This saves the legislation from being obsolete and therefore become sustainable. The adoption of technological specificity texts in the legislation is nowadays discouraged.
projects have been undertaken to improve legislation texts, such as the use of general technology neutral provisions. Scholars have also suggested the use of the sociological method of Regulatory Impact Assessment. This is emphasized by the EU and the OECD Better Regulation and Regulatory Impact Assessment programmes. Another possible way to improve the quality of legislation is by establishing domain specific ad hoc committees or observatories. A good example is the Swedish IT Law Observatory under the IT Commission.

In many legal systems for a law to be legitimate the subjects ought to be able to comprehend the legislation. Hence legislation is promulgated. However, it does not make sense if the law to be promulgated is voluminous or of poor quality.

Adding salt to the sore, the traditional approach is problematic as it makes the laws unpredictable. This drives away investors wishing to invest in technology because it minimizes incentive to innovate. That is why some technologists have blamed legal systems for interfering with ICT industry. The technologists are arguing that, there is a right to innovate and they are defending that right. However, others have backed the current legal framework, arguing that the increase of technology goods and services is a result of free market and less government interference. One may sum up this part by an observation that, although the traditional approach has serious flaws, it has paved way to the development of all ICT goods and services available today.

However, the existence of flaws in the traditional approach makes it pertinent to explore other approaches so as to make an informed conclusion.

46 Wahlgren, P. (2004), supra note 4, p. 608.
47 IT Law Observatory was a team of IT Law experts who could see and foresee the problems and advise the government whether to change the law or make new law. The IT Law Observatory was established in 1996 by virtue of the Government Bill 1995/96:38. The business of the ICT Commission and IT Law Observatory were set to last by 2003. It is worth noting that the ICT Commission exists in phases and for a particular period of time.
51 Wessner, C. W., supra note 19, at p. 18 & 90.
2.2 Technological Approach

The problems posed by ICT cannot be addressed by an excellent legislative text in the statutes because law enforcement acts after fact and not before fact. The legislation has to be embedded in physical or technological measures. The citizens cannot leave the doors of their homes unlocked expecting that the law against burglary will guarantee security. Similarly, the provisions of legislation banning spread of computer viruses cannot in any case protect our personal computers against risk of viruses unless one has installed anti viruses. That is why the ICT sector increasingly demands code to be a solution. ICT is both a sword and a shield. As the sword it inflicts harm on human beings while at the same time it is the shield against that harm.

One may rightly argue that such innovations are not without a price and therefore have to be done cautiously as the developers may influence the technical system(s) to be developed. This of course is advantageous to ICT developers. A good example is Digital Rights Management Systems (DRMs) which can work to the advantage of copyright owners where the developers have ended up developing lock in technologies. For instance, Apple developed iTunes that were not interoperable and hence jeopardising consumers’ rights and fair competition. Similarly, Secure Digital Music Initiative (SDMI) is likely to be in conflict with fair use or fair deal doctrine as it has ability to deny access even to legitimate users.

The other cost likely to arise, is that, democracy is challenged by technocratic approaches like this approach. Therefore, there could be a lack of transparency on the part of ICT vendors particularly when developing products. Additionally, code lacks legitimacy and affects other interests like privacy. However, these problems should not deter the efforts

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53 Other examples include; E-signatures, Privacy Enhancing Technologies (PETs), etc.
55 To address the problem the French Parliament enacted DADVSI 2006 Act, for more detail on this see Nicolas Jondet, Apple v. French who’s the DADVSI in DRMs? available at http://www.law.ed.ac.uk/ahrc/script-ed/vol3-4/jondet.asp. See also part 2.4 on Instrumental Approach.
to embrace code as regulatory mechanism. The approach is vital as it warrants more effectiveness and efficiency. Also it promotes technological innovation. Since there are problems in this approach it is therefore necessary to inquire into other approaches as well.

2.3 Utopian Approach

The Utopian approach is an ambitious approach purposed at pre-empting legal problems. Under this approach law is sought to address problems that exist or will exist in the future, hence ensuring that problems do not arise at all. The approach works in a society where individuals are able to plan ahead. An analogy can be made with the way in which parties to a contractual transaction are able to foresee the possible risks and manage them before they occur. The emphasis is on timely and regular legal guidance and earlier consultation to pre-empt legal problems, that essence is risk analysis. Such a proactive approach includes also the use of checklists, certifications and licensing. In broad perspective one may contemplate development of culture of planning in technology and economy. In this regard pattern recognition may be employed as a planning tool particularly in identifying and recognizing problems which require legislative actions. This may help to realize that there are few situations culminating into real legal problems. Thus, a problem may be addressed before its occurrence.

It is argued that a traditional role of government and law is to react against problems, thus any attempt to eliminate problems before such problems emerge is not welcome. The reactive approach to problems is the

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58 Technological approach is the use of technology in which legal rules are embedded in physical measures like the use of DRMs or e-signature, etc.
60 Susskind, R., supra note 3, pp. 25–27 has elaborated the use of ICT as a dispute preemption tool or mechanism. Susskind’s explanation “from legal problem solving to legal risk management” is typical utopian approach.
61 Ibid
63 The Utopian approach may be credited for its capability to keep pace with changes and convergence of ICTs. See also: Gilchrist, B. and Wessel, M.R. (1972) Government Regulation of the Computer Industry, Montvale New Jersey: AFIPS Press, pp. 1–22.
survival kit of politicians.\textsuperscript{65} Besides, the citizens expect the government and law to react promptly to any emerging technology problem.\textsuperscript{66}

Truly, the increase in magnitude of crimes and other problems necessitate the employment of the Utopian approach. This approach is an attempt to eliminate \textit{inter alia} crimes before they arise. Thus, regardless of the risk of undermining other interests such as privacy, the approach employs surveillance technologies, Biotechnology and DNA. Metaphorically speaking, the Utopian approach may be viewed as a vaccine against ICT problems. This is vital as it is anticipated that a convergence of ICT, biotechnology and nanotechnology will bring more problems. Significantly, the approach fosters ICT innovation as more technological solutions are required to eliminate problems before they occur. That being said, society and legislator ought to be educated on the merits of exploiting this approach. Therefore, the future of the Utopian approach is quite promising.

2.4 Instrumental Approach

While all legislative techniques have instrumental traits, the Instrumental approach as such is a distinct approach. The trend indicates that modern legislators are increasingly resorting to instrumental legislative technique. That reveals how important the approach is.

The Instrumental approach as a technique regards legal rule as a tool for realizing a certain goal in the society. It assumes that the rule is developed to achieve a specified goal.\textsuperscript{67} ICT is used in many sectors like commerce, banking, government, and health. Therefore ICTs as tool for regulation is used to secure the enforcement of law.

The embedding of law in ICT tools for efficient and effective enforcement is a bold step. Such instrumental approaches have resulted in Copyright legislation with Digital Rights Management Systems (DRMs).\textsuperscript{68}

\begin{footnotes}
\footnote{Ibid pp. 604–605.}
\footnote{The Utopian approach is controversial as presumably law and government exist mainly because there are legal problems in the society. And if there are no problems one may argue why should there be law? The interdependence between law and other values either positive or negative cannot be separated. However, this does not necessarily mean that law does not serve other purposes other than addressing legal problems.}
\end{footnotes}
Though, the Instrumental technique involves the cooperation of legislator and technology engineers, quite a few technology engineers do fully cooperate with the legislator. In many instances the ICT vendors care about profit making or Intellectual Property Rights.\(^{69}\) In turn there is a risk of developing normative technology which is not based on the spirit of the legislator.\(^{70}\) The fact that some of aspects of technological approaches are similar to Instrumental approach, does not necessarily mean that such approaches are supported by the legislators; since the same could be a result of technologists’ fantasy.\(^{71}\)

Central to the Instrumental approach there is legal instrumentalism. This is based on S-M-R relation; where (S) Sender-legislator, (M) Message-rule and (R) Receptor-subjects.\(^{72}\) The legislator being the sender of the message is presumed to develop clear and unambiguous norms. Scholars have rightly pointed out that such sender is also influenced by receptor and other interest groups and lobbyists.\(^{73}\) It has been assumed that the Message is transmitted without being destructed: thus reaching the receptor without interference and hence producing the desired results. However there is noise in the media of transmission which distorts the Message. Hence the legislator promulgates the laws. The media through which the message is transmitted normally range from statute books, ordinances, to technologies like (DRMs).

One of the fundamental setbacks of S-M-R model is that it ignores media’s profound ability to affect the message transmitted. The Privacy legislation which allows Privacy Enhancing Technologies (PETs) like the Platform for Privacy Prevention Preferences (P3P). The increasing surveillance technology like Closed Circuit Television (CCTV) is a good example of instrumental legislative techniques aimed at eliminating crimes.\(^{69}\) See footnote 71

\(^{70}\) A good example is French DADVSI legislation of 2006 geared at addressing the Apple customer lock-in iTunes. The main issue was interoperability; the Apple iTunes could only play on Apple iPods hence undermining consumer rights, fair competition and innovation. The overall intention of the French legislator was to deter lock-in attitudes. See: Nicolas Jondet, supra note 56; Nicolas Jondet, Better Regulation for Consumers: Integrating ICT Standards and Consumer Protection, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1303061

\(^{71}\) The difference between Instrumental approach and Technological approach is that the former is broad and always must be legislator’s initiative complemented by the engineers developing ICT tools onto which rules are embedded. The latter is narrow and does not always involve the legislator as in some instances it is technologists’ fantasy. This challenges the legitimacy of the legislation and the entire legislative process.\(^{72}\) See: Mark Van Hoecke, (2002). Law as Communication, Oxford: Hart Publishing; Koen Van Aeken, supra note 68, pp.74–77; Isola-Miettinen Hannele, Theoretical Reflections on the principled regulatory strategy-About the conditions of Rationality in Law Making?, The paper presented in the 2nd International Conference on Legislative Studies. Better Regulation-A Critical Assessment, March 1–2, 2010, Helsinki Finland.\(^{73}\) Koen Van Aeken supra note 68, pp. 75–76.
construction of such media by ICT engineers is sometimes ignored by the legislator, hence ignoring possible manipulation. For instance, DRMs as a medium for transmitting copyright norms can be manipulated to the extent that such copyrighted work cannot be utilized by the public sometimes, even where there are legal exceptions. Unfortunately most copyright legislation has banned circumvention technologies. In this case therefore the public and legitimate consumers are at risk.

However, it is important to note that the Instrumental Approach has several problems which include among others totalitarianism and effectiveness problem. Such problems make it imperative to revisit another approach which is not suffering from such defects. The approach referred to is the Evolutionary approach discussed below.

2.5 Evolutionary Approach

The Evolutionary approach is a legislative technique involving the blending of various approaches. The legislator looks at society and develops a rule or law that suits the society. The said rule is neither arbitrary nor static. This approach is embraced with law generic perspective. Moreover the approach demands consultation with society. This ensures that the societal values are preserved. This approach is akin to the utopian instrumentalism.

Since ICT is changing and converging bringing in new challenges every now and then, it is more ideal to adopt this dynamic approach. Such an approach neither hampers the area to be regulated nor does it assume that the area to be regulated is unchangeable. In order to address threats posed by the emerging technologies such as ICT, the approach at hand ought to be adopted.

Although the Evolutionary approach resembles the Utopian approach as it emphasizes planning such approaches are dissimilar. Unlike Utopian approach Evolutionary approach is appealing for use of legislation as a

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74 See footnote 71.
76 The same could be said about the possibility of manoeuvring with the duration for protection of copyright. The copyright owner can manoeuvre by devising a Digital Rights Management System (DRM) which last beyond the time stated by the legislator.
77 See also: Koen Van Aeken, supra note 68 pp. 69–72
78 Albeit differently this approach has been explored by Koen Van Aeken, supra note 68 pp. 77–88
79 Ibid
legal framework in which approaches could work. The approach recognizes that for legislation to be sustainable it must be drafted in general provisions to avoid technology specificity. As for ICT penal legislation and as a requirement of Criminal law jurisprudence, the approach strives to guarantee certainty in penal legislation. Since, the role of the approach at hand is to secure the interests of the society; technologies such as Biotechnology, DNA and CCTV\textsuperscript{80} are employed to protect the society against crimes.

As opposed to the Instrumental approach, the Evolutionary approach acknowledges that the process of formulating and transmitting a rule to the subjects is not free from encumbrances which may affect the entire rule. Thus the approach demands Regulatory Impact Assessment and alternative to regulation.\textsuperscript{81} It is imperative that legislators and regulators employ such assessment as change and convergence of ICTs leaves legislation redundant. This approach therefore is more pragmatic as the legislation’s operating context has become more complex. Moreover, there are many factors hindering the linear legislative goal attainment.\textsuperscript{82} In as far as the modern world influenced by ICTs is concerned it is not surprising to find that the law enacted fails to attain the goal so set. The attainment of the legislation’s goal is a probability in the changing and converging world of ICTs.\textsuperscript{83} This could however be true even to other sectors and therefore not limited to ICTs. For that reason legislation should therefore be evaluated and shaped accordingly. This is the essence of Better Regulation (BR) and Regulatory Impact Assessment (RIA).


\textsuperscript{81} See: Koen Van Aeken; supra note 68, pp. 79–88

\textsuperscript{82} Ibid. p. 80.

\textsuperscript{83} Use of Surveillance Cameras under which the goal set by the legislator is to eliminate crimes has never been achieved. Crimes are being committed even in places where there are surveillance cameras. Law has a probability of reaching its goals; see: Koen Van Aeken, supra note 68 pp. 80–82.
3 Concluding Remarks

The aim of this article has been to take the debate further a field. Thus, it has tentatively explored the question of whether the change and convergence of ICTs can be overcome by the legislator. The aim has been to analyse the possibility of employing legislative technique as a cure to malaise among others the obsolescence of legislation resulting from change and convergence of ICTs. The article has therefore, albeit briefly, explored the approaches to legislative techniques. It is envisaged that, the article offers contribution to the field of theory of legislation or *legisprudence*. It is also expected to contribute to a foundation built by other legal scholars in this wake of law keeping pace with technology.

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**Reports, Articles in the Reports and unpublished papers**


3 IMPACT ASSESSMENT AND ADMINISTRATIVE BURDEN
IMPACT ASSESSMENT IN THE MULTI-LEVEL CONTEXT OF THE EUROPEAN UNION

Anne Meuwese

Abstract

‘Anglo-Saxon style’ impact assessment (IA) has made its way to the European Union (EU) policy process. Introduced as a mere change in internal procedures, the tool has had a remarkable impact on the way law and policy are being developed and decided upon in the EU. Specific characteristics of EU IA are its function as an ‘information tool’ rather than a ‘decision tool’ and the unique involvement of ‘non-executive’ bodies such as the European Parliament and the Council of Ministers. The paper highlights one particular dimension of the progressive institutionalisation of IA, namely how regulatory oversight mechanisms are emerging. In the final section, the paper deals with IA in the multi-level context of EU lawmaking: what use can Member States make of EU IA?

1 Introduction

An enthusiasm for what was long considered an ‘Anglo-Saxon’ approach to lawmaking has swept the EU in the past five years. After many doomed attempts to reform the regulatory environment in the 1990s, the European Commission put in place an ambitious set of regulatory reform initiatives under the label ‘Better Regulation’ from 2002 onwards. A simplification programme, a screening exercise of all pending legislative proposals and in 2005 a dedicated programme to reduce administrative burdens triggered by EU policies by 25% by 2012, just to mention some of the biggest eye-catchers. However, putting in place a comprehensive and integrated impact assessment (IA) system could be said to be the most ambitious initiative of all.\(^1\) The commitment to systematically carry out, in an early stage of the policy cycle, assessments of the potential economic, social and environmental implications of EU policy initiatives is unique to the EU, and is not to be confused with the Community law obligation for Member States to carry out ‘environmental impact assessments’ on projects or plans. See Council Directive 97/11 amending Directive 85/337 on the assessment of the effects of certain public and private projects on the environment, and Directive 2001/42 of the European Parliament and of the Council on the Assessment of the Effects of Certain Plans and Programmes on the Environment.

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\(^{1}\) This article is originally published in P. Kovač (ed.), Presoja učinkov regulacije v Sloveniji, Ljubljana: University of Ljubljana Press, 2009.

effects of all policy initiatives has required a complete overhaul of the traditional way of lawmaking in the European Commission and the other EU Institutions.

After a few years of remarkable silence, considering that the tool – by some accounts at least – is a “conscious exercise of legal borrowing” (Wiener, 2006) from the United States, impact assessment has been thrown into the limelight. Academic interest in European IA (hereafter ‘EU IA’) has boomed recently, raising or provoking as many new questions as the research it sparked has managed to answer. Who profits from IA? Can it ever be objective? How will the Commission’s commitment to assess impacts from the three pillars (economic, social and environmental) on an equal footing play out in practice when at the same time the new political direction for better regulation is tied to the Lisbon agenda (Radaelli, 2007)? Is this technocracy going crazy or have we finally become rational about lawmaking? This chapter is relevant for answering these questions but does not deal with them in-depth. The chapter starts from the assumption that EU IA tool is a procedural device for infusing the lawmaking process with economic analysis and scientific evidence. In the words of the policy documents on the subject: IA should “inform the legislator” by functioning as “an aid to decision-making, not a substitute for political judgment” (European Commission, 2002b). The chapter analyses the new impact assessment system from its early days as a pilot in 2003 to the current, highly institutionalized framework that is in place today. The main source of the potential transformative power of EU IA stems from the developing regulatory oversight mechanisms. Thus, this aspect will be dealt with in greater detail. Finally, the capacities of EU IA to serve as a multi-level tool, facilitating the involvement of actors from other levels than the supranational one, and in particular the Member States will be touched upon.

2 What is IA?

Impact assessment provides a format for assessing ex ante a range of regulatory activities. The core of IA is to assess the environmental, social and/or economic impacts of proposed regulatory interventions various societal groups. It is important to stress that although cost-benefit analysis (CBA) is an important component of many types of IA, IA does not equal CBA. CBA is a method for decision-making; impact assessment is a highly structured process of policy formulation which shows the methods adopted to assess different options and the test used for comparing them (which
could be a net-benefit test, but not necessarily so) and possibly reaching a
decision, who was consulted and what type of evidence was collected.

Another common misunderstanding is that ‘an IA’ is a document. However, IA is first and foremost a process that forces or encourages
decision-makers to follow certain analytical steps. True, an IA document
which documents the process and its findings is a crucial element which
guarantees the transparency of the process. The absence of such a
comprehensive, public, IA report has even led experts to question whether
certain national ex ante assessment frameworks the label ‘impact
assessment’ (Jacob et al., 2008). But the opposite situation: a tangible IA
report which contains nothing more than a checklist or which only pays lip-
service to an otherwise highly politicised process is worse on all accounts.
In the strongest, and some would argue ‘original’ type of IA, we often find
a legal requirement that only regulation which passes a cost-benefit test can
be enacted. This means that maximisation of net benefits decision criterion
has been laid down in a statutory provision beforehand. Often, this type of
strong IA is meant to compensate for the delegation of regulatory power
and to exercise a control function over, for example, US federal agencies.
As we will see below, the type of impact assessment that the European
Commission put in place differs markedly from this.

3 Putting in place an IA system in the
European Commission

In the wake of the White Paper on Governance, the European Commission
first set the tone with a report on Improving and Simplifying the
Regulatory Environment (European Commission, 2001) and subsequently
adopted a Communication on Better Lawmaking in 2002 (European
Commission, 2002a). In this latter communication three main categories of
measures to improve the EU lawmaking process were announced:

1) A programme to simplify and update the existing body of European
law;

2) The promotion a culture of dialogue and participation, through the
establishment of minimum standards for external consultations;

3) The systematic use of integrated impact assessment by the
Commission when preparing policy proposals.

The Action Plan also mentioned the long-term objective of developing a
‘common legislative culture’, which seemed to imply a call for greater
convergence among Member States’ lawmaking procedures (see section on
IA as a tool for multi-level lawmaker below). The 2002 package also contained a special communication on impact assessment which outlined the three main features of what was to develop as the integrated approach to impact assessment:

1) An integrated approach including the three ‘pillars’: environment, society and economy;
2) IA as an aid for decision-making;
3) A link with subsidiarity and proportionality. (European Commission, 2002b)

3.1 Specific features of EU impact assessment

The European Commission’s IA procedure conforms to the ‘text book’ template in the sense that it consists of a series of key analytic steps: problem identification, definition of the objectives, development of the main policy options, impact analysis, comparison of the options in the light of their impact and an outline for policy monitoring and evaluation. EU is said to be ‘integrated’, which means that a wide range of impacts (economic, social and environmental) expected from various options for new policies are considered.

Arguably, the one defining feature of EU IA is that there is no fixed decision criterion. The IA Guidelines by the European Commission recommend applying cost-benefit analysis where possible and without any obligation to choose the least costly policy option. Because IA is used in the first instance as an internal tool by non-democratically elected officials who are only mandated to prepare proposals and not decide on them, care is being taken to leave the final decision on what the content of a proposal should be to the College of Commissioners. But even the College does not have a ‘blank mandate’ to propose just anything. The Commission’s lawmaking powers are heavily restricted by the Treaty, which for many policy areas specifies certain policy goals to be pursued or certain considerations to be taken into account. A new framework for policymaking such as EU IA, which has not been put in place by a Treaty revision, but by ‘soft law’ and by changes in internal procedures only, cannot superimpose any decision criterion. Instead, the European Commission opted for a ‘soft touch’ procedural type of IA, where the main goal is to make lawmakers aware of the costs and benefits – or ‘impacts’ in the terminology preferred by the European Commission – associated with the legislation they plan to adopt and to make them aware of possible alternatives (Meuwese and Senden, forthcoming 2009). But IA is not only
meant to simply inform those involved in the formation of law and policy at the EU level. By structuring the policy process and by highlighting the trade-offs that the political decision-makers face, IA is envisaged to make more transparent the way in which various actors exercise their powers. The primary attraction of IA as a tool of Better Regulation is thus that it makes legislative actors more intelligent and more accountable. (Radaelli and Meuwese, 2009). However, it should be noted that this ‘soft touch’ comes at a price. EU IA, by not replacing political decision-making, has to accommodate other tools that support the political process, such as pressure from interest groups, political discussion in the cabinet, white papers and evidence produced by expert committees.

The above also means that the concrete uses that the policy process makes of IA can vary widely. In 2002 the impact assessment procedure was established by the European Commission following recommendations from the Mandelkern group on better regulation as a “general purpose impact analysis tool”. The ambition was to “integrate, reinforce, streamline and replace” all existing practices in the field of ex ante evaluation (European Commission, 2002c). EU impact assessment in its original form was based on the idea that competitiveness, sustainability and governance form a set of interlinked drivers of legislation, generating trade-offs that must be highlighted in the legislative process (Radaelli and Meuwese, 2009). Thus the original IA framework was set up as part of a Better Regulation strategy that was centralised and non-sector specific, relying on a regulatory philosophy according to which ‘quality’ comes before ‘quantity’ (Radaelli and Meuwese, 2009). But as the Better Regulation programme matured, things shifted slightly towards a clear political preoccupation with administrative burden reduction, with IA partially being put to the service of this much narrower, cost-oriented goal.

Impact assessment starts as early in the policy process as possible, long before the proposal is published or even prepared. At the stage of the Annual Policy Strategy (APS) Commission services publish a Roadmap which indicates what its plans and planning roughly are with regard to specific policy initiatives and what is envisaged in terms of impact assessment. The European Commission’s impact assessment procedure then follows the key analytical steps already mentioned above: problem identification, definition of the objectives, development of the main policy options, impact analysis, comparison of the options in the light of their impact and an outline for policy monitoring and evaluation (European Commission, 2005b). Stakeholder consultation and collection of expertise are integrated in the IA process and inform the wider assessment process. At the end of this internal assessment process, the Commission publishes
an IA report together with the proposal, which summarises the results and – ideally – highlights the trade-offs between the impacts associated with various policy options.³

3.2 The transition to a fully-fledged IA system

The Commission started off with a carefully orchestrated pilot phase in 2003, which was extended in 2004 to prepare for full operationality in 2005, when IA became obligatory for all proposals in the Commission’s Legislative and Work Programme (European Commission, 2005a). Recently, the Commission has decided to stretch the scope of application of IA beyond the Work Programme; where appropriate this could also include Comitology items (delegated lawmaking).

Part of the relative success of the IA tool, established also by an external evaluation of the Commission’s IA system in 2006–2007 (The Evaluation Partnership, 2007), is due to the fact that it has been integrated into the policy-making process (rather than superimposed at the end of it as an obligatory checklist). As such it has primarily become a tool for policy coordination among the various parts of the Commission administration, notably the Directorates-General (DGs). The IA Guidelines from 2005 already imposed an obligation to establish Inter-Service Steering Groups (ISSG) for each impact assessment process (European Commission, 2005b). The revised Guidelines of 2008, at least in the draft version that was available at the time of writing, tellingly renames those groups ‘Impact Assessment Steering Groups’ (European Commission, 2008a). Thus, the process through which DGs are supposed to agree on the content of a proposal is structured by the IA template. In the wider context of EU lawmaking, so outside of the preparatory phase at the Commission, IA is obviously only one mechanism among many that can play a role in operationalising principles in the daily practice of EU lawmaking, others being for instance pre-legislative scrutiny by national parliaments and judicial review. However, of all these mechanisms, IA is the one that most explicitly plays a role as a vehicle for various trade-off devices already at work in EU lawmaking such as subsidiarity, proportionality and the precautionary principle.

The year 2005 was a crucial one in the institutionalisation of EU IA in more than one respect. The ‘Common Approach to Impact Assessment’ was

³ Often simply referred to as the ‘impact assessment’ even if in fact the term ‘impact assessment’ covers the whole process and not just the report. All impact assessment reports can be downloaded from http://ec.europa.eu/governance/impact/practice_en.htm.
one of the key documents to be adopted in that. Although it has limited authority – at most it is one of the ‘informal’ inter-institutional agreements (Snyder, 1996) – it gave hands and feet to earlier commitments on the part of the European Parliament (EP) and the Council of Ministers in the 2003 Inter-Institutional Agreement on Better Lawmaking to use Commission IAs and produce their own IAs on ‘substantive amendments’. Yet, these commitments have so far proved difficult for both Institutions to deliver on.

The Parliament has struggled to integrate the production of impact assessments on amendments in its working procedures. Since all amendments are prepared at the Committee stage, it is mainly up to the ‘rapporteur’ to commission an impact assessment. Yet time is usually short and those who have pioneered EP IA, such as rapporteur Toubon in the case of the pre-packed products directive, have not necessarily achieved results (Meuwese, 2008, p. 236). More than the Commission, the Parliament is a hyper-political body, where the language of ‘interests’ and the decision-making mode of ‘negotiation’ are not easily replaced by ‘impacts’ and ‘highlighting trade-offs’. Another problem that the Parliament faced was a lack of expertise and a lack of dedicated budget. As a result impact assessments were commissioned from external consultants using the general research budget which on quite a few occasions led to a re-labelling of the reports as ‘studies’ because Members did not like the findings and were afraid that the impact assessment label would carry too much weight. However, the Parliament has set aside a special budget for impact assessments and there have been initiatives to train staff.

As for the Council, integrating impact assessment into the procedures has not proved the most difficult element, at least not at Working Party level. Under the Austrian Presidency an internal guidance document for Working Party Chairs was issued. And although the finer details of this guide seem to have gone lost in practice, the underlying idea of getting the Commission to illustrate its proposals by giving a presentation based on the impact assessment has caught on. The first problem, however, is to make IA part of the decision-making at the higher and more political levels, mainly COREPER. The second problem is that using Commission impact assessments is one thing, producing them on amendments is quite another. The emerging practice shows that much depends on the goodwill of the Member State holding the Presidency. Early on, The Netherlands led a successful experiment on one dossier, the directive on batteries and accumulators, and the United Kingdom has initiated a few. The Slovenian Presidency also made it a priority to make substantial progress on the use
of impact assessment in Council and even to learn from the European Parliament in this area.4

4 Regulatory review

No aspect of the design of the EU IA framework has received as much attention as the issue of quality control. Many commentators and stakeholders have argued in favour of an independent review body for IA, often from a conviction that such a mechanism would increase the chances of success for parliamentary review of IA. However, establishing such an independent, specialised body or awarding the task of IA review to an existing body has proved a few bridges too far at the moment, not in the least because of the constitutional problems such a move would trigger. But there are some incipient developments. A different kind of review mechanism has presented itself in the capacity of the newly established Impact Assessment Board (IAB), a purely internal body, but one with increasing internal and external leverage. Also, the Court of Justice, as final arbiter on the validity of EU law, has shown some signs of an ambition to play a role in IA oversight (Alemanno, 2009), albeit indirectly. Finally, in a recent development that will not be dealt with in-depth here for lack of published results so far, the Court of Auditors, long proposed as a candidate (Mather and Vibert, 2006), is venturing into the grey area between audit and regulatory oversight, previously only treaded on by the British National Audit Office (NAO).

4.1 The Impact Assessment Board

On 4 April 2006 President Barroso committed himself at a plenary debate at the European Parliament to establishing a quality control body for Commission impact assessments. Subsequently, on 14 November 2006, the European Commission officially confirmed this commitment (European Commission, 2006). A note by the President officially established the Impact Assessment Board (IAB), a novel type of body within the Commission and a hybrid between a control body and an advisory organ.

The Board consists of five Directors from different DGs who have been appointed in personal capacities, which means that they cannot commit their DGs concerning individual IAs and may not receive instructions from their

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4 Speech of the Minister of Public Administration Dr Gregor Virant at the Legal Affairs Committee of the European Parliament, 21 January 2008.
DGs.5 The current compilation includes DG Enterprise, DG Employment, Social Affairs and Equal Opportunities, DG Economic and Financial Affairs and DG Environment.6 These DGs were selected because they represent all three pillars of IA and because they have considerable experience in IA, having been actively involved in the pilot phase and the IA Working Group. The composition of the Board was a sensitive issue, raising concerns in the Commission services that the IAB would become a tool to block initiatives for substantive reasons even before they reach the stage of Inter-Service Consultation (DGs are required to submit their draft IAs one month before the launch of the ISC). The Board is chaired by the Deputy Secretary General and works under the direct authority of the President and reports directly to him. The Board members are supported by a secretariat consisting of officials from the Secretariat-General. Both internal and external expertise may be used on a case-by-case basis. The term of office of IAB members is two years with the possibility of extension.

The IAB is a hybrid body because it is part of subtle system of checks and balances rather than clearly exercising a regulatory overview task as the Office of Information and Regulatory Affairs (OIRA) in the United States Office of Management and Budget does. The IAB operates alongside internal Commission quality control mechanisms such as the support units in the DG, the presence of the SecGen in Inter-Service Steering Groups, the informal economists’ IA network which meets once a month over lunch, the IA working group which was continued after the 2005 stock-taking operation and the high-level group of national regulatory experts whose mandate covers only general policy advice. The task of the IAB is to “provide widespread quality advice and control whilst ensuring that the responsibility for preparing assessments and the relevant proposals remains with the relevant departments and Commissioners” and “contribute to ensure that impact assessments are of high quality, that they examine different policy options and that they can be used throughout the legislative process” (European Commission, 2006). It is envisaged that although quality control at the level of individual impact assessments will be the initial focus of the board, its activities will gradually broaden to “advice on methodology and on the approach at the early stages of impact assessment preparation” (European Commission, 2006). In the medium term the Commission expects the IAB to “offer advice and support in

6 This composition is entrenched in the current mandate of the IAB, see http://ec.europa.eu/governance/impact/docs/key_docs/iab_mandate_annex_sec_2006_1457_3.pdf.
developing a culture of impact assessment inside the Commission” and “to develop into a centre of excellence”.

The competences of the IAB were formulated whilst balancing carefully between the constitutional position of the Commission in terms of the Treaty and existing internal procedural rules. For instance, the idea of lending the IAB the power to issue ‘return letters’ – a competence many stakeholders in favour of strong review of IA would have liked to see included – was thwarted because it would breach the principle of collegiality (Article 217 EC Treaty) since the possibility of delegation to one commissioner only is limited to administrative acts. In other words: the Commission cannot simply establish a new body that has the de facto power to decide on legislative and policy proposals when this is a prerogative of the College of Commissioners. The outcome is that the IAB has no veto power but it is entitled to ask for resubmission of draft IAs, with the Secretariat General, represented on the Board in the person of the Deputy Secretary General, expected to guard the line between quality control and control over substance will become blurred. The IAB opinions are not binding but experience has shown that they are influential. The IAB also has the power to send DGs so-called ‘prompt letters’, asking them to carry out and IAs on items falling outside the current obligatory scope of items included in the Commission’s Work Programme.

Crucially, all IAB opinions are published online but only once the proposal and the IA themselves have been published. This is in order to avoid the IAB opinions being regarded as ‘previews’ of the real IAs by stakeholders. Probably for that very reason, stakeholders would have liked to see the opinions be made public earlier, but the Commission holds on to the position that this would undermine the necessary and constitutional space in which it can exercise discretion. 7

In January 2008, the Impact Assessment Board presented its first annual report on its experiences in the first full year of its existence, followed by a second one in 2009 (European Commission, 2008b, 2009). In the former report the Impact Assessment Board noted that it will, among other things, take an active role in encouraging the consideration of regulatory alternatives. A further suggestion is that its ‘early quality support function’ could be strengthened, if there are more explicit requirements for Roadmaps, such as more detailed information on the need for EU action, objectives of the initiative, options for action, provisions for appropriate data collection and stakeholder consultation.

7 Regulation 2001/1049 would probably have obliged the Commission to grant access to most of these opinions upon application by members of the public anyway.
A survey of the IA reports scrutinised by the IAB reveals a careful tone with a preference for incremental improvements, such as clearer justifications and the inclusion of more tables (Meuwese and Senden, forthcoming 2009). However, this approach is understandable given that the influence of the IAB clearly relies on (very) soft power. Anecdotal evidence suggests that the Impact Assessment Board does have an impact on the way Commission officials approach impact assessments and preparing proposals more generally, especially because it raises awareness of the tool among the higher ranks of the Commission administration.

4.2 The Court of Justice and IA

A quotation from Vice-President Verheugen nicely illustrates the possible link between the EU IA framework and the activities of the Court of Justice:

“If in the co-decision process Parliament and/or Council produce amendments, changes which are not only just minor but real changes, then there should be an Impact Assessment. If it is not there the Commission will make it very clear that the Commission does not feel that there is a sound basis for a proper decision.”

