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Why do Doctors Leave – and What Would Make Them Stay?

On the Characteristics of the Migration of Medical Doctors from Hungary

ÁGNES HÁRS – DÁVID SIMON

The migration of medical doctors is an important policy issue in the healthcare sector, which is closely linked with the more general anomalies of the Hungarian healthcare system and the problem of the shortage of medical staff. However, the international migration of medical doctors is not something new, nor is it something specifically Hungarian. The widening of the scope of tasks and possibilities of medicine and the demographic trends generate increasing demand for medical doctors in the developed world and lead to their increasing migration. Measuring the more and more important phenomenon of the migration of medical doctors is not simple, so it is often replaced by asking doctors about their intention to migrate, which is easier to measure. The data collection in the present research looked at the actual size of the migration of doctors, as well as its motivating factors, the drives and the impediments of migration of medical doctors in Hungary. The research covered Hungarian doctors currently working abroad and those who have spent a period of time abroad but have returned, having gained experience in migration and those without emigration experience. The first part of the article discusses the scope of doctors' migration, the professional and age makeup of the doctors working abroad and the dynamics of migration. The second part of the article explores the question what factors influence the decision of Hungarian doctors to work abroad and their expectations concerning working outside Hungary. Model calculations examined how the various aspects of living and working conditions affected the

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probability and the patterns of working abroad. Compared with our expectations, higher salaries in themselves are not sufficient to motivate migration decisions and raising doctors' salaries is not enough to stop the migration trend either. The intensity of the emigration of medical doctors and their expectations concerning future decisions predict the prevalence of the emigration of young doctors. This can be identified as the most serious problem of the emigration of medical doctors from Hungary.[*]

Journal of Economic Literature (JEL) code: C83, I10, I20, J40, J60, J61.

Reasons, explanations and measurability

The international migration of medical doctors is subject to the general push and pull effects of migration (*Massey,* 1988, *Massey* et al., 1998, *Stark,* 1991) and the diversity of factors specific to the mobility of highly qualified professionals and the brain drain *(Beine* et al*.,* 2008, *Bhagwati–Wilson,* 1989, *Stark,* 2005). Ever since the 1970s the migration in the globalising labour market of medical doctors was subject to the pulling effect of the shortage of doctors and the differences in their working conditions (*Bach,* 2003, 2004, *Mejia,* 1978, *Mejia* et al., 1979). The general shortage of doctors is influenced by the increasing demand of the healthcare system augmented by the increasing GDP expenditure on healthcare, and some institutional characteristics, especially the cyclical nature of medical training and recruitment (*Buchan,* 2007, *Buchan* et al., 2014, *Dumont–Zurn,* 2007). The strong increase in demand for qualified doctors and the number of doctors working abroad has quickly increased worldwide over the last few decades. In the target countries of the migration, the number of home-trained local doctors has increased as well; nevertheless, these countries have continued to attract significant and increasing numbers of doctors from abroad. The most important target country for the migration of doctors is the USA, but the proportion of doctors who obtained their qualification in other countries is high in all the developed countries outside Europe, and it has increased rapidly in the UK, Germany and the Scandinavian countries. In the most

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Translated by *Júlia Károlyi.* Translation checked by *Chris Swart.*

significant target countries the proportion of doctors graduated abroad can be as high as 25-35% (*Buchan* et al., 2014, *Clark* et al., 2006, *Dumont–Zurn,* 2007).

The countries of Eastern Europe joined in the global flow of doctors' migration as early as the 1990s, before their EU accession, but with the expansion of the Union this process gained speed (*Kaczmarczyk,* 2006, *Wiskow,* 2006, *Young* et al., 2010), transforming the earlier European migration patterns and directions (*Dumont–Zurn,* 2007, *Glinos* et al., 2014, *Merçay* et al., 2015). In 2002 migration expectations were significant among the medical doctors of Eastern Europe, but the Hungarians reported the most serious intentions (*Vörk* et al., 2004). The actual migration of medical doctors, however, failed to meet the overheated expectations, and, in the case of Hungary, it was far from the stated serious intentions as well (*Dumont–Zurn,* 2007, OECD, 2015).

Parallel with the diversification of the migration patterns of doctors several attempts were made to accurately describe the processes and to carry out international comparisons and standardisations (*Buchan* et al., 2014, *Dumont–Zurn,* 2007, *Merçay* et al., 2015, *Tjadens* et al., 2013). Despite the efforts of the WHO and OECD to compile databases and statistics suitable for measuring the migration of medical doctors and made up of compatible data, the sources and content of these data remain heterogeneous (*Buchan* et al., 2014, *Dumont–Zurn,* 2007, *Merçay* et al., 2015). Measuring the scope of actual migration is thus often replaced by asking doctors about their intention of migrating, which is more feasible. This practice is very widespread among researchers of doctors' migration, (e.g.: *Dumont–Zurn,* 2007, *Glinos* et al., 2014, *Maier* et al., 2014). The majority of Hungarian publications presenting medical doctors' migration is also based on such data predicting the potential of migration.

There is no reliable inventory of medical doctors in Hungary.[1] This uncertainty entails the possibility of over- or underestimating their number, while the doctors who have disappeared from official records have presumably left the country.[2] The research on migration potential usually measures the possible rather than the actual flow, just like the analyses based on the number of applications for the official certificates needed for doctors' employment abroad (*Balázs,* 2012, *Csernus et al*,

[1] In the registry of doctors with a certificate to practice there are also ones who do not, in fact, practice, while in the registries of those working in state-run institutions private doctors (GPs, dentists and other professionals only running a private practice) are not featured, while there is no separate registry for these doctors.

[2] The estimate of *Varga* [2016] proves that those leaving the medical profession outnumber those going to work abroad as doctors.

2013, *Eke et al*, 2009, 2011). Both procedures obviously overestimate the actual outward-bound flow of doctors and ignore the possibility of doctors' coming back to Hungary. The stock of Hungarian doctors abroad can be estimated by mirror statistics based on the number of Hungarian doctors registered abroad, which makes it possible to quantify the proportions of the stock of emigrant doctors. In 2012 about 9-11% of Hungarian doctors were living abroad, which means approximately 3250 persons, with a strong tendency of increase. In 2009 the number of Hungarian doctors living abroad was only 5-6%.[3] We estimated the intensity of the outward flow of Hungarian doctors on the basis of administrative data. To calculate the scope of flow we used the administrative official certificates data required for employment abroad. On the basis of the number of the applications for the official certificates for the first time between 2009 and 2012 on average 700, while in the 2013–2014 period on average 500 doctors intended to work abroad, which amounts to 2.7-1.9% of the estimated total number of medical doctors in the country.

Empirical research – the emigration of medical doctors

Our empirical research presents the background of the decision of Hungarian doctors working abroad using two different approaches. One approach looks at actual employment abroad and the factors behind it, while the other looks at the migratory and returning potential and their interconnections. In addition, we look at the emigration of career starters and their potential motivations separately.

The Methodology of Data Collection

We carried out empirical data collection with three target groups: medical doctors involved in employment abroad, career starter doctors and – as a control group – those doctors who have never worked outside Hungary. We defined "involvement in employment abroad" as at the time of the interview or at any time in the 2000–

[3] To calculate the proportions of migration on the one hand we made an estimate based on mirror statistics, since we know the numbers of Hungarian doctors working in Germany, the UK and Sweden (OECD, 2015) and the number of all official certificates issued for these three countries is estimated to be 60% of the total number (*Katona,* 2015), we estimated the total number of Hungarian medical doctors currently working abroad on the basis of these two. The estimated number of doctors working in Hungary, 30 000 persons in 2012, was calculated on the basis of the data of the GYEMSZI (Institute of Quality and Organisational Development in Pharmacology and Health Care), the data of the Central Statistical office, and experts' estimates on the number of doctors running exclusively a private practice.

2015 period with the respondent having spent at least one week working abroad. We defined medical students or doctors who had graduated in the year of the research or in the previous years as "career starter doctors".

We approached doctors not involved in migration in a stratified random sampling based on an address list and then weighted the sample for the geographic region of their place of work, their age group and type of work. The doctors previously involved in migration but currently working in Hungary were approached with a similar sampling scheme, using screening methodology. As for the doctors currently working abroad, we used network sampling relying on their groups created on social networking sites as the starting point for our sampling. First we processed the data given by the person under their profiles and took a sample relying on the data concerning their networks. Our sampling procedure followed the rules of a modified version of respondent driven sampling (*Salganik,* 2006), the so-called reweighted random walk (*Gjoka* et al., 2010). We created chains long enough for a balance (considering the estimated size of our target group as described above) and applied appropriate weighting to compensate for the impact of network size on the probability of getting into the sample. The sample that we arrived at in this way was not significantly different in effective sample size from those generated by the usual multistage sampling procedures,[4] which can be even smaller because of the relative size of the sample compared to the population[5]. With the help of Hungary's medical universities, we made an effort to reach the entire group of career starters.

The data were collected online.[6] The sample contained 736 medical doctors working only in Hungary, 154 currently working in Hungary with earlier work experience abroad and 196 currently working abroad (un-weighted item numbers). In the sample of career starters there were 152 doctors and dentists who had graduated within two years and 140 medical students (doctors and dentists) who had graduated within one year.

The statistical characteristics of the sample, descriptive statistics

We approached both doctors working abroad at any time within the given period and at the time of data collection. Our models made it possible to draw comparisons

[4] Design impact can be considered to be cc. 2.

[5] Our estimate is 7% in this segment.

[6] Prior preparing the questionnaire a set of interviews were conducted with doctors and recruitment agencies involved in migration. When compiling the questionnaire, we relied on these interviews; the contributions made by *Eszter Szabó* in various countries were especially useful.

concerning changes within different time periods and migrant groups. The total size of the sample was 1116 persons, two-thirds of which had no experience working abroad at all and 20% was working abroad at the time of the data collection. Only a very limited number of respondents was working or had worked both abroad and in Hungary at the same time. Compared with the previously estimated number of medical doctors working abroad, 3000 persons, those who had got into our sample constitute 7% of this group. The structure of the migrant and the control group is presented in *Table 1.*

Table 1

The distribution of respondents according to fact of ever working abroad*

Works in Hungary or abroad (at the time of responding)?			Ever worked outside Hungary?		
	Persons	%	Persons	%	
Works in Hungary	886	79.4	745	66.7	Never worked abroad, currently works in Hungary (or doesn't work at all)
			148	13.2	Has worked abroad, currently works in Hungary (or doesn't work at all)
			893		Total
Works abroad	198	17.7	223	20.0	Currently works abroad
Works both in Hungary and abroad	23	2.1			
Doesn't work	9	0.8			
Total	*230*				
Total	1116	100.0	1116	100.0	Total

* Rounded values.