Since EU IA is meant to strengthen the evidence-base of EU legislative and policy measures it could become part of the grounds of review applied by the Court of Justice. But awareness of IA has only come to the Court fairly recently. For the moment, the threat of judicial review is having more of an impact on the lawmaking process than the actual case law, much along the lines of Stone Sweet’s remark that “[t]he spectre of constitutional censure hovers over the legislative process” (Stone Sweet, 1998, p. 119). Alemanno has pointed to a link between this judicial threat and the establishment and development of the IAB, asking whether Better Regulation and the IA framework in particular is not some sort of ‘trojan horse’ that the Commission will regret to have welcomed in its ranks (Alemanno, forthcoming 2009). Apart from some anecdotal evidence that IAs have been used by parties in judicial proceedings in front of the Court, there is one notable example of a case in which IA played a role. In case C-310/04 Spain v. Council the issue at hand was that Commission and Council had amended the rules on the aid to cotton farmers, decoupling, aid from actual

8 Vice-President Verheugen at his examination by the European Union Committee of the House of Lords on 4 July 2005.
production because the old system only led to overproduction. Spain objected and took the case to court, putting forward the argument that Commission and Council had failed to take labour costs into account, leading to a disproportionate outcome in the regulation concerned. On 16 March 2006 Advocate-General Sharpston in her opinion on this case explicitly mentioned impact assessment. She regarded IA, or rather the lack of it, as a factor in concluding that proportionality had been breached because it made choices by the Commission and the Council appear arbitrary, ignoring the Commission’s defence that no IA was required in this case. The Court agreed on the outcome of her conclusion and annulled part of Council Regulation 864/2004 for breach of the principle of proportionality. It also concurred with the Advocate-General in that failure by the Council and Commission to take into account certain relevant costs, were of crucial importance, but it did not attach similar importance to the absence of an official IA as such.

The limited engagement of the Court of Justice with IA could perhaps be expected given the established case law on the marginal review of the reason-giving requirement of Article 253 EC Treaty and the wide margin granted to the Institutions when it comes to applying the proportionality principle. And yet, the case has caused quite a stir within the EU Institutions, where civil servants are preparing for more involvement of the Court in IA through an increased judicial interest in the the evidence-base of lawmaking.

5 IA as a tool for multi-level lawmaking

The development and adoption of law and policy at the EU level takes place in a rather special setting: that of a multi-level environment in which the Member States still take up a very prominent position. The involvement of the Member States in their Council capacity has already been touched upon briefly above. The issue of what individual Member States can do to improve their involvement in EU lawmaking through impact assessment is a different matter. On the surface, Member States, who have always pushed the European Commission to carry out IA, are not very keen on getting too involved in the actual process themselves: the EU IA framework even contains a notable exception for legislative proposals under the so-called ‘Third Pillar’. Whenever Member States put forward a proposal in this area for which they have the exclusive right of initiative, an impact assessment
is not required. However, looking beyond the surface, we find plenty of initiatives from Member States in the field of impact assessment. Not only have many among them adopted IA-like tools in their national lawmaking processes (Jacob et al., 2008), they have also shown an increasing interest in the European tool (Meuwese, 2008).

From the side of the Commission, Member States are being encouraged to intervene using the means that are open to all stakeholders. The German federal government has taken this up by producing a guide for its civil servants, which has been translated into English, presumably for the sake of sharing best practices, explaining how to lobby effectively using impact assessments (German federal administration, 2006). The chapter on ‘Recommendations for action within the relevant ministry divisions’ offers the following piece of advice:

“...The quality and usefulness of IAs depend not only on Commission measures, but also on the active participation of Germany and other Member States. In order to ensure that German interests are effectively taken into account, it is important to assist the Commission in carrying out IAs and to keep a critical eye on the process from the very beginning. (...) By remaining aware of/participating in IA, Germany can also influence Commission proposals from an early stage, depending on the circumstances. In particular, it is important to clarify the possible impacts of a planned proposal on German interests” (German federal administration, 2006, p. 20).

There are two main paths that Member States can follow to ensure Commission impact assessments take specific national impacts into account. The first is an initial check at the Roadmap stage to make sure the IA work is planned in such a way that country-specific impacts are not overlooked. The second is a monitoring of the IA process, informally or through the consultation process while the Commission is still undertaking the work, and more formally once the IA has been published. For the IA process is not finished with the publication of the IA report. There is still the question of how the IA findings will be used from then on by the other Institutions involved in EU lawmaking. Impact assessments are also useful

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10 The European Commission considers this an instance of ‘institutional inequality’ and hopes to renegotiate the point when the Common Approach is next revised, see Meuwese, Anne C.M. 2008. *Impact Assessment in EU Lawmaking*. Kluwer Law International, The Hague.

11 However, it should be noted that some domestic ‘impact assessment’ tools bear very little resemblance to ‘text book’ IA. The most common deviations are the absence of a comprehensive IA report, a limited range of considered impacts and little or no economic analysis. For more information on IA procedures in Member States see the project website of the European Network for Better Regulation http://www.enbr.org/diadem.php.
tools as a basis for discussion with the Commission, other Member States and the European Parliament before and during the negotiations.

The United Kingdom, where impact assessment has long been an established tool domestically, is the Member State that is most active when it comes to integrating the use of this instrument into its standard procedure for negotiating European legislation. One concrete example is the UK ‘Regulatory Impact Assessment’ – as the British tool was then called – which helped convince other Member States that the European Commission proposal to set new emissions limits for vehicles undergoing a roadworthiness test had many practical weaknesses, including that the proposed limit values were not suitable for the timescale, and could in fact result in vehicles incorrectly failing the test. The UK government’s ‘Transposition Guide’ on ‘how to implement European directives effectively’ teaches civil servants that ‘[a]n RIA can be very effective as a tool, both to inform the negotiation and the transposition of a European directive’ (Cabinet Office). In line with the British habit of producing IA systematically at home, the guide focuses on the complementarity of the national IA and the Commission IA. The reasoning is that information that has been collected for a domestic IA is more likely to be relevant to an EU IA as well, since it can be presented already in an IA template. Also, given the special status that IA has acquired in EU lawmaking over a relatively short period of time, papers that are labelled ‘impact assessment’ are likely to have more authority in Brussels. This is partly a dangerous development. A simple re-labelling of position papers as impact assessment may give subjective advocacy an objective flavour with overburdened civil servants and lawmakers who do not have time to check the source of an ‘IA’ that is in front of them. However, if the popularity of the IA template gives stakeholders (in the broadest sense of the word, so including public stakeholders such as regions and Member States) an incentive to carry out more rigorous research by imposing the need to justify any methods used and reveal data sources, the development could be a good one.

A final way in which Member States can get involved in IAs is through their parliaments. One specific exercise to encourage this use was the one on joint subsidiarity scrutiny by national parliaments coordinated by the Conference of Community and European Affairs Committees of Parliaments of the European Union (COSAC). Two collective subsidiarity and proportionality checks were conducted; one on the Commission proposal on jurisdiction and applicable law in matrimonial matters (COM(2006) 399 final) and the second on the Commission proposal on the liberalisation of postal services (COM(2006) 594 final). The national parliaments repeatedly referred to the Commission’s impact assessment in
their reactions, often even to specific findings. On the whole the reactions to this experiment were positive, but many parliaments reported problems due to translation and, more importantly, to ‘information overkill’. This experiment suggests that ‘pre-digesting’ Commission impact assessment for use by national lawmakers is helpful. At the same time, research has shown that IA findings easily get misrepresented (Meuwese, 2008), so safeguards like the one-on-one transposition of tables used in the Commission IA to compare trade-offs are commendable.

An example of how governments can facilitate scrutiny of European proposals by national parliaments through impact assessment comes from the Netherlands. There it has long been a tradition to prepare ‘fiches’ which contain a summary of new EU proposals, specifically tailored to the needs of the Dutch Parliament. Since 2007 these fiches systematically contain a section on the Commission’s impact assessment for the proposal, including references to the opinion of the Impact Assessment Board and a link to the Commission’s IA website. It is unclear whether there is a causal link, but recently the findings of EU IA have been mentioned regularly in legislative debates in the Netherlands (Meuwese, 2009). Again, the risk here is that the government quotes too eagerly those parts of an impact assessment that support its preferred negotiation stance, whilst ignoring other parts. Also, the status of an impact assessment as an information tool only cannot be emphasised enough: an IA rarely proves anything, it merely structures the debate on a regulatory problem.

6 Concluding remarks

This chapter has demonstrated that impact assessment as it is used in the EU context, is more than just a superfluous checklist that nobody cares about. By elevating IA to the main tool for internal policy coordination and by watering down the ‘strong version’ of IA to a mere information tool, the European Commission has adapted impact assessment to the needs of the European lawmaking and policy processes. The establishment of an Impact Assessment Board has ensured that IA is taken more seriously by both internal stakeholders (the Commission services) and external stakeholders (mainly lobby groups, but also Member States for instance). The question always on everyone’s lips is ‘does it work?’. Do we really have better regulation because of impact assessment? This question has not been answered in this chapter, nor has it been anywhere really, not in the least because economists are still arguing over whether there is a good way to measure a macro-level effect of this kind. Evaluations of the effects of the
introduction of IA have to limit themselves to findings on a smaller scale. A slight culture change within the Commission towards more transparency, enhanced regulatory oversight and more ‘munition’ for Member States to scrutinise EU lawmaking are among those dealt with in this paper. A lot of problems surrounding EU IA remain, not in the least with its implementation in the European Parliament and the Council, but there are at least as many existing flaws that were only exposed by the introduction of IA, such as the difficulty of processing evidence in politicised processes.

References


MEASURING AND REDUCING
ADMINISTRATIVE COSTS AS AN
INSTRUMENT FOR REALISING BETTER
REGULATION IN EUROPE:
Recommendations for Improving the Standard
Cost Model by Using Management Accounting
Expertise

Lena Deuschinger and Gunther Friedl

Abstract

During the last few years the measurement and reduction of administrative costs has become a very important instrument for improving regulation in the European Union (EU) and its Member States. Administrative costs are defined as the costs incurred by enterprises and other institutions in meeting legal obligations to provide information on their activities or production, either to public authorities or to private parties (European Commission 2009a, p. 45). To quantify this kind of cost most governments have chosen the Standard Cost Model, which was originally developed in the Netherlands. The application of the model differs slightly in each country but the basic assumptions are identical. The Standard Cost Model seems to be a practical method and is widely-used. But does it quantify the cost of bureaucracy in a realistic and accurate way?

An analysis from a business point of view shows that the model is based on well-founded considerations on the one hand. On the other hand, clear weak points are recognizable and an advancement of the model based on findings from management accounting research shows promise. Management accounting provides solutions for the measurement and structuring of costs and the assignment of costs to cost objects in companies. This knowledge can be transferred to the measurement of administrative costs. In this paper we are examining administrative costs from a company’s point of view and presenting a conceptual advancement of the Standard Cost Model.
1 The Better Regulation initiative of the European Commission and the role of reducing administrative costs

In the context of the renewed Lisbon Strategy, the European Commission has launched a strategy on Better Regulation to ensure that the regulatory framework in the EU contributes to achieving growth and jobs, while continuing to take into account the social and environmental objectives and the benefits for citizens and national administrations. This policy aims at simplifying and improving existing regulation, at better designing new regulation and at reinforcing the respect and the effectiveness of the rules, all this in line with the EU proportionality principle (European Commission 2009b). The European Commission’s target is thus a more effective and less burdensome regulation instead of deregulation and liberalization of the European market.

For realising Better Regulation, the European Commission is using an array of instruments (European Commission 2006, p. 6):

- Introducing a system for assessing the impact and improving the design of major Commission proposals
- Implementing a programme of simplification of existing legislation
- Testing Commission proposals still being looked at by the Council of Ministers and the European Parliament to see whether they should be withdrawn
- Factoring consultation into all Commission initiatives
- Looking at alternatives to laws and regulations such as self-regulation, or co-regulation by the legislator and interested parties.

An important success factor for simplifying and improving legislation is regulatory impact assessment (RIA). It allows estimating or calculating the economic, social and environmental impacts of existing laws or alternative policy options. With the help of RIA proposals can be tailored to the needs and negative side effects can be minimised at the same time. Administrative costs are one type of impact arising from laws.1 In this article we are going to take a closer look at administrative costs, its characteristics and methods to quantify them. For this purpose we adopt the definition of administrative costs used by the European Commission: “Administrative costs are defined as the costs incurred by enterprises, the voluntary sector, public authorities and citizens in meeting legal obligations to provide information on their action or production, either to public authorities or to private parties. Information is to be construed in a broad sense, i.e. including labelling,

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1 Nijsen describes different types of costs caused by regulation. See Nijsen et al. 2009, pp. 30.
reporting, registration, monitoring and assessment needed to provide the information.” (European Commission 2009a, p. 45)

An example illustrates the definition: “A regulation on air quality sets an obligation to keep a register of pollutant emissions and an obligation to meet an air pollution threshold. Keeping a register of pollutant emissions is an administrative cost, while action taken to meet an air pollution threshold is not. That type of compliance cost is sometime referred to as ‘substantive cost’ because the obligation affects the essence of the (industry) activity. Keeping a register does not entail in itself any obligation to change the production process, the nature of the end-products or the treatment of emissions. Meeting the pollution threshold will require a substantive change at these levels (for instance the installation of new filters).” (European Commission 2009a, p. 45)

The European Commission as well as many European Member States are committed to reduce administrative costs by simplifying existing laws and improving future legislation. It is important to mention that reducing administrative costs does not mean abolishing necessary information obligations.² It is aiming at making laws less time-consuming, easier to understand and more effective where possible, instead. Although administrative costs are incurred by enterprises as well as by the voluntary sector, public authorities and citizens, we will focus on the measurement of administrative costs arising in enterprises. We will examine these costs from a company’s point of view.

To quantify this kind of costs the European Commission and several governments within the EU Member States have chosen the Standard Cost Model (SCM) which had originally been developed in the Netherlands (Nijland 2008). The application of the model differs slightly in each country, but the basic assumptions are identical. The SCM seems to be a practicable method and is widely-used. But does it quantify the cost of bureaucracy in a realistic and correct way? And if not which conceptual advancements of the SCM are required for supporting the reduction of unnecessary administrative costs at the best?

To be able to answer these questions, we have to consider two major challenges which are critical for a permanent successful reduction of administrative costs within Europe.

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² The term information obligation is as a synonym for legal obligation.
• Concerted actions and standardized methods in the EU and its Member States
Success in simplifying existing law and improving future legislation depends on the EU Member States to a great extent. They have primary responsibility for the correct and timely application of EU Treaties and Legislation (Commission of the European Communities 2007, p. 3). This affects the transposition and implementation of EU law as well as the quality of national and regional regulation. Thus, not only the European Commission but also the Member States need to have a strategy and an institutional structure supporting the reduction of administrative costs. Additionally, a model for measuring administrative costs is necessary to be able to plan and control the reduction of unnecessary costs. As the improvement of legislation has to be a European initiative which requires a concerted action of all Member States, a standardized way of assessing administrative costs is essential. Only if administrative costs in different countries and departments are being assessed in the same standardized way, the data is comparable and enables to work with on European, national and regional levels.

• Long-term program which guarantees an enduring decrease in administrative costs
The majority of EU Member States have taken actions in the measurement of administrative costs and the reduction of burdens. Many ad-hoc initiatives are being launched: Most countries started with measuring administrative costs arising from existing national laws and developed and determined simplification measures. But one-time projects and the focus on improving existing laws is not enough for lasting success. Strategic concepts which can be integrated in the lawmaking process are necessary for ensuring long-lasting positive effects. However, only few of the Member States have developed a comprehensive simplification programme to date. For this reason, it is essential to include new legislative proposals systematically in the impact assessment. Draft laws have to be evaluated regarding their impact on administrative costs. During the legislative process different regulatory alternatives have to be compared in terms of different criteria like economic, social and environmental impacts. The administrative costs have to be one of these criteria.

The structure of this paper is as follows. Section 2 starts with an overview on academic research and literature on administrative costs. In section 3 we will explain the basics of management accounting which are important for the analysis and advancement of the Standard Cost Model. Besides, we point out the characteristics of administrative costs. The requirements for a model for measuring administrative costs are defined in section 4. Based on these requirements an analysis of the EU Standard Cost Model will show the strengths and weaknesses of this instrument in section 5. Section
6 considers the weaknesses of the model and shows how a conceptual advancement of the Standard Cost Model enables a more accurate measurement of administrative costs. Section 7 concludes and indicates the need for further research.

2 Academic research and literature on administrative costs

While Better Regulation is playing an important role in politics at EU and at national level research has been relatively slow to respond to the new developments. There are few edited books and public policy research papers dealing with this topic (Radaelli, Meuwese 2009; Radaelli, Meuwese 2010; Wiener 2006). Especially for the evaluation of the results of Better Regulation initiatives, measures for quantifying the outcome are necessary (Nilsson et al. 2008; Nijsen 2009). Meanwhile, a range of publications on RIA is available (Verschuuren, van Gestel 2009; Radaelli 2009). Measuring and reducing administrative costs in particular became one of the most important instruments for realising and evaluating Better Regulation. Already in the 1970s, scholars and consulting companies started to conduct studies to quantify administrative or regulatory costs in companies. A summary of studies of regulatory costs can be found in Elliehausen (Elliehausen 1998, p. 31). Another study to compare administrative costs in Europe has been conducted by the OECD (OECD 2007). From 2003 on European governments began measuring administrative costs arising from laws. There are manuals indicating how to quantify administrative costs (European Commission 2009a, Statistisches Bundesamt 2006). They are mainly published by governments for promoting and simplifying the reduction of administrative costs in their countries. However, there is hardly any research dealing with the analysis and improvement of existing methods to measure administrative costs (Keyworth 2006; Den Butter et al. 2009).

In summary research on Better Regulation and the measurement of administrative costs in particular exists. There is a focus on describing and analysing the historical development and the current situation (Radaelli, Meuwese 2009, pp. 642). Besides, scholars started to develop a conceptual framework to put available results into context. Existing research shows that many countries have still not gone further than pilot projects in RIA (Radaelli, Meuwese 2009, p. 644). According to Nilsson et al. the use of assessment systems is differentiated and on the whole very limited, in particular when it comes to more advanced tools (Nilsson 2008, pp. 335). Regarding the measurement of administrative costs a well-founded analysis
of the existing measuring instruments is still missing. The existing research results are demonstrating that there is need for further research.

3 Basics of management accounting and characteristics of administrative costs

Costs are defined as a resource sacrificed or foregone to achieve a specific objective (Bhimani et al. 2008, p. 38). As costs are playing an important role in a company, management accounting was developed to help managers understand the costs of running a business. Traditionally, costs are being measured, structured and assigned to cost objects which are the products or services the company sells. It is the company’s goal to plan and control its costs and thus maximize its profitability.

Administrative costs are a special type of costs: As they are arising from legal information obligations which have to be fulfilled, companies barely have the possibility to control or reduce these costs. Hence, it is the lawmaker’s responsibility to create laws in a way that any company concerned does not suffer from unnecessary burdens caused by administrative costs. To be able to make this burden as low as possible the lawmaker has to know the administrative costs arising from different information obligations. Administrative costs are being calculated for fulfilling one information obligation. The information obligation thus serves as a cost object in this case.

To get precise information on administrative costs, data has to be collected from the companies concerned. Elliehausen discusses several methods to measure regulatory costs. He compares inferring costs either by econometric methods or by collecting the data from companies by using case studies or surveys. According to his results case studies “can provide accurate and comprehensive information about regulatory costs at the institution studied. “ (Elliehausen 1998, p. 11) This task is challenging as costs arising from legal compliance are not classified as regulatory or administrative costs in a company’s accounting system (Joshi et al. 2001, pp. 171, 190). Most companies are structuring their costs in cost types like material, labour and overhead (Weetman 2003, pp. 500). Then costs are being assigned to cost objects. Administrative costs are included in these costs. As they are ‘invisible’ and hardly ever reported individually, they are hidden costs (Joshi et al. 2001, p. 171). To calculate or assess administrative costs the necessary cost data has to be collected for this purpose. Using existing data is rarely possible. In the next chapter we are discussing requirements for a model for measuring administrative costs. Management
accounting supplies solutions for the measurement and structuring of costs and the assignment from costs to cost objects in companies. This knowledge can be transferred to measuring administrative costs.

4 Requirements for a model for measuring administrative costs

A methodical approach is needed to be able to quantify costs which arise from fulfilling a legal information obligation. In this chapter we will define the following four requirements for a model for quantifying administrative costs.

a A correct, but also clear and comprehensible model

The various kinds of ex ante and ex post evaluation methods applied for assessing the impact of regulation are met with criticism, sometimes. As a model for measuring administrative costs is one of these methods, we have to deal with these critical comments. There are two major points which have to be considered when assessing or designing a model for quantifying administrative costs: “Firstly, most evaluations of laws in the past have failed to feed the lawmaking process because of bad timing. The policy cycle usually revolves quicker than the research cycle, with the result that ‘real time’ evaluations often have little influence on law and policymaking.” (Verschuuren, van Gestel 2009, p. 5) Secondly, the used methodology is often unclear (Köck 2002, pp. 1–21). Some governments have published manuals explaining their approach of measuring administrative costs but in many cases the explanations are rather vague.³ Reports on conducted impact assessments are rarely available, especially on national level. For this reason, the European Commission claims a more systematic assessment of economic, social and environmental impacts and more transparency on the results (European Commission 2009c). Consequently, a methodology for quantifying administrative costs has to be a systematic and very well elaborated approach leaving no lack of clarity. At the same time it has to be reduced to its bare essentials to enable the user to do an assessment of administrative costs in a relatively short time. Unnecessary complexity would make the application of the model too costly and time-consuming. Furthermore, the method must be described clearly and comprehensibly in order to increase its acceptance.

³ An example will be given later.
b Assessing administrative costs imposed by both existing and planned legislation

Administrative costs can be minimized by simplifying existing laws as well as by making new laws less costly. As mentioned above, many European governments and the European Commission have started initiatives to measure administrative costs imposed by existing laws, the so-called ex post assessment, for companies. Simultaneously, potentials to unburden companies were identified and the governments have begun simplifying information obligations and reducing the cost impact (Verschuuren, van Gestel 2009, p. 7). As a next step, the measurement of administrative costs with a forward looking perspective, a so-called ex ante evaluation, has to be integrated in the legislative process of the Member States: In the future there will be a focus on designing new laws as cost-efficient as possible while fulfilling the political goals (Commission of the European Communities 2009 b, p. 7). Thus, one important requirement for a model is the ability of measuring administrative costs from an ex post perspective as well as from an ex ante perspective.

c Measuring all relevant costs arising from an information obligation

Costs are a resource of a company sacrificed to achieve a specific objective. In the case of administrative costs this objective is to observe a law by fulfilling an information obligation. “The total cost of a regulation is the cost of performing all the activities that it requires.” (Elliehausen 1998, p. 3) Relevant costs which have to be considered are thus all costs arising from the fulfilment of an information obligation. Traditionally management accounting theory is defining different types of costs like

- Labour costs
- Material costs
- Overhead costs (Bhimani et al. 2008, pp. 38)

Referring to costs arising from regulation other cost types are important (Elliehausen 1998, p. 3)

- Legal costs
- Consultancy costs
- Costs for restructuring and modifying information systems
- Costs for programming and testing software
- Training costs
- Outsourcing costs (if administrative activities are contracted out)
- Depreciation costs
All these types of costs may arise in a company for complying with an information obligation. Categorising costs in cost types helps us getting a general idea of relevant costs. A model for measuring administrative costs has to consider all these types of costs.

The use of a standardized methodology which supplies comparable data

Legislation in European Member States is more and more determined on EU level. This requires a close cooperation of the concerned countries among each other and with the European Commission. A standardized methodology and comparable cost data are enabling an efficient teamwork within Europe. An EU draft, for example, is often meant to replace 27 different national legislations and decrease total administrative costs. For this purpose, cost data indicating the cost burden before and after the unification of the legal rules is necessary for evaluating the effectiveness of the simplification measure. Comparable cost data is also useful for conducting cross-country or cross-policy area comparisons, benchmarking, comparing regulatory alternatives implemented in different countries and elaborating best practices. Hence, there should be a standardised model which can be used all around Europe and supplies comparable cost data.

In the next section we will explain the EU Standard Cost Model (EU SCM) and examine if the model fulfils the requirements and in which parts an improvement of the model is necessary.

5 Analysis of the EU Standard Cost Model

“The SCM was designed to measure the administrative consequences for businesses, when complying with legislation.” (OECD 2007, p. 29) It has originally been developed in the Netherlands in the 1990s (OECD 2007, p. 114). Meanwhile, the EU and many of its Member States have adjusted the model in order to use it as well. The model offers an approach for quantifying administrative costs caused by an information obligation for all the businesses concerned. It is an activity-based methodology assuming that fulfilling an information obligation can be divided in single activities. According to the SCM standardized types of activities can be defined which cover most of the activities necessary to fulfil an information obligation, for example ‘Retrieving relevant information from existing
data’, ‘Producing new data’ or ‘Submitting the information to the relevant authority’ (European Commission 2009a, pp. 45–50).

According to the SCM, administrative costs have to be assessed on the basis of the average cost of the required administrative activity (price) multiplied by the total number of activities performed per year (quantity). The average cost per action is generally estimated by multiplying a tariff and the time required per action. The tariff is based on average labour costs per hour. In the EU SCM overheads are included; in the manuals of other European countries like Germany prorated overheads are not included in the administrative costs (Statistisches Bundesamt 2006, p. 22). Other types of costs such as outsourcing are taken into account both in the EU SCM and in the German model, whereas equipment or supplies’ costs are part of the administrative cost on EU level but not in Germany.

The quantity is being calculated as the frequency of required actions multiplied by the number of entities (companies) concerned. In case of multiple relevant administrative activities per information obligation these need to be summed up to calculate the administrative costs per information obligation (European Commission 2009a, p. 46).

\[
C_a = \sum_{i=1}^{n} c_i t_i m_i f_i
\]

\(C_a\) = Total administrative costs  
\(n\) = number of legal information obligations  
\(c_i\) = average costs per hour to fulfil one legal information obligation  
\(t_i\) = time required to fulfil one legal information obligation  
\(m_i\) = number of companies concerned  
\(f_i\) = frequency of fulfilment

Table 1  The core equation of the EU Standard Cost Model

The Standard Cost Model seems to be a practicable method and is widely-used. A major part of the European Member States is using the SCM to quantify administrative burdens (SCM Network 2010). But does it quantify the cost of bureaucracy in a realistic and correct way? And does it fulfil the requirements defined above? An analysis of the model will help us to answer these questions. As the application of the SCM differs slightly within the Member States and on EU-level, we will refer to the EU SCM for the analysis (European Commission 2009a, p. 50).
Activity-based costing (ABC) is a costing model that identifies activities in an organization and assigns the cost of each activity to all products and services according to the actual consumption. In a business organisation, the ABC methodology assigns an organisation's resource costs through activities to the products and services provided to its customers. The SCM uses this approach to measure administrative costs. Instead of products or services the cost objects in this case are the information obligations. Calculating administrative costs based on average costs per action for one company is one appropriate way. Other methods like econometric models to calculate regulatory costs deliver vague results which are not suitable for the reduction of administrative costs (Elliehausen 1998, pp. 5). Using an activity-based approach is a comprehensible, practicable and convenient way to estimate administrative costs uncomplicated and quickly. The fact it is meanwhile used in many countries worldwide shows the acceptance of the SCM.

Assessing administrative costs imposed by both existing and planned legislation

The EU SCM aims at delivering a guideline for measuring administrative costs imposed by legislation. There are remarks which make clear that the model should be used to assess the impact of both existing and planned legislation (European Commission 2009a, pp. 45, 51). But in this approach there is no distinction between an ex post assessment and an ex ante evaluation. It must be pointed out that the two types of assessment differ: Measuring costs of existing laws from an ex post perspective is based on existing data. As concerned companies already fulfill the information obligations for some time they are able to deliver information about the required activities and the costs arising from these activities. Based on these data, administrative costs can be calculated. The EU SCM delivers a detailed guidance how to proceed in this case (European Commission 2009a, p. 60). An ex ante evaluation in contrast rests upon a forecast. For the planned information obligation the required activities, the activity duration and the frequency have to be predetermined as well as the cost parameters and the number of entities concerned. The EU SCM gives instructions how to do that by giving an overview of possible types of actions, a list of relevant cost parameters and an outline on data sources respectively a guidance for approximating numbers (European Commission 2009a, pp. 50–60). Regarding the planning of the required
activities, the activity duration and the anticipated costs the instructions
in the manual are not sufficient. A concept how to predict these variables in
an easy and cost-efficient way is missing.

The distinction between ongoing (recurring) administrative costs and
start-up (one-off) administrative costs is another important issue. Ongoing
costs incur each time an information obligation has to be fulfilled. Start-up
costs arise when a law is enacted and companies have to adapt to a new legal
situation. In the EU SCM a differentiation is made. “Recurring
administrative costs and, where significant, one-off administrative costs have
to be taken into account.” (European Commission 2009a, p. 45) But further
guidance is missing. Many questions are remaining unanswered: How can
ongoing costs and start-up costs be distinguished? In which cases are start-
up costs significant? In which way should they be taken into account?

c  Measuring all relevant costs arising from an
information obligation

According to the EU SCM “it is assumed that the main costs induced by
information obligations are labour cost.” (European Commission 2009a, p.
52) They are composed by the gross salary plus 25% overhead costs by
default. Furthermore, the model considers outsourcing costs. In addition,
equipment costs (depreciation costs) or supplies’ costs should be taken into
account where appropriate (European Commission 2009a, p. 52). Several
cost types which also may arise for fulfilling an information obligation are
not mentioned in the manual:
- Legal costs
- Consultancy costs
- Costs for restructuring and modifying information systems
- Costs for programming and testing software
- Training costs

The EU SCM is thus neglecting certain costs types.

d  The use of a standardized methodology which
supplies comparable data

A standardized proceeding for assessing administrative costs would make
results internationally comparable and help simplifying European law in a
consistent and harmonized way. But different national interpretations of the
SCM regarding the relevant costs which are taken into account are
preventing these possibilities: Data on administrative costs from different
European countries is not comparable (Commission of the European Communities 2009a, p. 10.). Given different approaches for data collection at national level, estimating the total administrative costs of European companies is very complex or even impossible. Reducing administrative costs on EU level is difficult since the net reduction can’t be calculated and the advantage of the initiative can’t be assessed.

To illustrate the differences and show why administrative cost data from different institutions or countries are not comparable we will check the EU SCM against the German SCM (Statistisches Bundesamt 2006, pp. 20). The EU SCM considers labor costs including 25% overhead costs. In contrast the German SCM takes labor costs into account without adding an overhead rate. In the German SCM supplies’ costs are not taken into account (Statistisches Bundesamt 2006, p. 21). Both models consider outsourcing costs. According to the German SCM, costs for equipment which was only acquired to fulfil a certain information obligation may be taken into account. There is no further guidance indicating in which cases they should be taken into account (Statistisches Bundesamt 2006, p. 22). The analysis shows that approaches of the SCM differ regarding relevant costs types which have to be considered. As a consequence cost data are not comparable. For this reason also the European Commission sees a need for “further data harmonisation and comparability.” (Commission of the European Communities 2009a, p. 9)

A consolidated view indicates that the SCM is based on well-founded considerations. An activity-based approach fits very well for this purpose. On the other hand, weak points are clearly recognizable:

- A distinction between ex post and ex ante assessment is missing within the SCM. An ex ante evaluation rests upon a forecast and predicting all relevant variables is a challenge. Furthermore, new laws do not only cause ongoing costs but also start-up costs. Hence, a specific guidance is essential for enabling users to conduct a correct ex ante evaluation and to distinguish start-up and ongoing costs.

- The adaption of the SCM differs in European countries, especially regarding cost types which have to be considered. This leads to the following question: Which cost types are relevant and thus have to be considered in a model for measuring administrative costs? A consensus in this question will lead to a harmonisation of the concept and will be the basis for a standardized model providing internationally comparable results.

An improvement of the model based on expertise from management accounting research seems to be promising. In the next section we will present a conceptual advancement of the SCM in order to eliminate these weak points.
6 Conceptual advancement of the Standard Cost Model

6.1 Ex ante evaluation of administrative costs by drawing analogies

The ex ante evaluation aims at assessing the anticipated administrative consequences of a draft law, draft executive order or other initiative. It forecasts the administrative costs presumably arising from a rule or initiative which may be implemented in the future. The results from an ex ante assessment deliver information on expected administrative costs and provide a basis for choosing the best draft alternative or for improving a draft law. For the ex ante evaluation an outline how to proceed is missing in the EU SCM. As ex ante measurements differ notably from ex post measurements a suitable methodology is necessary. We will present a concept how to predict variables like

- required activities
- the activity duration
- the anticipated costs.

By now the SCM proposes to calculate administrative costs using an activity-based approach. Calculating administrative costs caused by an existing information obligation is based on historical cost information. Assessing administrative costs from an ex ante perspective in contrast is based on forward looking information. As a calculation is not possible in this case, a cost forecast has to be conducted instead. Elliehausen proposes to use analogies (Elliehausen 1998, pp. 9. The European Commission also proposes to use analogies in the Guidelines, but there is no further instruction how to proceed). This means that administrative costs can be estimated by drawing analogies between activities required by an information obligation and activities for which data are available. This may be activities undertaken to comply with already existing information obligations or business activities.

We use an example to demonstrate this method: In 2002 a legislative initiative on the energy performance of buildings was adopted in the European Union (The European Parliament and the Council of the European Union 2002). As a consequence the Member States have to apply minimum requirements regarding the energy performance of new and existing buildings, ensure the certification of energy performance and require the regular inspection of boilers and air conditioning systems in buildings (European Union 2007). Buildings have to be certified for their
energy efficiency since the transposition and implementation of this EU law in the European countries. Hence, businesses like building companies have to fulfill a new information obligation. The companies concerned have to make energy performance certificates available for their customers when buildings are sold or rented. Before the commencement of the act the administrative costs which would be caused by this information obligation could have been calculated by using analogies. As mentioned above analogies can be drawn from activities undertaken to comply with already existing information obligations. For example, an information obligation requesting an emissions report from energy suppliers may necessitate similar activities and cause similar costs. Equipment to measure the data has to be acquired. The data must be detected, collected and subsumed in a report. The findings on required activities, activity duration and anticipated costs to fulfill this information obligation can be applied to predict the costs for the new information obligation on energy efficiency. On the other hand business activities can be used to draw a comparison. Building companies design real estate flyers to inform their customers about the property details. The marketing or sales department of a building company can deliver data on required activities, activity duration and anticipated costs to design a real state flyer. Based on these data administrative costs arising from the creation of an energy performance certificate can be predicted. To determine the required activities and the activity duration it is promising to use the support from a company’s functional department like purchasing, production, marketing, or sales. Potential sources of cost data include the departments of controlling, cost accounting and book keeping.