There were slightly more males than females among those who had worked or were working abroad (60%), while there were slightly more females than males among those who had never worked abroad (56%). The difference in age groups is

significant. More than half (58%) of those working abroad at the time of the interview were young (35 or younger), the middle-aged group constitutes another 30%, while the elderly are not very numerous at all. Most of those working both in Hungary and abroad were middle-aged (68%) and obviously the percentage of those only working in Hungary increased with age (see *Table 2*).

Table 2

Working in Hungary or abroad, by age groups*

(*N* = 1102, in percent)

	aged 35 or younger	age 36–50	more than 50	Total
In Hungary	19.4	35.8	*44.8*	100
Abroad	57.7	29.0	13.4	100
Both in Hungary and abroad	24.1	*68.1*	7.8	100

*The differences are significant as tested by the chi-squared test ($p < 0,001$).

If we only ask those currently not working abroad, there is little difference in terms of age groups between those with some and with no earlier work experience abroad (see *Table 3*).

Table 3

Has the respondent ever worked abroad*

(*N* = 890, in percent)

	aged 35 or younger	aged 36–50	more than 50	Total
Yes	16.2	41.4	42.4	100
No	20.5	34.3	45.2	100

*The differences are not significant as tested by the chi-squared test ($p = 0,226$).

87% of those never having worked abroad were medical doctors as opposed to 13% of dentists, which corresponds to the proportions within the entire group of certified medical professionals. As for the group of those with any experience of working abroad, these numbers are 94% and 6% respectively, where the 6% is lower than the percentage of the official certificates issued, but we don't know whether doctors

and dentists have got the same chances of actually using their official certificates for working abroad. The proportion of those with specialisation completed was lower among those with earlier working experience abroad and especially among those currently working abroad than those working exclusively in Hungary (86%, 65% and 56% respectively). Age obviously plays some part in this, but the proportions are important, because they show that many of those going abroad do so before even completing their specialisation.

The dynamics of migration could be reconstructed by the migration histories of the individuals involved. During the interviews we asked doctors in detail about their earlier and current work experience abroad (for each year separately since 2000), and also about their first ever experience working abroad, which may have happened earlier than 2000. As for the average time of their first employment abroad, there are significant differences across age groups. The individual dates are linked to the important dates in the history of free movement and free employment as well as those of social and economic changes in Hungary – as corroborated by other research findings. Those over 50 first went to work abroad on average around 1996, after the regime change, those in the 36–50 age group around 2006, just after Hungary's EU accession, while those under 36 tended to leave around 2011, in the aftermath of the economic crisis bringing about social problems and great difficulties within the healthcare system. It is clear that the average age at first employment abroad has decreased significantly among the younger respondents: in the under 35 group it is 27 years, while in the older age group it is between 33 and 40 (see *Table 4*).

Table 4

Average age at the time of first employment abroad and average year of employment

Age	Average year of first employment abroad		Average age at time of first employment abroad		Sample size (no. of items)
	Average year	Standard error	Average age	Standard error	
35 or younger	2011	0.2	27.3	0.2	199
36–50	2006	0.5	33.3	0.4	114
50+	1996	1.4	39.9	1.1	55

This, however, doesn't necessarily mean that those in our sample worked abroad first as medical doctors. We have approximate information concerning this question for almost three-quarters of those with working experience abroad. (We asked respondents whose first working experience abroad happened after 2000 for detailed information on this.) Among those under 39 many worked without specialisation, while among the older age group the majority worked in their own fields. There were few respondents in our sample who worked abroad but not as doctors (see *Table 5*).

Table 5

Type of work at first working experience abroad by age groups*

	Specialist in own field	Specialist in other field	Medical doctor without specialisation	Works in health care but not as doctor	Works not in health care	Not works but studies abroad	No. of items
			%				persons
35 or younger	7.9	0.9	85.2	0.3	2.2	3.5	112
36–50	60.6	3.3	26.8	8.2	1.2	0.0	107
50+	81.5	0.0	12.4	0.0	0.0	6.1	45

*The differences are significant in total as measured by the generalised Fischer exact test ($p < 0{,}001$).

Based on their annual career description, for the doctors who had working experience abroad we could also examine to what extent seeking employment abroad between 2000 and 2014 was a one-off decision and how the dynamics of working abroad and in Hungary changed during the respondents' careers. We broke up the period into three stages: early, crisis and recent sub-periods. When looking at the previous year's workplace of those currently working abroad, this meant the periods 2001–2008, 2009–2012 and 2013–1014, while when looking at next year's workplace, the periods are (obviously) one year earlier: we look at where the respondents worked in 2000–2007, 2008–2011 and 2012–2013. It was true for the entire period in question that if a respondent had worked abroad once, they would probably work abroad permanently. 90% of those who were found to work abroad in any one given year within the 2001–2014 period only worked abroad in the previous year, and this percentage increased over time, from 86% in 2001–2008 to 91% in 2009–2012 and 92% in 2013–2014. The percentage of those returning to Hungary is

likewise small: those who were found to work abroad at any point between 2000 and 2013 were highly likely to have worked abroad in the next year as well – this was true for 88.5%.

The changes over time are highly significant. In the 2000–2007 period many respondents changed the location of their work. Of those working abroad in any one year of this period 75% worked only abroad the next year as well, a smaller number of them sought employment abroad for shorter periods of time and 16% returned to Hungary or started studying. After 2008, however, this trend took a sharp turn, with 98% of those working abroad found to work abroad the next year as well.

Looking at the dynamics of the migration of doctors it seems to be the obvious trend that compared to the period before 2007 finding employment abroad proves to be permanent and there is an increase in the percentage of young, freshly graduated doctors among those who work abroad. *Table 6* shows these changes.

Table 6

Previous and next workplace of doctors working abroad in the given year, by location of working for 2000-2014

(N_{max} = 133)

Status in previous year	Not worked	Worked only in Hungary	Spent some days or weekend working abroad	Spent one or several months working abroad	Worked mainly abroad, occasionally in Hungary	Worked only abroad
Previous year's workplace by location of working (%)						
2001–2008	2.4	1.0	0.0	7.0	3.4	86.2
2009–2012	0.0	3.7	0.5	2.2	2.7	90.9
2013–2014	0.9	1.9	0.0	2.6	2.4	92.2
2001–2014	0.8	2.5	0.2	3.4	2.8	90.2
Next year's workplace by location of working (%)						
2000–2007	3.3	15.9	0.5	3.6	2.0	74.6
2008–2011	0.9	0.6	0.0	0.4	0.0	98.1
2012–2013	1.4	0.7	0.0	0.1	0.0	97.8
2000–2013	1.3	6.9	0.4	2.0	1.0	88.5

The factors influencing the emigration of medical doctors

Using logistical regression models we attempted to answer the question how various factors influence the chance of doctors' migration and its forms. We looked at demographic and personal factors (gender, age, family marital status, usual place of living within Hungary), migration experience (place of birth, time spent abroad not for employment purposes), family background (any other medical doctors or people working in healthcare in the family) and qualification (graduated as doctor or dentist, where, whether or not acquired specialisation certificate). Also, we examined family factors (child or any other dependant relatives in need of financial or other support) and how the perceived importance of family, professional and other factors influence the chance of seeking employment abroad.

We used two models to describe the prospects of migration. The first model only examined the factors influencing the outward migration of doctors only working in Hungary (by comparing the responses of those only working in Hungary with the answers of those only working abroad). The second model shows the chances of change in doctors' migration (on the subsample of those currently working in Hungary but having work experience abroad and those currently working abroad).

In the following, we shall summarise our findings. The significant odds ratios of each model are given in *Appendix 1.*[7] The two models show numerous similarities, but the probability of working abroad is different for the model for those working in Hungary and the model for those having worked abroad earlier. The former shows the chances while the latter gives insight into temporal processes, so we describe the outcomes of the two models in comparison.

Some of the variables didn't prove significant in either model, despite our expectations. Gender, place of birth, whether there were other doctors in the family, the completion of specialisation and whether any relatives were dependant on the respondent's financial or other kind of assistance weren't found to be significant. Among the variables concerning work that we had expected to be the most significant, the importance of salaries, had an impact clearly not as a sufficient motivation for migration. Also, a set of professional factors expected to have great impact weren't found to be significant, such as the availability of in-service trainings and further specialisation, the attractiveness or interesting nature of the job, professional

[7] The explanatory power of the models was high in all the three cases (Nagelkerke R^2 0.6; and 0.7). For more detailed findings please contact the authors of this paper – we could only publish some of the findings here, due to lack of space.

developmental opportunities, working environment, working conditions and work-life balance. As for individual factors, housing conditions and the availability and cost of healthcare had no significant impact on the changes in the probability of seeking employment abroad.

Demographic and personal factors

In the first model marital status has no impact on the chance of migration only in comparison with the doctors only working in Hungary. In the second model, which explores the changes in employment abroad, it does – namely, in comparison with doctors with earlier working experience abroad, being single as opposed to married increases the chance of working abroad by four and a half times.

In total, the place of residence – or, for those living abroad, their usual place of staying in Hungary – has significant impact on the chance of working abroad in both models. Compared to those working only in Hungary the chance of those living in the Észak-Alföld (Northern Great Plain) and Nyugat-Dunántúl (Western Transdanubia) regions was much higher for working abroad; that of the residents of the Közép-Magyarország (Central Hungary) and Dél-Dunántúl (Southern Transdanubia) regions tends to be lower. In the second model, which also examines the dynamic impact, the place of residence of those living in the Nyugat-Dunántúl (Western Transdanubia) and Dél-Dunántúl (Southern Transdanubia) regions strongly increases the chance of working abroad in comparison with earlier working experience abroad, while for the Közép-Magyarország (Central Hungary) and Észak-Alföld (Northern Great Plain) regions place of residence had a stronger impact earlier on the chance of gaining working experience abroad, but this regional impact disappeared over time.

Age has a significant impact on working abroad only in comparison with the doctors only working in Hungary, not in the second, dynamic model. In the first model the chance of working abroad for those in the 40–54 age group is almost eight times higher than that of those over 55, and even that of those under 40 is four times higher. The impact of the chance of working abroad of young respondents can't be clearly seen in the variable (it is not strongly significant either) – probably the influences concerning specialisation take up its effect.

Migration experience

To gauge respondents' migration experience, we asked them whether or not they had ever spent a minimum of 3 months abroad not with the aim of working. In the

case of the first model, earlier migration experience had a significant impact on the chance of working abroad, increasing it over six times. In the second model, where the comparison was drawn with earlier working experience abroad, the impact was not significant and presumably was no different from that in the previous period.

Factors linked to the status of respondents as doctors

In comparison with dentists, doctors have ten times more chance to work abroad, no matter if we compare them with those only working in Hungary or with those with earlier working experience abroad. Compared with those only working in Hungary, the chance of working abroad was not significantly affected by completing one's university studies abroad. However, the difference is significant between those who worked abroad earlier in the case of currently working abroad, which is indicative of the growing importance of getting qualifications abroad in defining one's chances to work abroad. Looking at the differences between the various universities' medical schools we saw that this effect was especially strong with the graduates of Semmelweis University compared to other universities, which can be interpreted to indicate that with those who worked abroad earlier, graduating from a university abroad or not in the capital increased their probability of working abroad, unlike graduating from Semmelweis University, but this effect gradually petered out.

In the first model, specialisation significantly decreases the chance of working abroad in the majority of cases. Specialising in internal medicine, gynaecology, or becoming a GP results in one tenth the chance, while specialisation in other fields results in one fourth – while being a pathologist or anaesthesiologists results in a nearly five times higher chance of working abroad. Being a surgeon, paediatrician, psychiatrist or neurologist, on the other hand, seems to bear no significant impact. In the second model, incorporating also the dynamic change, specialisation in the majority of cases has no significant impact on the chance of working abroad, with the notable exception of GPs: their chance of working abroad is one-twentieth of those with earlier experience of working abroad and it is one-tenth for those with other (or several) specialisations (compared with those on the list above).

The importance of professional factors influencing seeking employment abroad

In the first model, the chance of working abroad is almost doubled by the greater importance the respondent assigns to finding employment in their own field.[8] In the second model this influence was not significant in comparison with those with earlier working experience abroad, so it can be considered constant.

Considering it important to move ahead in one's career significantly increased the chance of working abroad in both models – almost doubling it in the first model compared to those working only in Hungary and increasing it three and a half times in the second model, in comparison with those who have earlier working experience abroad.

A factor that was significant in both models and had a reversed impact was how important the respondent considered the opportunity to take part in research projects. In the first model when this consideration was more important, it reduced the probability of working abroad by one half compared to those only working in Hungary, in the second model by two-thirds compared to those with earlier working experience abroad, which indicates that while this used to be more important as a factor, the importance of taking part in research abroad has diminished.

Considering work infrastructure important significantly increases the chance of working abroad – in the first model it nearly doubles the chance compared to those only working in Hungary, while in the second model it is nearly tripled in comparison with those with earlier working experience abroad.

In the first model there seems to be a weak significant correlation between the importance of the respondent's relationships to their colleagues (teamwork, boss *vs* underling) and the willingness to work abroad, increasing its probability by half, while in the other models there was no such correlation.

The importance of personal factors influencing the work abroad

The importance of security in the second model increased the chance of working abroad two and a half times compared to those with earlier working experience abroad. This influence didn't prove significant with the other models, so it can be considered a factor with increasing importance.

[8] In each case we describe the impact of moving one unit along the five-grade scale of the given factor indicating the importance in employment.

The importance of interpersonal relationships in the first model reduces the chance of working abroad by half. This influence was not significant in the other models, so it can be considered quite constant in time.

Moving one grade up along the scale of importance of the feasibility of arranging official matters (obtaining documents, the language barrier in administrative issues) reduces the chance of working abroad by two-thirds in the second model in comparison with earlier working experience, which indicates the increasing importance of this factor.

Finally, moving up one unit on the scale of importance of entertainment and new experiences increases the chance of working abroad by half compared to those only working in Hungary. In the other models there was no similar significant effect, so this one can be considered constant.

The factors influencing the expectations considering working abroad

In the next models we examined respondents' expectations concerning working abroad. The specific question was about the intention to work abroad in three years' time, to be answered on a five-grade scale (1 – certainly won't work abroad, 5 – certainly will work abroad in 3 years' time). To make answers easier to interpret, we considered them subjective estimated probabilities (thus "certainly won't work abroad" yielded the value 0, certainly will work abroad yielded 100). We formulated the questions in the same wording for those currently working abroad and those currently working in Hungary, so in the case of the former group their answers actually refer to their estimates concerning their continuing to work abroad.

Presenting the models

Dividing the population into three groups (currently working abroad, currently working in Hungary but with earlier experience of working abroad and no history of working abroad) yielded the average subjective estimated probabilities for working abroad as given in *Table 7.*

Table 7

The subjective probability of working abroad in 3 years' time among the different groups of respondents

	Subjective probability of working abroad	95% confidence interval	
		Minimum	Maximum
Those who had never worked abroad	24.9%	23.1%	26.7%
Those currently working in Hungary but with experience working abroad	38.6%	33.9%	43.3%
Those currently working abroad	81.8%	78.8%	84.7%

We applied an independent explanatory model for each of the three groups in order to examine which factors have the greatest influence on the subjective probability of working abroad. For the estimate we used a general linear model. We examined the impact of the same factors in each of the cases, which were the following: demographic and family factors (age, gender, place of residence or region of staying when in Hungary, marital status, dependent relatives), contacts abroad and migration background (family member, friend or colleague living abroad, history of living abroad when younger, having been born outside Hungary), professional background (family members working in healthcare, place of graduation, being a doctor *vs.* a dentist, having completed the specialisation tier, field of specialisation) and the subjective outlook on the Hungarian and international situation in terms of working abroad (professional, social and financial considerations). We measured the subjective outlook on the Hungarian and international conditions in various dimensions, asking several questions in each individual dimension, asking respondents to rate their importance concerning seeking employment and also whether the respondent judged the situation better in terms of these specific factors working abroad or in Hungary.[9] We used five-grade scales to ask for their opinion, where 1 stood for "the respondent thinks that the situation is a lot better in Hungary in this specific respect", and 5 stood for them considering the situation to be a lot better abroad. As for the subjective importance of each factor, we also used a five-grade scale where 1 stood for "not at all important" and 5 stood for "very important".

[9] In our questionnaire we asked respondents to mean by "abroad" the country where they worked, work or would work outside Hungary and where they think the conditions of working as a doctor are better than here.

We transformed the scoring so that marking "it's much better in Hungary" yielded the value –2 and "it's much better abroad" yielded +2. After this we weighted each factor by their importance in such a way that "not important at all" meant 0 weight and "very important" meant 1. After that we performed a dimension reduction procedure on the 17 factors in our analysis and created principal components. The findings of the principal component analysis of subjective opinions weighted using the importance of the conditions abroad and in Hungary are in *Appendix 2.*

Using principal component analysis, we created 3 variables from the 17 factors within the scope of our analysis.[10] The first principal component correlates mainly with the *professional considerations*, the second mainly with *social considerations*, while the third principal component covers the opinions concerning the *financial* and infrastructural *considerations*.

In the following we shall present the main findings of the models explaining the subjective probabilities of working abroad for the three subgroups. For the presentation of the models we shall use the estimated marginal means.[11] Compared to the complexity of the analysed phenomenon the explanatory power of all the three models can be considered high (they could explain 32.9–57.0% of the variance of the dependent variable). The tables summarising the findings of the three models are in *Appendix 3.*

Demographic and personal factors

From the demographic factors we examined, age was the only one that influenced the intention of doctors working in Hungary at the time but having earlier working experience abroad and this impact proved significant. The estimated average probability of those under 40 to work abroad is 45.4%, those between 40–54 is 15.4% and those above 54 is practically 0, if all the other factors are unchanged.

As for those without working experience abroad age, gender and geographic region all have a significant impact: among those under 55, among men and those living in more underprivileged regions (Észak-Magyarország [Northern Hungary] and Észak-Alföld [Northern Great Plain]) as well as among those living in the more developed region nearest the Western border (Nyugat-Dunántúl [Western

[10] The principal components after variance maximizing ration carry 15.5–21.5% (together 53.2%) of the variance of the original variables.

[11] Usage of marginal means eliminates the biasing effect of the distribution of other variables, however the estimated values are not typical for any real factor combinations (*Searle–Speed–Milliken,* 1980).

Transdanubia]) the estimated average subjective probability is higher. The estimated difference for gender is around 5 percentage points, for age groups around 15 percentage points, while for regions 12–22 percentage points.

As for the family factors, having or not having children is significant for all the three groups, although in different ways. Among those with working experience abroad having children increases the probability of staying put: those currently working in Hungary are less likely to leave, those currently working abroad are less likely to return if they have children. Among those with no working experience, however, having children increases, if only slightly, the subjective probability of going abroad to work.

Migration background

Among the factors under the category of foreign contacts and history of migration, only having been born outside Hungary had impact on the subjective probability of working abroad. Among those already working abroad, it is having been born in Hungary (which is not a significant factor in the other models): if all the other factors are the same, those born in Hungary have a higher subjective probability of staying abroad than those born abroad.

Professional background

Professional considerations only seem to be significant for the intentions of those with no working experience abroad. From the factors we looked at, the place of graduation and specialisation are the ones that have a significant impact. If all other factors are left unchanged, the graduates of University of Debrecen have 10 percentage points lower probability of working abroad, although this only proved significant if compared with the graduates of the University of Szeged. Having completed one's specialisation significantly reduces (by about 12 percentage points) the intention of going to work abroad (and specialising in neurology provokes the same degree of reduction).

Opinions concerning the conditions of employment abroad

Only one main component, the one comparing the social context of working in Hungary and abroad was found to have significant impact in all three models – in the

positive direction. The respondents who considered the social conditions better in the country of their choice had a far more positive view on the possibility of working abroad in 3 years' time (10–20 percentage points in the case of a 2 standard deviation difference).

As for the other two main components comparing the conditions of working in Hungary and abroad it was financial considerations that proved significant both for those not having working experience abroad and those who had worked abroad but were currently working in Hungary. This impact was positive in these cases as well.

The third dimension of factors, professional considerations, only had a significant correlation with the subjective probability of working abroad for those with no working experience abroad.

To sum up, it can be said that from the dimensions of considerations that we looked at it is the social dimension that seems to be consistently important, while professional considerations are mainly important in terms of respondents' aspirations (first attempt), and the financial considerations can be found among the motivations of leaving Hungary to find employment abroad, but not among the motivations of returning, once already working abroad.

The factors influencing the migration of career starter medical doctors

With the help of the medical schools of Hungary, we extended our research to the fresh graduates and final year students of medical faculties. All the four approached medical schools cooperated with the researchers, but the effectiveness of contacting the graduates and final year students was different depending on whether the potential respondents were doctors or dentists. Since the question of which university the respondent attended had no significant impact on the entire population of doctors in the models concerning working abroad and thus the differences by medical school presumably had no significant impact on the estimates concerning the migration of final year students and graduates. During the two years of our data collection we managed to include 152 freshly graduated doctors and dentists and 140 final year students in our sample.

The intention of working abroad and actual foreign employment

During the 2 years of data collection we approached both final year students and fresh graduates, so we can assume that those fresh graduates and final year students who got into our sample had other things in common beyond the fact that they were fresh graduates or final year students. In order to minimise the potential differences, we applied weighting based on logistic regression (Little, 1986) using geographic region, place of birth (Hungary or abroad), having medical professionals in the family, dependant relatives and nonfactors. The findings are given in *Table 8.*

Table 8

Intention of working abroad in 3 years' time – students

(*N* = 135)

Average subjective probability	95% confidence interval	
	Minimum	Maximum
49.4%	44.6%	54.2%

As for actually finding employment abroad, we could measure that in year 1 and it was 13.4%. Assuming that this rate of outward flow is steady, we arrive at 40.2% of freshly graduated doctors working abroad. Considering that the intention of working abroad is reduced to 41.2% among those graduates who work in Hungary or don't work at all, our findings suggest that the tendency is actually shrinking.