Drawing analogies between activities required by an information obligation and other activities for which data are available may deliver results which are not consistent with other data and not representative. Hence, it is useful to make several case studies based on analogies to be able to test if the findings are consistent. Despite this limitation, this method has two important advantages: It is neither time-consuming nor expensive since the cost calculation is based on existing data. Besides, even if the resulting cost data are not representative the exercise of carefully identifying the activities required indicates how burdensome the information obligation will be (Elliehausen 1998, pp. 9). Nevertheless using analogies with existing activities is a convenient way to forecast administrative costs which will probably be caused by a future law. This method can easily be integrated in the existing SCM and delivers reliable data.
6.2 Differentiation between start-up costs and ongoing costs

There are two different decision situations concerning the reduction of administrative costs: the ex post assessment of an existing information aims at estimating the current cost burden for companies. The results serve as a basis to simplify existing laws and thus reduce administrative costs. In contrast, an ex ante evaluation refers to future law which should be designed in a way that cost burdens are as low as possible. In each decision situation it is important to identify and consider the relevant costs (Hilton 2009, p. 592). In accounting theory a distinction is being made between ongoing costs and start-up costs. Start-up costs are costs “related to one-time activities for opening a new facility, introducing a new product or service, conducting business in a new territory, conducting business with a new class of customer, initiating a new process in an existing facility, or starting new operation.” (Nikolai et al. 2009, p. 476) In a legal context start-up costs are arising in a company each time a new law is enforced: “Start-up costs are one-time costs of implementing changes to conform to the requirements of a regulation.” (Elliehausen 1998, p. 3) Ongoing costs in contrast are the recurring costs of performing the activities required by a regulation. In the case of administrative costs, ongoing costs arise each time an information obligation has to be fulfilled.

We made a distinction between measuring administrative costs from an ex post perspective and from an ex ante perspective. Are start-up costs and ongoing costs relevant in both cases? In case of an ex post assessment of administrative costs, the law committing a company to fulfil an information obligation already exists. Hence, the company already adapted to the legal situation and start-up costs have already incurred. This kind of costs is called sunk costs: They are costs that have been created by a decision made in the past (the decision of the company to adapt in a way that enables the company to comply with the law) and that cannot be changed by any decision that will be made in the future (for example by an amendment) (Drury 2008, p. 36). For an ex post assessment of administrative costs thus it is justified to consider only ongoing costs. Start-up costs are sunk costs in this case and no more relevant. Ex ante evaluation of administrative costs is being made before a new law is enacted. The company which will probably be concerned by the future law does not yet have any costs caused by the draft, neither start-up costs nor ongoing costs. In this situation start-up costs as well as ongoing costs can still be influenced by the lawmaker. Hence, both types of costs are relevant.
According to these definitions start-up costs and ongoing costs can be specified: Start-up costs include legal costs for interpreting the regulation, advising managers and reviewing procedures and forms as well as labour costs for reviewing and revising procedures and forms, coordinating compliance activities and designing internal audit programs. Furthermore, they contain consultancy costs, costs for restructuring and modifying processes and information systems, costs for programming and testing software and training costs. Ongoing costs contain managerial labour costs for monitoring employee compliance and coordinating compliance examinations with regulatory agencies. Besides, there are labour costs for fulfilling the information obligations, legal costs for reviewing complaints, material costs for printing, postage and similar actions, outsourcing costs in case of contracting out administrative activities, depreciation costs and overhead costs (Elliehausen 1998, p. 3). Table 1 gives an overview.

<table>
<thead>
<tr>
<th>Start-up costs</th>
<th>Ongoing costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>● Legal costs for</td>
<td>● Managerial labour costs for</td>
</tr>
<tr>
<td>○ interpreting the regulation</td>
<td>○ monitoring employee compliance</td>
</tr>
<tr>
<td>○ advising managers</td>
<td>○ coordinating compliance examinations with regulatory agencies</td>
</tr>
<tr>
<td>○ reviewing procedures and forms</td>
<td>● Labour costs for fulfilling the information obligations</td>
</tr>
<tr>
<td>● Labour costs for</td>
<td>● Legal costs for reviewing complaints</td>
</tr>
<tr>
<td>○ reviewing and revising procedures and forms</td>
<td>● Material costs (printing, postage etc.)</td>
</tr>
<tr>
<td>○ coordinating compliance activities</td>
<td>● Outsourcing costs (if administrative activities are contracted out)</td>
</tr>
<tr>
<td>○ designing internal audit programs</td>
<td>● Depreciation costs</td>
</tr>
<tr>
<td>● Consultancy costs</td>
<td>● Overhead costs</td>
</tr>
<tr>
<td>● Costs for restructuring and modifying processes and information systems</td>
<td></td>
</tr>
<tr>
<td>● Costs for programming and testing software</td>
<td></td>
</tr>
<tr>
<td>● Training costs</td>
<td></td>
</tr>
</tbody>
</table>

Table 2 Start-up costs and ongoing costs: Relevant cost types

The distinction between start-up costs and ongoing costs and thus a distinction between relevant and irrelevant costs is not always clear-cut. For instance equipment like an infrared camera and computer software to detect and evaluate the energy performance of a building has to be acquired when the new law has been enacted and the information obligation has to be fulfilled. Although there is only one acquisition within several years the camera and the software will be used each time an energy certification has to be prepared. One key accounting principle to help identifying relevant costs of a decision is the matching principle. This principle says that expenses are recognised not when they are paid but during the period when they effectively contribute to the firm’s revenues (Hawawini, Viallet 2007,
In fact fulfilling an information obligation generally does not generate revenues but companies avoid getting a penalty which would have a negative effect on their revenue. A fixed asset, for example a computer is expected to be used for several years to generate statistical data for an information obligation. As time passes the value of this asset is expected to decrease. To account for this loss of value the purchase price is systematically reduced over the expected useful life. This periodic and systematic value-reduction process is called depreciation and discloses the annual costs (Hawawini, Viallet 2007, p. 40). Depreciation is an expense recorded to allocate a tangible asset's cost over its useful life (Nikolai et al. pp. 512). The SCM uses an activity-based concept to calculate administrative costs. Thus, we recommend using depreciation based on activity in this case. The depreciation rate is calculated as follows (Nikolai et al. pp. 519):

\[
\text{Depreciation rate} = \frac{\text{expense for the equipment}}{\text{total lifetime activity level}} - \frac{\text{residual value}}{\text{hours}}
\]

The residual value is the remaining value of an asset at the end of its useful life. The depreciation rate indicates the costs of using the equipments for one hour. This cost parameter can easily be included in the activity-based calculation of administrative costs.

In each decision situation it is important to consider all relevant costs. As we demonstrated above ongoing costs are relevant in an ex post assessment, start-up costs and ongoing costs are relevant in an ex ante evaluation. An attribution of cost types to start-up costs and ongoing costs was made in this section. The costs arising from equipment which can be used for many years or activities can be allocated to one information obligation by using depreciation. Using these findings will help considering all relevant cost types and improving the accuracy of cost estimates.

### 6.3 Relevance of different cost types: an example

A virtual example will illustrate the relevance of start-up costs: Based on EU Tariff law and the German Foreign Trade Regulation the proceedings for export declarations were changed in Germany during the last years. Since July 2009 declarations concerning export goods from Germany to non-EU countries can only be submitted electronically. Hardcopies are not in use any more. The amendment has also changed the administrative costs
which arise in an exemplary company. An exemplary calculation shows the impact of the amendment (see table 2):

Table 3  Exemplary calculation of the impact of the amendment

<table>
<thead>
<tr>
<th></th>
<th>Administrative costs for one export declaration (transmission using hardcopy) in €</th>
<th>Administrative costs for one export declaration (electronic transmission) in €</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ongoing costs</strong></td>
<td>Labour costs 60</td>
<td>Labour costs 20</td>
</tr>
<tr>
<td></td>
<td>Depreciation 10</td>
<td>Depreciation 20</td>
</tr>
<tr>
<td></td>
<td>Overhead (20%) 14</td>
<td>Overhead (20%) 8</td>
</tr>
<tr>
<td><strong>Total ongoing costs</strong></td>
<td>84</td>
<td></td>
</tr>
<tr>
<td></td>
<td>48</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Administrative costs to conform to the former law in €</th>
<th>Administrative costs of implementing changes to conform to the new law in €</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Start-up costs</strong></td>
<td>Not relevant as they are sunk costs 0</td>
<td>Consultancy costs 15,000</td>
</tr>
<tr>
<td></td>
<td>Costs for implementing and testing new software 3,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Costs for training for employees 3,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Labour costs 9,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total start-up costs</strong></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>30,000</td>
<td></td>
</tr>
</tbody>
</table>

Although the costs for depreciation have risen, the labour costs have gone down: All in all the ongoing costs for doing an export declaration based on electronic transmission are lower. However, start-up costs have been caused by the amendment. The company restructured its logistics process with the help of a consulting company to be able to use an electronic transmission system. Furthermore, they implemented new software. Two employees were trained on that software. Compared to that, the start-up costs to conform to the former law based on hardcopies are zero. The company had adapted to the former law many years before and the costs are not relevant any more as they are sunk costs.

Ongoing costs are lower after the amendment. If there were no start-up costs there would be a positive cost effect for the company immediately. But start-up costs of € 30,000 have to be considered. We are calculating the breakeven point assuming $x = \text{number of export declarations}$:

\[
84 \text{ €/export declarations} \times x \text{ export declarations} = 30,000 \text{ €} + 48 \text{ €/export declarations} \times x \text{ export declarations} \\
36 \text{ €} \times x = 30,000 \text{ €} \\
x = 833 \text{ export declarations}
\]
With the 833rd export declaration the breakeven point is reached. This means that for the first 832 export declarations which are submitted electronically the administrative costs in the company are higher than for export declarations based on hard copies. We assume that the company has to submit 100 export declarations per year: 833 export declarations : 100 export declarations/year = 8.33 years. Hence, the method change has a payback period of more than eight years in the company.

Taking only the ongoing costs into account, the amendment seems to have a positive effect for the concerned companies immediately. Looking at the start-up costs shows us that there are considerable costs arising for the adaption to the new law. For our company it takes more than eight years to benefit from lower administrative costs. This example shows the importance of considering all relevant administrative costs during the legislative process in order to assess the impact in a correct way and chose the best legislative alternative.

The fourth requirement we defined for a model for quantifying administrative costs was “the use of a standardized methodology which supplies comparable data”. The application of the SCM within European countries still differs. Especially, there is no elaborated method which can be used for an ex ante evaluation and there are different opinions regarding relevant cost types which have to be considered. Our propositions can serve as a basis for the European Commission and the European countries for discussing a common approach and for finding an agreement.

7 Conclusion

In this paper, we have analysed the Standard Cost Model as an instrument for measuring administrative costs from a management accounting point of view. Using activity-based costing, the SCM is a clear and comprehensible model for measuring the regulatory cost burden for all companies that are affected by legislation. However, the SCM has significant weaknesses in terms of the exact measurement of the administrative costs imposed by existing laws and even more so by legislation under consideration. It neglects some important cost types and fails to ensure data comparability between countries.

Therefore, we propose important adjustments to the SCM as currently used. First and foremost, we recommend using analogies with existing activities to estimate administrative costs. This procedure can help to enhance the accuracy of cost estimates. Second, we propose incorporating a more precise distinction between start-up costs and ongoing costs in the
model. We suggest including additional cost types in both start-up costs and ongoing costs. Moreover, since start-up costs are only relevant for future legislation, we suggest classifying these costs as sunk costs in the case of existing legislation. Hence, they should be neglected in this case. Based on our findings a harmonisation of the SCM within Europe is possible. A common approach following our proposals will allow the calculation of comparable data which can support the reduction of administrative costs inside Europe.

We believe that the proposed adjustments will help to make a major step towards a more accurate measurement of administrative costs. Including all relevant cost types makes it easier to find ways to reduce the regulatory cost burden. One important limitation of our proposal is the fact that, like the SCM, we are only considering the administrative costs without examining the benefits of regulation. Recommendations to legislators can only be made if one considers both the costs and the benefits. Furthermore, we focus on administrative costs while other types of regulatory costs, like substantive compliance costs and financial costs are not considered.\(^4\)

Future research should be undertaken to develop methods for measuring the regulatory benefits and other types of regulatory costs. Breaking down costs and benefits to certain groups like large, medium-sized and small companies would be of particular interest. Small companies are perceived to suffer to a larger extent from regulatory requirements without having substantial benefits. We also propose doing empirical research on our adjustments. A good next step would be quantifying the size of the proposed adjustments by using real data in order to get an estimate of the importance of our proposal.

References


\(^4\) For more details see Nijsen et al. 2009, pp. 30.


ADMINISTRATIVE COSTS OF ENTERPRISES: 
Some Critical Remarks

Kalle Määttä

Abstract

By administrative costs is meant costs of enterprises resulting from requirements to draw up, compile, store and/or submit public agencies or third parties. So-called Standard Cost Model (SCM) – originally developed in the Netherlands – has been in a key position when the amount of administrative burden has been quantified.

However, there are different kinds of loopholes and other drawbacks in the measurement of administrative costs. First, only such legal requirements are taken into account, which are obligatory to the enterprises. Secondly, taking into account this feature of the SCM, it is possible to reach the goals set by the government to reduce administrative burden without reducing the actual cost burden of enterprises. Thirdly, not all the costs imposed by the legislation are covered by the SCM. Fourthly, many studies have concentrated on administrative costs in general, not separately on small and medium-sized enterprises (SMEs). Moreover, transaction costs have been forgotten often in the discussion concerned.

International studies and proposals have concentrated on the simplification and streamlining of legislation in order to reduce the administrative costs of enterprises. Even though this approach is difficult to criticise as such, it omits the specific position of SMEs, and the potential measures which may be used to minimise their relatively large administrative burden. Therefore, so-called legal reliefs may be needed: SMEs may be exempted from certain legal obligations or at least their obligations may be relieved.

On the other hand, legal reliefs are not, of course, without problems. One problem is threshold effect. Bigger enterprises have an incentive to split their activities to smaller firms in order to take advantage of the legal reliefs, or small firms do not have incentive to grow since they are confronted with new legal obligations. In other words, the purpose is to analyse different kinds of problems related to the legal reliefs, and on the other hand, analyse the opportunities to solve these problems by legal means.
Introduction

By administrative costs is meant costs of enterprises resulting from requirements imposed by law to draw up, compile, store and/or submit to public agencies or third parties. Today, European Union has concentrated firstly, on the quantification of these costs, and secondly, on the reduction of these costs in order to improve the competitiveness of EU and in order to guarantee economic growth. Several Member States, like Denmark, Great Britain, the Netherlands and Sweden, have taken this task seriously, too. Instead, for instance, Finland has still much to be done in this field of economic policy. So-called Standard Cost Model (SCM) – originally developed in the Netherlands – has been in a key position when the amount of administrative burden has been quantified.

One purpose of this paper is to show how important it is especially for SMEs that administrative costs and other regulatory costs imposed by legislation, and their reduction would be taken seriously into account both in legal and economic policy-making. Or more specifically, the smaller the enterprise, the more important this issue is. Another purpose is to analyse different kinds of loopholes and other drawbacks in the measurement of administrative costs. Moreover, an important approach is to analyse the means by which administrative burden may be diminished, and in particular the burden of smallest enterprises. Finally, this brief paper may show how closely related topics legal and economic policies are with each other: on the one hand, many issues in economy are regulated by law, and on the other hand, laws have impacts in economy.

Some Results about the Administrative Costs of Enterprises

The Netherlands has been a pioneer in measuring the administrative costs of enterprises. In recent years, Denmark and Sweden have also devoted resources into this task. Moreover, for instance Belgium and Great Britain are Member States of EU, which have measured the administrative burden of enterprises, at least with respect to certain fields of legislation.1

Administrative costs imposed by legislation to the enterprises are not small figures. These figures have varied in the Member states of EU from

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1 See also Commission of the European Communities (2005).
1.5 per cent to over 6 per cent in relation to GDP. On the other hand, there is some uncertainty about the “right” amount of administrative burden of enterprises.

International studies have also shown that tax law, environmental law and labour law are the most important sources of administrative costs. Over one half the administrative costs are caused by these fields of legislation, and approximately so that the two first fields both have generated approximately 20% of these costs and labour law about 10–15% of these costs. These figures are based on measurement or estimates made in Denmark, the Netherlands and Sweden.

International studies – especially in some European countries – have concentrated on administrative costs of enterprises in total. In other words, there are only quite few studies which have estimated the administrative costs of SMEs. However, it is possible to refer to some results which show clearly that the relative administrative burden of small enterprises is much larger than that of bigger companies.

Already studies made during 1990s have shown that administrative costs of small enterprises were relatively large. For instance, according to German study, administrative burden per employee of micro enterprises was over 20 times larger than in large enterprises. Similar kind of study from the Netherlands showed that administrative burden per employee was six times larger in smaller enterprises than in bigger companies which had more than 100 employees.

Administrative costs per employee in value-added taxation show very well – and drastically – by which way these costs are distributed among firms. A reference can be made to a Swedish study. On average, administrative costs were 555 crowns per employee and per firm. However, this figure shows only one side of the coin. Another side is, of course, the distribution of these costs. When it was question about a large enterprise – more than 250 employees – administrative costs per employee were 9 crowns, but when it was question about micro enterprise, these costs were 1.575 crowns. The gap is – by one word – huge. On the other hand, these figures show that when the policy-making is approaching administrative burden of enterprises, SMEs – and especially smallest firms – have to be taken separately into account.

It is also possible to analyse the administrative burden more detailed taking into account which kinds of specific legal provisions generate

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3 NUTEK (2004a), 8.
5 NUTEK (2004b), 12.
administrative costs. For instance, the heterogeneity of tax legislation across different countries has made it more difficult to small enterprises to become important players in foreign trade. Thus, this factor is some kind of entry barrier and in particular to the smallest firms.\textsuperscript{6} Over-regulation is a self-evident cause for high administrative costs.\textsuperscript{7} The regulatory problem is – in principle – easy to solve, because under these circumstances fewer instruments are sufficient to regulate the social problem. Within this context, it has also been discussed about double regulation caused by non-coordination of national and EC legislation.\textsuperscript{8}

Moreover, inconsistent definitions in legislation are, of course, a factor generating unnecessary administrative costs. For instance, labour law has been criticised in Sweden because of this.\textsuperscript{9} On the other hand, improving the consistency of legislation across legal rules, e.g. between tax law and other parts of legislation, is one way to reduce administrative burden.\textsuperscript{10} In addition, differentiated VAT rates have caused in practice large administrative costs.\textsuperscript{11}

Certain features of legislation reveal also that the relative administrative burden is distributed unevenly among enterprises. First, \textit{ex ante} regulation is often such that the costs generated by it are fixed in nature. In other words, for instance the costs of making a plan to promote equality in the undertaking are such they are the same irrespective of the size of the production or the number of employees. Moreover, against this background, the claim that these kinds of costs constitute a market barrier for new enterprises is justified.\textsuperscript{12} What is worth noting too is the threat about ‘regulation circle’ due to this kind of entry barriers. This is as such leading to the reduction of competition in the markets which may worsen the welfare of consumers. This may lead to the tightening of the consumer protection law and perhaps other parts of legislation, too; which further harms competition since the entry barriers become higher; which may lead to stricter and administratively more burdensome legal rules; etc.\textsuperscript{13}

Another side of the coin concerns mostly \textit{ex post} regulation. Under these circumstances, big companies can make use of the ‘law of big number’, while SMEs usually are not well able to self-insure the risks, in

\textsuperscript{6} See e.g. Cnossen (2002).
\textsuperscript{7} NUTEK (2004a).
\textsuperscript{8} See also Skr. 2005/06:49, 31.
\textsuperscript{9} NUTEK (2004a), 25.
\textsuperscript{10} See e.g. Skr. 2005/06:49, 15.
\textsuperscript{11} See. e.g. SOU 2005:57, chapter 9, which concerns Swedish VAT system.
\textsuperscript{12} See e.g. Haupt (2003), 1163 with respect to the consumer protection law.
\textsuperscript{13} Määttä (2006).
particular, due to the large damages. Moreover, often third-party-market-insurance is not obtainable for small enterprises at reasonable cost.\textsuperscript{14}

Specific legal treatment of small enterprises may be justified still by other arguments. From interest group point of view, larger enterprises are in a better position than smaller firms in order to affect the content of legislation. Several reasons explain this. The starting point is that large firms constitute organisations to which only few participators belong, but SMEs constitute organisations to which belong plenty of firms. Under these circumstances, organisations of large enterprises have smaller internal transaction costs. Preferences are also more likely to be similar in groups consisting of only few participants. In addition, in smaller groups rewards for each firm are bigger. Another side of the coin is that in the groups consisting of plenty of firms, they may have incentives to free ride.\textsuperscript{15}

What is finally worth noting is to what extent administrative costs have been settled in the preparatory drafts of legislation. Following remarks concern Finnish legislation, particularly on the basis of government bills. An overview of these preparatory drafts has shown that administrative costs of enterprises in general and separately those costs of SMEs have been omitted. Instead administrative costs of public sector have been emphasised more. This is to some extent paradoxical, because public administrative costs are usually much less than private administrative costs. In addition, only very few remarks have been made at very general level about the relatively large administrative burden of small firms compared with bigger companies. In summary, the policy conclusion is clear-cut: when new legislation is introduced or existing legislation is amended, administrative (and regulatory) costs of private sector have to be studied better, and taking into account, too, the uneven distribution of these costs among firms.\textsuperscript{16}

\textsuperscript{14} See also Haupt (2003), 1163–1164.

\textsuperscript{15} See also Olson (1965).

\textsuperscript{16} See also Kanniainen & Määttä (2008).
Pitfalls in the Measurement of Administrative Costs

Even though it sounds good to cut the administrative costs of enterprises, there are quite many pitfalls in this approach. First, only such legal requirements are taken into account, which are obligatory to the enterprises. However, voluntary tasks may generate – and they sometimes generate de facto – quite large administrative burden to enterprises. For instance, small enterprises are exempted from auditing of the accounts in many countries. In practice, however, small enterprises have invested in audit even though they do not have any legal obligations to do this, but because they may otherwise lose e.g. their right to public grants. Moreover, audit is from administrative point of view an important field, since it has generated according to international studies approximately 10–15 % of the administrative burden of the enterprises. Another example is self-regulation understood here as “law” formulated by private agencies to govern professional and trading activities. Thus, administrative costs of self-regulation are not covered by the SCM, and again, the actual total administrative burden is larger than the burden measured by SCM.

Second problem is related to the objectives of reducing administrative costs. Taking into account the above-mentioned feature of SCM, it is possible to reach the goals without reducing the actual administrative burden of enterprises. This may occur e.g. by moving from traditional regulation to self-regulation, or by exempting small enterprises from legal obligations, which are not actual exemptions. Another kind of problem is created by the fact, if different goals are set ex ante to different fields of legislation (e.g. reducing administrative costs under tax law by 20 %, as well as under environmental law by 20 %). The threat is that the reduction of administrative costs does not occur cost-effectively under these circumstances.

Third problem is created by the fact that only administrative costs, but not other costs due to the legislation, are taken into account. By the term regulatory costs, we refer to the costs covering all the costs to the enterprises because of the legislation. For instance, it may be question about material costs resulting from requirements that necessitate investments in facilities or staff (in addition to administrative costs). Environmental law may show well, what kind of problems may emerge if we concentrate on administrative costs but omit regulatory costs in general.

17 See also Kanniainen & Määttä (2008).
In principle, enterprises should be given choice as to how to meet the environmental goals, since that encourages innovations and it is also more costs-effective than alternative solution. However, the benefits of such less interventionist measures might be outweighed by the costs of administering them. On the other hand, if, e.g. a standard compels the enterprise to employ certain production methods or materials, administrative costs are low. However, this kind of standard induces technological rigidity, etc., generating major social welfare losses. In summary, concentrating only on the minimisation of the administrative costs may lead to the increase in other regulatory costs. And at worst, the regulatory costs in total may become larger than otherwise. This result is far away from the aim of the SCM: improving the competitiveness and economic growth. What is worth noting still is that research in the United States has concentrated more on the measurement of regulatory costs, not only on administrative costs.\textsuperscript{18}

Fourth problem of many studies is that they have concentrated on administrative costs of business in general, not separately on small and/or medium-sized enterprises. This is very important, since the relative administrative costs of small firms seem to be much bigger than the relative administrative costs of large firms (e.g. in relation to the number of employees). What is worth noting still is that SCM facilitates that the administrative costs are measured separately, e.g. according to the size of the enterprises.

Fifthly, when international discussion has concentrated on administrative costs, transaction costs have been forgotten – at least – to some extent. Nevertheless, transaction costs work also like friction in business. Moreover, a realistic assumption here is that the relative burden of transaction costs of small firms is larger than this burden of big companies. In addition, it is not sufficient that the minimisation of transaction costs is emphasised under property and contract law, but that the issue would be analysed more specifically.\textsuperscript{19}

On the other hand, what is of great importance is that the saving of administrative costs may cause an increase in the transaction costs, and this increase may be larger than the saving of costs. Therefore, the net result would be in the economy negative. This may occur simply if each customer should settle separately the properties of the product, i.e. this could be many times more expensive than if the enterprise would collect and publish the information needed.

\textsuperscript{18} See e.g. Crain (2005).
\textsuperscript{19} See also Cooter & Ulen (2004), 91–96.
One potential pitfall in the measurement of administrative costs is that the research takes into account only certain fields of legislation, such as tax law, environmental law and labour law. Under these circumstances, one problem is that administrative costs imposed by other parts of legislation may increase drastically, but they are outside of the SCM results. Moreover, sometimes certain legal provisions may be removed from the legal fields studied by the SCM, but they are replaced by other legal provisions in other fields of the legislation. An instance for this is tax subsidies which may be replaced by direct subsidies to enterprises. From this point of view, if the analysis of administrative costs is not comprehensive, there is threat that these costs may not decrease in total even though SCM may show something else.

Still one issue is worth noting, and it is best characterised by a brief question: how easy should it be to get business licence? If only administrative costs are taken into account, the procedure should be as simple as possible in order to minimise the administrative costs. But other costs have to be taken into account here, too. They are, in particular, expected error costs, i.e. those persons getting licence who have not at all qualifications for the business. Thus, the regulatory problem is not how to minimise the administrative costs but how to minimise the sum of the administrative and expected error costs.20

Simplification of Legislation or Legal Reliefs for SMEs?

International studies and proposals have concentrated on the simplification and streamlining of legislation in order to reduce administrative costs of enterprises. Even though this approach is difficult to criticise as such, it omits the specific position of SMEs, and the potential measures which may be used in order to minimise their administrative burden. What is worth noting here are so-called legal reliefs: SMEs may be exempted from certain legal obligations or at least their obligations may be relieved.21

But first, for instance, should we simplify legislation by removing certain provisions from legislation? To some extent, a ‘warning’ example has been Danish corporate law in this respect. This act was written shorter,

20 See, however, Skr. 2005/06:49, 16.
21 On the other hand, tax subsidies may be enacted for SMEs but this option is omitted from this paper. However, in OECD countries this kind of alternative is in any case quite common.
but on the other hand, many relevant questions were left unanswered in the legislation. Thus, this kind of simplification would increase problems of interpretation and thereby administrative burden. In addition, one self-evident remark is that administrative burden may not decrease – but at worst increase – if removed legal provisions are replaced by other legal provisions.

In any case, simplifying legislation may be a good means to reduce rent seeking. And this may reduce administrative costs for, at least, two reasons. First, law would not involve anymore so many exceptions, like exemptions, which are sources of interpretation problems. Secondly, there would not be anymore so many amendments in legislation, which further reduces the administrative burden and also legal uncertainty.

In practice, legal system involves already nowadays different kinds of legal reliefs. On the other hand, what is worth noting is that they are not directed at SMEs in total but usually to smaller enterprises. Differences are reflected by the fact that reliefs are e.g. linked to the number of employees in the firm, sometimes to the turnover of the enterprise, and sometimes to the start-up stage of the firm. And still, for instance the critical number of employees may vary from one law to another. An instance of this is Finnish Act on Co-operation within Undertakings (725/1978) and on the other hand, Act on Equality between Women and Men (609/1986). The former act is applied to undertakings normally employing at least 20 persons, whereas the latter act is applied – concerning the obligation to make a plan to promote equality – to undertakings normally employing at least 30 persons.

Some further examples about legal reliefs for SMEs may be mentioned. Certain obligations of firms are continuous in nature. For instance, firms have to pay value-added tax every month in Finland. Under these circumstances, legal reliefs are easily implemented by lengthening the period of time in which small firms have to fulfil this obligation. In Sweden, enterprises have advocated this kind of regulatory option already during 1990s. Sometimes the legal reliefs have been implemented so that the law covers only corporations and other legal persons but not natural persons. An instance of this is Finnish Environmental Damage Insurance Act (81/1998).

Even though legal reliefs for SMEs can be justified in order to reduce the administrative burden of SMEs, they are not, of course, without

22 See also HE 109/2005 vp.
23 In principle, outlining legal reliefs is similar task than to outline tax expenditures (or tax subsidies) from tax legislation.
24 See further Kanniainen & Määttä (2008).
problems. Let’s start by the exemption of small firms from value-added tax. In Finland, the exemption has covered only enterprises with turnover below 8,500 euros. It is easy to see immediately that this kind of legal relief concerns only hobbies rather than economic life. On the other hand, in Great Britain the level of turnover threshold is much higher and approximately two million firms fall there below the threshold.26

Another problem due to the legal reliefs may be called threshold effect. It has at least two ‘faces’. First, bigger enterprises have an incentive to split their activities to smaller firms in order to take advantage of legal reliefs. However, this kind of impact should not be exaggerated. Legislator may require – and often does – that small enterprises should be independent from each other in order to get the right to legal relief. Another expression of threshold effect is that small firms do not have incentive to grow since they are confronted with new legal obligations. One way to mitigate the threshold effect here – as well as above – is that the threshold varies across legislation, as it does in practice for instance in Finland.

Third problem related to the legal reliefs concerns the interpretation of legal rules. In particular, it is inevitable that borderline problems emerge in determining whether the enterprise belongs to the scope of the relief or not. Problems of interpretation may be reduced by detailed – not flexible – legislation. On the other hand, detailed legal rules may have drawbacks, too. First, detailed rules do not take into account individual circumstances in which small firms have to act. Second, detailed rules become easily outdated requiring, thus, that they have to be amended. And amendments involve administrative costs as well as legal uncertainty. Moreover, detailed rules may provide – at least sometimes – incentives to inappropriate measures to circumvent the law. On the other hand, flexible legal rules may generate problems of their own. First, it takes time before the final decision has been made in court, especially if the decision has to be made in the Supreme Court. Moreover, costs of the legal process may be a threshold for small firms to go the court. In summary, this brief analysis shows that there is not at all such thing as perfect law and the selection has to occur between imperfect options.

Fourth problem confronted with is the under- or over-inclusiveness of legal reliefs. Sometimes reliefs are provided to the firms, which do not need for them, and sometimes firms, which may need for reliefs fall outside of them. Targeting problems should be taken into account seriously since according to the studies made e.g. in the United States regulatory

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26 See e.g. Kanniainen & Määttä (2008).
costs of industry are approximately and on average two times larger than similar costs of service sector.\textsuperscript{27}

Targeting may become a problem in the longer run, too. In particular, turnover-related reliefs are problematic since their ‘threshold value’ decreases under inflationary circumstances. Thus, there may emerge a need for ‘inflationary corrections’ in order to keep the real value of the threshold value unchanged. Another solution would be to link turnover-related reliefs to some price index. However, latter mentioned policy option has not worked well e.g. under consumption taxation.\textsuperscript{28}

Concluding Remarks

Even though Standard Cost Method has been useful in analysing the amount of the administrative costs of firms, it has still many pitfalls. For instance, it takes into account only such legal requirements to enterprises, which are formally obligatory to the enterprises, but on the other hand, it omits such requirements, which are not formally but actually obligatory to firms. From this point of view, the results of SCM are too small in relation to the actual administrative burden.

Moreover, administrative costs are not all the costs imposed by the legislation to enterprises. So-called regulatory costs have to be taken into account completely, if the purpose is to outline the actual burden imposed by legislation to enterprises. This is also compatible with the aims of SCM: to improve the competitiveness of EU and to guarantee economic growth.

Particularly in Europe studies have concentrated on administrative costs of enterprises in total. Even though this approach is needed also in the future, more resources should be devoted to the analysis of administrative burden of SMEs separately. The main reason is simple: administrative burden seems to be very unevenly distributed among firms.

In addition, if the position of smallest enterprises is attempted to be corrected, only simplifying and streamlining legislation is not sufficient. Political and research interest should be directed more at the legal reliefs for small firms.

\textsuperscript{27} See also Crain (2000).
\textsuperscript{28} See e.g. OECD (1988).
References


UTILIZATION OF LEGAL MONITORING IN LAW-DRAFTING

Larisa Vdovichenko

Legal monitoring is a new technology of an active analysis of legislation and of legal enforcement practices, forecasting and planning of the development of law-making process. Monitoring of legislation and of legal enforcement practices forms an integral part of the system of law-drafting, allowing constructing the whole legislative process on a transparent, fundamental legal basis. Legal monitoring has great value in a federal state, where federal and regional legislations are applied simultaneously. Legal monitoring is presently required as a factor unifying the legislative and legal enforcement activities of federal and regional bodies of power.

The discussion about the role of legislative monitoring in Russia and in some other countries as for example Kazakhstan, Azerbaijan, Armenia, demonstrated the interest on this new form of empirical studies of the policy process. Legal monitoring is an effective means of analysis of policy-making process. It helps detect weaknesses in the mechanism of state policy implementation and determine legislation’s critical and problems points.

1 Introduction: what was the original situation in law-drafting before the implementation of legal monitoring

At the beginning of XXI century legislation system in Russian Federation was in transition. From one side it has new democratic Constitution adopted in 1993 and many adopted legal acts in different branches of legal regulation.

But there were many substantive problems that law-drafters couldn’t resolve in law-making process such as:
- low legislation’s quality and inadequate efficiency of legal ground work;
- weaknesses in the mechanism of state policy implementation;
- many legislation’s critical and problems points;
- low observance of citizens’ constitutional rights and freedoms practice and so on.
Some law-drafters and scientific experts who analyzed legislation understood that it was necessary to **elaborate new approach to the law-making process, to create new groundwork of the legal practice.** One of these new approaches was named “monitoring of legislation and of legal enforcement practice” (herewith, legal monitoring). The subject of my article is not devoted to the history of appearance of this term and its development. It could be the contents of another article or book. I’ll try to show some results of this long track of legal monitoring.

In 2004 legal monitoring was proposed as an efficient tool of improving law-drafting process¹. An essential role in coordination of legal monitoring activity was played by the Council of Federation – the high chamber of the Federal Assembly of the Russian Federation.

### 2 Definition of legal monitoring

**Legal monitoring is a new technology of an active analysis of legislation and of legal enforcement practices, forecasting and planning of the development of law-making process.** It forms an integral part of the system of law-drafting, allowing constructing the whole legislative process on a transparent, fundamental legal basis.

It is called to synchronize legislative activity at the federal and regional levels of the Russian Federation. Such an approach to the process of law-drafting is becoming a vital condition of improvement of the quality of legislation. It helps to consolidate efforts by state bodies and civil society institutes in securing human and civil rights and freedoms. It completes interdisciplinary political, legal and managerial studies at a modern level.

### 3 Methodological base of legal monitoring

**Novelty of the technology of legal monitoring has methodological and organizational aspects.** **Methodological base of legal monitoring** compounds complex of methods of analysis of adopted laws and practice of its implementation, of developing projects of law and planning of law activity. Legal monitoring is based on the principles of targeted program and long-term planning.

After the appearance of the idea of legal monitoring it was necessary to elaborate more sophisticated methods to solve new tasks. Monitoring as a systematic analysis, control and forecast law-drafting involves choosing a system of indicators and indices allowing determining the quality of laws and degree of its implementation.