As for the character of working abroad, there is a significant gap between intentions and reality. We asked those medical students who gave a positive reply to the question whether they intend to work abroad within the next 3 years (35.6%) about their specific expectations. Slightly more than half of the student respondents (55.9%) said they intended to work abroad permanently in the future, the others would prefer short-term contracts for a couple of months (20.6%) or regular but even shorter assignments (17.7%). As opposed to these proportions, only 3% of those actually working abroad work in Hungary as well – the others who were working abroad at the time, did so exclusively.

The motivations of the intention to work abroad

We asked fresh graduates about the factors influencing respondents' intentions to work abroad as well. Some explaining factors included earlier were of course not needed in this case (age group, specialisation).

Similarly to the previous procedure we carried out a principal component analysis based on the responses concerning the comparison of working conditions abroad and in Hungary. We arrived at five main components, summarised in *Appendix 4.* The first principal component created this way concerns career prospects, the second questions working conditions (although probably this component is linked most strongly with housing conditions and security as well, perhaps because the agencies helping in finding employment abroad also promise to sort out the housing of applicants, while security can be interpreted in several different ways). The third principal component mainly concerns the social context, the fourth with new experiences, which we refer to as postmaterial values, and finally the fifth component concerns salaries and professional opportunities.

The findings of the model analysing the subjective probability is given in *Appendix 5.* From the factors examined being male and having a personal aspect of migration history (having spent time abroad and having been born outside Hungary) proved to have a positive impact. Four of the main components comparing conditions abroad and in Hungary – considering career prospects, working conditions, social context and salaries and professional opportunities better than in Hungary – significantly increased the subjective probability of working abroad (the last being the most significant). The university, the doctor/dentist divide, the final year students/graduate divide, the geographic region of the place of residence, marital status, having dependant relatives or relatives working in healthcare or living abroad and postmaterial values didn't prove significant.

Summary

In the paper we showed that there has been a significant increase in the intention of working abroad among career starter doctors, compared to other age groups. Our model yielded results: being younger only increases the probability of working abroad in comparison with those working in Hungary, being single progressively increases the probability as this factor was significant in comparison with those having earlier work experience abroad. Not having completed one's specialisation

also increases the probability of migration, which is probably explained by the fact that these respondents are those young graduates at the beginning of their careers who want to complete their specialisation abroad.

Looking at the preferences of importance explaining the tendency to work abroad we found that considering important certain factors concerning working conditions increased the probability of working abroad: the importance of finding employment in one's own field (compared with those only working in Hungary) and the importance of career prospects on the other hand increased it in comparison with all the other reference groups, so the latter is probably increasing in significance. A preference for good infrastructure also increases the probability of going abroad. It is noteworthy, however, that the variable expected to be the single most important factor, namely salaries, didn't prove significant in any of the cases, which can be explained by the fact that there is no difference in comparison with the reference group, so this impact in itself will obviously not motivate migration. It may have played a part, however, that all of the respondents listed salaries as one of the most important factors, so there could be no large differences.

As for the factors working against leaving the country the importance of nonmarket-oriented objectives was clear to see, so typically the importance of taking part in research projects is a factor that stops doctors from working abroad. As the model shows, commuting between Hungary and another country rather than permanently working abroad is made more probable by having several specialisations or being a practicing GP – that is, being more rooted in the Hungarian healthcare system. Personal, human considerations – relationships, coping with bureaucracy – also decrease the probability of leaving the country.

Apart from probabilities, we also estimated respondents' expectations for the future, which yielded results that chimed with the model for the probabilities. First of all, the younger the respondent, the greater is the probability of migration. The family aspect, having a dependant child had no significant impact on the probability of migration but it did have a significant impact on migration expectations for the future in all three groups of respondents: for those with earlier working experience abroad, it increased the permanence of location of work (the probability of staying put – those already abroad are less likely to return, those in Hungary are less likely to leave). For those without working experience abroad, having dependant children increased the subjective probability of working abroad, but only to some extent.

From the dimensions comparing the importance of considerations concerning working in Hungary or abroad, it was the social dimension that proved to be

significant with all the groups and turned out to influence the probability of working abroad positively (social contacts, accessibility and cost of healthcare, coping with authorities and finances, security, housing and new experiences). The importance of professional considerations seemed to be significant more in terms of wishes (first migration attempt). Financial considerations might motivate the outward flow from Hungary – especially among those with no earlier working experience abroad it has a high probability, which is a hopeful expectation. Among those with experience working abroad these expectations are lower. Financial considerations are not among the important motivating factors of returning.

Being younger increased both the chance and probability of migration, this is why it was especially important to look at the subsample of younger respondents separately. Within the group of fresh graduates prior migration experience increases the probability of migration and so does the comparison between most of the conditions in Hungary and abroad: the career prospects, working conditions, social conditions, and perceiving the salaries and professional opportunities as better abroad all contributed to a higher subjective probability of migration among fresh graduates. In this group, however, non-material considerations didn't prove to be significant.

The findings show the complexity of factors motivating the migration of medical doctors. Some of the factors are those behind general migration trends, while others are specific to the medical profession. Some of the expectations concerning the motivating factors behind migration were not justified – above all, we found that the expectation of better salaries in itself is not enough to bring about the migration decision, and financial considerations are not enough to stop it either.

It can be an important signal for policy makers that the intensity of migration and the expectations concerning future decisions predict the permanence of the outward flow of especially young medical doctors. Migration, however, is not the sole reason for the shortage of doctors in Hungary – a higher number of doctors leave the profession than the number of those leaving the country. These processes are not the cause but the consequence of the anomalies of the Hungarian healthcare system, and the migration of medical doctors is just one of their factors.

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Appendices

Appendix 1

Odds ratios of working abroad for different patterns of migration

	Model 1 Only in Hungary vs currently abroad		*Model 2* Earlier abroad vs currently abroad	
Nagelkerke R^2		0.594		0.695
Significant variables	Odds ratio	Sig.	Odds ratio	Sig.
Doctor (ref. dentist)	9.162	0.000	9.136	0.009
Univ of graduation (ref. abroad)		0.152		0.002
Semmelweis University	2.656	0.244	5.911	0.166
University of Szeged	1.166	0.865	0.678	0.770
University of Pécs	1.710	0.568	0.065	0.058
University of Debrecen	0.801	0.798	0.992	0.995
Place of residence or usual place of staying in Hungary (ref. Dél-Alföld [Southern Great Plain] region)		0.001		0.000
Közép-Magyarország (Central Hungary)	0.485	0.209	0.134	0.042
Közép-Dunántúl (Central Transdanubia)	0.834	0.805	0.711	0.800
Nyugat-Dunántúl (Western Transdanubia)	2.701	0.111	19.125	0.013
Dél-Dunántúl (Southern Transdanubia)	0.519	0.459	11.419	0.126
Észak-Magyarország (Northern Hungary)	1.121	0.862	0.877	0.904
Észak-Alföld (Northern Great Plain)	2.992	0.112	0.290	0.245
Age group (ref. 55+)		0.001		0.227
Age group –39	4.153	0.017	3.806	0.188
Age group 40–54	7.811	0.000	5.154	0.085
Single (ref. married/in relationship)	1.129	0.722	4.580	0.024
Gastroenterologist (ref. none)	0.062	0.000	0.549	0.486

	Model 1 Only in Hungary vs currently abroad		*Model 2* Earlier abroad vs currently abroad	
Nagelkerke R^2		0.594		0.695
Significant variables	Odds ratio	Sig.	Odds ratio	Sig.
Gynaecologist (ref. none)	0.083	0.002	0.637	0.705
GP (ref. none)	0.048	0.000	0.047	0.015
Pathologist, anaesth. (ref. none)	4.650	0.004	0.876	0.865
Other or several specialisat. (ref. none)	0.253	0.001	0.087	0.001
Earlier staying abroad for min 3 mths, not working (ref. no such history)	6.119	0.000	0.841	0.722
Importance of working conditions: employment in own field	1.786	0.017	2.004	0.106
Importance of working conditions: career prospects	1.826	0.001	3.534	0.000
Importance of working conditions: research participation	0.582	0.000	0.304	0.000
Importance of working conditions: infrastructure	1.724	0.033	2.808	0.014
Importance of working conditions: atmosphere (boss-underling, teamwork)	1.558	0.044	0.972	0.944
Importance of working conditions: security	1.356	0.202	2.512	0.022
Importance of working conditions: interpersonal (family, friends)	0.425	0.000	0.689	0.168
Importance of working conditions: coping with administrative issues (language, customs)	0.724	0.063	0.368	0.005
Importance of working conditions: entertainment, new experiences	1.653	0.004	1.758	0.054
Constant	0.000	0.000	0.000	0.037

Appendix 2

Major findings of principal component analysis of subjective outlook*

	Eigenvalue	Variance (%)
Principal component 1	3.7	21.5
Principal component 2	2.8	16.3
Principal component 3	2.6	15.5

Factors potentially influencing job seeking	Principal component 1	Principal component 2	Principal component 3
Professional development opportunities	0.764	0.116	0.222
Prospects for promotion	0.703	0.225	0.117
Opportunities to participate in research	0.702	0.040	0.091
Attractive, interesting nature of work	0.695	0.202	0.175
In-service training and specialisation opportunities	0.677	0.208	0.143
Atmosphere at work (boss-underling, teamwork)	0.571	0.203	0.237
Finding employment in own field	0.437	0.195	0.348
Interpersonal relationships (family, friends)	0.112	0.725	–0.147
Health care (access, costs)	0.235	0.701	0.231
Administrative and financial procedures (language, customs)	0.354	0.677	–0.019
Security	0.097	0.606	0.423
Housing	0.004	0.576	0.489
Entertainment, new experiences	0.235	0.558	0.215
Salaries of med. doctors	0.086	0.071	0.759
Infrastructure	0.324	0.069	0.735

Factors potentially influencing job seeking	Principal component 1	Principal component 2	Principal component 3
Working environment	0.344	0.109	0.714
Work-life balance	0.364	0.173	0.400

* Principal component over 1 eigenvalue were taken into consideration after variance maximizing rotation. Principal component values are standardised in all cases (mean 0, SD 1).

Appendix 3

General linear models for finding employment abroad in 3 years' time

Factors	Values	Estimated marginal means (standard errors)		
		Doctors only working in Hungary	Having worked abroad earlier, currently only in Hungary	Currently working abroad
Gender	Men	40.0_{a} (8.5)	Not significant	Not significant
	Women	35.2_{b} (8.6)		
Age	Age group –39	44.1_{a} (8.7)	42.6_{a} (27.4)	Not significant
	Age group 40–54	42.6_{a} (8.8)	13.7_{b} (28.1)	
	Age group 55+	26.1_{b} (8.5)	0.0^{*}_{c} (27.0)	
Region	Közép-Magyarország (Central Hungary)	$37.0_{a.\,c.\,d}$ (8.5)	Not significant	Not significant
	Közép-Dunántúl (Central Transdanubia)	$31.2_{a.\,c.\,d}$ (9.5)		
	Nyugat-Dunántúl (Western Transdanubia)	$43.5_{c.\,e}$ (8.9)		
	Dél-Dunántúl (Southern Transdanubia)	28.0_{d} (9.5)		
	Észak-Magyarország (Northern Hungary)	$50.1_{b.\,e}$ (9.1)		
	Észak-Alföld (Northern Great Plain)	$40.0_{a.\,b.\,c.\,d}$ (8.9)		
	Dél-Alföld (Southern Great Plain)	$33.5_{a.\,c.\,d}$ (9.3)		
Born in Hungary	No	Not significant	Not significant	$75{,}5_{a}$ (30,6)
	Yes			$93{,}9_{b}$ (29,4)
Financially dependant child	No	Not significant	Not significant	$79{,}8_{a}$ (30,1)
	Yes			$89{,}6_{b}$ (29,7)
Non-financially but dependant child	No	34.6_{a} (8.4)	28.1_{a} (27.2)	Not significant
	Yes	40.6_{b} (8.8)	4.0_{b} (27.7)	

Factors	Values	Estimated marginal means (standard errors)		
		Doctors only working in Hungary	Having worked abroad earlier, currently only in Hungary	Currently working abroad
University	Semmelweis University	$35.1_{a.\,b}$ (8.8)	Not significant	Not significant
	University of Szeged	40.8_{a} (9.2)		
	University of Pécs	$41.5_{a.\,b}$ (9.2)		
	University of Debrecen	29.9_{b} (8.8)		
	Foreign University	$40.7_{a.\,b}$ (9.5)		
Specialisation	No	43.6_{a} (9.3)	Not significant	Not significant
	Yes	31.6_{b} (7.0)		
Neurologist	No	46.6_{a} (7.9)	Not significant	Not significant
	Yes	28.6_{b} (10.3)		
Professional considerations (main component)	–1 SD	33.7_{a} (8.5)	Not significant	Not significant
	+1 SD	42.8_{b} (8.7)		
Social considerations (main component)	–1 SD	32.1_{a} (8.6)	5.95_{a} (27.6)	$76,0_{a}$ (29,9)
	+1 SD	45.1_{b} (8.5)	29.0_{b} (26.9)	$88,8_{b}$ (29,9)
Financial consideration (main component)	–1 SD	34.0_{a} (8.6)	13.7_{a} (27.1)	Not significant
	+1 SD	40.4_{b} (8.6)	28.6_{b} (27.7)	
R^2		0,329	0.570	0.437
N		582	146	162

Note: The varying notations for the one factor given in the lower index show significant differences between the marginal probabilities. The standard error of the estimates is given in brackets.

* Because of the characteristics of linear regression the marginal estimate may be outside the theoretical domain of the dependant variable, but in this case we give the possible minimum or maximum as our estimate, which is now 0.

Appendix 4

The major data of the main components comparing the working conditions abroad and in Hungary*

	Eigenvalue	Variance (%)
Principal component 1	2.636	15.507
Principal component 2	2.576	15.155
Principal component 3	2.413	14.191
Principal component 4	1.513	8.897
Principal component 5	1.497	8.806

	Main component				
	1	2	3	4	5
In-service training, specialisation opportunity	0.852	0.100	0.116	0.081	0.082
Career prospects	0.756	0.183	0.240	–0.021	0.140
Professional development opportunities	0.743	0.203	0.016	0.200	0.082
Work-life balance	0.147	0.689	0.236	–0.063	0.008
Working environment	0.090	0.679	–0.023	0.283	0.335
Working atmosphere (boss-underling, teamwork)	0.274	0.640	0.055	0.292	–0.200
Professional infrastructure	0.276	0.637	–0.087	0.264	0.192
Security	0.046	0.571	0.469	–0.050	0.220
Housing	–0.017	0.517	0.491	–0.116	0.192
Administrative and financial procedures (language, customs)	0.205	–0.035	0.776	0.165	–0.005
Interpersonal relationships (family and friends)	0.093	0.105	0.758	0.193	–0.005
Health care (access and costs)	0.121	0.161	0.657	0.113	0.179
Entertainment, new experiences	–0.089	0.146	0.359	0.748	0.142
Attractive or interesting nature of work	0.355	0.172	0.062	0.533	0.190

	Main component				
	1	2	3	4	5
Participation in research	0.458	0.029	0.174	0.516	–0.110
Salaries in own field	0.052	0.099	0.106	0.151	0.847
Work opportunities in own field	0.439	0.216	0.176	–0.014	0.611

* Principal component over 1 eigenvalue were taken into consideration after variance maximizing rotation. Principal component values are standardised in all cases (mean 0, SD 1).

Appendix 5

The significant factors of the model explaining the subjective probability of working abroad

Factors	Values	Estimated marginal means (standard errors)
Gender	Male	47.4 (9.3)
	Female	38.8 (9.4)
History of staying abroad	No	33.7 (9.2)
	Yes	52.6 (9.7)
Born in Hungary	No (or unknown)	33.8 (11.2)
	Yes	52.5 (8.7)
Career prospects	–1 SD	37.9 (9.6)
	+1 SD	48.1 (9.2)
Working conditions	–1 SD	38.7 (9.3)
	+1 SD	47.5 (9.5)
Social context	–1 SD	38.8 (9.7)
	+1 SD	47.3 (9.2)
Wage and job opportunities	–1 SD	36.5 (9.4)
	+1 SD	49.8 (9.4)

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Regulatory Bargain in a Free Market Environment: The Budapest Taxi Market – a case study

PÁL RÉTI

"Perhaps I don't understand economics, but economics does not understand me, either."
(*Lin Yutang*, 1937)

"We need to distort this market some more to set it right."
(Budapest cab driver, 2013)

*This case study analyses the events that led to the decision passed by the Municipality of Budapest in April 2013 radically transforming the taxi market of the capital as well as the measure's immediate impact. The new rules were aimed at establishing "law and order" in the taxi market of the capital and it is more or less in line with global trends although the municipality failed to conduct any studies about international developments in this area prior to making the decision. It became increasingly more obvious that the trade unions and employees' organizations got into a subordinate position vis-à-vis the Municipality of Budapest in the negotiations process for two reasons: they were lacking legitimacy, and the mayor succeeded in dividing the participating interest groups. The new rules were so strict they could not be adhered to, and as a result had to be modified merely two months after their introduction. Even with the amendments the rules impose uniform tariffs in a market, which had been highly segmented to begin with, one unexpected result being that players who are outside the regulated market are increasing their market share rapidly.**

Journal of Economic Literature (JEL) codes: K23, L51, L92, L98.

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In April 2013 the decision of the General Assembly of Budapest [2013*a*] turned the least regulated taxi market of Europe into the most tightly regulated one. On the following pages we look at the events that led to the decision, the decision making process, as well as how the climate originally favouring free competition had changed.

The hackney carriage industry and free competition

The taxi service – or hackney carriage service in general – is seemingly an ideal place for free competition to flourish. The market is easy to enter: it requires little capital, small company size (can be a one-person business), the demand is easy to estimate, adapting to changing demands poses no technical challenges, and there is the option of bargaining every time you make a deal. However, the hackney carriage industry was one of the first industries where the unregulated free market proved dysfunctional soon after the birth of the industry (in the middle of the 17th century). The proliferation of hackney carriages – which often ran on the streets vacant – completely ruined the streets of London, caused traffic jams, no equilibrium price developed, and defrauding passengers was rampant. They started to regulate the hackney carriage service as early as the 17th century in London:[1] limiting the number of entrants to the market, the number of market players, requiring hackney-coachmen to display their fares, and prices were set officially. These measures as well as some newer ones, like technical and business specifications – have been used ever since, to varying degrees at different times and cities, with periods of regulation followed by periods of deregulation, and vice versa.[2]

A study by Edwin Chadwick published in 1859 was the first one of its kind to point out that an unregulated hackney carriage market will imminently fail. *Chadwick* observed that at all times and all weathers there were long files of empty carriages

[1] In 1635, Charles I ordered that London hackneys be licensed so as "to restrain the multitude and promiscuous use of coaches", and some nineteen years later the British Parliament adopted the regulatory regime which limited the number of hackneys (*Dempsey*, 1996). On the regulation of the hackney market see also: *Bergantino* [2007], *Koehler* [2004] on tariffs, special payment methods (taxi cheque), long-term contracts.

[2] The literature on the regulation of the taxi business focuses mainly on the characteristics of the traditional hailing or cruising taxi market. But there are two other additional market segments: the taxi rank segment and the telephone-booking segment (*Bekken,* 2005). In Budapest the contract market segment also has some unique characteristics, where taxi operators entered into long-term contracts with institutions and companies at fares that were much lower than the usual tariff, with special payment method (taxi cheque).

waiting at cab stands, while a number of empty carriages were crawling about the streets looking for passengers. His conclusion was that at least one-third of carriages were unnecessary, but the customer also paid for their expenses as part of their fare, which means that the charge is double of what it could be if the number of hackney carriages corresponded to the demand. It was at that time that hackney carriage drivers proposed an appeal to Parliament for an augmentation of the fares, which – Chadwick argued – would lead to an increased number of competitors, which in turn would lead to overcapacity and therefore further fare increases. However, he saw the solution not in relaxing the regulations. To the contrary; he wrote the following about the total liberalisation of the market: "If there were no legislative restraints ... the field would reach such a height as to go far to extinguish the service altogether".[3]

Chadwick's conclusion was that in a service market where customers have no choice, and the providers of the service are not forced to compete with their prices, they would have to compete for the field and not within the field of service. In other words, the regulator would have to make hackney carriage companies compete, and the best one(s) would have to be chosen to provide a regulated service.

More than a century later authors who studied the taxi market of American cities arrived at the same conclusion as Chadwick with regard to market failure. In the 1960s and 1970s there was a climate of liberalisation and deregulation, which meant that the local taxi markets were often liberalised, or at least the restrictions on market entry and fares – which had been introduced since the 1920s – were removed. The results were a far cry from what had been expected of a liberalised market. Although the number of entrants increased as expected, fares did not decrease, quite to the contrary, and the quality of service became inferior, the incomes of drivers dropped and administrative expenses either remained the same or even increased.