Continuous monitoring is required for the following purposes:
1. To determine the quality of laws from the point of its impact on the quality of life of people, from the social, economic, political and other consequences of its implementation, from its accordance with others adopted laws and so on;
2. To find the most efficient methods of data collection of legal monitoring and to clarify the procedures of their analysis;
3. To receive information on efficiency of implementation of adopted laws, on the basis of which to work out and to introduce some changes into legal strategy and programmes of law-drafting.

Methods of analysis of adopted laws and practice of its implementation are oriented to give useful information for good orientation of current law-drafting process (Find below Table 1).

<table>
<thead>
<tr>
<th>1. to select the laws which don’t operate, or operate poorly, or impede the full implementation of other laws or subordinate laws</th>
<th>2. to determine causes why this or that law does not right operate normally</th>
<th>3. to track the dynamics of selected object (law or unit of laws) and its integration in the sphere of legal regulation</th>
<th>4. to receive representative results that may be used in law-drafting and law enforcement, in managerial and law-protection activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1 determination of the real needs of society in the sphere of operation of selected laws</td>
<td>2.1 changing of legislative sphere for the purposes of adjusting it to the state of actual affairs of the society</td>
<td>3.1 determination of the place of selected object of monitoring in the legal system by its sphere of operation</td>
<td>4.1 control of the attainment of the planned social results in legal enforcement practice</td>
</tr>
<tr>
<td>1.2 determination of parameters which could evaluate existing situation to the desirable one designated by monitoring specialists</td>
<td>2.2 improvement of laws by taking account of social consequences of its implementation</td>
<td>3.2 identification of the place and role of the object of monitoring in the system of regulation of social relations</td>
<td>4.2 predictions of unfavourable consequences of implementation of prescriptions of law</td>
</tr>
<tr>
<td>2.3 elaboration of proposals aimed to improve the existing legislation</td>
<td>3.3 choice of indicators of evaluation of legal acts from social, juristic and other positions</td>
<td></td>
<td>4.3 forecasting of law-drafting development</td>
</tr>
</tbody>
</table>

Table 1 Goals of monitoring of laws and legal enforcement practice
4 Organizational base of legal monitoring

Organizational base of legal monitoring is based on two types of potential subjects of legal monitoring: official and public (Find below Table 2). Word “potential” means that named institutions and organizations could carry out legal monitoring but some of them don’t use such possibilities just now.

Among official subjects of legal monitoring we could cite such institutions: legislative (representative) bodies of national (federal) state power; Government, Ministries and State agencies; legislative (representative) bodies of regional state power; Accounts chambers; Agencies of prosecutors; Constitutional, Arbitration and other courts; Human rights commissioners.

Potential public subjects of legal monitoring are: independent public associations; scientific organizations (for example Institutes of sociological researches); Universities (especially judicial and sociological Faculties); special Centres of legal monitoring; Public chambers. In the end every citizen has the right to analyse laws and its implementation and to address his proposals how to improve legislative practice to official and public institutions.

<table>
<thead>
<tr>
<th>Official</th>
<th>Public</th>
</tr>
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<tbody>
<tr>
<td>Legislative (representative) bodies of national (federal) state power</td>
<td>Independent public associations</td>
</tr>
<tr>
<td>Government, ministries and state agencies</td>
<td>Scientific organizations (for example Institutes of sociological researches)</td>
</tr>
<tr>
<td>Legislative (representative) bodies of regional state power</td>
<td>Universities (especially judicial and sociological Faculties)</td>
</tr>
<tr>
<td>Accounts chambers</td>
<td>Special Centres of legal monitoring</td>
</tr>
<tr>
<td>Agencies of prosecutors</td>
<td>Public chambers</td>
</tr>
<tr>
<td>Constitutional, Arbitration and other courts</td>
<td>Political parties</td>
</tr>
<tr>
<td>Human rights commissioners</td>
<td>Bodies of municipal service</td>
</tr>
</tbody>
</table>

Researches conducted in the context of legal monitoring should have a uniform or comparative organizational base. This requires special efforts to coordinate methodical support of these researches.

Organizing monitoring of specific law, it is important to clearly determine those groups and communities regarding whom the bodies of
power should choose a different strategy of conduct (informational, control, of social support, of collaboration, and so forth).

When organizing legal monitoring, it is necessary also to solve the problem of support such activity by state power and local administration. Conducting legal monitoring should study real state of legislation with consideration of the schedule of law-drafting efforts and of particular features of the social and economic situation in the region.

5 Theory and practice of choosing parameters of legal monitoring

The main problem in organizing and conducting monitoring was to define indicators and indices which could be used to qualify rating of laws and its implementation. The other problem was to find initial data necessary for determination of the absolute value of selected indicators and indices. Legal monitoring was seen as an effective means of analysis policy-making process. It could help to detect weaknesses in the mechanism of state policy implementation and determine legislation’s critical and problems points. The monitoring results could allow presenting a list of demands for the modern legislative process. It is insufficient to simply develop a draft law or adopt relevant legislation; it is very important to foresee the actual mechanism of its implementation, and the consequences of its enforcement. The general theoretical idea of legal monitoring is to a large degree grounded on the assumption of social welfare maximization as the primary objective of law enforcement. Legal monitoring is aimed to the improvement of the mechanism of responsibility of state power and local administration for the existing social relations.

As an example, in the Tomsk Oblast of the Russian Federation the process of monitoring is based on more than 300 indicators and indices grouped into two basic units:

1. Indicators of attainment of goals of development of the Oblast and indices of fulfilment of tasks, their forecast values which it is necessary to reach by 2010;
2. Dynamics of indices characterizing the expected results of implementation of the basic directions of regional policy for social and economic development of the Oblast.

Most indicators and indices of legal monitoring (two thirds) are results of research and sociological surveys; one third is the data of public statistics. Monitoring surveys are carried out: 2,000 small business entities, the
sample being formed on the territorial cross-section and for economic activities, organization and legal forms (small enterprises, entrepreneurs, farms); 200 middle and large enterprises, a sample is also formed with taking account of distribution by municipal and urban districts of the Oblast and by economic activities; 3,200 households (8 thousand people) in the territorial cross-section.

More than 500 various enterprises, organizations and agencies are additionally surveyed for the purpose of monitoring (potential participants of clusters, insurance, consulting and financial organizations, leading investment institutions).

Each region (its state power institutions) determines the number of controlled indicators and indices: thus, in Tomsk Oblast there are 321 of them, in the Republic of Tatarstan 326. Choosing of indicators and indices depends on its value in quality rating of law and its implementation. In every region there are specific problems appearing in implementation of regional laws. That’s why regional institutions conducting monitoring used different indicators.

Some of them note the inconsistency of indices calculated by public statistical authorities and information submitted by enterprises and organizations. Many statistical indices at the moment of conducting monitoring are preliminary and consider revising later. Moreover, in their calculation the methodology of «additional counting» is used.

For a more efficient implementation of a system of continuous monitoring by performance indicators in constituent entities of the Russian Federation it is advisable:

1) To ensure the working out of a single conceptual document determining the strategic landmarks and the role of each of the regions (a group of regions at least) in the long-term development of the Russian Federation;

2) To organize the working out and approval of procedures of information exchange between bodies of state power of constituent entities of the Russian Federation and federal territorial bodies of the Federal Tax Service and the Bureau of Public Statistics in the sphere of exchange of operational information on payments to Oblast and local budgets of all levels.
6 Sociological monitoring of legislation and law enforcement

Numerous problems in the sphere of legislation and law enforcement have brought about an objective need in sociological monitoring of legislation and law enforcement. The practice of legal monitoring has shown the multiple aspects of the existing problems and has raised the importance of their multidimensional sociological analysis. For these purposes in 2008–2009 the Russian sociological service «Barometer» jointly with the Centre of Legal Monitoring under the Council of Federation of the Federal Assembly of the Russian Federation conducted a number of sociological surveys. Participants of these surveys compounded: representatives of executive, legislative, judicial power (federal and regional), other participants of political process (non-governmental organisations), experts and scientists.

Some scientific Institutes of Russian Academy of Science (Institute of Sociology, Institute of Social-Political Researches) conduct their own independent sociological surveys where they use blocs of questions about estimation by population and experts law-making activities. The main task is the raising of quality of laws as a most important integral index of law making activity.

Studying the quality of law enforcement activities and the level of legal awareness of people implies carrying out of its complex examination. Of special interest here is public examination of legislation that may be conducted with the help of such sociological methods of research (Find below Table 3).

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### Table 3 Methods of sociological monitoring of laws and legal enforcement practice

<table>
<thead>
<tr>
<th>Expert survey</th>
<th>Public opinion poll</th>
<th>Focus group</th>
</tr>
</thead>
<tbody>
<tr>
<td>survey of specialists able to express a competent, professional opinion on the issues in which researchers are interested</td>
<td>interviewing and (or) questioning of respondents sampled from the general population of subjects of legal regulation on the basis of the methodology of probabilistic or quota sampling; an analysis and generalization of the obtained data</td>
<td>discussion in a small but sufficiently representative group of people who are ordinary participants of regulated social relations</td>
</tr>
<tr>
<td><strong>An expert’s questionnaire</strong> should be designed for collecting information on the condition of the social relations, contradictions and gaps in their legal regulations, on drawbacks in the mechanisms for law implementation.</td>
<td>A questionnaire for respondents should be designed for collecting information on public opinion oriented toward study relations of people to laws, regulatory legal acts.</td>
<td><strong>Preparation of a scenario</strong> for discussion should be designed for studying relations of people to laws, regulatory legal acts and problems of legal enforcement.</td>
</tr>
<tr>
<td>The first part of the questionnaire should be oriented toward collection of objectively established information.</td>
<td>The first part of the questionnaire should be oriented toward studying people’s appreciations of laws, regulatory legal acts.</td>
<td>The conduct of discussion should be oriented to the questions under research.</td>
</tr>
<tr>
<td>The second part should be oriented toward study of evaluations, stances, preferences, awareness and points of view of public civil servants and servants of municipal bodies of power.</td>
<td>The second part should be oriented toward study of people’s appreciations of law enforcement activities of bodies of state and municipal power.</td>
<td></td>
</tr>
</tbody>
</table>

Sociological monitoring of legislation and law enforcement allows analyzing wide range of problems in different spheres of legislation aimed to identify socially important tasks needed to be solved primarily. But sociological research in the context of legal monitoring has its special features differing from the other sociological studies (Find below Table 4).
Table 4 Stages of sociological research (in context of legal monitoring)

<table>
<thead>
<tr>
<th>The first stage of sociological monitoring</th>
<th>The second stage of sociological monitoring</th>
<th>The third stage of sociological monitoring</th>
</tr>
</thead>
<tbody>
<tr>
<td>work out a strategy of conducting sociological research</td>
<td>determination of the priority laws and problems which need continuous monitoring</td>
<td>analysis and synthesis of the materials received in the second stage of monitoring and in current practices</td>
</tr>
<tr>
<td>formalization of the stages of monitoring</td>
<td>choice of laws in the social sphere as an object of research</td>
<td>determination of limits of intrusion in the existing mechanisms of social regulation</td>
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<td>coordination and methodical support of sociological research</td>
<td>conducting public polls</td>
<td>forecasting of the development of legal enforcement practice</td>
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<td>carrying out of expert surveys</td>
<td>forecasting of the development of legislation</td>
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<td></td>
<td>focus group’s researches</td>
<td>elaboration of proposals how to develop the legislation in the future</td>
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<td>collection of data about relations of people to the quality of legal regulation</td>
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<td></td>
<td>including received data into a uniform database</td>
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Analytic forms of monitoring of quality of legislation include:
- departmental examination with the help of such expertises as judicial, anticorruptional, economical, ecological and so on (as usual, conducted by state institutions);
- scientific examination with help of such methods of research as an expert survey and a focus group;
- public examination of legislation with help of public opinion polls.

By the results of the conducted surveys\(^3\), only insignificant part of respondents estimated the quality of laws being passed sufficiently high. To the contrary, on the average each second of those interrogated gave a critical evaluation. Almost each second of the interrogated considered that in this sphere there were no positive changes, or the situation worsened. The quality of laws being passed was undoubtedly determined primarily by the state of the law making process. The practice showed that there were

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many unsolved problems, and the results of the conducted surveys proved this fact. There were generally critical evaluations of the modern law making process.

Participants of the conducted surveys offered a number of various measures to improve the law-making process. A considerable preference was given to elaboration of legal strategy of development of Russia, and to improvement of the quality of laws as a most important priority, and this was done purposefully. According to each second of respondents, the quality of laws and improvement of law-drafting were not within the main priorities of the state policy.

By the results of surveys, only the activities of the President received the positive index (predominance of positive evaluations over negative ones). The law-making activities of the State Duma, federal and regional bodies of executive power were evaluated most critically. At the same time it should be underlined that it was difficult for a considerable part of the participants of the surveys to evaluate the law-making activities of the Supreme Court of the Russian Federation and the Supreme Arbitration Court of the Russian Federation.

Cooperation of bodies of executive, legislative, judicial power and other participants of law-making activities gains special importance in today’s conditions. At the same time, by the results of surveys, this partnership has not been properly developed. One of the reasons is that far from all subjects of law-making activities take active participation in the improvement of the legislation.

To improve the legislation, enhance its quality, of principal importance today is the changing role and significance of the parliamentary institutions. According to the surveys, there occur contradictory evaluations of their activities. Along with the acknowledgement of the positive tendencies, not a small part of respondents stated the lessening role and importance of the parliamentary institutions in the improvement of the quality of legislation. Mostly these evaluations refer to the activities of the State Duma.

The legal support of complex nation-wide objectives should play an important role in the implementation of the legal strategy in the sphere of law-making. One of the priority objectives of the legislator in this respect is the legal support of the implementation of national projects. According to the surveys, the level of their legal support was estimated on the whole as critical. The most critical was the estimation of the legal support of the priority national projects «Development of Agricultural complex», and especially «Affordable and comfortable housing to citizens of Russia».
7 Some results of sociological impact in legal monitoring

Nowadays the problem of correlating the legislation with these or those social criteria become more relevant. According to the surveys, in the first place draft laws should be evaluated in terms of the implementation of the constitutional obligation of the state in observance and protection of human and civil rights and liberties, the constitutional provisions on the assurance of worthy human life, fight with corruption, strengthening of the unity of the country, the development of Russia as a federal state.

The modern state of human measurement of the legislation makes a task of reorientation of all subjects of the initiative toward acknowledgement, observance, and protection of human and civil rights and liberties in the Russian society extremely relevant. By the results of the surveys, the legislation in terms of the support of human and civil rights and liberties in the Russian society is generally evaluated critically. At the same time the corresponding activities of the parliamentary institutions are generally critically evaluated. The necessity of improving the legislation urgently requires a more active use of the abilities of the civil society. Legal monitoring is called upon to become an efficient form of dialogue of the authorities and the society.

There are many unsolved issues in this sphere. By the results of surveys, social institutions participate poorly in the improvement of the legislation. The cooperation of parliamentary institutions and civil society institutes is not being properly developed. There are no efficient legal mechanisms of cooperation of the powers and the society. Accounting of interests of various social forces in law-making is becoming prominently important. According to the respondents, paramount significance will gain such phenomena: active participation in law making of civil society institutes, great openness of the law making process, development of mechanism of feedback of legislators with people, accounting of public opinion in law-making process, raising the number of subjects of legislative initiative and so on.

The mechanism of participation of the Public Chamber of the Russian Federation in the improvement of the legislation also requires further improvement. According to the surveys, current activity of the Public Chamber is evaluated critically. At the same time respondents supported the idea of adoption of the law «On Public examination» which could wide possibilities of the Public Chamber in expertises of laws.
The conduct of legal monitoring implies a deep and comprehensive analysis of law enforcement. According to the surveys, the state of law enforcement at the federal, regional, and especially at the municipal level is generally evaluated critically. Only an insignificant part of the interrogated (4% to 9%) noted positive changes in this sphere.

An important role in improving the efficiency of law enforcement could play the legislation. High number of drawbacks has a negative impact on the state of law enforcement. According to the surveys, respondents noted such main causes of this: low quality of draft laws being passed, instability of the legislation, underdevelopment of codification of the legislation and absence of the full register of regulatory legal acts, insignificant number of laws of immediate action, considerable number of obsolete regulatory acts, non-compliance of a number of draft laws with the international standards.

According to the surveys, respondents evaluated generally critically the law-enforcement and control activities of bodies of state power on various levels. Relatively high they evaluated the law-enforcement activities of the President of the Russian Federation and of the Constitutional Court of the Russian Federation. They have, as evaluated by the respondents, a positive index. The most critical was evaluated the law enforcement activities of executive power and law-enforcement bodies.

According to the surveys, the present state of law enforcement requires carrying out of a complex of measures: rising of responsibility of law-enforcement structures for their activities, enhancing of legal awareness of people and, above all, official persons, overcoming of legal nihilism widespread in the society. Sociological surveys aimed to analyze the effectiveness of applicable laws and of the passing of new ones would have been greatly important. The raising of the role of the parliamentary institutions in controlling executive bodies of power would have principal importance for improving efficiency of law enforcement. According to the surveys, this role is insignificant, and no major changes toward the better are observed.

The social significance and practical relevancy of legal monitoring requires today adoption of complex measures for its qualitative development. Certainly, over the recent years there have been some noticeable positive tendencies in the development of legal monitoring. By the results of the conducted surveys, there is generally a positive tendency. Many bodies of state power, scientific institutions, civil society institutes and the expert community have demonstrated more attention to legal monitoring. Sufficiently interesting initiatives of the ideas for accumulating positive experience are arising. In a number of regions legal monitoring centres have been set up. The setting up of the Centre of Legislative and
Legal Enforcement Monitoring (Centre of Legal Monitoring) under the Council of Federation of the Federal Assembly of the Russian Federation in 2008 has become the logical conclusion of the entire working stage in the sphere of legal monitoring.

At the same time, the process of establishing the national system of legal monitoring is sufficiently complex and contradictory. Positive changes taking place in this sphere are not yet based on principle. A number of factors are still in effect which hold back the development of legal monitoring. These are, above all, organizational, financial, manpower and political factors. The mechanism itself of the functioning of legal monitoring is far from being streamlined; its legal basis is almost missing.

By the results of the conducted surveys, it’s very important to treat legal monitoring as an independent trend of the state legal policy, adoption at the federal and regional levels of legislative acts on organization and conduct of legal monitoring. It’s necessary to keep on working out the methodological basis and scientifically justified indicators of the effectiveness of legal monitoring, to develop intensively the methods of preparing manpower for conduct of legal monitoring, to use actively the abilities of scientific institutions, civil society institutes, of the expert community. It is also important to use international expertise.

Sociological research as part of legal monitoring carries out the function of fast feedback. Under the conditions of contradiction, instability of the legislative base, the instability of law enforcement, the general goals originally inherent in the law are often deformed. As a result, the real goals of law enforcement actions essentially begin to contradict the intentions of the legislators, the general provisions fixed in laws, programs and the basic directions of the development of the social sphere.

It should be noted that the openness of the law making process is still insufficient. Subjects of the right to initiate legislation and the society have no timely and complete information on the draft laws reviewed in the State Duma, on the contents of responses and expert opinions. The situation can be rectified by setting up a special databank, maintaining a «law file» as one of the basic and obligatory forms of monitoring the legislation and law enforcement ensuring continuous support of a law from the germination of the idea to work it out until its application is ceased.

Legal monitoring could be understood as a system of actions aimed to achieve not only a formally juristic but also social result. Information obtained by legal monitoring is required not only for a juristic but also for economic and social analysis.

The development of legal monitoring system could help create a new model of state administration, open to institutes of civil society, business, social groups, clear to every citizen, and based on fruitful cooperation between the individual, society and the state.

8 Conclusions: achieved results and perspective

Over the past decade, a passage has been made from a theoretical justification of the idea of legal monitoring, to attempts of practical implementation of its system in Russian Federation. The institution of legal monitoring as an inevitable stage in the process of improvement of legislative system has gained some recognition. Up until presently the experience of monitoring laws on the federal and regional levels of the Russian Federation has been accumulated, which allows of making certain generalizations and conclusions. The results of such monitoring are summarized and it’s analysis in comparative with the current practices shows that this institution should develop at a sufficiently firm methodological basis and find its place in the legal system. Only upon this condition it is possible to receive representative results that may be used both in law making and in law enforcement activities.

The last six years Council of Federation of the Federal Assembly of the Russian Federation published annual reports “Legislative groundwork for the principal directions of domestic and foreign policy”. These reports were prepared on the base and crucial results of legal monitoring in corresponding years.

Not long ago special department of legal monitoring was created in the Ministry of Justice of Russian Federation.

Legal monitoring of federal law stimulated the creation of regional analysis systems. Regional bodies of state power also joined this process. A growing number of regional parliaments created their own monitoring services and presenting the results of their work in the form of public reports (approximately 30). These reports analyzed federal legislation and the legislation of the constituent entities of the Russian Federation from the
standpoint of quality of the legal groundwork in different spheres of law-drafting.  

All these results of monitoring of legislation (federal and regional) made some contribution in improving law-drafting and legal enforcement. Legal monitoring experts identified a series of substantive problems that law-drafters must still resolve. They analyzed federal legislation and the legislation of the constituent entities of the Russian Federation from the standpoint of quality of the legal groundwork.

But named results don’t indicate that all methodological and organizational problems were been solved. New, more effective methods of expertise (especially judicial, humanitarian, anticorruptional, economical, ecological and so on) are still in process. Some of named potential subjects of monitoring didn’t become real subjects. Public organisations (parties, different movements and others) don’t jet monitor situation in legislation. Many state institutions (especially in regions) don’t jet understand main advantages of legal monitoring and ignore this practice in their work as a hole and in law-drafting in particular.

Serious problem with financing of sociological support of legal monitoring has remained before now. The question is about financing public opinion polls, expert survey and research of focus groups. It’s necessary also to help development of scientific and public examination of laws and its implementation by methods legal monitoring.

Legal monitoring aims to become an essential mean of regulatory impact on the law-making process and legal enforcement practice. The monitoring results allowed to create a single database of legislative practice and to make important conclusions. It is insufficient to simply develop law-drafting or adopt relevant legislation; it is also essential to foresee the actual mechanism for its implementation, and envision the consequences of its enforcement.

Legal monitoring creates a single database for comparative studies of results of previously adopted conclusions and recommendations in different spheres of socio-economic development inside the country and international relations. The development of legal monitoring system could help to create a new model of state administration, open to institutes of civil society, business, social groups, clear to every citizen, and based on fruitful cooperation between the individual, society and the state.

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References


COMPETITIVENESS AND BETTER REGULATION – IN CONFLICT OR IN HARMONY?
DEVELOPING CONSUMER PROTECTION OF AIR PASSENGERS WITH REDUCED MOBILITY IN THE EU
Stakeholder Preferences for Regulatory Choices

Minna Ollikainen

The paper provides an overview of the consumer protection of air passengers with reduced mobility in the EU as well as an update of current developments regarding their rights. The paper discusses stakeholders’ regulatory preferences regarding the consumer protection of air passengers with reduced mobility in the EU, how European Commission proposals and resulting legislation take these preferences into account, and also how key stakeholders’ positions have developed over the past decade. This small case study analyses the views of key stakeholders in three consultations. These indicative results show that the Commission and its right of initiative have had a decisive role in forming the passenger rights and that the European Disability Forum has been very efficient in lobbying for the rights of passengers with reduced mobility. Airline and airport organisations have learned to better accept legislative measures to protect passengers with reduced mobility. Once made public in the latter part of 2010, the contributions for the Commission’s latest public consultation on air passenger rights will provide an update on whether this trend continues.

Disclaimer: The author is an official of the European Parliament. The views expressed in this paper are those of the author and do not necessarily represent those of the European Parliament.

1 Introduction

The number of people in the European Union (EU) directly affected by some form of disability is estimated at around 10% of the total population (COM (2000) 284 p. 4). The entry into force of the Amsterdam Treaty in 1999 introduced new EU competencies in consumer protection (Article 169 of the Lisbon Treaty) and discrimination (Article 10 of the Lisbon Treaty). Article 10 states that in defining and implementing its policies and
activities, the EU shall, among other criteria, aim to combat discrimination based on disability.

As the air transport sector was the first to undergo liberalisation, the Commission put forward the first legislative proposals to ensure passenger rights. Since 2000, the Commission has been active in drafting initiatives and proposals to promote passenger rights, beginning with air transport and the rights of travellers with reduced mobility. In addition, some passenger rights in the EU stem from international law, such as the Montreal Convention of 1999 on air transport.

Over past decade, the European Commission has actively used public consultations both in preparing new policies and legislation on air passenger rights as well as in assessing existing laws. In recent years, the European Commission has also introduced impact assessments in its legislative proposals. In this small case study, the results of three consultations will serve to analyse key stakeholders’ preferences for regulatory choices in the protection of passengers with reduced mobility.

2 Objective

The paper aims analyse key stakeholders’ preferences for regulatory choices in the protection of air passenger with reduced mobility in the EU during the past decade and to discuss the results achieved with the combination of regulatory choices and techniques adopted thus far. The key stakeholders studied include the European Commission, airlines and airports as well as disability organisations. On the basis of Commission documents and position papers presented by other stakeholders, the case study aims to determine the preferences of key stakeholders in guaranteeing the rights of passengers with reduced mobility: Who should regulate and how?

3 Stakeholder preferences regarding who should regulate and how

Mitchell, Agle and Wood (1997, pp. 853–854) define a stakeholder as any person or organization who can be positively or negatively impacted by or cause an impact on the actions of a company, government, or organization. Types of stakeholders are:
- Primary stakeholders, who are those ultimately affected – either positively or negatively – by an organization’s actions;
- Secondary stakeholders, or ‘intermediaries’ (i.e., persons or organizations indirectly affected by an organization's actions);
- Key stakeholders, who have significant influence on or importance within an organization. They can be either primary or secondary stakeholders.

In management studies, stakeholder analysis of corporations aims to develop cooperation between the stakeholder and, usually, a project team. Stakeholder analysis takes place when there is a need to clarify the consequences of envisaged changes or at the start of new projects and in connection with organizational changes generally. In this paper, key stakeholders represent the main groups affected by the legislation in question and the aim is to illustrate how well their views were taken into account in the legislative process.

In the case study, the Association of European Airlines (AEA) represents the airlines, the Airports Council International (ACI Europe) represents the airports, and the European Disability Forum represents the disability organisations. The views of the EU legislators, the European Parliament and the Council of the European Union, are left out of the scope of this paper. Even though both the European Parliament and the Council have in the recent years become more active in influencing the legislative agenda already prior to the Commission proposal, the Commission can be seen to represent the overall European interest in this small case study.

What would be the “correct” level of regulation on consumer protection for air passenger, which would not diminish consumer choice, but nevertheless adjusts the imbalance in economic power between the consumer and the service provider? What would be the optimal balance in consumer protection between interests of airline industry and air passenger, especially one with reduced mobility? Who has the power to regulate and who should – according to key stakeholders – have the power to regulate? Does consumer protection in air transport suffer from ‘regulatory gaps’ described by Weatherill (2005, p. 20), where Member States are precluded from taking action by Community law but where the Community fails to act? How are the rights of persons with reduced mobility ensured?

As the European Union has been extending the Community-level passenger rights from the air transport to other modes of transport (e.g., COM (2005) 46), the evaluation of the experiences in air passenger protection is timely. Karsten (2007, p. 135) finds that in passenger law, traditional EC consumer law has developed an independent branch. He
considers that passenger regulations are the most developed example of the full harmonisation of European private law. In addition, the analysis of air passenger protection in the EU is relevant for other branches of consumer law, which are being developed towards further harmonisation (i.a., Commission proposal for a directive on consumer rights COM(2008) 614).

Micklitz (2008, pp. 10–12) finds that the EU has in its transport legislation used private law instruments for contract law and liability, traditional regulatory instruments for mandatory rules, and agrees with Karsten that the aim has been full harmonisation. As regards contracts for services, he catalogues the 2001 Voluntary Commitments by airlines and airports as co-regulation, and IATA's Recommended Practice 1724 on Air Passenger Rights as self-regulation by the air transport industry (Ibid. pp. 23–24). Micklitz lists participation of stakeholders under 'voluntary basis' (Ibid. p. 24), even though the Commission had a very active role in setting up the 2001 Commitments and threatened to include some of the specific minimum criteria in its planned legislation on contracts, unless the airlines agree on ‘convincing’ commitments by April 2001 (COM(2000) 365, p. 16).

As regards safety rules, airlines are used to being subject to Regulations as directly applicable legislative acts. In most other cases, the airlines seem to prefer soft-law instruments like voluntary agreements by the airline industry associations instead of legislative interventions by the national or EU authorities. For the average consumer, the regulatory choice can be assumed less important as long as the air passenger rights are honoured and enforceable (c.f., Weatherill 2005, Karsten 2007, Micklitz 2008, COM(2000) 365). The disability organisations have on several public consultations indicated a strong preference for binding and enforceable legislative measures.

Micklitz (2008, p. 33) deems on the basis of his overview of the different sectors of EU service regulation that the Commission applies an instrumental, sector-related approach and “understands each new sector as a testing ground for new tools, strategies and instruments”. On the contrary, Karsten (2007, p. 135) finds that at least as regards different transport sectors, the trend is to abandon separate industry-specific legislative regimes and apply standard concepts of EU consumer law. However, Passenger Regulations remain sector-specific and risk eventually suffering from the lack of cohesion (Ibid. p. 133).

The consumer protection of air passengers with reduced mobility cannot be considered to suffer from ‘regulatory gaps’ described by Weatherill (2005, p. 20), where Member States are precluded from taking action by Community law but where the Community fails to act.
In any case, choice of regulatory technique as well as the level of regulation (e.g., European versus national and administrative versus judicial enforcement) plays an important role in developing air passenger protection in the EU. A key question is how to achieve the best possible regulation for all parties involved: 1) who should regulate (global level, EU, Member States, airlines/airports); 2) in which way (international treaties/conventions, EU regulations/directives/recommendations, national law, voluntary agreements, codes of conduct)?

4 Development of rights for air passengers with reduced mobility

How did disability, consumer and transport policies and legislation get together at the Community/Union level? The European Community's involvement in the area of disability policy was originally limited and restricted in the absence of Treaty competencies (Waddington 2006, p. 51). The Commission established between 1974 and 1996 four multi-annual disability action programmes, which aimed at promoting exchange of information and best practice, and contributing to the creation of a wider disability policy at Community level. Waddington (2006, p.6) finds it positive that European networks were set up, even if no broader disability policy was achieved at the time. The early disability action programmes were criticised for failing to involve the disabled (Ibid. p. 21). Therefore the two latter action programmes in the later 1980s and early 1990s, Helios I and II, actively encouraged development of disability non-governmental organisations (NGOs) and, even more importantly, established a formal consultation mechanism with these organisations. Under Helios II programme, the Commission had a key role in launching the European Disability Forum, which has later become an independent body. By 1996 political climate had changed: the principle of mainstreaming made disability action programmes unfashionable and they were discontinued. Waddington (2006, p. 6) also points out that in 2003 a new disability specific action programme was adopted and, perhaps paradoxically, one of the key objectives is the mainstreaming of disability issues.

In the field of legislation, the Council adopted in 1986 a non-binding Recommendation 86/379/EEC on the Employment of Disabled People, which was the first attempt to come with a broad policy instrument. The anti-discrimination measures at Community level have been mainly concentrated at employment, and only in 2008 the Commission made a proposal for a Regulation to implement the principle of equal treatment between persons
irrespective of religion or belief, disability, age or sexual orientation outside the labour market (COM(2008) 426). Outside anti-discrimination, most of specific EU rules on services concern quality and safety, which is mainly relevant for transport and energy supply (Micklitz 2000, p. 24).

The Commission presented in 2000 a Communication on the Protection of Air Passengers in the European Union (COM(2000) 365), which launched a new era of initiatives on air passenger rights. The Communication could even be considered as a White Paper preceding major new legislative proposals. Based on the European Commission presentation in the communication, the protection of air passengers can be divided into four different areas:

1) Safety-related provisions (air carrier liability for death and injury);
2) Contractual conditions of carriage (internet booking, delays, denied boarding, lost and damaged baggage, bankruptcy of the airline, package travel, ticket pricing, electronic tickets);
3) Airline business practices (computer reservation systems, code-sharing, interlining, frequent flyer programmes, air fares, no frills airlines);
4) Information and transparency (data protection, simple procedures for lodging complaints and settling disputes, making service quality reports available, strengthening the representation of passengers).

In 2001, 29 European airlines adopted a voluntary agreement to improve air passenger rights: Airline Passenger Service Commitment, which covers 14 areas. On that basis, each airline would develop their individual Service Plans. One of the areas covered is the commitment to provide assistance to passengers with reduced mobility and passengers with special needs. At the same time, Airports Council International (ACI) Europe adopted Voluntary Commitment on Air Passenger Service covering 11 areas, starting with persons with reduced mobility. Both commitments are accompanied with a two-page attachment on meeting the needs of people with reduced mobility. The signatory airlines and airports developed their own individual service plans, which incorporated also international provisions, notably ICAO Annex 91 and its follow-up ECAC Document 30 (Section 5).

The Regulation 1107/2006 concerns the rights of disabled persons and persons with reduced mobility (PRMs) when travelling by air is a specific part of a general plan to reinforce passenger rights on all forms of transport. Persons placed at a disadvantage by reduced mobility, whether caused by disability, age or another factor, should have opportunities for air travel

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1 One of the 18 technical annexes to the Convention on International Civil Aviation, also known as the Chicago Convention.
comparable to those of other citizens. Under the regulation, people with disabilities and/or reduced mobility are protected from being discriminated against during reservation and boarding. They are also entitled to receive assistance at airports (on departure, on arrival and in transit) and on board airplanes2.

During the negotiation process of Regulation 1107/2006, the Commission committed itself to launch a study and make a report on the scope of the liability of air carriers if a wheelchair or other mobility equipment is destroyed, damaged or lost during a flight. The main results were presented in a Commission Communication (COM(2008) 510). The Commission is currently assessing the state of play of the implementation and will on that basis decide whether further legislative action is needed.

5 Public consultations as a policy-making tool

Public consultations have become over the past ten years a key tool for the Commission to find out about the stakeholders’ views and thereby to improve the quality of legislation. Development of EU air passenger rights has been one of the first areas, where the European Commission has used public consultation widely. At least in the field of air passenger protection, the Commission has in its public consultations moved from asking general comments towards specific questions in a structured manner.

The Commission continues to actively use public consultations. Nowadays, the public consultations are conducted only in electronic format via the Commission’ interactive policy-making tool. The contributions for the latest consultation on air passengers’ rights should have reached the Commission by 10 March 2010. In this public consultation, the Commission summarises “the main points identified where there seems to be room for regarding the application of three regulations” (Commission Public Consultation 2009, p. 2):

1) Regulation (EC) 889/2002 on air carrier liability in the event of accidents, notably regarding limited liability for lost, delayed or damaged baggage, with special attention to mobility equipment checked in by passengers with reduced mobility;

2) Regulation (EC) 261/2004 on compensation and assistance to passengers when boarding has been denied, the flight has been cancelled or when there is long delay; (Excluded from the scope of this paper.)

2 For more information, check the Commission website on PRM: http://ec.europa.eu/transport/passengers/air/prm_en.htm.
3) Regulation (EC) No 1107/2006 on the rights of passengers with reduced mobility.

The contributions\(^3\) of the public consultation have not by end of June 2010 been published on the Commission’s website. The Commission will use later in 2010 the results of the public consultation to assess the legislation on air passengers’ rights\(^4\).

6 Case study

The paper includes a limited case study, which will analyse the replies given on the rights of air passengers with reduced mobility by key stakeholders in one public consultation by the Commission on its Communication COM(2000) 365 on Protection of Air Passengers in the European Union and one non-public consultation on the same Communication by the European Parliament and the results provided in the Civic Consulting’s study. The compensations for delayed flights are left outside the scope of this paper.

6.1 Commission

The Commission is the main initiator of legislation in the EU. With its Communication on Protection of air passengers, the Commission aimed at opening a discussion on how to best strengthen the representation of passengers with Member States and passengers’ organisations (COM(2000) 365, p. 4).

The Commission, however, admits that overregulation could raise costs, reduce competition and co-operation between airlines (Ibid. p. 7). It acknowledged the difficulty of enforcing the Community legislation, for which “adequate mechanisms and sanctions may not be in place” (Ibid. p. 6). Nevertheless, it finds that “legislation will doubtless be needed but will

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\(^3\) Rather surprisingly, in the call for public consultation on air passengers’ rights, the Commission is also interested in getting the views of the European Parliament and the Council. Even though the cooperation between the institutions is close, it hard to imagine that the Parliament or the Council as EU legislators would respond to Commission’s public consultation call for Member States authorities and interest organisations through a website.

\(^4\) The Commission organized a Stakeholder Hearing in Brussels on 28 June 2010 to analyze the results of the latest public consultation.
be not the whole solution: voluntary commitments taken by the airlines, may sometimes be an effective course of action” (SEC(2000) 535).

As regards ensuring rights of disabled people in air transport, the Commission lists in the Communication the advantages of using Community legislation: various requirements could be set without high costs. Assistance to and from the aircraft free of charge, special assistance, guide dogs in the aircraft cabin and full liability for loss or damage to wheel chairs are among the examples mentioned (COM(2000) 365, p. 13).

The Commission welcomes the preparatory work by the Association of European Airlines on a set of basic commitments on passenger service. Among other minimum criteria, the Commission requires that the commitment will include provisions to meet the needs of the disabled, e.g., training staff and disseminating information (Ibid. p. 15). As mentioned in Chapter 4, the Commission also demanded the airlines to agree on “convincing” commitments by April 2001, otherwise some of the minimum criteria listed would be included in its planned legislation on contracts (Ibid. p. 16).

The Commission also recognised the need for informing passengers of their rights (Ibid. p. 6). In the draft Charter on Air Passenger Rights in the European Union suggested in 2000, the Commission does not mention passengers with reduced mobility at all (SEC(2000) 535). The Commission has been worried among other things about the inconsistency in treatment of passengers with reduced mobility: concerned about discriminatory charges and some low-cost airlines charging extra fees from passengers, and has responded by proposing legislative measures, which resulted in Regulation 1107/2006.

In the unpublished comments for the European Parliament, the Commission states that passengers’ essential interests should be protected by legislation, which allow legal enforcement. This category should include air carriers' liability for damages in the event of death and injury, delays and mishandling of baggage as well as denied boarding. In the Commission's view (Replies to Questions, 2000, p. 1), Community legislation could first be extended to "reinforce rights is the event of denied boarding and to extend them, where appropriate, to cancellations and to long delays” and "set minimum requirements for airlines' contracts, so that there is legal certainty for both sides and a better balance of rights and obligations between airlines and passengers. These should also cover the rights of the disabled people.” Second, the other interests can be advanced through voluntary commitments. These would mean services offered by airlines, such as offer of lower fares, rapid notification of delays and cancellations, faster check-in, and handling of complaints (Ibid. p. 2).
In 2008, the Commission analyses a study it commissioned regarding the possibility of improving the rights of air passengers whose wheelchairs or other mobility equipment was destroyed, damaged or lost (COM(2008) 510, p. 2). The actual number of incidents with mobility equipment is very low: little over one complaint per million passengers (COM(2008) 510, p. 3). Nevertheless, passengers with reduced mobility are travelling less by air than the average population and one of the reasons could be that they are worried that their mobility equipment is damaged or lost. Another reason is that the compensation levels under the Montreal Treaty and the EU legislation implementing it is far lower than the value of an electric wheelchair (Ibid. p. 9).

The immediate assistance to PRMs whose wheelchair has been lost, damaged or destroyed is currently covered by voluntary commitments by airlines and airports. However, the Commission states that voluntary agreements are not always properly honoured: few airlines and airports developed their own plans to implement the voluntary agreements, the plans adopted and the results are different, and the plans or customer policies are not always published (Ibid. p. 4).

In 2008, the Commission did not propose immediate legal action on the issue (COM(2008) 510, p. 10). The Commission proposed to the Council that EU could launch an initiative within ICAO to clarify the situation and encourage the airlines to unilaterally waive the current liability limits on mobility equipment.5

### 6.2 Organisations representing airlines and airports

#### 6.2.1 Association of European Airlines

In its comments to the Commission Communication on Air Passenger Rights (COM(2000) 365), Association of European Airlines (AEA Comments 2000, pp. 1–5) states its clear preference for self-regulation by the industry and voluntary agreements. AEA point out that there is a problem in ensuring the application of the EC Regulations and that appropriate measures should be taken before strengthening legislation. AEA wonders why the Commission has not included an impact assessment in the form of cost/benefit analysis. The Comment paper does not mention persons with reduced mobility.

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5 As of 18 March 2010, the Commission has not published on its website the report foreseen in Article 17 of Regulation 1107/2006, which would include a chapter on the rights of PRM whose mobility equipment has been lost damaged or destroyed.
In the unpublished comments for the European Parliament, the AEA underlines the importance of the Voluntary Commitment. AEA (2002, pp. 1–2): "Once the framework of the Voluntary Agreement is available and the names of the airlines who will be signatories are known, the regulators will then decide what remains outside and may require legislation. The implementation of the Voluntary Agreement would need to be monitored by the authorities with regular reports as it is done in the United States." There is no reference to PRMs.

When the Airline Passenger Service Commitment was signed in 2001, Association of European Airlines (AEA) Secretary General Karl-Heinz Neumeister stated: “The European Commission has made it clear, throughout the process, that they prefer a voluntary code to a legislative solution” (AEA press release 2001, p. 2).

In 2009 Position Paper (p. 3), AEA says that no further regulation is needed, except to implement the current legislation. "The biggest problem today is lack of coherent implementation, application and interpretation at Member States' level.” (Ibid. 2009, p. 4).

In the replies on the study on the compensation thresholds of lost or damaged mobility equipment, airlines (AEA was one of the respondents), majority of airlines states that the procedures for lost, damaged or destroyed wheelchairs or mobility equipment as well as immediate replacement equipment meet the needs of PRM (Civic Consulting 2008 p. 77) and there is no need to improve administrative enforcement of the existing rules (Ibid. p. 104). Majority of airlines considered the compensation limit of the Montreal Convention appropriate (Ibid. p. 88). Majority of airlines do not consider that there is a need to improve the existing rules regarding compensation thresholds (Ibid. p. 102).

6.2.2 Airports Council International ACI Europe

Airports Council International (ACI) Europe, which represents over 450 airports in 45 European countries, is selected as the representative of the airlines. In its Position Paper of 2000 on the Commission communication on the Protection of Air Passengers in the EU, ACI Europe welcomes the Commission’s objective to promote air transport industry’s voluntary commitments to improve service, but rather than aiming at pan-European voluntary commitment for airports, European guidelines to be implemented at national level should be adopted instead. In addition, ACI believes that “voluntary commitments would benefit the consumer more than a new and necessarily complex legal framework. Over-regulation would be
detrimental to all parties involved in the process of legislation on air passenger rights [...]” (ACI Europe Position Paper of 2000, p. 1).

ACI Europe disagrees with the Commission’s assumption that the ground services for Persons with Reduced Mobility could be provided without major costs (ACI Europe Position Paper of 2000, p. 3). However, ACI Europe agrees that airports should make sure that their infrastructure suits the needs of PMRs.

In the unpublished comments for the European Parliament, ACI Europe underlines the importance of the pan-European voluntary Charter for the protection of air passengers (ACI Europe Comments 2000 cover page, pp. 1–2). As regards rights of persons with reduced mobility (Ibid. p. 3), ACI Europe recalls that the process of assistance in boarding the aircraft is a ground handling activity as defined in Directive 96/67 and should be treated as general airport facilities. In order to avoid any disadvantages for PRMs, ACI Europe considers that the costs could be shared between all passengers making use of air transport.

ACI Europe adopted a Voluntary Commitment on Air Passenger Service in 2001, which has Persons with Reduced Mobility as first commitment out of 11: “Each airport will prominently publicise the services it offers for assisting passengers with reduced mobility (PRMs). Most crucially each airport commits itself to the new special protocol on ‘Meeting the needs of the people with reduced mobility’.” The attached protocol is the interlinked with the protocol of airlines’ voluntary agreement.

In the ACI Europe Position Paper of 2005 on the proposal for PRM Regulation, the level of regulation or the regulator is not anymore discussed. ACI Europe simply notes the adoption of the Commission proposal and insists that airlines must not be able to opt-out of the centralised assistance service for the PRMs, and that airlines must pay a charge for airports to cover the assistance costs.

In the replies on the study on the compensation thresholds of lost or damaged mobility equipment, airports (ACI Europe was one of the respondents), approximately half of airports states that the procedures for lost, damaged or destroyed wheelchairs or mobility equipment and immediate replacement equipment meet the needs of PRM, but some concerns were raised about the appropriateness of the replacement equipment and that airlines or passengers may not always have information about the availability of replacement equipment (Civic Consulting 2008 p. 80). A considerable percentage of airports (3 out of 9) did not express a view in this matter.
6.3 European Disability Forum as representative of the disabled people

When the Commission organised a public consultation “Air passenger rights in the European Union” in view of its Communication of year 2000 (COM(2000) 365), it received 61 replies from different stakeholders: the Member States, airlines, airports, travel agents and consumer organisations as well as 11 organisations representing the disabled (COM(2000) 365, pp. 24-26). The European Disability Forum, which is the European umbrella organisation for the disabled, has been chosen to represent the disability organisations in this case study.

In its replies to the Commission’s public consultation on air passenger rights in 2000 (DOC EDF 00/02 p. 4), the European Disability Forum welcomes the Commission’s idea for a [non-binding] Passengers’ Charter, which would aim at ensuring that a minimum standard of service is offered to all passengers. However, the EDF requests that the Commission includes all points raised in the reply in the development of the European legislation in this field (Ibid. p. 7). The overall preference is thus on the binding legislation at Community level.

EDF in its response paper of 2002 to the Commission consultation paper on Airlines’ Contracts with Passengers “strongly supports the European Commission’s plans to propose legal obligations to carry PRMs and to provide a package of assistance free of charge” (DOC EDF 02/15 p. 3). The EDF supports also voluntary agreements, but is “greatly concerned” that not all airlines sign up and points out that there have been problems with air carriers which are “very unlikely” to sign up (Ibid. p. 3). It reiterates its strong support to Community legislation several times in the response paper (DOC EDF 02/15 pp. 3, 5–6).

In 2004, when commenting the Commission Staff Working Paper on Rights of Persons with Reduced Mobility, the EDF presents its preference for binding legislation in a very clear manner: “EDF strongly believes that certain matters relating to disabled air travellers or travellers with reduced mobility cannot be addressed through voluntary commitments and must be addressed through European legislation.”

In the replies on the study on the compensation thresholds of lost or damaged mobility equipment, disability organisations (European Disability Forum was one of the respondents), majority of PRM do not believe that the procedures for lost, damaged or destroyed wheelchairs or mobility equipment and immediate replacement equipment meet the needs of PRM (Civic Consulting 2008 p. 84). Overwhelming majority of PRM organisations considered the compensation limit of the Montreal Convention insufficient
PMR organisations believe there is need to improve the existing national or EU legislation in these respects (Ibid. p. 114).

6.4 Summary of the case study

The results of case study sample data can be roughly summarised as follows:

Figure 1 Development of stakeholder preferences on regulatory choices concerning rights of air passengers with reduced mobility

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Commission</td>
<td>Community legislation/ Voluntary commitment</td>
<td>Considers new EU legislation</td>
</tr>
<tr>
<td>Airlines</td>
<td>Self-regulation/ Voluntary agreement</td>
<td>No further legislation is needed</td>
</tr>
<tr>
<td>Airports</td>
<td>European guidelines implemented at national level</td>
<td>Takes note of Commission proposals</td>
</tr>
<tr>
<td>Disability Forum</td>
<td>European legislation, but welcomes also Voluntary agreements</td>
<td>European legislation</td>
</tr>
</tbody>
</table>

7 Conclusion

The Commission estimates that around 10% of the European population suffers from reduced mobility⁶ (COM(2005) 46 p. 9) and that the amount will increase significantly with the aging of population. During the past decade, the EU institutions, airline industry and organisations representing airlines, airports, consumers and people with disabilities have invested significantly in improving air passenger rights in Europe. Different means have been used to achieve better protection of air passengers in general and persons with reduced mobility in particular. Consequently, consumer protection in air transport in the EU is currently subject to several types of regulation at various levels by different actors.

The Commission has increasingly used public consultations both when preparing legislation and when evaluating its effect. The disability organisations are one of the most ardent and efficient lobbyists of EU legislation. The Commission has had an important role in encouraging and supporting disability organisations. The case study sample on the rights of air passengers with reduced mobility clearly confirms that the disability

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⁶ The figure on persons with reduced mobility includes not only disabled persons but also persons needing assistance when travelling due to age or illness.
NGOs are excellent in getting their points included in the EU legislation. Perhaps the successes in early cases like the lift directive have encouraged the disability organisations to fight for their rights.

The Commission has been very active in coming up new rules to protect disabled air passengers in the recent years and moving towards more detailed legislation. Over the period studied and in the specific cases analysed, the European Disability Forum has been consistent in its demand for binding legislative measures. The airlines and airports have moved their preference from voluntary agreements towards better acceptance of legislative measures, but they prefer to avoid new rules and insist on better implementation of the current measures.

Overall the implementation of and compliance with the legislation in force would be worth further analysis. In April 2010, the disruptions to the air traffic due to the Icelandic volcanic ashes put the compliance with the EU air passenger legislation under a very severe test. The Commission’s impact assessments on the legislative proposals, which were introduced in 2002, have not yet been fully implemented in the proposals concerning air passenger protection. This will be an interesting issue for future follow-up. Another interesting issue for follow-up is the EU accession to the UN Convention on the Rights of Persons with Disabilities. It will also be interesting to study the results of the latest public consultation on air passengers’ rights, when the contributions will be made available in the second half of 2010, and to see if the trends on stakeholder preferences for PRM rights remain similar to the ones identified in this paper.

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**Books, reports and articles as well as other material**

ACI Europe. (2001). Airport Voluntary Commitment on Air Passenger Service


COMPENSATORY FINES IMPOSED BY THE FINNISH LABOUR COURT TO LOCAL TRADE UNIONS IN THE CASE OF ILLEGAL INDUSTRIAL ACTION

Anssi Keinänen and Teemu Tukiainen

Abstract

The aim of the study is to analyse the breaches of collective bargaining agreements by local trade unions and the determination of compensatory fine by Labour Court. We try to identify factors that affect the determination of the compensation payment.

The research data covers the Labour Court’s cases in Finland from 2000 until end 2009 where local trade unions have been charged with illegal industrial action. The data covers 101 cases of the Labour Court where the law of collective labour agreement was broken by local trade unions. The data contains information on 258 local trade unions’ compensatory fines and other relevant factors.

Empirical results show that when economic loss increases with € 100 000 the compensatory fine will be € 18 more than otherwise. The result is statistically significant. We can conclude that although the result is statistically significant, the impact of economic loss on the compensatory fine is rather insignificant in practice to create the deterrence effect on local trade unions to avoid illegal industrial actions. In the future in Finland, we must engage in the optimal level of compensatory fine so that it will create for both parties (employees and employers) incentives to not to violate the Collective Agreement Act or spirit of it.

1 Introduction

Significant monetary losses occur yearly because of illegal industrial actions. This topic pops up to the news every time when some big employees’ organisation threatens to start a strike. Especially the Confederation of Finnish Industries (EK) is asking how reliable the present system is, if it cannot guarantee one of the most important things of collective labour agreement, that is, permanent industrial peace.

In Finland, the Labour Court hears and tries the legal disputes arising out of collective agreements. The Labour Court also imposes sanctions for a breach of these agreements. The possible sanction imposed by Labour Court is a compensatory fine. In 2009, the maximum fine in the Collective Agreement Act is EUR 28 300. The compensatory fine is payable to the
employers’ or employees’ organisation, not for example for a single firm, winning the specific case.

EK criticises that the compensatory fine does not correlate in the same ratio with the damages caused by industrial action. Employees’ side sees the illegal industrial actions as a way to express their feelings against employer’s plans of reducing labour. According to the President of Labour court, Pekka Orasmaa, employer’s monetary losses are not the prime criterion when determining the amount of compensatory fine (HS article 24.8.2008).

Above there were introduced three different subjective aspects about the current state of the labour system. Comprehensive clarification does not exist. This research aims to give objective facts about the criteria which affect the amount of compensatory fine. Research also compares how the criteria fit with the economic theory of contract remedies. The ground for this research is the data which consists of all cases of Labour court where employees’ side has been charged with illegal industrial action. The data will be analysed statistically by the multiple independent variables regression method.

It seems that Labour Court does not have tools which are effective enough to prevent illegal industrial actions. The research also reveals the imperfections of Labour Court’s methods. On the Law and Economics point of view, considering the criteria which affect the sum of compensatory fine, the Court should prefer more monetary arguments instead of others. The Court should also give more detailed justifications of judicial decisions. That would ease all parties to understand better which criteria affect the amount of compensatory fine and by which intensity.

Table 1 shows the reasons for the strike in Finland in 2009.¹ The table shows that the most often strikes are related to the disagreements with the pay, the amount of labour or work arrangements. In fact, 84 % of the reasons for strikes are concerned one way or another employer Direction right².

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¹ EK’s industrial statistics 2009.
² Kairinen (2002) p.107 and Kairinen (1983), p. 53–65. The employer has the right to manage and monitor his employees. Direction law is a base for a distinction between the employer and the employee, the employee is subordinate to the employer.
<table>
<thead>
<tr>
<th>Reason of Industrial Action</th>
<th>Number of Industrial Actions</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>The requirement to pay or other wage dispute</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Workforce reduction or threat of it</td>
<td>58</td>
<td>57</td>
</tr>
<tr>
<td>Procedures of supervision, work organisation</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td>Working conditions, occupational safety and health</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Other internal reason</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Sector’s collective bargaining</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Support Measure</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Other external reason</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Reason not reported / not known</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>101</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>


In response to illegal industrial action, the employer may bring a suit against the employee side. The action goes to the Labour Court, whose task is to concern the problem of collective bargaining and collective agreements resulting from the application and interpretation of disputes and breaches of industrial peace. As far as the defendant is found a guilty, the defendant can be doomed according to the collective bargaining law (436/1946) 9 § to pay compensation fine. Currently, a compensatory fine is limited to a maximum fine of EUR 28 300 per industrial action.

In 2000–2007 Finland had lost in industrial actions the third highest amount of working days in the EU countries relative to the number of employees.³ Priority must therefore be considered the loss of labour disputes arising from the loss of labour input. It should also be noted that industrial actions in many cases are detrimental to third parties; customers, suppliers and subcontractors are often unable to prepare for sudden changes quickly enough, or they do not have any alternative or substitute available. It is noteworthy that in such situations, these interest groups may have a right to damages, for example due to late deliveries⁴. The actual payer of the damages is not only the company itself, but also the consumers who have to pay part of the loss in increased commodity prices. The question of how much that share will be depends on the field of the company and on how competitive the sector is.

The study examines the breaches of collective bargaining agreements by *local trade unions* and the determination of compensatory fine by Labour Court. The determination of trade unions’ fines is not made clear in

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³ Statistics Finland’s publication 2007. Only Spain and Italy were above Finland.
this study. This is to ensure that research data should be as homogenous as possible⁵. The aim of this study is to determine empirically by which criteria the compensation amount of the fine is assessed, for example, the weight of the duration of the strike, financial loss incurred by the strike or the number of participants for the strike⁶. The legislature has left wide discretion for the authority applying the law, in this case, for the Labour Court, writing the law that ”where the duty to convict must take into account all the points of the circumstances ... “⁷. These circumstances are not written on, but the legislature has found sufficient to mention a few of the main circumstances which at least must be taken into account. Therefore, the question arises how far the Labour Court, by imposing a compensatory fine, has emphasised the different circumstances and, in particular, where does it estimate to set up the yardstick.

This study aims to identify factors that affect the determination of the compensation payment. Chapter 2 introduces the compensation payment for essential determinants; identifies the Finnish legal status and presents the various forms of industrial action and their underlying causes. Chapter 3 presents the statistical data, or the Labour Court case law dealing with industrial action. In chapter 4 the statistical analysis is carried out and the results are presented. The fifth chapter goes through the investigation and the issues raised in the conclusions presented.

2 Finland’s collective labour market system

2.1 The preliminary aspects of the Finnish labour market system

The labour market’s rules consist a package, which includes the Employment Contracts Act (436/1946), labour disputes, conciliation Act (420/1962) and the umbrella between the Conventions, which govern the procedures for negotiations⁸. At the individual level are matters governed by labour contract law (55/2001). The investigation was limited to examine these whole labour standards in perspective: this case will weigh the matter

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⁵ In the future, it would be good if the breaches of collective bargaining agreements by officials would be also analysed.
⁶ Shavell (2004), p.1–3. This is the approach to be appointed for a positive aspect of Law and Economics. It will examine what the case really is.
⁷ Employment Contracts Act 10 §.
first and foremost law on collective agreements in the industrial peace obligation on the basis of the provisions.

The main achievement of the collective bargaining system, is to allow the interests of both parties into the agreement. Employers' side, this means first and foremost as comprehensive as possible the working climate and the fact that direction right is as unrestricted as possible. Employees in turn require effective consultation system, basic safety and the possibility of operation also when a collective agreement is in force.9

2.2 The collective Agreements Act and its special features

The collective Agreements Act (436/1946) sets the reference frame within which the collective agreements and contracts can be mirrored. Collective Agreement is a special contract, which is agreed on behalf of third parties: the signatories to the agreement, therefore, are regulated in relation to external relationships. A collective agreement shall be binding on:

1) the employers and associations who or which concluded the collective agreement or subsequently accede to the agreement in writing and with the consent of the parties;
2) registered associations which are subordinated directly or through one or more intermediaries to the associations mentioned in the preceding point; and
3) employers and employees who are, or during the period of the agreement were members of an association bound by the agreement; and the said employers and employees shall be required to observe the provisions of the collective agreement in all contracts of employment concluded between them.

Collective Agreements Act 6 §: Where any part of a contract is at variance with a collective agreement applicable thereto, such part of the contract of employment shall be invalid and superseded by the corresponding provisions of the collective agreement.

Collective Agreements Act 7 § sets a ceiling for compensatory fine. If any employer or employee bound by collective agreement knowingly violates, or should reasonably become aware of infringing the provisions of the collective agreement, may be sentenced to pay a compensatory fine not

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exceeding € 28 300 in the case of an employer and not exceeding € 280 in the case of an employee.\(^\text{10}\)

According to the 8 § of Collective Agreements Act a collective agreement shall bind all employers and associations who and which are parties thereto or otherwise bound thereby, and likewise any associations whose members or subordinate associations mentioned in point 2 of the first paragraph of section 4 have concluded the agreement with the consent of the association, to refrain from any hostile action directed against the collective agreement as a whole or against any particular provisions thereof. Furthermore, the associations which are bound by the agreement shall be required to ensure that the associations, employers and employees subordinated to them and covered by the agreement refrain from any such hostile action and that they do not contravene the provisions of the collective agreement in any other manner.\(^\text{11}\) Control cannot be merely formal, but it requires a situation of a particular activity. It is essential that the association will take industrial action after being notified of circumstances, taking into account sufficiently rapid and effective steps to restore social peace\(^\text{12}\). According to 9§ an association and employer, party to the collective agreement or otherwise bound by it, which does not fulfil its responsibilities under the agreement, as referred to in section 8, shall, unless otherwise stipulated in the collective agreement, pay a compensatory fine in lieu of damages.

If the contravention of the provisions of the collective agreement consists in the fact that a money payment provided for in the agreement was not made, the offender may also be required to pay the amount due.

According to Collective Agreements Act 10 § for a special reason, it shall be possible to refrain from imposing a compensatory fine. Although the law speaks only to a fine to condemn the failure, give a government proposal for understanding that also making fine equitable would be possible for a special reason. The reduction of the Compensatory fine and impunity will be dealt more specific in the later chapter with the impact criteria.\(^\text{13}\).

\(^{10}\) Government regulation of collective bargaining law for compensatory adjustment of the maximum fines 12.18.2008 1007/2008. Serving fine, the maximum credit under review takes place every three years.


\(^{13}\) Government Bill 248/1985 diet.
2.3 The industrial actions in the practise

Compassion Fighting (sympathetic collective action)

Collective action is illegal if it is taken during the current collective bargaining agreement. The exception to the above-mentioned forms of collective action, which is to address non-issue for collective agreement. For example, compassion fight can support another area of ongoing industrial action or a political collective, which we want to inform the decision makers of potential deficiencies in the labour market, in this case, the collective power of the state and not subject to collective agreement\(^\text{14}\).

Compassion Fight is an action taken by other reasons than the employers or workers own benefits. It is an established rule that true compassion fighting does not violate unions own industrial peace obligation.\(^\text{15}\) For labour dispute it is an absolute fact that industrial action could not, even indirectly, be subject to a collective agreement\(^\text{16}\). Compassion battle may be legally taken, notwithstanding that the measures taken are bound by the existing collective agreement. The requirement, however, that sympathy is a measure supported by the labour disputes Conditions of Employment permitted, in other words, illegal industrial action may not be supported.

The work refusal

The most common way to implement the employee side of the industrial action is to refuse to work or go on strike.\(^\text{17}\) A strike is a joint decision of the agreed work out of retirement or, in some cases, merely the work of a failure, either in part or in full\(^\text{18}\). So it does not matter, if any workers are in the workplace or not, fulfilling essential criterion is simply compliance with the provisions of the employer's supervisors. The strike is taken by employees the most serious and usually the most effective collective action. It creates the hardest economically pressure to the employer in order to grant the workers' demands. The strike may include all parties in the workplace or it can be implemented spot strike when only one point in the chain of production or part of the company's employees is on strike.

\(^{17}\) Collective Statistics 2007.
\(^{18}\) It is, however, situations where workers' refusal to work is not considered industrial action. For example, an employer not to pay wages, or fails to comply with safety regulations.
Usually the selected point is the most critical one, which prevents the other parts of the chain functioning. 19 It is also possible that the workers refuse to work on something down. Thus, for example, overtime may be prohibited by the refusal of the collective measure if it is due to other than personal reasons.

**The measure of the threat of industrial action as an industrial action**

The situation can be interpreted as collective action although no concrete steps had yet been made. As an example, the mere threat of a strike is sufficient to take industrial action. A requirement for threat of industrial action to be an industrial action is that, the threatened action if it is implemented would be an industrial action according to the Collective Agreements Act.

Usually, the threat is considered less stringent measure than the threat to the implementation, but it is still always reprehensible act, if the court has been able to prove that the employer has reason to believe that threat would be fulfilled. 20

**Covered industrial action**

Covered industrial action means, according to its name, an industrial action fulfilling characteristics of the law on collective industrial action, but which seeks to 'hide' so that it appears to be other than industrial action. In practice, this occurs so that the breached party denies that he has taken industrial action. Contested the motivation of the industrial action set out, for example, that collective agreement on standards has not been presented, or that the local trade union did not make a collective decision of taking disciplinary action.

In the covered industrial action with the Labour Court's assessment of the industrial action, the decision criterion is the actual consequences of what is really intended and what has been done. If the essential elements of industrial action are fulfilled, there is industrial action even if it is disguised as something else.

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19 TT: 2001-42.
2.4 Reviews about legislature’s set of criteria to convict compensation fine

Labour Court decision is always based on a case by case consideration. Although the court is ex officio obliged to investigate all factors affecting the case, so Collective Agreements Act § 10, however, includes the illustrative list of circumstances which at least should be taken into account when determining the fine credit. The determinants are the extent of the loss, guilt, the other party breaches any of the subjects and size of the association or the company.21

Has the legislature failed to assess those factors responsible for court, it is not collective bargaining law or any government proposals in this respect, to guide how these criteria should be evaluated. The following analyses these criteria, first in terms of what these criteria mean, and, second, how these should be evaluated in Law and Economics from the scientific perspective.

The extent of damage

Extent of the loss is understandable about the amount of economic loss, which is a result of industrial action have been lost. Such losses may be, for example sales or production loss. In particular it should be noted that in assessing the amount of damages involved in the illegal industrial action mainly losses incurred to the other party are taken into account. Losses for third parties are usually excluded from the analysis because these losses are difficult to assess, and their inclusion in the scope of the contract would be nearly impossible.22 However, the saved costs during the industrial action (such as wage and raw material costs) should be taken account when assessing the total amount of the losses caused by industrial action. The difference between losses and savings is the net amount of harm, which in principle should be replaced by a positive interest in accordance with a contract, the breach of the restricted party for the loss should be ”fully covered”23.

An additional challenge is the assessment of extent of the injury labour dispute threatening, especially if it leaves before the realisation, which does not give rise to significant financial losses. In this case, should assess

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the likelihood of threat realisation of a threat at the time of the presentation is and how great a threat in the implementation of economic harm would follow. From law and economic point of view, the amount of the fine should be the same as the probability of occurrence multiplied with resulting injury, in other words the expected loss of income.\textsuperscript{24}

\textit{Extent of guilt}

The amount of guilt in assessing similarities may be sought for Finnish Compensation Law (1974/412) and the Criminal Law (1889/39). Compensation Law § 4:1’s view: “... is obliged to pay an amount which is deemed reasonable by taking into account ... act of nature, causing the accident position, the victim need and other circumstances.” Criminal Law § 6:4 in to states that “punishment must be measured so that it is fair in relation to crime and the dangerousness of the injurious, making motives, and the rest of the offence arises the guilt factor.”

Assessing guilt is first measured with the quality of labour dispute: whether it is a threat, for example, braking, total strike, or perhaps a combination of the above. It is economically justified to impose a fine according to the expected harm. Could one have assumed that the threat is less severe economic consequences of the measure than the strike? Under the principle of \textit{marginal deterrence} strikes should be sanctioned with higher compensation than the treat of labour disputes, because then the factor (for example, an employee union) would have an incentive to refrain from more severe forms of labour disputes.\textsuperscript{25} In other words, if the strike and the treat of strike would be sanctioned equally severely, it should be the same for the trade union to go on strike rather than make a threat. This would not be socially desirable, because the economic consequences of the strike to society are many times higher compared with the fact that the threatening with the strike is nothing more than a threat.

Secondly, in assessing the sanction from an industrial action one should take into account the amount of repetitions. Criminal Law 6:5 § mentions as an aggravating circumstance ”the author earlier crime, if the new offence, and the ratio of crime due to the similarity or otherwise demonstrate a manifest disregard for the law factor prohibitions and commandments.” Collective Agreement Act § 7 states unequivocally that ”where a duty condemnation can be repeated until a collective agreement contrary state of affairs has been removed.” Posner justifies tougher

\textsuperscript{24} Määttä (1999) p. 13.
\textsuperscript{25} Shavell (2004).
punishment for repeaters because of the facts that 1) the earlier illegality establishes a presumption that the author has deliberately acted unlawfully, when the probability of an innocent sentencing is lower, and 2) the criminal has learned and developed their skills in the previous offence, when he is able to operate more efficiently, and as a result of this, paragraph should also be stricter.26

**The other party's contribution**

Explicit criterion means that the victim should influence the emergence of the injury. It can be interpreted that the injured party should have an obligation to try to limit the consequences of the injury. If the victim does not restrict harm of the illegal industrial action when it is reasonable, the amount of the compensatory fine can be moderated. The above-mentioned obligation creates an incentive to the victim to take the optimal amount of due care (or at least more care), in which case the overall costs are reduced27.

The contribution of the other party is not the weight of the so-called "counter industrial act"28. This measure only refers to collective industrial action, which has been put in consequence of the other party initiated the collective agreement or collective agreement for unlawful activities.

**The size of the association or company**

From the law and economics point of view to determine the amount of the fine should not draw attention to the association or member of the company in terms of size, but the fine should be determined according to the harm inflicted. Evaluation of the party could be subjected to property and the ability to cope with the fine. The analogue may be derived from tort law. According to the tort Law, Chapter 2 § 1: "Compensation for damages may be adjusted if the liability is considered excessively cumbersome, taking into account the tortfeasor and the injured party's property conditions and other circumstances.” In the same chapter, however, is an important addition to remark: "if the damage was caused deliberately, however, full compensation for the condemnation, unless for special reasons, be considered reasonable to reduce the compensation.”

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It can be concluded that although illegal industrial action participating organisations would be a weak ability to pay the fine (e.g., due to the low level of membership), it should not affect the amount of the fine if the organisation has understood the illegality of the action.

**Criteria affecting to a compensation fine from the law and economic point of view**

A baseline for determining of compensation must be regarded as net harm of the industrial action i.e. the amount remain after all the savings accruing to the employer (saved wages, unused materials, etc.) has been reduced from harm. Generally accepted an idea in the law and economics is that, in principle, the promisor should cover the damage in full to the promisee.

Law and Economically, the optimal compensation amount of the fine should be only determined in direct proportion to the harm inflicted. Exclusion of other factors in assessing the amount of the fine can be justified for two reasons. First, the evaluation is based authority’s own subjective assessment, which is not always without problems relating to monetary value. Second, the victim can be assumed to undergo only the economic losses; very rarely the victim has experienced another kind of harm from the illegal industrial action than financial loss. The optimal compensation should be equal to the harm caused by the illegal industrial action, because the victim’s experienced harm equals financial loss from the industrial action.29

3 **Research Data**

The research data covers the Labour Court’s cases in Finland from 2000 until end 2009 where local trade unions have been charged with illegal industrial action. The data covers 101 cases of the Labour Court where the law of collective labour agreement has broken by local trade unions. The data contains information on 258 local trade unions’ compensatory fines and other relevant factors.

Table 2 is a brief description of variables in the data. A single case was selected among the data if all relevant information was found from the Labour Court’s decision. In other words, if any relevant information of the local trade union level were not available from the Labour Court’s cases.