The explanation was argued to be the characteristics of traditional taxi markets that have already been mentioned above: due to the nature of the market there is no price competition, but drivers charge their increased expenses (resulting from more waiting at ranks and cruising the streets empty due to the increased number of taxis) on customers. The new market players who entered without any type of control lowered quality standards significantly, and no equilibrium price or fare was set as had been expected.

But the regulated market was no bed of roses either. Regulating the taxi market has traditionally been aimed at protecting customers (e.g. the 1624 regulation in

[3] *Chadwick* [1859], p. 394.

London requiring hackneys to place their fares on display [*Koehler,* 2004]). Fixed fares were to protect customers, although the regulation remained illusory in the absence of a device that could record distance, it was to be negotiable. Even after the invention of the taximeter[4] in 1891, it took two decades for it to overcome the resistance of drivers and become widely used (cabs in Germany were fitted with the device earlier than cabs in England, despite the fact that Germany did not have such a long history of cabs.)

However, the Great Depression ushered in a whole new era of regulation in the taxi market. In terms of a New Deal for taxis the regulator now began to protect the income of taxi drivers. The turn of the tide manifested itself most strikingly in the taxi regulation of Chicago. Until then a regulation had been in effect since 1866 that protected customers by regulating the fares, setting minimum quality standards, and providing a financial guarantee. The economic crisis completely overrode regulatory motivation; the main aim was now creating stability in the industry by introducing fixed fares, restricting the number of drivers and securing the market share of incumbents. Chicago set the standard for taxi regulation, and other cities followed suit, New York came next in 1937 by passing the Haas Act, and as a result the city has fewer medallions today than seven decades ago.

In any case, it was basically these strict regulations serving to protect the market that provoked reregulation in a liberal vein which in fact meant deregulation of the taxi industry in the 1960s and 1970s. The authors of economic literature argued in favor of lifting entry barriers and incorporating competition on merit into the regulation (worse cars – lower fixed fares) (*Koehler,* 2004). Some authors even suggested that taxi drivers should compete not only with each other but also with subsidised public transport, in which scheme having fixed fares would have put them into a disadvantageous position. *Bekken* [2003] came to the conclusion that applying strict requirements on quality standards and entry into a free market would be the most ideal form of market regulation. Actually, this is gaining more and more ground in Europe. As we will see later on, as a result of a regulatory bargain the Budapest taxi regulation passed in the spring of 2013 worked towards this end.

[4] The word taxi probably comes from here, as it originally referred to a hackney equipped with a taximeter.

The Budapest Taxi Market

We have no reliable data on the Budapest taxi market. The Hungarian Central Statistical Office (KSH) collects no data about the taxi market (with the exception of fares). There are no publicly available data about the number of taxi licences issued, the number of people who have a taxi driver's licence, the number of taxi entrepreneurs, and the number of people who make a living from this service or market turnover for that matter. According to the estimates of those working in the industry the number of taxis on the streets of Budapest was between 5.5-6 thousand in 2012 and the first half of 2013 (the new taxi regulation of Budapest entered into force on September 1, 2013). 80-90 percent of the service was provided by taxi operator companies. Taxi drivers, taxi operators and the leaders of chamber and trade union representatives all agree that the number of taxis in Budapest is too high. However, when compared to other cities, with three taxis per 1000 residents, we find that Budapest is ranked in the middle. Although it is true that the taxi supply is double that of Brussels or New York, but it is lower than in Prague (4 taxis/1000 head of population), Stockholm (7 taxis/1000) or Dublin (11 taxis/1000).

As of the end of the 1940s only the state-owned company Főtaxi provided taxi services in Budapest, and then another state-owned company Volán Taxi appeared in 1972. Private taxi companies started operating in 1982. Currently there are two types of taxi businesses on the market: taxi operators and taxi entrepreneurs who own the cabs. As of the middle of the first decade of the 21st century there have only been pure profile businesses: taxi operators do not own cars (there were several attempts at the contrary, but all of them failed after a few years of operation), and taxi entrepreneurs do not get involved in travel operations. The estimated number of taxi companies (including operators) in Budapest and agglomeration was 800-900, and the total including private entrepreneurs was estimated to be 8 thousand in 2011.[5] Industry sources estimate the annual revenue generated by the Budapest taxi market at HUF 23-35 billion.[6]

[5] See: http://www.bisnode.hu/rolunk-es-kapcsolat/sajto/54/csak-a-nagy-taxicegeknel-lathato-nemi-nyereseg

See: http://www.opten.hu/kozlemenyek/on-rendelt-taxit

[6] The HUF 35 billion amount was disclosed by *Endre Komáromi* (Traffic Safety, Taxi and Parking Division, Centre for Budapest Transport) via email.

The unorthodox behaviour of the Budapest taxi market

The domestic taxi market which has developed since the early eighties at first glance seems to have been behaving differently from what could be expected based on the literature on the effects of alternating periods of regulation and deregulation.

It seems that spontaneous deregulation between the second half of the eighties and the mid-nineties replacing a long period of socialist regulation based on hundred percent state-ownership produced more or less the outcome described above: quality suffered, no equilibrium price was set by the market, fishing in troubled waters was not only a marginal phenomenon, but part and parcel of the system.[7]

As of the late 90s the market settled to some extent without the regulator responding to the market failure with re-regulation. Or more precisely, the market split into two well-defined segments: the cruising taxi and the telephone booking (including contracted) taxi market segments. The former was still characterized by market failure associated with an unregulated market. However, the latter showed some signs of the positive effect of competition: improving quality standards due to competition on quality, reduced prices due to price competition. This could be seen in the turnover as well: the telephone booking segment of the taxi market was growing continuously, the 80 per cent share of the segment prior to the introduction of the new regulation was high when compared internationally. When we look at the market as a whole we are faced with the paradoxical situation that the price of better quality service (better car, reliable booking by phone, reliable service quality) was in fact lower than the poorer-quality or at least less reliable service of taxis hailed on the street.

However, those who participated in the price and quality competition on the hailed and contract market segments were not the taxi entrepreneurs themselves. Since it was not them who set the price and quality requirements, but the taxi operators who owned no cars and employed no drivers.[8] So the taxi operators set

[7] *Bara* [1999] considers this to be the symptom of a phenomenon he defined as closing market. A closing competitive market is easy to enter, but difficult to leave, because – as is the case in the taxi industry – it is full of entrepreneurs who have no other qualifications or capital to do anything else. *Bara* argues that the competition that occurs on a closing market is destructive, which leads to lower quality standards that can only be remedied by limiting the number of players and regulating prices.

[8] “They (the taxi companies – *P. R.*) were competing with each other and we financed their competition.” (Interview with the leader of an association representing the interests of taxi drivers.)

“The Hungarian taxi market is ruled by the operators. …passengers no longer trust taxis hailed in the street because of the rampant swindling, passengers want to get in a taxi that is verifiable. Then as a result of the competition between operators prices were lowered. So the situation that developed was

the price of a service that was not provided by them, the price was not the result of a "bargain" between customer and service provider. The income of taxi operators did not come from the fare, but the fixed monthly fees paid by small entrepreneurs who had joined the network. So the taxi operator's interest was to increase the number of members.[9] While the taxi entrepreneur's interest was to increase his own revenues, which hinge upon two factors: fare and the number of trips.

New taxi operators entering the market tended to set lower fares than the existing ones upon their entry, and as their turnover increased they could employ more and more entrepreneurs who accepted lower fares in exchange for the increased number of trips. This downward spiral – together with falling demand due to the crisis and the consequent oversupply[10] – resulted in prices that were lower than the cost price.

The reason the lower price limit could be so soft and that taxi drivers put up with it in the long term is due to the following four factors. 1. The deterioration of the labour market situation (taxi drivers having no other qualifications, and therefore no other career opportunities became self-employed out of necessity). 2. Using up the amortisation money, i.e. not calculating amortisation in the expenses (i.e. giving up on saving up for a new car). 3. Industry-wide, matter-of-course tax evasion.[11] 4. Self-exploitation (working 10-12 or even longer hours). Meanwhile a tacit agreement was reached between taxi drivers, legislators and the tax authority that the latter would

quite absurd, if I got into a cab that was waiting in the taxi rank, I had to pay HUF 240, but if, while still standing in a rank, I called one – which could be the same one waiting there – I had to pay only HUF 180." (An interview with a middle-manager at the authority having jurisdiction.)

[9] "I had the chance to look at some of the contracts operators signed with taxi drivers… there is not a single word in them about what the operator provides in return for the monthly fee, like for example a minimum number of addresses every month." (Interview with a middle manager at the authority having jurisdiction.)

[10] While demand for taxi services dropped by thirty to forty per cent as a result of the economic crisis, as a result of the price competition in the industry and the high fuel prices the market is struggling … Meanwhile, in spite of the fact that the number of taxi companies in liquidation is growing every year, the number of companies operating in the market has increased by forty per cent over the past five years. (The number of taxis has risen in spite of the difficult position of the market. See: http://www.origo.hu/hirmondo/uzletinegyed/20110420-novekedett-a-taxisok-szama-a-piac-szorongatott-helyzete-ellenere.html)

[11] "So far the difference between price a huge part of which was the cost and the real price was paid by the taxi driver and the state together. The taxi driver cannot earn enough to cover the amortisation, the state does not get the tax." (Interview with the leader of an association representing the interests of taxi drivers.)

not prosecute taxi drivers for evading taxes, but on the other hand did not recognise taxi driving as a business like all other businesses[12], and neither did the legislator.[13]

History of regulation in Budapest

Private taxis were first allowed to operate in Hungary in 1982, and the first taxi operators – not operating as businesses – were set up the same year. In fact this is when the taxi industry started to turn into a more or less competitive market in Budapest. In the two decades following the political transition legislators were too timid and cautious to change legislation on the industry, even though there were certain phenomena that would have warranted legislative measures: illegal taxiing, airport mafia, unregulated rank use, ripping off passengers who hailed taxis in the street, etc. A ministerial decree issued in 1992 set the technical requirements for taxis. And the Budapest Regulation on Taxi Fares was issued in 1998 (and consequently amended in 2000), which set the maximum fare (HUF 240/km) valid until September 1, 2013, but the average price per kilometre was 20-40 per cent lower than the ceiling even before the new municipal taxi regulation entered into force.

The city council came up with the most obvious solution to reduce the marked oversupply:[14] limiting the number of taxis – hoping that it would also improve the quality of the service. Although limiting the number of cabs has been used as a means of regulating the hackney carriage market for centuries, the Constitutional Court of Hungary annulled subsection (2) of section 19 of the Act I of 1988, in response to a claim submitted by a private citizen challenging the constitutionality of the subsection, which until then gave municipalities – in principle – the right to limit the number of taxi licenses issued.

[12] "The taxi driver cannot reclaim the VAT, because the tax authority suspects that if it worked, everybody would suddenly become a taxi driver. They completely ignore the fact that having a vehicle means having costs, so much so, that my accountant tells me I should not even bring any invoices that have the word car in them." (Interview with the leader of an association representing the interests of taxi drivers.)