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29 See also Eric A. Posner (2000) about the efficient under-compensation.
(e.g., amount of compensatory fine), the case was not selected in the data. The research data consists of 32 per cent of all possible Labour Court cases during 2000–2009. In the following we shortly describe the research data.

On average 2.6 local trade unions participated in the illegal industrial action. In this study the branches of the local trade unions were divided into four categories. Forest covers everything in the forest, wood, paper, paperboard and paper industry and the woodworking industry (35 % of all cases), transportation covers the automotive and transport, including port working stevedores (9 %), metal covers metal and technology industries (38 %), and other group includes all other industries (19 %).

<table>
<thead>
<tr>
<th>Table 2 Summary Statistics</th>
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<tbody>
<tr>
<td>Variable</td>
</tr>
<tr>
<td>Number of cases</td>
</tr>
<tr>
<td>Number of local trade unions</td>
</tr>
<tr>
<td>Number of local trade unions/cases: average</td>
</tr>
<tr>
<td>Forest (N/%)</td>
</tr>
<tr>
<td>Transport (N/%)</td>
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<tr>
<td>Metal (N/%)</td>
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<tr>
<td>Other (N/%)</td>
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<tr>
<td>Size of local trade unions (persons): average</td>
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<tr>
<td>Number of participants per local trade union: average</td>
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<tr>
<td>Organisation of work (N/%)</td>
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<td>Reducing of labour (N/%)</td>
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<td>Wage (N/%)</td>
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<td>Sympathy strike (N/%)</td>
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<tr>
<td>Interpretation of contract (N/%)</td>
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<tr>
<td>External labour force (N/%)</td>
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<tr>
<td>Duration of strike (days): average (min-max)</td>
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<tr>
<td>Economic loss in 2009 value: average (€)</td>
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<tr>
<td>Mean of compensatory fine in 2009 value (€)</td>
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<tr>
<td>Mean of compensatory fine/economic loss in 2009 value: average</td>
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<tr>
<td>Mean of compensatory fine/number of participants in 2009 value</td>
</tr>
</tbody>
</table>

In the data, an average size of local trade unions (number of persons) was 656 and the amount of participants in the illegal industrial action was on average 264 employees. The most common reasons for illegal industrial actions were the organisation of work (37 % of all cases), the reducing of labour (32 %) and the disagreement over wages (24 %). On average the duration of the strike was two days and the longest strike lasted 65 days.

Economic loss is measured in monetary loss, which is indicated in the application caused by industrial action. Economic loss has been modified in the 2009 equivalent value of money. An average economic loss from
illegal industrial action was €1,153,000 in 2009 value. Figure 2 describes the amount of damages from illegal industrial action (€100,000) in the 2009 value for money.

Figure 2  Economic losses in the year 2009 money value. The case of TT:2006-4 was excluded (the loss was 60 million)

The amounts of the compensatory fines have also been changed in the year 2009 monetary value. The average amount of the fine was €2,906. The maximum penalty was €16,500, which is not the same as the possible maximum fine. Minimum amount of the fine was €194.

When comparing the amounts of compensatory fines with the economic losses caused by the illegal industrial actions, the average ratio was 0.023. In other words, an average fine covers somewhat more than two percent (2.3%) of the economic loss. This amount is very far from the economists’ thought, that the compensatory fine should fit the economic loss in the industrial action.

The correlation between the compensatory fine and the economic loss was 0.26, which is lower than the correlation between the number of participants and the economic loss (0.64). Correlations are positive in line with expectations, because the law requires taking into account these variables in determining the amount of the compensatory fine.

Figure 3 describes the relationship between the amount of compensatory fine and the economic loss (€100,000). In addition, a line in
the graph describes the best the linear dependence between the variables (ols estimations). According to a simple linear regression analysis, we can conclude that for every additional €100,000 of economic loss the amount of the compensatory fine will increase only by €40. The result is statistically significant, but in practice the determination of the compensation fine in relation to the harm is insignificant.

![Figure 3](image)

**Figure 3** Relationship between compensatory fine and economic loss (€100,000)

### 4 Statistical analysis

Statistical dependencies in the previous chapter demonstrate the link between two variables. When explaining the amount of the compensatory fine in the empirical analysis, we must control simultaneously several different factors that also affect the compensatory fine. Regression analysis can be used to control the influence of a number of factors in the determination of the compensatory fine at the same time, resulting the ”pure” effect of a single variable.

It should be noted that, in some case, it is inherently assumed that the certain variable has an impact on the determination of the compensation payment. The Collective Agreement Act includes an illustrative list of circumstances which at least should be taken into account when
determining the compensatory fine. These are the amount of the loss, guilt, the other party breaches any of the subjects of labour contracts and the size of the company. On the other hand, the amount of damages should, in principle, affect the imposed compensatory fine. Nevertheless the law does not “tell” how much the influence should be.

An important part of statistical research is to analyse practical significances of the empirical results. A statistically significant result is not necessarily financially, legally or practically significant. For example, even small differences in the compensatory fine between industries will be statistically significant if the number of observation is large enough. However that does not mean that the difference would be significant in the legal sense.

An amount of the fine was explained with eight models. That is because we can analyse whether empirical results depend on the explanatory variables included in the models. Reliability of the results will not be satisfactory if different models give different impact of economic loss on the amount of the compensatory fine.

By adding new explanatory variables, we can examine how the impact of economic loss caused by illegal industrial action on the compensatory fine changes between the models. The greater the changes are, the more important it is to include correct variables in the empirical model. Regression results are reported at Table 3 when the dependent variable is the amount of the fine in 2009 value terms. At the table, we report the size of coefficients and p-values.

The size of the research data was 258 observations. The TT 2006:4 case was excluded from the study, because the loss suffered by the amount of EUR 60 million differed so much in other cases. The next largest loss was in the case TT 2008:81, slightly less than EUR 10 million. One abnormal case distorted the statistical results and in order to give an overview of typical cases one case was excluded from the analysis.

In the models the amount of compensatory fine was explained with the amount of economic loss (€ 100 000), the size of local trade union (number of members), the number of participants in industrial action, the duration of days to industrial action, the number of local trade unions included in the case (also quadratic) and the year. In addition, the models included dummy variables, which take into account both the industry and the cause for illegal industrial action. Empirical models were built so that in the next model, one new variable was included in addition to old variables. This allows us to review how the coefficients in the models are changing when the number of explanatory variables increases.
Table 3 reports the results of the empirical analysis. Coefficients and p-values (heteroskedasticity-robust standard errors were used\textsuperscript{30}) of each variable are reported at the table. In addition, the last row of the table reports 95 per cent confidence interval for the coefficient of economic loss. By analysing the goodness-of-fit of the models we report $R^2$, adjusted $R^2$, p-value of the omitted variable bias test and p-value of the multicollinearity test\textsuperscript{31}.

According to adjusted $R^2$ the last (e.g. eighth) model fits best to the data and therefore we concentrate on analysing the results of that model. Furthermore, the eighth model does not suffer omitted variable bias or multicollinearity. The variables explain 55 percent of the variation in the amount of compensatory fine. Empirical results show that when economic loss increase an € 100 000 the compensatory fine will be € 18 more than otherwise. The result is statistically significant and 95 per cent confidence interval for the coefficient is € 8–28. We can conclude that although the results is statistically significant, in the practice the impact of economic loss on the compensatory fine is rather insignificant to create, for example, a deterrence effect on local trade unions to avoid illegal industrial actions.

The size of the local trade unions is not related to the amount of the compensatory fine. On the other hand, the number of participants is a statistically significant factor to explain compensatory fine. 10 more participants in the illegal industrial action increase the amount of the fine by € 33. The impact is equal than economic loss increasing by € 184 000. The duration of industrial action had no significant effect on the compensatory fine.

Examining the causes of industrial action shows that only in a situation where the cause is the interpretation of the contract agreement, the amount of the compensatory fine differs from the reference group, namely the work of management. In this case, the compensatory fine is around € 2360 higher than otherwise (p-value 0.000). On the other hand, it must be noted that there was only one case in which the reason was the interpretation of the contract and therefore the result is not reliable to make generalisation.

In the metal and transportation industries the compensatory fines are greater than in forest industry when all other factors are taken into account. Results are statistically significant at 10 per cent risk level. Of course there is not any legal reason why the amount of compensatory fine differs between industries.

\textsuperscript{30} See more e.g Wooldridge 2006.
\textsuperscript{31} Reset -test for analysing omitted variable bias and VIF test for analysing multicollinearity.
### Table 3: Results of Regression Analysis

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
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<tr>
<td>Economic loss (100,000 €)</td>
<td>40.3</td>
<td>36.7</td>
<td>16.2</td>
<td>16.1</td>
<td>20.7</td>
<td>20.6</td>
<td>18.1</td>
<td>17.9</td>
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<td>Size of local trade union</td>
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<td>0.0</td>
<td>0.0</td>
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<td>-0.1</td>
<td>-0.1</td>
<td>-0.1</td>
<td>-0.1</td>
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<td>3.3</td>
<td>3.3</td>
<td>3.4</td>
<td>3.3</td>
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<tr>
<td>Duration (days)</td>
<td>32.9</td>
<td>34.5</td>
<td>34.8</td>
<td>28.3</td>
<td>20.9</td>
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<td>1933.4</td>
<td>1923.7</td>
<td>1722.0</td>
<td>2197.3</td>
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<td>Metal</td>
<td>700.9</td>
<td>687.8</td>
<td>579.1</td>
<td>638.2</td>
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<td>Other</td>
<td>-133.3</td>
<td>-140.1</td>
<td>-301.0</td>
<td>-181.2</td>
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<tr>
<td>Year</td>
<td>9.8</td>
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<td>(Number of local trade unions)^2</td>
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<tr>
<td>Reducing labour</td>
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<td>Wage</td>
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<tr>
<td>Sympathy strike</td>
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<tr>
<td>Interpretation of contract</td>
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<tr>
<td>Use of external labour force</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>2441.8</td>
<td>2174.4</td>
<td>1847.9</td>
<td>1784.2</td>
<td>1642.0</td>
<td>1586.9</td>
<td>2255.1</td>
<td>1965.7</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.182</td>
<td>0.229</td>
<td>0.424</td>
<td>0.434</td>
<td>0.500</td>
<td>0.500</td>
<td>0.532</td>
<td>0.551</td>
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<tr>
<td>adj. $R^2$</td>
<td>0.179</td>
<td>0.223</td>
<td>0.417</td>
<td>0.425</td>
<td>0.486</td>
<td>0.484</td>
<td>0.513</td>
<td>0.523</td>
</tr>
<tr>
<td>Omitted variable -test</td>
<td>0.000</td>
<td>0.000</td>
<td>0.004</td>
<td>0.006</td>
<td>0.076</td>
<td>0.078</td>
<td>0.112</td>
<td>0.183</td>
</tr>
<tr>
<td>VIF</td>
<td>1.00</td>
<td>1.03</td>
<td>1.35</td>
<td>1.28</td>
<td>1.30</td>
<td>1.33</td>
<td>9.03</td>
<td>6.99</td>
</tr>
<tr>
<td>95% confidence interval</td>
<td>28.1-52.4</td>
<td>25.4-47.9</td>
<td>6.3-26.0</td>
<td>6.3-25.9</td>
<td>12.1-29.4</td>
<td>12.0-29.2</td>
<td>8.3-27.8</td>
<td>8.0-27.7</td>
</tr>
</tbody>
</table>

When we comparing all the empirical models with each other, we will notice that the economic loss was statistically significant variable to explain the amount of the compensatory fine. The following graph describes the coefficients of economic loss and 95 per cent confidence interval on those coefficients in each of eight models. In the graph, we can see that the coefficients of the economic loss are relatively stable between third and eight models. This is important for the reliability of the results because it is no good that the sizes of coefficients vary a lot depending on the other parameters that have been included in the models. In this study the results of the impact on economic loss on the compensatory fine can be considered reliable because of a small variation of the sizes of the coefficient.
Conclusions

In this study we examined the determination of the compensatory fine for local trade unions in the case of illegal industrial action. Illegal industrial actions cause harm to the employers but actions may cause harm or damage also to third parties. Industrial actions which are against the existing collective agreement are prohibited by law. In this study, we found that the economic losses to employers caused by the illegal industrial action are a significant factor for the economic point of view.

The empirical results show that the amount of economic loss affects the size of the compensatory fine. However, the results are not very flattering from the economic point of view, because the change in the compensatory fine is relatively low in comparison with the change in economic losses: economic losses increased by € 100 000 will increase the compensatory fine only by € 20. This is far from a situation in which the fine is equal with harm occurred by the illegal industrial actions. In addition, factors which are not entitled to the economic analysis of the optimal compensation such as the amount of participants or the size of the local trade unions, explained the determination of the compensatory fine. On the other hand, those variables are mentioned in the Collective Agreement Act as the possible determinants of the compensatory fine.

In Finland the Collective Agreement Act ban illegal industrial actions, but an effective “tools” to implement the law are missing, because of the
amount of the compensatory fines are so low and fines hardly create deterrence effect to avoid illegal actions for employees. The research revealed that the compensatory fines are equal to an average of about two per cent the amount of damages suffered by employers, and the monetary amount of the fines are so low that it is not likely to have an impact to the decisions of the local trade unions.

According to the law and economic analysis, the fines should be the same size as what the employees incurred economic losses actually are. That is meant if the economic losses (including third party) increase by one 1 million euro the compensatory fine should also increase by 1 million euro. This is not the situation what we can find in Finland nowadays.

In the labour market system, more financial thinking should be extended. The question is not only sharing their mutual benefits between the contracting parties, but the costs and benefits should be examined at the whole level of society. It is important for the Finnish international competitiveness point of view that the amount of illegal industrial actions could be reduced to more close the average level of Europe. It would be therefore advisable to consider a compensatory fine reform in Finland. At this moment, the level of compensatory fine is insignificant to prevent illegal industrial actions. In the future in Finland, we must engage in the optimal level of compensatory fine so that it will create for both parties (employees and employers) incentives to not to violate the Collective Agreement Act or spirit of it.

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1 Introduction

Market, hierarchies and networks have traditionally been seen as alternative or competing paradigms of organisational types. In different countries objectives to improve public sector productivity have been resulted to reforms to reorganise the production for public services. The providing public services by bureaucratic organisation or complete privatization of these services are not only solutions to improve the quality and efficiency for providing public services. Le Grand and Barlett (1993)\(^1\) use the term quasi-market because “markets” in the public sector differ from “real” ideal type market in many ways. Le Grand and Barlett outline number of ways in which quasi-market differed in the terms of economic theory from open markets in private sector. Especially in financing and regulating services the differences are great between public and private sector. These differences reflect also the differences in the interpretation the concepts of market, hierarchies and networks.

Hierarchies, markets and networks are well established “model of co-ordination” or governing structures (Thompson et al, 1991; Rhodes, 1997a, b). The market is usually defined within neoclassical model. It is based upon notions of exchange which produce market signals upon which actors are assumed to operate. Equilibrium is the supposed outcome as supply and demand is brought into line (“indivisible hand”). However, other conceptions beyond this neoclassical model are possible. These include the transaction cost economy (Williamson, 1983) and new economic sociology (Granovetter, 1985 and Wagner, 2007). Hierarchies conjure up the idea of bureaucracy, which is characterised a high degree of centralisation of policy making and resource allocation, essentially suggesting a transmission belt to implement central directions, with limited autonomy for the periphery. Public sector organisations tend to have a vertical division of labour based on a hierarchical distribution of authority and responsibility (Walsh, 1995, p. 12). For most post war countries in OECD,

\(^1\) quasi-market is a public sector institutional structure that is designed to reap the supposed efficiency gains of free markets without losing the equity benefits of traditional systems of public administration and financing
public sector has been seen as the archetypical hierarchical organisation, often described in terms of “command and control” command in terms of policy goals and objectives, control in terms of the mechanism to achieve such goals.

As “extended chains of connections and linkages”, networks are often characterized by informal organizational forms and a common ethic or outlook, which often involve the formation and sustenance of trust relationships linked to reciprocity and mutuality. Multiple and overlapping networks create dense patterns of action, interaction and reaction between network members within and between organisations. Networks have often been associated with the critiques of markets and hierarchies. Networks offer an alternative type in a sense that, as Granovetter (1985) argues, economic action is achieved through actors operating in networks, not as atomized individuals. Similarly, Powell (1991) rejects the market – hierarchy dichotomy in favour to networks. To summarize the conclusion of literature, the trilogy of hierarchies, markets and networks are different organisational types, with different co-ordination mechanism: “If it is price competition that is the central co-ordinating mechanism of the market and administrative orders that of hierarchies, then it is trust and co-operation that centrally articulates networks” (Thompson et al, 1991, p. 15).

In those countries, which have adopted in there reform policy on public sector so called NPM paradigm (New Public Management), it could be seen some transmission policy to more market based action. Some part of policy measures are privatisation of public owned enterprises and other part of policy measures are called the adaption of market type mechanism in public sector regulation.

2 Some general orientation to quasi-markets analysis

The traditional orientation to toward public finance construes its object, state, as intervening in the economy to change the resource allocations that would otherwise have resulted. The seminal articulation of this orientation is Richards Musgrave’s (1959) treatise The Theory of Public Finance. Musgrave presented a three-fold analytical schema for state intervention that has provided the foundation for fiscal theorizing since. Musgrave conceptualized the state as pursuing its tasks within a three part budgetary framework whose elements were allocation, distribution and stabilization. The dichotomy between allocation and distribution is still full play in contemporary fiscal theorizing. The interest in stabilization through fiscal
policy is also still alive, except that it is now treated as a topic for macro theorizing more than in fiscal context.

For policy conclusion it is important to know that distribution of income and allocation for resources affects each other. Change in income distribution causes also a change in supply of public goods. It is proved (Richard Musgrave) that decisions of these two phenomenons can be separated, but then it must assume that taxes are so called lump sum taxes. But in general the supply of public goods is financed in other ways than lump sum taxes. Richard Musgrave also separated above two phenomenons for different tasks of public authority. In legal context these tasks are very complex institutional structure.

Most legal rules can be implemented also in quasi-market context. But there is differences especially some area of property rights implementation. As Charles A. Reich (1964) has studied in his New Property article the institution called property guards the trouble boundary between individual man and the state. One of most important developments in OECD countries during the past decades has been the emergence of government as the important source of wealth. Public sector is large actor. It draws revenue and power, and pours the wealth: money, benefits, services, contracts, franchises and licences. In the development of basic rights individualism has been weighted more than before. But in same time also the view of citizen as the member of society and member of different networks has become interpretation of basic rights (KM 1992:3, 110 and HE 309/1993 vp, 25). Also a general duty to the public authority secure these rights (PL 22 §) has increased more pluralist interpretation of the tasks of state and local community.

The primary aim of basic rights is to give equal constitutional protection for all individuals. In order to reach this aim, it is not necessary to leave legal persons outside of scope of application of basic rights as mainstream constitutional doctrine do. Argumentation to favour this is stronger in quasi-market context where basic services are financed by tax revenue. According traditional doctrine, legal persons enjoy constitutional protection only indirectly. This does not mean that protection of those rights should necessarily be as strong as the protection of basic rights of the individuals (Pekka Länsineva, 2002).

The basic conceptual orientation toward public finance bears a mirror image relationship to the theory of welfare economics. This latter is summarized by two theorems. The first asserts that competitive resource allocations are Pareto efficient. The second theorem asserts that one Pareto-efficient allocation can be transformed into an alternative Pareto-efficient allocation through a set lump-sum taxes and transfers. This two –
theorem framework of welfare economics, maps directly into conceptualization of public finance in terms of allocative and distributive branches. The territory to be filled by the allocative branch is the territory where the first theorem of welfare economics fails to hold. In the presence of such alleged failures, various arguments are advanced that states should use their budgetary and regulatory powers to offset market failure by providing public goods and by contracting externalities (Atkinson & Stiglitz, 1987).

From the social theoretic orientation pursued here, the state is not agent of intervention but an arena or process of interaction among people who are pursuing ends and whose relationships with one another are governed by the various institutions that constitute those relationships. Fiscal phenomena are thus emergent and not so much “social planner,” and the relation between phenomena that are ascribed to state and those ascribed to market is coeval and not sequential. The conclusion is that orthodox welfare economics have some restrictions as analytical framework for quasi-market problems. Just because emergence replaces social planner as the organizing analytical orientation does not remove the interest we have in the quality of social order.

The above mentioned welfare theorems bring a stark simplicity to the organization of choice theoretic orientation to public finance, for any state activity can be expressed in terms of its allocative and its distributive impacts. Welfare economics thus provide a two-dimensional embeddedness structure for the theory of public finance. The first dimension treats distributive justice, and concerns the preconditions that are thought to be necessary before market outcomes are thought to be warranted even if they are competitively organized. The second dimension treats the allocative activities of government, and these activities are conceptualized as arising from a lack of genuine competitiveness in market allocation. That lack of competitiveness is thought have several aspects. The one of most immediate relevance to a theory of public finance is the presumed inability of market processes to generate a provision of public goods.

Responsibility of public sector is to supply goods and services, which are not supplied in private sector (market failure). Such services like security and ownership rights sustain the essential civil rights. Public interest is that consumptions of these types of goods and services are not delivered by the ability to pay them a market price. Pure public goods are traditional example for a kind of goods in which public sector are think to be the most efficient producer. Reason for this is some technical (non-rivalous, non-excludable) aspects, which make private production inefficient in certain situation. A clear-cut dichotomy between private and
public goods does not exist, and this is essentially why there can be so many disagreements on how to classify a given good a service. All goods are or less private or public and can – and constantly do – change with respect to their degree of privateness/publicness as people’s values and evaluations change, and as changes occur in the composition of population. A benefit of public funds in providing on collective goods\(^2\) is in positive external effects, which accrue in consuming these goods and services. Public services are often regarded as core of welfare state and are organized by local communal authority. Common natural resources are a different question and it is not analysed in this paper.

The production for public goods, collective goods and market goods has special aspects in relation to property rights, which make their parallel production problematic in the circumstance in open market context. One aspect is that public and community goods have strategic importance from the point of public authority (moral hazard problem). This has created a need to find solutions to some old public sector problems of economic inefficiency. Also the accelerated development of globalisation has increased demand for new regulative solutions. Competition and globalisation have emphasized the importance of public and community goods in the consumer’s choices (Tuomala 2009).

Market failure, as mention above, is one reason for production of public goods. If everybody think to benefit the consumption of public good independently to funding its cost, people has not incentive to pay consumption by voluntary base. That is the reason why public goods are normally finance by taxes. Basically there are two models to provide public goods for people. One is public production by bureaucracy or private supplying by tax financing. The problem is how it to be supplied efficiency the public goods. The Pareto efficient condition to supply private good is \(\text{MRS}=\text{MC}=\text{MRT}=p\) or price is equivalent to marginal cost. Basically it be possible to define same kind of condition to the public good; \(\Sigma \text{MRS}^h =\text{MRT} (=\text{MC})\) (\(h\) referee to individual person). This condition is called Samulson condition according to his famous articles on public goods. Samulson rule can be interpreted so that the benefit of additional public good create marginal utility for person A + marginal utility to person B. For private good the situation is opposite and the utility goes to person A or person B. For public goods \(\text{MRS}^h\) can be interpreted as “individual price” or individual tax. Because distribution of income and allocation of resources effect demand for public goods no unique Pareto equilibrium could be finding (Tuomala, 2009)

\(^2\) Collective goods are included public goods, goods which have large positive external like natural monopolies and merit goods like school books (Tuomala 2009, p. 82)
According to paretian agenda, the state engages in two types of corrective activity. One is to correct resource misallocation; the other is to correct mal-distribution of initial endowments. The first type of activity follows the analytical path framed by the first theorem; the second type follows the path framed by the second theorem. The paretian grammar is necessarily ambiguous to apply because the formal statements it offers in terms of equalities or inequalities among various marginal rates of substitution and transformation are not subject directly to observation. Whether one sees a market failure that government corrects or a market success that government disturbs will almost invariably be matter of what the beholder’s eye chooses to see or there is possibility to both market failure and government failure. For observation problem there is one strong motive for market mechanism and it is *residual claimacy*. In a market setting to promote ex ante exploitation of all gains from trade; an agent that failed to exploit such gains is one that is not maximizing its net worth. From the perspective of this agent, the market provision of public goods necessarily fulfils the paretian condition once the all relevant costs are taken into account, because the contrary is to assume that people knowingly refusing to try to be effective in their actions (Wagner, 2007).

The intellectual root of quasi-market problem can be traced to the discussion for Austrian economist Rudolf Goldstein in the course of his debate with Joseph Schumpeter over the treatment of Austrian public debt after the end of World War I and the dissolution of the Austro-Hungarian Empire (Hickel, 1976). While the immediate point of the debate was how to service Austria’s large public debt, the intellectual core of the debate was the place of the property in the conduct of state activity. Schumpeter supported imposition of an extraordinary tax that would allow the debt to be extinguished. Once this was accomplished, the state would finance with normal level of taxation. In contrast, Goldscheid supported the recapitalisation of the state, by which he meant a return to cameralist-type arrangements wherein the state derived significant revenue from property and commercial activity through its taxes (public funds). Goldscheid operated with notion of an entrepreneurial state, Schumpeter thought in terms of a tax state. Goldscheid thought that tax state would operate to depress vigorous commercial activity through its taxes, so he advanced the notion of state as an entrepreneurial actor. There is surely the merit in both lines of argument, as well as a great deal of imponderable points of ambiguity involved in trying to sort out the issues.
3 Competition in quasi-markets

One consequence of the reforms in public sector is that the purchase and sale of secondary public services resemble market transactions. Because, however, many of the providers are part of the same public governance structure as purchasers and because of extensive powers of ministerial administrations, where it thinks appropriate, it is usual to refer to these arrangements as quasi-markets. Two particular areas of policy concern in these quasi-markets are the form of interaction between purchasers and providers, which is often specified in a contract, and the extent and consequences of competition between the providers. In this context, increase competition is usually as being synonymous with an increase number of suppliers (at least potentially) without restriction of competition (KRL 4 §). This is appropriate definition also in this paper because increased complexities of policy goals increase the demand of specific labour and assets. Traditionally, concentration is viewed as an important influence on the performance of a market. What is not, however, clear is how greater competition in the public sector services will affect the performance of the quasi-markets.

Economic models of public services have long recognized two important features of these services. First, as emphasized by Arrow (1963), with health services there are particular problems in ensuring that patients are as well informed as providers about the quality, appropriateness, and cost of treatments. Second, public services are in many cases paid for by a third party, such as insurance company or public authority. In the presence of these features attention has centred on how to ensure that providers deliver appropriate standards of services and how to keep costs down. It is these two concerns of quality and cost that have to be focus on in considering the role and importance of competition in quasi – market.

In assessing the role of competition and market type mechanisms in public sector services it is useful to evaluate the experiences for some other countries (like UK, USA and Australia) especially in the institutional structures associated with the production, delivery and funding for public sector services. The emergence and growth of new forms of funding public services (like ppp-contracts) and public service delivery organisations, has served focus research on the way public services markets work (Dibben, Wood and Roper, 2004). The existence of purchasers with possible different objectives is also a feature the public sector services. Different policy area authorities, which are majority purchasers of these services, are public bodies bounded by primary constitutional goals, which mean that the objectives have to be taken beyond typical well-being of a particular
interest group (PL 124 § ). At the same time, an important and growing number of services are purchased by fundholders, who might be expected to be more narrowly focused on the interests of their own practices and clients.

There are, however, important differences between quasi-market and open real market, both in the organisation of public service provision and, possibly, with regard to objectives of providers, and these need to be born in mind before drawing policy conclusions. In real market the objective of the owners is to increase money value of their wealth, meanwhile in quasi-market the utmost objective is to increase the well-being of citizens or taxpayers. The borderline between quasi-market and open real market is not clear because some number of actors is near non-profit organisation (subsided) or they provide services by public money. How these various features of the quasi-market affect policy conclusions depends, at least partly, upon the kind of quasi-market under consideration. In the beginning it is useful to consider separately two conceptually distinct markets within public sector. The first, which I call public authority market, is one in which public authorities purchase public services on the behalf of their population. The second, which can be called actors fundholder market, is one in which actors as fundholders (off-balance sheet budget funds) in their role as agents for customers purchase public services on their behalf. By definition in terms of volume and value of services transacted, public authority market is larger than fundholders market (because parliamentary power to tax).

Competition has potentially two roles in quasi-market context. The first is efficiency role of helping ensure that the contract goes to the most efficient provider, so that unnecessary resources are not used in the provision of services. The second is rent allocation role of helping to ensure that the public authority does not pay more for services than necessary. In the conventional textbook monopoly, these two things together- the monopolist raises prices to extract rent and, in process of doing that, distorts the choices of purchasers so resulting in the efficiency loss. When purchasers negotiate over services and prices, the two effects can become de-coupled. The purchaser and provider both have interest in negotiating for the efficient provision of services and agreeing a total payment that allocates the rent without distorting that provision.

When both purchaser and provider are equally well informed about the costs of providing services, the efficiency role of competition is trivial because the purchaser knows which provider has the lowest expected costs and will negotiate directly with that provider. Moreover, the rent allocation role may also be limited or nonexistent. This is most apparent if public authority can make “take it or leave it“ offers. In that case, public authority
could simply specify the services it wants at prices that exactly reflect costs and extract all the rent even if the provider has no competitors. If public authority cannot make such offer, which is typical case, increased competition may help them by enabling them to play providers off against each other during contract negotiations and thereby get services delivered for lower prices. But weather or not that is the case, even in theory, on some complex issues of bargaining into which Osborne and Rubinstein (1990, ch. 9), who analyse the effect of competition in markets where there is bargaining over prices, provide insight.

When a purchaser is less well-informed about costs than providers, competition has a clear role in rent allocation. Without competition, provider may be able to extract revenues over and above those that are strictly necessary to ensure the delivery of services. *Excess revenues of this kind are referred to as informational rents.* They can arise even if a public authority can make “take it or leave it” offers because the public authority needs to ensure that services are available even if the provider has high cost. The high prices necessary to ensure provision then lead to a low-cost provider getting an informational rent. This issue has been widely discussed in the context of government procurement (Laffont and Tirole, 1993). Informational rents can still arise when providers share the same concerns as purchasers. For broader context, even parliament that share a public authority’s concern for the welfare of citizens, may wish to retain rent that they can then spend on residual risk type of expenditure, which legislator has define on constitutional base. One role for competition in, for example, the form of competitive tendering, is to induce providers to offer lower prices for supplying services and thus reduce the informational rents they may otherwise appropriate.

Auction and bidding theory provides an insight into a efficiency role and the effect of tendering on informational rents. McAfee and McMillan (1987) have an accessible review this. A standard result in auction theory is that, if providers differ in prices at which they are prepared to provide a particular service because of their different costs, competitive tendering will result in the contract going to lowest –cost provider at the price that on average reflects the cost of the second-lowest-cost provider (auction where one is finally left). The last but one bidder will drop out at its reservation price, leaving the winner to accept a price marginally below that. Competition among providers and subsequent bidding for contracts can thus both ensure efficiency in allocating the contract to the lowest-cost provider and limit the informational rent to the difference between the costs of the lowest-cost and of the second-lowest-cost providers.
But it may not be efficient to allocate the contract to the lowest-cost provider if that provider supplies a low-quality service. In the absence of objective measures of quality that can made enforceable in contracts, bidders who are competing on price have an incentive to cut costs by reducing standards of service as long as these reductions are unlikely to be perceived by public authorities. To counter this, public authorities has to create incentives for providers to deliver the quality of services that it wants. If the users of public services perceive, albeit imperfectly, quality differences in the public services offered by different providers, then providers may use quality to attract users of public services and hence demand can be used to create such incentives. One way for public authority to exploit this demand mechanism is to set an appropriately price for services so that providers have an incentive to expand the number and quality of services. If the provider is the only supplier of services in the particular area, the best it can hope to achieve by increasing quality is an expansion of the market. If, however, a provider competes with others it has the possibility, through offering enchased quality, of increasing it market share. In such circumstances, therefore, competition between providers may substantially change their incentives to supply high-quality services. Thus, with greater competition between providers, the same quality can be achieved at lower price which may enable the public authority to purchase services at a lower overall cost.

From the research perspective for informational rent, theories underlying government regulative information standards are mostly normative, in contrast to positive theory of business financial accounting. Coase 1937 and Williamson 1985 have studied property rights and transaction costs (TCE) in the contexts of organisational behaviour and it is possible to draw inspiration on their work to solve public sector informational problems. TCE recognizes the incompleteness of all contracts, since organisations can neither have perfect information nor possibly foresee all future contingencies. It also assumes that economic actors behave not only in bounded rational form, but also opportunistically. Because renegotiations are costly, bounded rationality, opportunism, and relationship-specific investments expose one of the transacting parties to the hazards of ex post hold-ups (Williamson 1985). In addition, ex ante uncertainty creates strategic misrepresentation risks such as moral hazard to the parties. Either situation may lead to the non – realization of investment or underinvestment in otherwise lucrative governmental relationships. The major sources of transaction costs identified in the literature are uncertainty, the frequency of contract updates, and asset specificity: physical, human, site, and dedicated assets (Williamson 1983).
The higher the uncertainty, frequency, or specificity governing contracts in a relationship, the higher transaction costs will be. Therefore, government would organize their boundaries to minimize these costs.

Although empirical results have systemically supported the propositions that frequency of transactions, demand uncertainty, and especially asset specificity are positively associated with vertical integration, results are mixed to say the least when testing the influence of technological uncertainty on organisations’ boundaries. One possibility for this lack of empirical regarding technological uncertainty is that the competence perspective may play an important part in an innovative setting, diluting the influence of TCE as drive of integration.

In analysing quasi-market one utmost goal is the welfare of citizens. How can approach these welfare arguments, when profit and wealth of owner’s is not only goal of providers? The first step is to analyse transaction cost as a drive of the institutional change. The initial structural for regulative regimes is the hypothesis to evaluate overall efficiency of quasi-market structure. In figure 1 I analyse the welfare effects of new regulative structure.

**Figure 1. Regulative efficiency and welfare effects in two different submarket**

In Figure 1 it is assumed that total markets are formed by two different types of submarkets. The informational relationship of these two submarkets is described by equilibrium price $P_0$ and by different transaction cost levels ($t_{c1}$, $t_{c2}$, $t_{c3}$, $t_{c4}$).
measured by unit cost. Industrial and tax policy give some subsidies to real market actors, which increase supply from $Q_D$ to $Q_F$. If these subside is competition neutral the society as whole can get welfare benefits. But if there is distortion competition effect, the net impact can be zero or even negative. In quasi-market side the initial bureaucratic model supply an amount $Q_B$ for public services and after the adaption process an amount $Q_C$ by transaction cost $t_{c_4}$. But the change in institutional structure can create new supply of public services so that final supply is in equilibrium at $Q_A$. The difference $Q_A - Q_B$ is the welfare benefit created by quasi-market and partly financed by lower transaction cost.

Both submarkets are regulated, but quasi-market more than real market. Most regulated is bureaucratic model. The goals for public square can be related several targets like productivity (resource allocation), cost efficiency and sustainability of public funds. There is also endogeneity of legal and fiscal capacity as the variables, which have to take account of evaluation for adaption processes. The effect on productivity is most closely linked to transaction costs, which create different obstacles or possibilities for overall economic efficiency. In which level transaction costs are, is an empirical question?