[13] "It is a fact that the cost of the car and the fuel are not eligible. There was a bill calling for it, but the committee took it off the agenda. The legislator, and the National Tax and Customs Administration of Hungary – like with company cars – suspects that people use the cars for private purposes, and as they are not separable use them as private vehicles." (Interview with a middle manager at the authority having jurisdiction.)

[14] "At the time there were 12-13 thousand licences, which they wanted to reduce to 7500." (Interview with the top manager of an operator.)

The dispute and bargaining about Budapest taxi regulation went on for two decades taking on a unique political tinge, the taxi blockade of 1990 setting the scene and giving the public a taste of the power taxi drivers have in their hands when they stand up for their interests. It showed that Budapest taxi drivers could organize themselves efficiently; they could stick together and can get really radical in protecting their own interests. And if they are like that, then it is better to be careful with them, and not change regulations, as their reactions could have "unforeseeable" consequences.

This image remained vivid in the minds of decision makers – politicians and senior civil servants – for a very long time in spite of the fact that the taxi industry of Budapest transformed considerably. When the media reported on organised actions by "the taxi industry" and speaking up for their own interests, as of the mid-nineties they used the term for taxi businesses. However, with a few exceptions the "taxi drivers" themselves were not even employed by these companies, but only had a contract with them.

An aborted attempt at regulation

In the autumn of 2004 on the initiative of the Municipality of Budapest the government put forward a proposal to amend the price act, which made one single amendment to the law in force since 1988: into the paragraph on setting administrative prices a new item was inserted: the price of taxi services. This created the bizarre situation that in the main text of the Price Act of Hungary a taxi service is the only type of service for which an administrative price can be set.

So the Municipality of Budapest took the first step in the preparation of the re-regulation of the taxi industry – in quite a covert way. When in January 2005 the proposal was made public, the "representatives" of cab drivers said they were shocked that the municipality was planning to introduce a fixed fare – equivalent to the fare ceiling in force since 2000, i.e. HUF 240/kilometre.

Only the managers of taxi operators spoke to the media about the proposal in the name of "taxi business", claiming that the person representing the Municipality of Budapest, *Imre Rusznák* made a deal with the representatives of Independent Trade Union of Taxi Drivers (TGFSZ) behind their backs.[15]

[15] "When the proposal of *Rusznák* et. al. was made public, all hell broke loose, as they only consulted the Independent Union of Taxi Drivers. It was a proposal that the municipality formulated

In April 2005 Budapest taxi companies “announced at a joint press conference that they were protesting against the so-called fixed fare taxi regulation of the city of Budapest, as they believed it would distort competition and negatively discriminate consumers, therefore it is against European Union regulations as well as the competition law.” The Hungarian Competition Authority (GVH) also “disapproved of a uniform, fixed administrative price for personal transportation services –, which according to the proposed regulation would encompass all segments of the taxi service market – for economic reasons, reasons of competition[16] as well as for legal and constitutional considerations.[17] Furthermore, the president of the Hungarian Competition Authority added: “…should the General Assembly of the Municipality of Budapest adopt the proposed regulation, I am resolved to turn to the Constitutional Court to have it declared unconstitutional.”[18]

However, even being caught in crossfire might not have been enough to block the proposal without a conflict that developed between parliamentary coalition partners: over the election of the president of the republic. One manifestation of the feud between the Hungarian Socialist Party (MSZP) and the Alliance of Free Democrats (SZDSZ) was when the liberals realised all of a sudden that the Rusznák-proposal had some anti-liberal features, and successfully torpedoed the debate of the proposal.[19] The multiple failure of the proposed regulation in 2005 discouraged regulators from making another attempt at re-regulation for long years to come, even

together with taxi drivers, but which was then torpedoed by the operators.” (Interview with the top manager of an operator.)

[16] The Competition Authority levied a fine of HUF 0.5-10 million on the biggest taxi companies for entering into agreements restricting competition.

[17] Competition Authority president *Zoltán Nagy*’s letter to town clerk *Zsolt Tiba* dated April 27, 2005. The letter continues: “By preventing competition in every segment of the taxi market, and causing significant price increase in comparison to existing fares the proposed regulation would not remedy the problems of the market – which are caused partly by oversupply and partly by the lack of control – but to the contrary, it would increase tensions even more due to falling demands and increasing supply which can be expected if it is passed” (*Nagy*, 2005).

[18] “Judging from the decisions they made in the past the Competition Authority and the Constitutional Court believe that the municipality cannot pass a regulation without going against the constitution, which – except for in a case when it serves public interest – restricts the right to do whatever the person wants with his/her property (case in point, by banning the reduction of prices), furthermore which disproportionately infringes on free competition (especially the telephone-booking and contract segment of the market by fixing tariffs)” (*Nagy,* 2005)

[19] See: http://www.baon.hu/orszag-vilag/budapest/az-szdsz-mar-nem-akar-rogzitett-taxitarifat-14182 “The election of the president of the republic led to a serious conflict between the Alliance of Free Democrats and the Hungarian Socialist Party, therefore the free democrats did not vote for it.” (Interview with the top manager of an operator.)

though it was badly needed due to market anomalies and the pressure – which was of varying intensity, but nevertheless constant – exerted by trade organisations.

2010–2013: Strength and Display

As a result of the economic crisis that hit Europe in the autumn of 2008 demand for taxis declined all over Europe, and of course Budapest was no exception. Although due to the lack of data we do not know how much. Another reason is that the market proved to be extremely flexible, responding to the lower demand by lowering prices.

According to data collected by the Central Statistical Office (KSH) as of the second half of 2009 taxi prices were much below the rate of inflation: as much as 2-3 percent in 2011, and 1-2 per cent after 2011. In general the rate of taxi fare increase was only half of the rate of inflation between 2009 and 2013.

The declining demand caused by the crisis was accompanied by increasing supply in Budapest. Even in the middle of the first decade of the 21st century the number of taxi companies was still growing – partly due to relatively high fares at the time. Until then 5-6 companies had had enduring dominance, but by 2013 there were 21. New entrants almost invariably tried to compete with their prices. Although their entry made the incumbents lower their prices as well, the majority of them managed to stay afloat.

The crisis on top of the existing self-exploitative system was like adding insult to injury, and as a result taxi drivers became increasingly more frustrated,[20] and they started demanding the re-regulation of the market. While earlier taxi drivers reacted ineffectively or not at all in an organised manner when taxi operators presented their pro-competitive views as if it were the views of the whole "taxi community", as of 2010 they started demanding stricter price regulation and the capping of taxi numbers by administrative means more and more forcefully.[21]

[20] "Taxi entrepreneurs are bled dry as a result of a decade-long price competition dictated by operators – a price competition that is neither in the interest of passengers nor in the interest of drivers and lacks any economic calculations to support it." See the letter of the Independent Trade Union of Taxi Drivers to Mayor *István Tarlós* dated September 18, 2011 at http://hallotaxi.hu/_user/downloads/dokument/Tisztelt%20Tarl%F3s%20Istv%E1n%20F%F5polg%E1rmester%20%DAr!pdf

[21] "For a long time it was the companies that represented the taxi industry everywhere. They treat common taxi drivers as somebody who can only steer the wheel, as if he were illiterate. They only let me sit down at the negotiating table when it makes no difference anymore." (Interview with the leader of an association representing the interests of taxi drivers.)

At their demonstration on June 8, 2011 the taxi community demanded some comprehensive taxi reform in Budapest from the mayor, including the introduction of a fixed administrative price, direct cap on the number of vehicles and effective control.[22] They seem to have taken a U-turn compared to the middle of the first decade of the 21st century: "the taxi community" who were once the champions of free competition was now demanding the strictest regulation measures. At least that is what utterances by their representatives talking to the media led the public to believe. What actually happened was that while it was taxi operators who spoke for the "taxi community" in the late 2000s, after 2010 it was increasingly more the taxi drivers or trade union leaders who became the oft quoted representatives of the sector.

The conflicting interests within the sector have from time to time split the taxi community: drivers, taxi operators, those who had a contract with these companies and the so called "lone wolf" taxi drivers over several fundamental regulatory issues ever since the 1990s. Taxi operators traditionally supported free competition combined with strict control, while taxi drivers who had a contract with them wanted first and foremost fixed fares and capping taxi numbers.

With the crushing oversupply that developed in the wake of the crisis their views became more and more similar. Companies that have been around for a long time realized that their market was not threatened so much by the so called "lone wolf" self-employed taxi drivers, but new companies entering the market and offering their services at very low prices.[23] Meanwhile they also felt the pressure coming from inside, that is that the taxi entrepreneurs they had a contract with were demanding the introduction of an administrative fixed price and a cap on the number of taxis. The demonstration in June 2011 was jointly organised by the National Taxi Association (OTSZ) and the Alliance of Taxi Operators.[24] *István Tarlós* [2013] responded to this

[22] See: http://taxisokvilaga.hu/aktualis/cikk/39/taxis-demonstracio-frissitve-0608-an-tekintse-meg-kepgaleriankat

[23] "The management of City finally accepted our single-minded fixed tariff idea. Due to the HUF 150 tariff they had fewer fares and it was not as easy to evade taxes as it had been 5 years before." (Interview with the leader of an association representing the interests of taxi drivers.)

[24] According to one participant, the mayor's close colleagues were consulted about the demonstration in advance: "We held a demonstration together with OTSZ and TFTSZ – TGFSZ stayed away – and handed over a petition to the representative of the Municipality of Budapest. Of course before the demo I approached them saying 'there is nothing else I can do but organise such a demonstration, as the taxi industry and the passengers expect me to do so'. They reacted calmly, it was prepared through diplomacy, they knew the content of the petition." (Interview with the leader of an association representing the interests of the taxi industry.)

by initiating the "overview of the totally obsolete Budapest taxi regulation, which had been left untouched for 11 years, and the preparation of a new regulation."

At the beginning of the negotiations it seemed that – in spite of the fact that the trade unions were getting more active – it was still the taxi organisations dominated by operators that were going to have a say in what shape the regulation would take.[25] The organisations of taxi drivers did not take a unified position. There were some that seemed to cooperate with the city council very smoothly, while others – although they also took part in the negotiations – chose to influence the outcome of the negotiations from the street.[26]

The negotiations initiated by the mayor in the summer of 2011 covered all four areas that representatives of the profession had kept bringing up as the ones that need to be regulated *jointly*. So separate working groups were formed for the capping of the number of taxis, setting a fixed administrative price, the issue of taxi ranks and control, furthermore – the regulation of taxi operators. This was without doubt a breakthrough considering that the Constitutional Court's ruling made the capping of taxi numbers a taboo, while according to the decision of the Hungarian Competition Authority universal fixed fares were another no-no.