4 Informational relationships for quasi-market actors

The development of government accounting is related to the constitutional form of government that provides separation of powers, and checks and balances among legislative, executive, and juridical branches of government. In an administrative hierarchy, the superior holds subordinates accountable and requires feedback information on their performance. A legislature monitors the conduct of the executive branch, for example, in executing the approved budget. Furthermore, a government has the incentive to disclose information in order to induce others to provide resources to it. These include potential buyers of government securities; vendors of goods and services, and other actors contracting with government. In these voluntary exchanges, information is used to predict a government’s ability to carry out the terms of contracts. After transactions are made accounting information is used to monitor contractual performance (Chan 2003).

Government accounting has three purposes. The first and utmost is to prevent illegitimate the constitutional rights as social performance by detecting processes, which weaken these rights. For instance corruption in
government exists in various forms and is nurtured by incentives. This is an acute problem in poor, developing countries, but corruption is not limited to them (Rose Ackerman 1999).

The intermediate purpose of government accounting is to facilitate sound financial management. Financial management includes activities such as collecting taxes and other revenues and collecting information on expenses on the principle for fair and sufficient knowledge on the public sector activities. In a well-run government, these activities are budgeted or otherwise planned. Their execution through duly authorized transaction is recorded in the financial accounting system.

The advanced purpose of government accounting is to help government discharge its public accountability. Public accountability exists in three levels of principal–agent relationship, accountability of bureaucracy to chief executive, of the executive to the legislature, and the legislature to the people (Chan 2003). This purpose can be better achieved by increasing the agent’s incentive to disclose and by lowering the principal’s information costs. The main attraction of government–wide financial reporting is that it might reduce the information analysis and evaluation costs of users. Over 40–years ago, Downs (1957) warned that high information costs would discourage voters from obtaining more and complex information about government. Voters are rationally ignorant after weighing the marginal benefits and marginal costs of information search, in a manner similar than consumer’s behaviour (Stigler 1961).

In order to serve the three identified purposes, financial accounting and management accounting cannot be so neatly compartmentalized in public sector, where management accounting refers to parliamentary budgeting and control, rather than accounting solely in the service of managers. The budget is an expression of public interest and political preferences. It is an instrument of fiscal policy on revenue and spending to achieve macroeconomic and welfare objectives. It provides benchmarks for productivity measured partly by the accounting system. The value of public activities is closely linked to parliamentary decision making especially on taxation in overall sense.

The ownership concept is problematic in the public sector, but basically it could be solve by interlinked it in parliamentary and local voting process. In property right theory voting is special type of property right. In principal it is possible to estimate statistically an accounting equation (assets = liabilities + owner’s equity) and its corollary profit (return on taxes as value of public services) = revenues – expenses). Unfortunately, the assets and liabilities of the national government of a sovereign state are difficult to identify and harder still to measure in financial terms. Qvasi-market
approach makes the measurement problem easier to solve at least in micro level.

Accounting principles allow a business, whether private or state owned, to recognize revenues only to the extent of goods or services provided. Governments uniquely provide public goods and finance them through taxation. Public goods are consumed collectively, and non payers cannot be excluded – hence requiring tax finance. These characteristic sever the link between service delivery and revenue recognition, making it impossible to match revenues to expenses. This accounting problem is also exacerbated by the involuntary nature of many transactions between government and people. The government’s operating statement tracks the resource flows, and only incidentally measures the government’s service efforts and accomplishments. In contrast to limited liability rule, governments in democracy are prone to expand to their responsibilities, resulting to larger budgets and frequent deficits. This further makes severer the matching problem (Buchanan and Wagner, 1977).

The government balance sheet provides important information on the financial and legislative performance (in economic sense) of the government from period to period. Because of theoretical weaknesses of balance sheet definitions an increasing net worth means that a government is reducing rather than increasing net liabilities on future generations. In theory it should be possible to determine the present value characteristics associated with major expense obligations created by law and invest assets (partly reallocation of resources) to offset these risks. However, there are many rights (like collective property rights3) and obligations of government that are excluded from the balance sheet, mainly because of valuation problems. The most significant item missing from the balance sheet is the “primary asset” or taxpayers’ equity. The source of value of this primary asset is for the government power to tax (Wilson Au-Yeung & al. 2006). While this power is limited by such factors as the constitution, international tax competition, the size and growth of the economy, the effects of tax rate and base changes on economic efficiency and welfare equity – the taxing power provides strong assurance of the government’s ability to meet its liabilities.

The performance of public sector activities can be reflected by constitutional rights and the economic interpretation of residual risk. Taxpayer’s equity and net worth are both important concept in linking long term public economy sustainability and balance sheet management into quasi-market regulation.

3 Collective property rights are residual claim in the bundle of property rights in public sector balance sheet, when special assets are defined.
Taxpayer’s equity (forward looking item)
adding liabilities, which are not debt
  + constitutional value added
  + reservations
  + adjustment of values
  + constitutional membership fees (like EU membership fee)
subtracting
  - adjustment of values
  - revaluations of fixed asset
  - expense item covering several financial periods, but not being asset
adding correction for adjustment values
subtracting
  - tax rebate

= Net worth (backward looking item)

Unless presented carefully, this can lead to misunderstanding of the underlying economic value of specific assets and liabilities on a government’s balance sheet. Probably the largest contingent liabilities not recorded on the balance sheet relate to future pensions and public health costs and human capital costs as assets. However, these obligations to fund future expenses have an impact on the economy today, as well as on fiscal sustainability. These conceptual and measurement problems mean that government balance sheet is not directly comparable with similar private sector financial statements not even on quasi-market context. Government balance sheet management therefore requires a different framework for determining whether investment strategies are optimal. In particular, contingent assets and liabilities are likely to have a significant influence on how best to structure the government balance sheet to reduce risk and improve fiscal sustainability.

There are some important criticisms of the taxing power approach that can affect our policy conclusions. First, there is the potential problem of policy endogeneity. If the government’s improved financial asset performance encourages greater government spending then the independence between government spending and taxing is violated. The bulk of the super liability relates to previously accrued entitlements that are reasonably well defined. Finally, the government reports its underlying cash surplus exclusive of net worth earnings so that they cannot be used for recurrent expenditure. Moral hazard is a particularly severe for of policy endogeneity that appears to have limited the use of some financial
instruments to manage government balance sheets. Traditionally, the economics literature on optimal debt management has focused on “state-contingent” debt. More recently, the literature has focused on hedging the balance sheet by optimal design of the maturity and denomination of conventional debt securities. But from the point of balance sheet management this is too narrow performance measure for overall net worth evaluation.

5 Concluding remarks

Quasi-market is one of the diverse histories to study the effects of regulatory reforms in sectors which were traditionally most heavily sheltered from competition and have witnessed, at different times and to different degrees, some form of deregulation and privatization in various countries. Specifically, I have looked at the effects of regulation on investment in institutional structure (legal capacity defined by property rights and transaction cost. Preliminary analysis for two types market and their information structure can tell us that competition neutrality and its relation to weak and strong incentives has important role in forming quasi-market framework. The empirical study is needed to find indicators to measure regulation with different time varying behaviour that capture entry barriers and the extent of public ownership, among other things. Studies in OECD countries since have proved that regulatory reforms have had a significant positive impact on capital accumulation in the utilities industries. In particular, liberalization of entry in potentially competitive markets seems to have had the largest and most significant impact on private investment. The effect of privatization is less clear-cut. On the one hand privatization may lead to more profit opportunities for private firms; on the other hand public enterprises may overinvest if they pursue political objectives and/or if managers are not constrained by the discipline imposed by capital markets. There is also evidence that the marginal effect of deregulation on investment is greater when the policy reform is large and when changes occur starting from already lower levels of regulation. In other words, small changes in a heavy regulated environment are not likely to produce much of an effect.

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4 See Winston (1993)
References


TO UNDERSTAND ESSENTIAL FACILITIES DOCTRINE

Beata Mäihäniemi

Abstract

The essential facilities doctrine (henceforth EFD), which dates back to 1912 and the American case of *The United States v. Terminal Railroad Association*, is constantly applied on both sides of the Atlantic Ocean. The doctrine is applied when access to a facility is essential and, in order for a person to operate on a certain market, the owner of the facility may, in particular circumstances, be obliged to grant access to that person. The concept of the EFD cannot be introduced without proving that the owner of that facility is in possession of monopoly power. Monopoly power is then the indispensable basis for antitrust principles and remedies. Nevertheless, the presence of “essentiality” and ease of duplication according to some scholars should also be considered as legal conditions. In addition to that, the importance of the condition of impracticability of duplication needs to be stressed, because it guarantees that the doctrine will only be applied to the cases where no feasible alternative exists or where a facility cannot be reproduced. The first aim of this paper is to understand the essence of the EFD. Which facilities are more likely to be deemed essential? Which economic conditions influence the application of the essential facilities doctrine? What are the boundaries of the doctrine (the difference between cases involving the essential facilities doctrine and refusal to deal)?

As an introduction, the paper will identify industries where the doctrine is commonly applied. The nature of the EFD initially derives from the “classic cases”, which arose in areas of transport, communication services, as well as press and medicine. However, nowadays, in the presence of network industries, the doctrine may not only take a form of a physical asset, but also of information or an intangible asset. In *Bronner* for example, Advocate General Jacobs stressed that facility could be a product, such as raw material or service, a facility may also include condition of an access to a place such as harbour or airport or to a distribution system such as the telecommunications network. Additionally, *Bronner* mentioned three criteria, which appropriate the concept of the EFD. First, the access to the facility must be denied in order to prevent competition. Second, the access needs to be essential for the applicant to manage his business. Finally, the access should be refused without an objective justification.

The EFD is present on both sides of the Atlantic Ocean; however there are significant differences in its application in the European Union and in the United States. This situation derives from the fact that in the EU a general duty to deal is imposed on enterprises, while in the US companies can choose freely whom to deal with. In the EU the idea of the essential facilities doctrine is still alive; however, in the US many scholars attack it and postulate abandoning the doctrine. Nevertheless, both the Supreme Court and the European Court of Justice have
never formally recognized the doctrine. Despite the criticism, the doctrine is still widely implemented, in particular in the area of network industries. Network industries are characterized by network effects, which are also known as demand economies of scale and can create or reinforce existing barriers to entry, insulate the monopolist from competition and lock consumers into the existing technology. From an economic perspective, this kind of situation may be very harmful for consumer welfare and create a need for a system of open standards and full interoperability that can be achieved by the application of the EFD.

In the EC law, the development of the doctrine is based on Article 102 of the Treaty on the Functioning of the European Union (ex Article 82 TEC) and the provision implicates that abuses of dominant position within the Common Market are forbidden. European version derives the liability from the relationship between the essential facility and the relevant market. In the US, where the regulation of the doctrine is rooted in Section 2 of the Sherman Act, liability needs to be based on the competitive relationship between the parties. Therefore many lower courts in the US require plaintiffs to prove that they are competitors who were denied access to an essential facility controlled by the defendant, monopolist.

There is a controversy around the EFD, which is accompanied by significant changes in its popularity, definition, and application by the courts and enforcement agencies as a basis for imposing antitrust liability. We can observe evident attempts to hamper its use. Nowadays we can also witness the shift towards the new “convenient facilities doctrine” approach which is strongly advocated by the European Commission. The approach has been applied since the famous Microsoft case. “Convenient facility” is an “asset without access to which it would be inconvenient for rivals to operate on the market, because they would need to offer customers a better product in order to overcome the advantages of the incumbent”. “Convenient facilities” approach is often perceived as unjustified in economic terms. This situation has raised questions in the economic literature on the optimal environment for innovation. To evaluate the optimal environment for innovation it is crucial to balance between the situations when unrestrained monopoly power is likely to be too lazy to innovate, and when a firm with no chance of achieving a share of market power cannot expect to produce the funds to finance valuable investments in innovation.

Finally, there is a need to identify doctrine’s limits and limitations. The first main problem arising in connection to the application of the EFD is the defence of the doctrine in natural monopoly cases. Natural monopoly is obtained when a single firm can supply the entire market at a declining average total cost of production. Encouraging entry into natural monopoly markets may therefore, result in wasteful expenditures on these fixed costs of production. Should then, as some scholars claim, natural monopolies be sheltered from antitrust liability? The second major issue is resentment towards the use of the essential facilities doctrine in the area of intellectual property rights (henceforth IPRs). A large number of scholars claim the doctrine should not be applied to IPRs at all. However, according to classic economic theories of intellectual property rights IPRs have characteristics similar to the ones of a natural monopoly, such as large fixed costs and low variable costs. Therefore, if the doctrine would be applied to the cases concerning a natural monopoly patent or copyright, it would have to be modified in order to distinguish between regular patents and copyrights and the ones with characteristics of a natural monopoly. Can this implication change the
The purpose of the paper is therefore to investigate the problem of the EFD, with its limitations and in circumstances involving its constant evolution. This will be primarily done by thorough analysis of the case law and scholars’ articles by means of the comparative law and economics.

1 Introduction

The nature of the essential facilities doctrine (henceforth EFD) derives from the classic cases that have been solved in the area of transport and communication services, press and medicine, where the issue was initially discussed. The doctrine is “not a piece of law but a systematic interpretation of how the courts have applied European competition law and American antitrust law in a particular class of situations” (Bergman 2005, p. 7). Essential facility cases can be regarded as “specialized examples of general rules about discrimination and handicaps created by dominant companies” (OECD 1996, p. 94).

In the European Union the application of the EFD is based on the Article 102 of the Treaty on the Functioning of the European Union (ex Article 82 TEC). The article prohibits, as incompatible with Common Market any abuse by one or more undertakings of a dominant position within the Common Market or in a substantial part of it, so far as it may affect trade between Member States. The article includes the list of possible abuses which is not exhaustive. Article 102 is related to exploitative behaviour (excessive pricing) and exclusionary practices such as predatory pricing, exclusive dealing, refusal to supply and tying. In the United States the essential facilities doctrine has its roots in Section 2 of the Sherman Act, which prohibits monopolization, attempts to monopolise a market and conspiracies to monopolise “any part of the trade or commerce among the several stages, or with foreign nations” (however having a monopoly position is not by itself illegal). The act carries its own penalties which include imprisonment up to three years and recently jail sentences for antitrust enforcement have been given more often. On the contrary, in the EU competition law does not allow imposing criminal penalties in antitrust violations, although some of the Member States (Austria, France, Germany and Ireland) do.

The EFD is being constantly criticized. The Supreme Court attacked the doctrine in the report of the Report of Antitrust Modernization Commission (2007) as well as in the recent report of the Bush administration Justice
Department. On the other hand, in Europe, the doctrine (also known as unilateral refusals to deal) has been in use for the last 30 years. The European Commission, the Court of First Instance, and the European Court of Justice have been implementing and applying the EFD, as well as have been the courts of the twenty seven Member States.

The purpose of this paper is to understand the nature of the essential facilities (which forms can it take? when is the facility essential?) and explain the situations where the EFD is applied (what are the criteria? where is the application recommended or not recommended?). It also seeks to compare the American and European versions of the doctrine. The paper approaches the problems from Comparative Law and Economics point of view, which can be defined as a discipline which is located at the boarders of contemporary legal research and combines the analytical tools of complementary social sciences in order to develop a critical approach to legal rules and institutions (Mattei and Monti 2001, p. 1).

2 Definition and Origins of Doctrine

An essential facility can take a form of any input, which is deemed necessary for all industry participants to operate in a given industry and is not easily duplicated. The input can take a form of either physical or intangible asset. An essential facility also gives its owner a competitive advantage over rivals which have inferior inputs, therefore when input is easy, cheap and possible to reproduce it is difficult to say it is essential. The examples of the essential facility include slots in the airport, port installations, local loop, transmission, certain chemical components in pharmaceutical industry etc.

The concept of essentiality is understood similarly in American and European Union legal jurisdictions. In the US the facility ought to be essential to potential competition between plaintiff and monopolist and must not be available from another source or easy to duplicate by the plaintiff or others (Areeda and Hovenkamp 1996, para. 773.b). Competition law in the EU has its own definition of essentiality, which can be found in Access Notice, where essential is “a facility or infrastructure which is essential for reaching customers and /or enabling competitors to carry on their business, and which cannot be replicated by any reasonable means” (EC 1998, para. 68). One of the definitions of “essentiality” can be found in the case of Radio Telefis Eireann and Independent Television Publications Ltd v Commission of the European Communities, known as the case of Magill (1995). Magill concludes that the EFD does not entail
identical conditions for all competitors; it rather works as a mechanism where competition may exist on previously foreclosed markets. Therefore, mandatory access to the facility should be granted only when there is an overwhelming barrier to entry for competitors of the dominant company, or where without access, competitors would be threatened with “a serious, permanent and unavoidable competitive handicap which would make their activities uneconomical” (Lang 1994, p. 437).

The essential facility situation can be explained using simple example (see below Figure 1.1). It occurs when an undertaking (A), which is active at both the upstream and downstream levels of an industry, possesses a monopoly at one or another level and denies access to the facility to other firm (B) who wishes to provide either upstream or downstream services only. In order for B to supply final consumers B requires access to a downstream asset which is controlled by A (Walker 2006, p. 56).

![Figure 1.1 Example of a Downstream Bottleneck (Walker 2006, p. 56)](image)

“Essential facility” has been defined by the EC\(^1\) in its *Sea Containers* (1994, recital 66) decision in the following way:

An undertaking which occupies a dominant position in the provision of an essential facility and itself uses the facility (i.e., a facility or infrastructure, without access to which competitions cannot provide services to their customers), and which refuses other companies access to that facility without objective justification or grants access to competitors only on terms less favourable than those which it gives its own services, infringes Article [102], if the other conditions of Article [102] are met.

The roots of the doctrine can be found in the US where the legislation prohibits monopolization and any attempt to monopolize a market

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\(^1\) *See also* Notice on the Application of the Competition Rules to Access Agreements in the Telecommunications Sector, Framework, Relevant Markets and Principles (Access Notice) OJ 1998 C265/02, recital 68.
(Sherman Act 1890, §§ 1–7). However, the term “essential facilities doctrine” was used for the first time in 1970, when Neale illustrated and investigated the line of the Supreme Court and lower – court cases concerning the refusal to deal with a competitor by a vertically integrated dominant enterprise (Neale 1970, p. 67). The first known application of the doctrine is the case in *The United States v Terminal Rail Road Association of St. Louis* (1912). The case analysed the problem of allowing open and equal access to all competitors where the sanction has been imposed on the joint operators of the only railroad bridge across the Mississippi River. The doctrine has not been explicitly named; however, the Court held that refusing the access to the facilities of a dominant firm constituted a violation of the antitrust laws (Waller 2008, p. 361). *Terminal Railroad* (1912) stressed the social benefit of the natural monopoly and narrowed its antitrust liability to a compulsory license agreement.

The EFD based on natural monopoly characteristics can be also concluded from *Otter Tail Power Co. v. United States* (1973), *MCI Communications Corp. v. AT&T* (1983), and *Aspen Skiing v. Aspen Highlands Skiing* (1985), however in this last case the court has chosen to treat the natural monopoly with the normal regime of antitrust liability (Martin 2006, p. 31). In *Aspen Skiing* the doctrine was applied to a case concerning common selling of ski resort tickets by three competitors. After the decision on the common selling of multi-area ski tickets has been terminated, customers lost the possibility of using different areas’ ski resorts at a discounted price. The court stated that an essential facility has taken a form of multi-area and the defendant (one of three competitors, the only one excluded from the common selling of the tickets) was denied the access to it, which constituted an obvious intent to exclude the competitor.

3 Criteria for Application of Essential Facilities Doctrine

There are several criteria that need to be fulfilled in order to apply the EFD. Among them, is the crucial requirement of proving that the owner of that facility is in possession of monopoly power. The second condition includes the anticompetitive intent of the dominant undertaking. Some scholars, such as Lipsky and Sidak (1991, pp. 1211–1213) claim that the presence of “essentiality” and ease of duplication should be considered as legal conditions the same way as the issue of monopoly power. Additionally, there is the condition of impracticability of duplication, since it guarantees that the doctrine will only be applied to the cases, where no
feasible alternative exists, or when facility cannot be reproduced. The criteria for the application of the doctrine will be characterized below.

Firstly, in order to apply the EFD the owner of the facility has to possess monopoly power, which is an indispensable basis for antitrust principles and remedies. “Monopoly power” is the power of a single firm, which is not acting in cooperation with competing seller, to maintain a price slightly above the competitive level. This concept differs from the one of “market power”, which is the real significance of concentration; it facilitates collusion, explicit or tacit, among the firms in the market by reducing the costs of collusion and of detecting cheating (Posner 1976, 2001 p. 124).

Monopolistic bottlenecks are common occurrences in a number of industries such as energy, rail, or telecommunications. The term “bottleneck” represents the effective constraints on the minimum speed or level of an activity. Inefficiency of monopoly is based on the fact that a monopolist produces less than the competitive amount of output and is therefore Pareto inefficient. While a competitive industry operates at a point where price equals marginal cost, a monopolized industry operates where price is greater than marginal cost. Thus in general the price will be higher if a firm behaves monopolistically rather than competitively. For this reasons, consumers will typically be worse off in an industry organized as a monopoly than in the one organized competitively (Varian 1996, pp. 411–412). The outcome of monopoly pricing is a wealth transfer from consumers of a product to the seller. When the price raises and the monopolist is trying to maximize the profits, some consumers will not be able to afford the product anymore and will have to be excluded. Monopoly then leads to the classic case of the occurrence of dead weight losses: the part of the consumer surplus that the monopolist cannot correct, however consumers lose (Depoorter 1999, pp. 501–502).

The second condition for the application of the EFD is an assessment of anticompetitive intent of the dominant incumbent. This view is widely applied in the US, where many courts have established that a refusal to deal, combined with anticompetitive animus, may help to asses finding of antitrust liability. This finding may occur without proving that a particular facility is indeed essential. For example, in Intergraph Corporation v. Intel Corporation (1999) the court stated that “a refusal to deal may raise antitrust concerns when the refusal is directed against competition and the purpose is to create, maintain, or enlarge a monopoly”. Anticompetitive intent to maintain monopoly is prohibited in the US antitrust law, but in the EU, intent is not an element of the Article 102, since EC competition law has a goal of preventing only the abuse of a dominant position when acquired regardless of any intent. To sum up the problem of
anticompetitive intent Article 102 opts for a simple dominance, while Section 2 sets a much stricter standard of monopolization or an attempt to monopolize (Stratakis 2006, pp. 434–435).

The third requirement in the claim concerning the EFD is lack of a real or potential substitute for a product or service. If it is easy and cheap to substitute a facility, then it cannot be considered “necessary” or “essential”. For example, if the retailer gains profits outside a shopping mall, then the shopping mall owner does not possess monopoly power over real estate as well as over other services associated with retail shopping expediency (Lipsky and Sidak 1999, p. 1216). Additionally, it needs to be stressed that while it is true that an undertaking in possession of an “essential facility” is in a dominant position on any market for that facility it does not always work the other way round. The fact that a given facility is not “essential” or “indispensable” for an economic activity on some distinct market, within the meaning of the existing case law, does not mean that the owner of this facility might not be in a dominant position. As an example, we can take a network operator who can be in a dominant position despite the existence of alternative competing networks, if the size or importance of its network allows him to behave independently from other network operators (EC 2002, p. 17). The presence of other corresponding facilities can also prevent the classification of one such facility as “essential.” For example, even if an access to a shopping mall is absolutely essential for the commercial success of the retailer, there is no guarantee that if access to the shopping mall is denied, retailer will not use other facilities with similar characteristics available to the retailer (Lipsky and Sidak, p. 1216).

Fourthly, while applying the EFD, an assessment whether building a second facility makes sense from an economic point of view is highly required. The economic point of view includes “all parameters, such as the increase in market size created by the new facility and the possibility of sharing the facility with other competitors or other undertakings in other markets” (Evrard 2004, pp. 521–522).

If the new entrant cannot recoup the costs of a new facility, access to the existing facility should be granted (Ibid., p. 522). However a duty to provide access to a facility should be imposed only where there is an undefeatable barrier to entry for competitors of the dominant company, or if without access, competitors would be subject to a serious, permanent, an unavoidable competitive handicap that would make their activities uneconomical (Lang 1994, p. 437; Turney 2005, pp. 189–190).

Finally, the EFD should not be relevant in cases where, in order to include a new user, it is necessary to expand the capacity of the facility. This argument has never been justified; however, it might be one of the
ways to avoid judicial omission of economic decisions, which obviously cannot be made in the process of litigation. Without expansion of the undersized capacity, the access given to the new competitor will not improve the downstream equilibrium. Unless the courts will avoid imposing requirements, which promote entrance to undersized capacity, the EFD will be useless as means to improve consumer welfare (Lipsky and Sidak 1999, p. 1222). The division between cases where there is spare capacity and where there is none derives from the principle of proportionality, which is present both in economics and in the Community. Additionally, there is a problem with justifying refusal to access which occurs in two particular situations: first, where the capacity of the essential facility is not fully used; and second, where the capacity is unlimited by nature. In any case, when the owner of the essential facility or its associated company holds a strong or a dominant position in the downstream market, it may be much harder to argue for refusing the access. He can be ordered to scale down or reorganize the activities only in the case where it is estimated to bring a significant increase in competition. It is also crucial to analyse if the capacity owned by the dominant company is indeed fully utilized (OECD 1996, p. 98).

4 Essential Facilities Doctrine v Refusal to Deal

There is a thin line between the EFD and refusal to supply concept. Two examples below could be helpful in explaining the difference. Refusal to supply occurs in the following example, where a shipping company X integrates backwards and builds new port installations in a certain town A, located in the “home” country. Given the location, using this port’s infrastructure gives firm X a great advantage in serving the maritime route from the home country to a certain other foreign country. Company Y now requests use of the port and firm X denies it. The essential facilities doctrine can be found in the second example, where firm Y complains to the competition authorities that it should also have access to town A’s port installations. Competition authorities decide that the owner of the input had engaged in an illegal practice and is obliged to make the facility available to competitors. In most of the cases the essential facility has characteristics of natural monopoly (Motta 2004, p. 67).

The EFD is considered as a particular case of refusal to deal strategies enacted by a dominant firm, which is a "bottleneck monopolist". These strategies aim to exclude competitors from the market not only by refusal to deal but also by imposing conditions, such as pricing, tying etc., which in fact
constitute a barrier to entry for competitors (Castaldo and Nicita 2005, pp. 3–4). The linkage between the essential EFD and the refusal to deal implies that there has to be a horizontal and not vertical relationship between the owner of the essential facility and the firm demanding access to it (Robinson 2001, p. 29). Horizontal agreements, which are agreements between competitors, restrict and/or reduce competition and in most of the cases should be strictly prohibited. They are allowed only in some specific circumstances, e.g. cooperative agreements in Research and Development. By contrast, vertical agreements – agreements between firms operating at different stages of the production process, e.g. manufacturer and a retailer – are usually efficiency enhancing and do not create problems to competition, unless they are undertaken by firms with considerable market power (Motta 2004, p. 32).

5 Comparison of Application of Doctrine in the US and the EU

In the United States the application of the EFD is based on Section 2 of the Sherman Act, while in the European Union on the Article 102 of the Treaty on the Functioning of the European Union. Both provisions are concerned with the regulation of the market concentration. Similarly, under both regulations the possession of monopoly power or dominant position is unlawful. However, Article 102 is concerned with abuse of a dominant position, whereas Section 2 – with the matter in which an undertaking acquires, expands or maintains monopoly power. The similarities between American and European systems include the common purpose of promoting consumer welfare. Consumer welfare (surplus) is the aggregate measure of the surplus of all consumers. The surplus of a particular consumer is given by the consumer’s valuation for the good considered and the price, which effectively he has to pay for it (Motta 2004, p. 19). Consumer welfare is then promoted by eliminating exclusionary or anticompetitive behaviour. Nevertheless, competition law in the EU has an additional goal of promoting the integration of Member States’ markets and has been often concerned about the protection of competitors, in particular in early Article 102 cases. Despite the application of the “Chicago school” economic analysis to the European antitrust enforcement, there are still some remaining instances where protecting competitors may be within the scope of European competition law, under the cover of preserving the competitive structure of the market (Stratakis 2006, p. 434). The difference between legal framework where the EFD is
applied has been stressed by many commentators, including Venit and Kallaugher (1994, pp. 315, 325), or Fine (2002, p. 457).

In the US the essential facilities cases are exceptions to the general “Colgate defence” principle, which states that undertakings are under no obligation to deal. In the EU, firms holding a dominant position have a general duty to deal and the essential facilities doctrine is a specification of the application of this general duty (Ong 2005, pp. 215, 217). However, the most significant difference, which limits the application of the EFD in the US, is the approach to leveraging. “Leverage” denotes using anticompetitive practices to protect and reinforce the market power a firm has in one market or to extend it to other markets (Motta 2004, p. 362). The “Berkeley Photo Formula”, stated in Berkeley Photo, Inc. v Eastman Kodak Co. (1979) had an aim of dispensing the need to show an attempt to monopolize or actual monopolization in the second market. It was then attacked by the US government and buried by the Supreme Court, therefore leveraging is still relevant in the American cases, while in the EU competition law market power in the downstream market is irrelevant for the analysis of the essential facilities.

On both sides of the Atlantic Ocean the highest courts do not plan to officially announce that the doctrine is vivid and can be fully applicable. In the US, the Supreme Court has never openly called the EFD by name. Therefore, the Court following its treatment of the doctrine had an opportunity to remote itself from the doctrine in the case of Verizon Communications Inc. v. Law Office of Curtis v. Trinko, Llp (2004). The customary declaration of the doctrine was not announced in any of the three main decisions of the Supreme Court, but only in the Seventh Circuit’s MCI Communications Corporation v. AT&T (1983) opinion. It is clear that the Supreme Court does not favour the EFD, since in the same decision, MCI, it has established that companies do not have general duty to deal with rivals with whom they do not have a prior course of dealing. At the same time, the Supreme Court rejected the possibility of any involvement in the development of the doctrine, claiming that the EFD is a creation of lower courts (Trinko 2004, p. 410). The Court declined its application even when the doctrine would be applicable only when there are no means of access. Therefore, it seems that in the US the status of the doctrine is rather unstable, regardless of the problem of the application of the doctrine in the intellectual property rights area (Ibid.). In Europe, the EFD, which is also known as unilateral refusals to deal, has been in use for the last 30 years. The European Commission, the Court of First Instance, and the European Court of Justice have been implementing and applying the EFD, as well as have been the courts of the twenty seven Member States.
6 Where Should the Essential Facilities Doctrine Be Applied?

The courts were trying to apply the doctrine in cases where the denial of access would be socially wasteful, harshly restrain innovation and competition and likely have effects that expand beyond harm to competition in the in-between affected market. Such a conclusion derives from the fact that key essential facilities cases have included networks and/or natural monopolies, which were providing necessities or were a part of society’s infrastructure (Lao 2009, p. 567). Networks and natural monopolies share some common features. For example, one hypothesis assumes that network effect may be a reason for natural monopoly. This is explained by the assumption that a firm trying to enter the market for a network good, needs to acquire first not only fixed costs of building a competing network, but the costs of persuading customers of the existing network to switch. This assumption does not take into account whether the existing firm faced declining average costs of production in building the existing network and it also omits the relative extent of switching costs to the variable costs of producing the competing network (Martin 2006, pp. 26–27). However, natural monopolies and network effects differ in the way that in the case of natural monopoly we can observe scale economies of supply, which means that the marginal and average costs of production decline throughout the demand curve for particular market. On the contrary, in the case of network effects demand-side economies of scale can be found, which means that the shape of the demand curve is affected by existing demand.

6.1 Application of the Essential Facilities Doctrine to Natural Monopolies

The application of the EFD can be justified by the natural monopoly characteristics. Before exploring the connection between the EFD and natural monopoly a word about the phenomenon of natural monopoly itself should be mentioned. A “regular” monopoly occurs where marginal revenue (that is an additional income from selling one more unit of good) equals marginal cost (the cost of producing one more unit of good) and thus too little output is produced. Therefore, regulating monopoly by setting the price equal to marginal cost and expecting that profit maximization will fix the inefficiency may look like a perfect solution. Nevertheless, this analogy
misses an important aspect of the problem: it may be that the monopolist would make negative profits at such a price. This situation can be found in the presence of large fixed costs (the part of total cost which does not depend on the level of current production) and small marginal costs and it is referred to as a *natural monopoly* \(\text{(Varian 1996, p. 416)}\).

Natural monopoly appears when the production technology is characterized by increasing returns to scale. In a productive process, average productivity is increasing with output. Therefore, increasing all inputs in the same proportion results in a more than proportional increase in output \(\text{(Black, Hashimzade and Myles 2009, p. 219)}\). Additionally, in natural monopoly situation a single firm can supply the complete market at declining average total cost of production \(\text{(Depoorter 1999, p. 499, see below Figure 1.2)}\).

![Figure 1.2 Illustration of natural monopoly](image)

The examples of natural monopoly include the area of public utilities, such as telephone industry, electricity and water supplies, because these industries are characterized by very high fixed costs. Fixed costs do not affect the profit-maximizing level of output in the short run, though in the longer run (a period long enough for the firm to adjust all its inputs to a change in conditions) a firm which cannot cover its fixed cost will become insolvent and exit \(\text{(Black, Hashimzade and Myles 2009, p. 172)}\).

At the heart of natural monopoly lie the concepts of economies of scale and scope. Economies of scale are the factors which make it possible for larger organizations or countries to produce goods or services more cheaply than smaller ones. Economies of scope are the benefits arising from carrying on related activities. These are similar to economies of scale, but with
economies of scale cost savings arise from carrying out more of the same activity, whereas with economies of scope cost savings arise from carrying out related activities. Given the prevalence of multi-product firms, much of what normally referred to as economies of scale is in fact economies of scope. However, as noticed by Robinson (2001, p. 35) the theory of natural monopoly, as a static concept does not include dynamic conditions of the market and therefore, when we take into account technology or economic factors, economies of scale and scope may occur to be only temporary. Conditions are constantly changing, just like policy recommendations; therefore we have to accept the fact, that many markets, originally considered as natural monopolies, are no longer thought as such (Ibid.).

There is a requirement that, in order to apply the EFD the facility in question needs to show natural monopoly characteristic, however it may be difficult to support. This is due to the conflict between the essential facilities principle of sharing and the traditional lesson of natural monopoly market. Although the conflict has been overlooked by most of the courts and commentators, there is one exception to that rule. Judge Posner, who has insistently attacked the EFD on specifically this ground (Blue Cross 1995, pp. 1412–1413), has claimed that the monopolist should not be obliged to share its monopoly profits by allowing access to its facilities to the competitors, because “antitrust laws are not designed to regulate natural monopoly – that is the business of regulators” (Ibid.). However, Posner stated that forced sharing of monopoly facilities with other firms in order to affect monopoly rents is unjustified. It should not be done as matter of antitrust or regulatory policy. In every case regarding facility, which is, naturally monopolistic we need to assess whether there is a legitimate competitive purpose beyond mere sharing rents. Moreover, it may be the case, however, according to Posner, only sometimes (Robinson 2001, p. 34).

Nevertheless, in the situation of natural monopoly, where a single firm is able to supply the entire market at declining costs of production, the EFD can be a functional rule for identifying that rare case where competition is crucial and new entry needs to be promoted. Therefore, Martin (2006, pp. 24–25) claims that natural monopolies should be exempted from antitrust liability to some extent. This exemption would be justified on the grounds that monopoly helps opening new markets and it is socially wasteful to encourage new entry to such a market. The EFD may then efficiently protect socially beneficial enterprises operating in natural monopoly markets (Ibid.).
6.2 Application of the Essential Facilities Doctrine to Network Industries

The need to provide access may take place in modern networks for example in the case when a monopolist, who is in control of essential technical information, refuses to license that information to competitors, usually in secondary (or complementary) markets. Such behaviour deprives consumers of demand-side economies of scale, which are a common outcome of network and also exclude competitors who offer complements to the monopolist’s product and give no other choice to the consumers but to use monopolist’s complement. Lao (2009, p. 558) suggests that the essential facilities doctrine could be used in such a case as a sound basis for antitrust intervention.

To begin with, the concepts of networks, network effects/externalities will be clarified. Networks are “composed of links that connect nodes” (Economides 1996, p. 674). To provide a typical service a certain amount of components of networks is needed. Therefore network components are complementary to each other (Ibid.). The existence of network leads to occurrence of network effects, which can arise directly and indirectly. Direct network effects are characterized by increasing utility which derives from increasing number of interconnections as a result of increasing number of users. Direct externalities occur in a physical, two-way communications network. For example, a purchase of a fax machine, directly benefits existing fax machine owners, since they now have an additional person with whom they may communicate (Page, Lopatka 1999, p. 954). In the case of indirect network effects, the value is increasing because there are more complements for the product, resulting from the increasing number of users. Indirect externalities can arise only when, as it usually happens, components are purchased at different times. For example, applications software programs are often purchased at various times over the useful life of a computer (Ibid., p. 955).

There are differences in the terminology concerning network industries. In particular, depending on the scholar, there may be a distinction between the definition of “network effect” and “network externality”, but they can also be treated as one and the same phenomenon. For example, according to Liebowitz and Margolis (1994, p. 135) a “network effect” can be defined as “the circumstance in which the net value of an action (consuming a good, subscribing to telephone service) is affected by the number of agents taking equivalent actions”. Broadly defined network effects are omnipresent. However a term “network externality” is limited to characterize “a specific kind of network effects in which the equilibrium
exhibits unexploited gains from trade regarding network participation” (Ibid.). The definition of a “network externality” derives from the common perception of externality as an example of market failure (Ibid.). Katz and Shapiro (1994) have been supporting the distinction between network effects and network externalities, however only in theory. They disagree with Liebowitz and Margolis arguing that true network externalities are in practice much more common. Other scholars (Economides 1996, Klausner 1995) apply the term “network externalities” to cover all network effects.

The phenomenon of network effects, which are also known as “demand-side economies of scale”, is the main characteristic of network industries. The examples of network industries include telecommunications, computers, Internet and they are based on network or have network-like properties (Economides 2006, p. 471). Industries, which are based on networks, provide the infrastructure or other necessities for the society and may include transportation systems (railroads, airlines, subways); banking and finance (ATMs and credit/debit card systems); news and entertainment (broadcasting and cable TV), basic public services (electricity generation and distribution), and others (Ibid.).

The efficiency of networks comes from the fact that they are reflecting economies of scale on the demand-side. Therefore, the more users join the network, the greater benefits every user will receive. Nevertheless, as network externalities are based on complementarities, in order to realize positive effects we will need interoperability. Interoperability is essential in order to achieve the implementation of one common standard, which would allow components and complements work together (Lao 2009, p. 561). Additionally, in the context of networks, analyzing practices and competition appears to be a difficult and delicate task. Where network externalities are present perfect competition is inefficient. This is because “the marginal social benefit of network expansion is larger than the benefits that accrue to a particular firm under perfect competition” (Economides 1996, p. 682). Perfect competition will grant a smaller network than it is socially optimal and in the case of high marginal costs perfect competition will not make the good available while it is socially optimal to provide it (Ibid.). What is more, in the context of networks below cost pricing must be accepted as unavoidable, also such practices as tying agreements or exclusive dealing restrictions may cause the expansion or strengthen the positive externalities from network participation and consequently is welfare enhancing rather than reducing. A similar problem may be found when we assess horizontal relationships among evident competitors. Collaboration among competitors may be a way to capture
network benefits or even a progress towards a larger and more beneficial network (Priest 2007, pp. 8–9).

7 Where Should the Doctrine Not Be Applied?

In certain circumstances it may be inappropriate to apply the EFD. These cases involve three particular situations. One of the circumstances is the lack of monopoly power. In such case, there is no basis for antitrust intervention of any kind. The standard for identification of an “essential facility” should be at least as strict as the standard for proof of monopoly power. The second circumstance involves the situation where the facility is not a single, indivisible unit, but a collection of potentially independent and viable competitive units. Such a facility should not be considered a candidate for mandatory sharing. Instead, the facility should be the subject of structural remedies, like divestiture, that restore competitive market conditions. There is no need for regulatory substitute for competition when a different and more direct remedy can be applied. The third, and probably the most important case is that the essential facilities should not be applied to intellectual property. It is argued that doing so may be against the basic idea of the legal systems that create incentives for the production of information and this would constitute a threat for the technical progress (Lipsky and Sidak 1999, p. 1220). The last of the presented cases where the doctrine should not be applied to, is, nevertheless, widely discussed and debated on; therefore it needs a detailed analysis, which is provided below.

7.1 Application of the Essential Facilities Doctrine in the Area of Intellectual Property Rights

Intellectual property rights (henceforth IPRs) are private property rights in ideas. They may take the form of copyright, where material such as books or music can be copied only with permission from the copyright owner, who can charge for this, or patents where processes or product designs can only be used with permission from the patentee, who can charge a licence fee. Such property rights originally rest with owner or inventors, or their employers, but can be bought, sold or inherited (Black, Hashimzade and Myles 2009, p. 234). IPRs are difficult to classify and therefore courts tend to completely reject antitrust liability when an accused monopolist has raised barriers to entry using valid IPRs. In the classic regime, competition law is designed to encourage new entry into existing markets by means of
punishing enterprises that raise barriers to entry. Outside the classic regime however, the EFD is protecting natural monopolies by making them offer access to their natural monopolies market to downstream competitors on level-headed terms. Intellectual property rights as barriers to entry promoted by government can be classified neither inside nor outside the classic regime (Martin 2006, pp. 32–33).

The essential facilities doctrine and intellectual property rights share some common features, such as the fact that they both give exclusionary power to their owners, because of the lack of economically feasible substitutes (Aoki and Small 2004, p. 17). They also both entail significant capital investments to obtain; therefore their duplication may be socially wasteful. Once investment has been made, it is not possible to regain sunk costs and the essential facility, which has been built or technology that has been created, allowing access to others can bring only benefits. These benefits derive from reducing the dead weight loss. However, when these benefits are too great they may also have undesirable dynamic consequences, for example when the access price is too low. When duplication is not prohibitively expensive, a more market-orientated approach may lead to less harmful dynamic consequences (Ibid., pp. 17–18). Nevertheless, there are some significant discrepancies between the essential facilities and IPRs, such as different reasons for the existence of market power. For example, one of the IPRs – patents includes in their nature the right to exclude others from applying the technology, while essential facilities market power may derive from their physical properties or from past decisions. Therefore, market power of the essential facilities is justified by the lack of a specific legal action to remove it, while market power linked to the intellectual property rights comes from the presence of specific legal protection (Ibid.).

On one hand, the application of the doctrine to the areas of the IPRs can be based on the claims against patent and copyright owners and it has its roots in the assumption that the essential facilities doctrine can be applied only in the case of natural monopoly. The classic economic theories of intellectual property markets classify IPRs as the ones having large fixed costs and low variable costs, which are also the characteristics of natural monopolies. However, the existence of an IPR is neither necessary nor a sufficient condition for the occurrence of a natural monopoly and that is why in order to identify a natural monopoly of patent or copyright, in the application of the doctrine we first need to distinguish between the regular patents and copyrights and the ones which give their owners a natural monopoly power (Martin 2006, p. 33).
On the other hand, there are also arguments against the application of the EFD to the IPRs area. It may for example reduce firms’ incentives to invest in the development of such intellectual property. Apprehension concerning incentives is based on the presumption that protecting exclusive use is crucial in order to preserve the owner’s incentive to invest in innovation. This kind of problem occurs always when other enterprises are given the opportunity to free ride on the investment made by the competitor, and it makes no difference if the investment includes regular tangible assets or proprietary assets. Therefore, while we can assume that sharing of intellectual property should be forbidden, it is equally suitable to say there should be assumption against sharing any asset to which the firm has an exclusive property right (Robinson 2001, p. 31). When the investment in research and development of IPRs has been made, the owner should not be deprived of its right to it only because it creates a competitive advantage and needs to be classified as an abuse. If we start interpreting the essential facilities doctrine other way, it would weaken the core of an intellectual property right. Therefore, the “monopolist should be able to exploit its advantage to the maximum level the market will tolerate as a reward for its creativity and innovation” (Turney 2005, p. 190). However, overprotection of IPRs may result in less innovation. This may happen when the system overcompensates the innovator. In this case, such a protection may instead hamper innovation, because without access to crucial information, competitors are not able to progress. Such a situation would additionally diminish the chances of future innovators or potential innovators in the same field to or in adjacent markets to create new innovations (Lao 1999, p. 214).

Another argument against the application of the EFD to the IPRs is that they cannot be used without disclosure or significant possibility of disclosure. Therefore, when a crucial output of the facility includes information or some other form of intellectual property it will not be a good candidate for application of the doctrine. If the crucial output would be revealed it can be easy misappropriated, and its value may be simply destroyed. In order to protect the incentives for creation of new knowledge, the legal system awards the creator or inventor with the ability to maintain the exclusivity of that knowledge, or the exclusivity of its use (Lipsky and Sidak 1999, p. 1219).

Despite the number of arguments against the application of the EFD, current trends show that antitrust and intellectual property will appear together in larger number of cases. This unstoppable trend has to be taken into account by scholars, practicing lawyers, and judges, so that they would be able to come up with theoretical justifications for the common application of both doctrines. Pro-competitive theories of patent and
copyright law might be of great help in this case. To work on the right balance, each body of law should have doctrines and remedies that are flexible enough to accommodate that balance (Martin 2006, pp. 51–52). In the case where a compulsory license is granted, there is still a need to specify the terms of the contract. A holder of the intellectual property should be able to receive reasonable royalties, despite the fact that he is duty-bound to license the intellectual property. There is, however a question if such compulsory license should be based upon the expected monopoly profit or the market value (Turney 2005, p. 185). Nevertheless, in the case where the regulator is interested in ensuring that new derivative products are not barred from emerging, a license based on monopoly profits would enable competitors to penetrate the market without disturbing the right holder’s expected compensation. However, if the creation of identical conditions for competition is the main objective, a license based on market value is more suitable (Ibid., pp. 185–186).

8 Conclusions

The opponents of the essential facilities doctrine attack it on various grounds. Hovenkamp claims that it is troublesome, illogical and impossible to control. He states that the best solution is analysing the general refusal to deal doctrine by case-by-case approach. Hovenkamp characterizes the latest version of the doctrine as pointless. He also claims that due to compulsory sharing the courts need to spare some time for the setting of forms of access and have to function as administrative agencies (Hovenkamp 1999, p. 305). Similarly, Areeda recommends caution while imposing liability based on the EFD theory. A defence of the doctrine should be based on genuine business justifications. Areeda defines the concept of “essential facility” as “anything one has that another wants”, while “the essential facilities doctrine” is “less the doctrine than an epithet, indicating some exception to the right to keep one’s creations to oneself, but not telling us what those exceptions are” (Areeda 1990, p. 844).

Many propagators of the EFD recommend competition authorities to apply the doctrine “cautiously and reasonably”, with “special care”. Improper application may damage the incentives of undertakings to start risky investments. If companies are discouraged to innovate it can potentially significantly reduce the dynamic efficiency of an industry (Walker 2006, p. 56). According to Ridyard, proper resolution of essential facilities case cannot be done without a price regulation on the monopoly facility. This price regulation has to be of a similar kind to that which is used
to control natural monopoly utility networks. A requirement to grant access without specifying the terms of access is not sufficient for solving the problem. Because such regulation may do more harm than good, it is argued that it should only be limited to cases where there has been an extreme and chronic collapse of the competitive process (Ridyard 2004, p. 673). Additionally, some scholars claim that allowing a monopolist to control a critical asset, which makes it possible for the monopolist to leverage his monopoly power in one market into adjacent markets by denying rivals in adjacent markets access to that critical asset, is considered a bad policy (Economides, Hebert 2008, pp. 462–463). Many commentators claim this rationale is unsound, because increasing competition through access cannot improve consumer welfare. This argument has its roots in “single monopoly profit theory”, which has been promoted by the so called “Chicago School”. The theory states that only a single monopoly profit can be made in the sale of a product and its complement. Therefore, when a monopolist in one market is not able to gain extra monopoly profits by dominating the complement as well, any attempt by the monopolist in the first market must have been undertaken for efficiency reasons. The argumentation leads to the situation where there is no need for antitrust intervention, because consumers are no worse off (Lao 2009, pp. 587–588).

There is a controversy around the EFD, which is accompanied by significant changes in the popularity of doctrine, definition, and use by the courts and enforcement agencies as a basis for imposing antitrust liability. We can observe attempts to hamper or eliminate its use have become more evident. The doctrine is in the process of constant evaluation, which takes the form of creating groups or forum where the idea is being discussed. The EFD has been criticized by the academic scholars for years. In particular, those who wish that dominant firms could be protected from having to share their property under the rules of antitrust liability use the same language of private rights that is fuelling the same positions in hotly contested debates in intellectual property, telecommunications, and other fields (Waller and Frischmann 2008, p. 3). Without a doubt, the application of the EFD is one of the most difficult tasks for antitrust authorities on both sides of the Atlantic Ocean. This is partly because there are no clear guidelines or legal rules, which would clearly define the situation in which the doctrine could be of use. The criteria for the application of the doctrine change, depending on legal system where the bottleneck problem arises in. Additionally, it is difficult to assess the limits of the doctrine and its relationship to other anticompetitive practices, such as tying or discriminatory pricing. Reasonable way to understand the doctrine is therefore to apply it on case-
by-case basis, taking into consideration the concept of “efficiency”, which is obtaining the maximum output for given inputs.

There are many more questions which could be asked in connection to the EFD and might be valuable as policy recommendations. These include the most important question if law should determine (or provide guidelines) what kinds of facilities may be essential in the nature. Would narrow interpretation be better in this respect? Another interesting issue concerns the regulation of the doctrine. Is ex post regulation, that is regulation of general competition law better than ex ante regulation provided by special law, such as for example telecommunications law? Or maybe it depends on the circumstances? Since the EFD is constantly developing, the number of questions connected to its application as well as the number of areas where it can be applied will be growing.

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First of all, I shall begin with a disclaimer regarding the scientific nature of this presentation. During my professional activity related to creation of a national IPR strategy in Finland, I haven’t come across a book or even an article trying to create a coherent, scientific approach on the subject. There seems to be no studies on this international phenomenon. The intention of this article is to be an introduction to the area of national IPR strategies in order to raise awareness of the issue, and hopefully also create some scientific interest in the future.

However, the lack of scientific studies also means that the topic may well be of interest from scientific perspective, as this information is new – actually in the making – and not yet analysed in a scientific manner. I shall cover some general points and then refer to the Finnish IPR-strategy as one example of such exercises.

Some basic identification of the subject is in order first. Intellectual property includes patents, trademarks, copyrights, industrial designs, utility models, business names, domain names, geographical indications, and plant breeder’s rights. The scope may even contain protection of confidential information. Intellectual property rights are also referred to as immaterial property rights or IPRs (short for intellectual property rights).1

Intellectual property rights are generated by creative activity, such as artistic expression, or scientific research and development. These rights are extensively exploited in commercial operations. The broader concept of intangible capital is often used to provide a broader-scale description of assets that cannot be reduced to possession of physical objects. It has been estimated that 75 per cent of company assets may be composed expressly of intangible assets.2 Intellectual property rights constitute a more and more central part of such company assets.

In this area, new international activity has spun approximately during the past five to ten years. The relatively new phenomenon is the creation of “national IP (or IPR) strategies” which I shall define in the following manner:

2 ibid. p. 27.
A national program to enhance competitiveness of the business sector by measures targeted to the effective protection and use of intellectual property, IP.

WIPO’s web-pages offer a more fine-tuned definition:\(^3\):

An IP strategy is a set of measures formulated and implemented by a government to encourage and facilitate effective creation, development and management of intellectual property. It outlines how to develop infrastructures and capabilities to support inventors of IP to protect, develop and exploit their inventions. An IP strategy may also be defined as a comprehensive national document which outlines how all the policy developments and implementation take place in a coordinated manner within a national framework.

During the past decade, the nations’ interest to develop a coherent approach towards intellectual property administration and legislation has been steadily rising. These countries are as diverse as China, Japan, Kroatia, the Netherlands, UK and Finland. World Intellectual Property Organisation (WIPO) has information on the projects of 23 countries\(^4\) but there are likely to be many more by the end of 2010 because several countries – sometimes referred to as economies in transition – have plans to carry out the strategy exercise with the expertise of WIPO. The European Union has developed an Industrial Property Strategy in 2008 and plans to set up a broader Intellectual Property Strategy in the year 2010.\(^5\) In a more scientific trait, the OECD has during the recent years intensified research activities in the field and produced important studies on IP.\(^6\)

The subject of the matter is basically the intellectual property rights and legislation regarding them. Usually this is also complemented with an analysis of the actual behaviour of business companies, i.e. how these rights are used in developing sustainable competitive advantages. These measures may also include other forms of protection, like applying innovative business models that are difficult to copy, relying on non-disclosure


\(^5\) Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee,”An Industrial Property Strategy for Europe”, COM(2008) 465. In the Communication from the Commission “Copyright in the Knowledge Economy”, COM(2009) 532 final, the commission makes several references to an “ambitious and comprehensive intellectual property strategy to be presented by the next Commission” (p. 3). So far, however, there are no concrete measures in this direction.

\(^6\) A comprehensive listing of OECD’s IPR-activities is included in the OECD compendium on IPR, http://www.oecd.org/dataoecd/60/61/34305040.pdf
agreements, or creating and sustaining a competitive advantage based on lead-time.

IP can be understood in a very broad sense. In e.g. the international accounting standard IAS 38, IP or intangible assets is a very broad concept. National IP strategies rarely apply so broad definitions, but are usually broader than IPR defined as legal rights. Sometimes these definitions alone do not reveal the nature of the exercise, but the content of the strategy is crucial in defining, whether we should see it as an IP or IPR strategy.

Why an IP strategy?

According to WIPO, an IP strategy is useful because it strengthens a nation’s ability to generate economically valuable IP assets. All nations have rich human capital, universities, research institutions and entrepreneurial businesses. The goal of IP strategy is to provide a plan over time whereby all national stakeholders can work together to create, own, and exploit research results, innovations, new technologies, and works of creativity.

Many countries have “innovation strategies”, like Finland, with broader target to enhance economic activity. Often the documents may have similar contents with IP or IPR strategies. IPR strategy may be part of, or supporting, the innovation strategy.

Main Features of IP strategies

The strategies may apply different methodologies. Many things are however common with these projects: analysis of the law, main problem

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7 IAS 38, pp. 1865–1870: An asset meets the identifiability criterion in the definition of intangible asset when it:

a) is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability, regardless of whether the entity intends to do so; or
b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

An intangible asset shall be recognised if, and only if:

a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
b) the cost of the asset can be measured reliably

8 "National IP Strategies", www.wipo.org

areas, analysis of the operators of the field (starting usually with the functions of the Intellectual Property or Patent Office), experiences of the business companies, and a (detailed) plan for action. The authorities that manage IP strategies vary from country to country. The strategy is often supervised by a high authority, in e.g. Japan the steering group is the government of the country with PM as the chairman of the IP strategy.\(^{10}\)

Private companies may apply IP strategies in their operations, but, needless to say, the scope of this paper is only on the public sector activities. IP strategies however may well require public-private – partnerships and of course, since the intention of the exercise is to increase the opportunities and abilities of the private sector to utilize IP.

The interest to create national IP strategies has spread globally. Since IP legislation is however organised by international conventions, largely managed by the WIPO, it seems that broad national deviations from the internationally agreed principles are not possible in the IP strategies.\(^{11}\) Therefore, it is obvious that the intention of the strategies is very much focused also in the functional aspects, i.e. increasing the knowledge and abilities of individuals, public sector and especially the business companies to increase abilities to operate with IP and to understand the nature and opportunities of IP. Education and research of IP is usually a fundamental element of an IP strategy.

When a country decides to carry out an IPR-strategy project, it is customary that the task in practice will be given to either the national patent – or IP-office. Sometimes the ministry in charge of IP issues may be the project leader, putting the project higher on the political agenda.

The project usually contains three different phases: survey of the current situation, setting the targets, and implementation.

First of all is the survey of the current situation, legal and economic.\(^{12}\) The country may have specific features which require a solid understanding of the country’s economic basics. Apparent failures of the legal system have to be identified. It is common that nearly all countries in the world participate in different international agreements regarding IP’s. The evaluation of the web of international agreements and to which extent the

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\(^{10}\) There are several net-sources available on Japan’s IP-strategy, e.g. 
http://www.ipr.go.jp/e_material/ipsj.pdf,
http://www.kantei.go.jp/foreign/policy/titeki/kettei/020703taikou_e.html

\(^{11}\) The Government’s Resolution on the Strategy Concerning Intellectual Property Rights, 26 March 2009, chapter “Background” p.2.,

\(^{12}\) In the case of Finland, ”IPR to efficient use!” is the report containing background ideas and conclusion. The document is complete with the text of the report and a set of company surveys and interviews and an evaluation of the Finnish IPR-field in general. The complete document is only available in Finnish.
country is participating to them is an essential part of the groundwork for an IP strategy. It is also instrumental to build a total picture of the level of know-how in companies, universities and public authorities. Major shortcomings must of course be identified in the project.

Secondly, the setting of targets follows. Some of the targets may be selected because the surveys point clear shortcomings. Sometimes this may be relatively easy but going forward to more future-oriented policy choices may prove difficult due to different views in society. Companies and individuals operating as right holders may see it of great importance to safeguard the protection of rights and leave all other activities to free markets to be decided. This may however be slightly illusory, as strong and rigid IP protection versus a more relaxed and flexible approach is also a choice of the legislator. A cynic might ask what else IP legislation is but constructing the market rules by the society rather than by the market: anyone demanding pure market rule should also require the abolishment of, say, copyright or patent protection. But this would clearly make not much sense.

At the same token, as timid regime may appeal to some, going too far may result in the society experiencing IP-related unrest and political movement. If this leads to the formation of political movement laying their philosophical base on IP agenda, the legislator should look into the mirror to see if the political elite has missed something. Maybe the voice of the consumers is being forgotten, which may make it difficult create a sustainable and balanced regime for IP protection. This type of balance-setting work in smaller details may be quite painstaking.

The third phase is implementation. This part is as tedious work as the previous phase, but if the establishment is able to agree on the targets and allocate sufficient resources to the project, this helps implementation a great deal. Implementation must however be part of the planning process, as the target-setting might have lead to adapting targets without adequate resources. Without necessary resources the implementation may land flat. It is better to lay targets and plans that are compatible with goals and resources rather than try to “make a mountain out of a molehill”.

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13 In the case of Finland, the target was set in the Government Resolution of 26th March 2009 in the chapter "Future prospects and targets status for 2015". See footnote 11 above.
14 The implementation phase has meant carrying out several studies in various areas: the evaluation of patent and register authority of Finland (carried out by consultancy Ramboll Ltd), open source –survey (by doctors Mikko Välimäki and Ville Oksanen), survey on unfair competition (by Eliisa Reempää), national evaluation of the effects of the community patent (Prof Kalle Määttä), and a survey regarding the group exemptions for R&D in European union (Finnish Competition Authority).
Case Finland

The Government's Resolution for a strategy concerning intellectual property rights (26th March 2009) was prepared at the Ministry of Employment and the Economy (MEE) in collaboration with the Ministry of Education (ME). The decision on drawing up a strategy concerning intellectual property rights was part of the Government Programme of Prime Minister Matti Vanhanen’s Second Cabinet.

The IPR strategy is a part of the process to strengthen national innovation policy. Special attention has been paid to the opportunities of SMEs and private inventors to utilise various forms of protection and thus improve the opportunities to commercialise their products. The strategy consists of measures based on the goals presented in the report drawn up in connection with the preparatory work.15

Background

The preparation was supervised by a steering group that published its report in January 2009.16 The steering group identified four key development trends which will have an impact on the importance of intellectual property – namely, globalisation, digitalisation and convergence, politicisation of intellectual property rights, and expansion of the scope of intellectual property rights. The steering group characterised these trends in the following way.

Globalisation is present in the everyday activities of Finnish companies in the form of international operations implemented in accordance with international rules. Even relatively small Finnish enterprises operate at least in areas neighbouring Finland or even globally. In other words, knowing the international practices in relation to issues of intellectual property rights is an essential success factor for Finnish companies. Finland’s decreasing legislative freedom of action is also associated with globalisation. Finland has joined agreements on international trade and intellectual property rights and, as a member of the EU, is under an obligation to comply with the Community legislation. On the other hand, engagement in international systems has also opened doors to international trade.17

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15 ‘IPR to efficient use! p.9.
16 “IPR to Efficient Use!”.
Digitalisation and convergence are internet–related trends. The development of information technology has brought versatile audiovisual production and distribution systems that are available to everyone. A private citizen may carry around a calculator, mail ability, banking and shopping services, a library (the Internet), games, radio, television, a camera, plenty of audiovisual content, and a positioning device, all in his or her mobile phone alone. Technological development has made copying and distribution of digital material in the information network practically free of technical cost.\(^\text{18}\)

The politicisation of intellectual property rights is evident in the fact that things that used to be remote to this field, such as health care, supply of medicines, or traditional cultural expressions (folklore), have been given a strong intellectual property rights dimension. For instance, today international negotiations address matters such as intellectual property rights related to pandemic influenza viruses.\(^\text{19}\)

The expansion of the scope of intellectual property rights, on the other hand, manifests itself particularly as an explosive increase in patent applications worldwide. The emerging economic powers of the Far East are using all their strength to enter this sector. Globally, there are approximately 3 million pending patent applications. The expansion also shows in that, while the field of intellectual property used to be distinctively about negotiations and agreements between companies, consumers today must face issues related to intellectual property rights more and more often. For instance, counterfeit products can be found in the arenas of information technology, pharmaceuticals, and design. Furthermore, with the Internet, copyrights have involved legislation affecting the behaviour of private citizens more directly than before, since the meaning of, for instance, communications content created by consumers has increased. Consequently, the consumer perspective has become emphasised in the field of intellectual property rights in recent years.\(^\text{20}\)

\textbf{Future prospects and targets status for 2015}

The structure of the Finnish IPR strategy is based on the Steering group’s description of the anticipated key elements of Finnish social development within the next few years. The list represents a “best guess” of the experts of the scenario for the near future. The strategy in its entirety is a strategy


“suitable for a country like Finland”, as one Steering Group member pointed out. Therefore the international aspect is dominant, as Finland is a small home-market where companies have to develop skills for foreign trade already at relatively small company size.21

“Future Prospects and Target Status for 2015

The importance as well as the amount of innovation and creative work has increased. Open innovation and, for instance, the great importance of content produced by consumers challenge the system of intellectual property rights based on exclusive rights. Skills, knowledge, and their controlled distribution are significant competitive factors. Patents, trademarks, and model rights are mostly granted through international systems. Direct licensing of copyrights will increase. Competition and IPR viewpoints associated with standardisation have become more central. Legal collisions have increased. Regulation of intellectual property rights is developed primarily by the EU and the WIPO. More often than before, legal disputes concerning intellectual property rights are settled at supranational level. The exploitation of digital technology has become more versatile, progressing to new areas. Convergence has changed and integrated conventional branches of business. Cross-licensing and co-operation projects crossing national boundaries have increased. The use of intellectual property rights as a medium of exchange has become more common. The expansion of the number of patent and trademark applications is a challenge to the intellectual property rights system.”

Target areas and action

In the Government Resolution of 26th March 2009, the “Outlook for 2015” is then broken down to four areas of action, “skills”, “the efficiency and clarity of rights”, “competition policy and functionality of markets”, and “functional and economic efficiency of the system”. Here are some examples of the targets and actions in the Government Resolution.

Skills

According to the Government’s Resolution, success in both domestic and international markets requires versatile command of protection of intellectual assets. Intellectual property rights training should be given a higher priority in both legal and business-related education. Strategies based on open innovation require full understanding of intellectual property rights as well. The conditions for co-ordination and integration in the field of education need to be improved. As far as possible, the technical, economic, and legal knowledge should be made available within the framework of one single line of study.

The exploitation of patent information is not sufficiently active. Addressing this would help avoid overlaps in research and development and speed up the generation of commercial applications.

Measures include e.g. promoting teaching and research concerning intellectual property rights in collaboration with universities and polytechnics and promoting intellectual property rights training in researcher education in particular. Teachers are to be provided with an expanded foundation of knowledge and competence concerning intellectual property rights by producing and offering content services for teacher education. Education in exploitation of patent information will be increased.22

The efficiency and clarity of the rights

In order to be efficient – i.e., implemented in an efficient manner – property rights should be clear and correctly dimensioned. The development of an electronic marketplace and information society must be promoted by means of counselling and information.

To achieve balanced final results, in legislation concerning intellectual property rights and in practical action, the status of the final user must be taken into account alongside that of the holder of the rights. This applies to both companies as commercial users and consumers as end users of products.

The high standard and speed of court proceedings hold a central position. With a view to effective exploitation of intellectual property rights, high-quality dispute settlement and court action are of great importance. High-standard court action is also a prerequisite for the development and maintenance of competence related to intellectual property rights in Finland. The standard of court action must be competitive at the EU level. Alongside

solid court handling, there must be functional and reflexive dispute settlement mechanisms that can provide agreement-type solutions.

Measures include the establishment of an IP court and several studies targeting to legal reforms on copyright. Increasing information and counselling on what is allowed and what is not allowed in data networks will be offered, and clarifying the legislation, as necessary. The legal risks associated with licensing and exploitation of open-source software will be evaluated. The Ministry of Education shall prepare assessment methods and criteria related to the functioning of the copyright system.\textsuperscript{23}

\textbf{Competition policy and functionality of markets based on intellectual property rights}

In the view of the Government, both the competition rules and legislation concerning intellectual property rights aim at ensuring efficient operation of the markets and effective exploitation of innovations. For Finland, whose competitiveness and national well-being are critically dependent on the country’s ability to produce new innovations and exploit them to the maximum, the meaning of open and well-functioning national and international markets is especially important. Market bottlenecks and obstacles to technological development should be actively cleared.

Use of intellectual property rights as company assets should be promoted by increasing information about the opportunities associated with intellectual property rights – in particular, issues related to valuation of intellectual property rights. The use of intellectual property as collateral is important in terms of financing opportunities for companies in the field.

Measures include monitoring the European Community Block Exemption Regulations, linking the issues concerning intellectual property rights with the performance negotiations of the Finnish Competition Authority and e.g. assessing the licensing practices of copyright organisations from the standpoint of competition policy, and issues of IPR in public databases. Ministry of Employment and the Economy is in charge of surveying the economic information tools regarding IPR’s and also IPR questions related to standardisation.\textsuperscript{24}


**Functional and economic efficiency of the system**

According to the Resolution, the intellectual property rights system should be co-ordinated in an efficient manner at a high political level, in order to ensure that state operations in the arena of intellectual property rights remain systematic and in compliance with the targets set. The status of the National Board of Patents and Registration of Finland as a high-standard authority responsible for intellectual property rights should be developed.

The public actors in financing and counselling roles should operate openly in an efficient and uniform manner in order to promote the development of intellectual property rights competence in practical business operations.

Measures include an assessment of the operation of the National Board of Patents and Registration of Finland is implemented in 2009, evaluating the development of the authority’s operations, the development needs of intellectual property administration, and the authority’s role as part of the Finnish innovation system. The problem areas related to intellectual property rights of universities and polytechnics and public research organisations will be mapped (Ministry of Education, Ministry of Employment and the Economy) in terms of: IPR in co-operation between research and industry. The way in which the efficiency of counselling concerning intellectual property rights could be increased will be explored.25

In addition to these areas of activity, there are some action points defined in the international fora and internal activities regarding the management of the strategy etc.

The Finnish case is by far not the best or broadest exercise carried out in the world, to the contrary, but it reflects a practical approach which was well put by a steering group member: a strategy suitable for a country like Finland. Something like this will quite certainly emerge in the next years around the globe as countries of all sizes and importance start to pay attention to this problem area and seek action. What will be the legal, political and economic consequences remains for us to see, but judging from first experiences in several countries, organised improvement of the IP sector may well have a positive input in the development of the countries’ business environment.

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Final Remarks

“Belief is nearly the whole of the Universe, whether based on truth or not.” (Kurt Vonnegut, Bluebeard, p. 144)

I shall end this article with a more theoretical note. As a devoted follower of the institutional theory of law I share the view that institutional facts are based on the mutual beliefs in society. It is therefore basically these mutual beliefs that also guide legal development.26

It looks like the international community is starting to get convinced that getting IP high on political agenda makes sense and is supporting businesses pursuing their goals. How is this going to affect international business on a broader sense will only be seen after maybe ten years. It is difficult to form an opinion yet on whether this development is entirely beneficial or are there negative side-effects such as the expansion of global patenting activity.

Good or bad, the phenomenon is evidently there. This development may in the long run change the view we have on businesses. The traditional manufacturing of physical goods remains necessary but in parallel to this activity the fortress of intangible assets is being built. It stands on the ground of international treaties and solid contractual practices, but also in the will of governments not engage themselves in protectionist behaviour that could effectively harm the international system of IP. How strong this fortress is going to be in the fluctuations of the economy remains to be seen.

If the “National IP Strategy”-approach helps developing countries and also countries in economic transition to get their economic infrastructures develop faster, we might expect gradual positive development and maybe even some changes in the international organisation of economy. Peaceful development of these countries may well bring about a promise of great economic potential and development also in the IP area.

IP strategy is by far not the only factor in any nation’s way forward but surely efforts in having the IP sector under solid administration and policy with clear targets will improve their development.

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Professor Anne Meuwese critically analyzed the role of impact assessment in EU law-making.

Professor Michael Faure gave a lecture under the title ‘Towards Better Environmental Regulation’.
Auditor-General of Finland Tuomas Pöysti (left) and Professor Peter Wahlgren (right) took part in the final panel discussion.

Professor Jyrki Tala, representing the organisers, commented vigorously on the exciting discussion on Better Regulation.
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