TGFSZ volunteered to formulate a proposal for fixed fares. "Based on their prior calculations of tariffs they worked out a base fee of HUF 1005, and a standard distance-based fee of HUF 804/km. However, considering that there would be no effective demand for their services at this price, they put forward a proposal for the administrative base fee to be HUF 580 and the distance-based fee to be HUF 280/km. They could not back up their proposal with exact economic calculations" (BKK, 2011*b*).

As the maliciously worded release of the City Council suggests no in-depth analysis[27] had been carried out prior to the negotiations; however, the city council put the blame on the interest group of taxi drivers. Throughout the negotiations accurate data were lacking on both sides, and the parties kept calling each other's data

[25] "We were sitting around the table like this: one representative for every taxi company and us, the Independent Trade Union of Taxi Drivers (TGFSZ). Everybody was eligible to cast one vote, Tele5 had one, City had one, Főtaxi and the other taxi companies each had one, and TGFSZ also had one altogether." (Interview with the leader of an association representing the interests of taxi drivers.)

[26] "Very often it was enough to threaten with protest. That is what the website hallotaxi.hu could be used for." (Interview with the leader of an association representing the interests of taxi drivers.)

[27] "We received no data as they said it was trade secret. (…) The taxi industry representatives presented such ridiculous cost tables that they were unacceptable as the basis of discussions. They were not willing to show us any real accounting data." (Interview with a middle manager at the authority having jurisdiction.)

into question.[28] Neither of the negotiating parties had any idea as to what the new regulation should consist of.[29] But after three months of consultation and negotiation the new draft was completed.

In the two most sensitive regulations restricting competition – fixed fares and the capping of numbers – the taxi community, which had been more or less united over these issues at the beginning, could not achieve their objectives. "The representative of the Municipality of Budapest rejected the proposal for the introduction of a fixed fare, but reminded the advocates of the taxi community that they can submit their proposal to the Mayor directly, and initiate its introduction, although it would only be reasonable once the quality of service, the condition and comfort of vehicles were approximated." (BKIK, 2011). A compromise was reached regarding the capping of numbers, to the effect that "the Municipality of Budapest shall go beyond the government decree on the taxi sector and as stipulated in the proposal regulate the conditions for issuing licences, and therefore indirectly limit the numbers" (BKIK, 2011). However, the negotiations were not concluded, but – according to the press release – "consultations have been suspended until the legal framework is established". As in the course of the negotiations it turned out in order for the municipality to pass a comprehensive regulation on the taxi business, a legal basis is absolutely necessary.

At the negotiations the various taxi organisations tried with all their might to push for regulations that would restrict competition, while it was the so called quality requirements that ranked high on the agenda of the representative of the municipality.[30] While however the Municipality of Budapest had had the power to set administrative fares since 2004, it had no such power to set technical and other specifications (colour, dimensions, etc.) Therefore the municipality could only carry on the bundling-style negotiation tactics if they first saw to it that a new passenger transportation act was passed. However, the taxi community wanted to prevent

[28] "The operators did not present any data claiming such data were trade secret. (…) The taxi industry representatives presented such ridiculous cost tables that they were unacceptable as the basis of discussions." (BKK, 2011*b*)

[29] "Nobody knew what was supposed to be included in a regulation of this type. There were a lot of things that the taxi industry asked for but we told them it was outside the jurisdiction of the municipality, it was legislative, the National Tax and Customs Administration (NAV), etc. had jurisdiction." (BKK, 2011*b*)

[30] "All we needed was one single thing: a fixed tariff. Ever since this crazy price competition started twenty years ago we have been fighting for this. (…) What they kept saying was that uniform tariffs can be charged for standardised services: first the service has to be standardised, and then we can talk about uniform tariffs." (Interview with the leader of an association representing the interests of taxi drivers.)

this by achieving fixed fares without giving anything in return.[31] Right after the negotiations were broken off, in September 2011 the Hungarian Alliance of Taxi Drivers and the Independent Trade Union of Taxi Drivers (TGFSZ) called on the mayor to "be so kind" as to impose an administrative price (TGFSZ, 2011).

On November 2 the demand was pressed more firmly by yet another demonstration[32] – this time organised by only two trade unions. The municipality of Budapest issued a communiqué to the effect of flat rejection. "Regarding the fixed fares taxi organisations are proposing that the fare be raised to the maximum allowable level, while there are a lot of services available to the people of Budapest today offered by transport entrepreneurs which are below this maximum price. We do not think it is justified to put Budapest passengers in a disadvantageous situation by eliminating market competition .., this *(the fixed fare)* cannot mean the considerable price increase achieved by administrative means, especially without supporting it with economic calculations."[33]

The two most important statements in this communiqué are: that the Municipality deemed both *competition* and *supporting economic calculations* to be crucial. In the following 18 months these two considerations never appeared again in the communication of the city council, and the regulation passed in April 2013 deliberately neglected them.[34]

On November 23 the mayor met the representatives of the two trade unions, and according to the press release "Tibor Fárbás and Zoltán Metál said they believed the introduction of fixed fares was of crucial importance, and which the representatives of the city council were not averse to".

This was a spectacular anti-competitive reversal of position considering that just two months earlier, in the negotiations lasting from June to September the representative of the Municipality flatly refused the introduction of fixed fares. The negotiations effectively started all over again with a new institutional framework and a new negotiator representing Budapest. As of January 1 the Centre for Budapest

[31] "And then the Municipality said OK, I'll tell you how things are going to be: first uniform cabs, stricter requirements, and when we have done all these, fixed tariffs will be introduced by 2015. And we told them there was no way we could make the taxi industry accept this. First we want fixed tariffs, and then we will have the money to pay for the uniform look." (Interview with the leader of an association representing the interests of the taxi industry.)

[32] "And then another demonstration was held, but of course we had consulted the mayor in advance. … the mayor now knew who he should negotiate with." (Interview with the leader of an association representing the interests of the taxi industry.)

[33] See: http://www.bkk.hu/2011/11/taxi_allasfoglalas/

[34] See: http://www.bkk.hu/2011/11/taxi_111123/

Transport "will be in charge of any taxi transport related issues", and its CEO *Dávid Vitézy* would take over as representative of the Municipality replacing the earlier representative appointed by mayor *István Tarlós*.[35] The trade unions once again demanded the introduction of fixed fares as of January 1 – but only in 2013 instead of 2012 – from *István Tarlós* who returned to the negotiating table from time to time.

The juggling with numbers started again. In April 2012 it was the Budapest Chamber (i.e. taxi operators) who presented a new calculation, which was exclusively based on costs ("we calculated taxi fares based on the cost side"). The paper did not even attempt to make a demand estimate, or a forecast on how the demand might change as a result of the price change. The proposed price per kilometre was HUF 344, double the fare at that time.[36] However, by the time this letter saw the light of day, the Centre for Budapest Transport (BKK) – now in charge – had already decided what it wanted to achieve. It seems that the Mayor had realised by then that "the taxi community" is not united, and therefore they are nothing to be afraid of.[37] The operators can be played off against the drivers, or one operator against another, or even the prominent figures of interest groups with dubious organisational background against each other.

The fact that it had not been defined who the "negotiation partners" were, who represented who and what degree of authorisation representatives had gave the Mayor a lot of room for manoeuvre. *István Tarlós* often claimed during general assembly debates that the taxi community did not even know what they wanted, some of them want this while others want that, so it is the responsibility of the city council to sort out the chaos.[38]

The proposal presented by *Dávid Vitézy* on April 6, 2012 left no doubt that it was actually a draft regulation, and the "debate" over it – judging from the release – reminded one of a public question and answer forum, not a consultation.[39] They decided that there was going to be a single fixed price, they set the requirements that

[35] See: http://www.bkk.hu/2011/11/taxi_111123/

[36] Letter of the Industrial Section of the Budapest Chamber of Commerce and Industry to the Centre for Budapest Transport dated April 4, 2012.

[37] "Mr. Tarlós was the first one who understood that the taxi industry will never be united on any issue. The wolf and the lamb will never walk hand in hand. And Tarlós was clever enough to take advantage of this. That is why a lot of bad compromises were made." (Interview with the leader of an association representing the interests of taxi drivers.)

[38] "… in less than two years there were over forty meetings with them. … it seemed almost like we were asking each and every person working in the taxi industry what his/her opinion was on the issue." (General Assembly, 2013b)

[39] Anyone can judge how seriously they took the discussion of the proposal, if the Centre for Budapest Transport (BKK) gave a ten-day deadline for "taxi drivers, operators and passengers to"

vehicles as well as operators had to meet. The regulation passed a year later used basically the same criteria (age of the vehicle, engine displacement, boot size, etc.) as the ones *Vitézy* had presented, and also the same corresponding figures.

By June 2012 a draft proposal essentially with the same content as the one presented in April was completed, but the Mayor withdrew it during the general assembly debate on June 20. The recital follows the "divide them" line explained in detail above: "…so far we have always consulted the taxi community, considering that – with some degree of exaggeration – we can say that the ten taxi associations want twelve different things, and we sense some basic conflict of interests between operators and taxi drivers".[40]

However, no new proposal was put forward by the city council by the next deadline in September, even though the new act on passenger transportation had entered into force on July 1, containing an article authorizing the municipality to introduce regulations. All this in spite the fact that a new draft proposal had been completed in August 2012, which however was found unsuitable by both the committee for the taxi profession of the Budapest Chamber of Commerce and Industry (BKIK) as well as the Independent Trade Union of Taxi Drivers. The articles that the trade unions objected to were left unaltered in the regulation passed the following April. Including the one worded as follows: "The driver of the taxi waiting in a taxi rank cannot leave the vehicle." All that taxi drivers asked for was to be allowed to stretch a little while waiting in the taxi rank.[41]

Meanwhile the taxi profession developed in the exact opposite direction with regard to asserting its interests than during the years following their period of activation in 2010. Then, by June 2011, the time when negotiations preparing the new taxi regulation started, there was a convergence of views, and the groups who otherwise had conflicting interests were united about three issues: new regulations, fixed fares and effective control were needed.

However, the utterances of city council officials aimed at dividing the community seemed to be becoming self-fulfilling prophecies. In February 2013 – one month before the general assembly debate – the Budapest Chamber of Commerce and Industry, which had previously taken a very firm position in the lengthy regulation-

present their "opinion and experiences" in writing to the BKK about the draft that took one whole year to complete.

[40] Minutes of the General Assembly meeting held on June 20, 2012 (Wednesday) in the Assembly Room of the City Hall (address: Budapest, V., Városház u. 9-11, I. emelet).

[41] The wording proposed by the Independent Trade Union of Taxi Drivers: The driver of the taxicab must not leave the AREA of the taxi rank." ibid.

preparation process, informed the mayor in a letter that they "had not been able to adopt a unified position in spite of repeated attempts" on the draft proposal. "Opinions have become divided even about the most fundamental issue, the introduction of a fixed fare over the period since the chamber's proposal was accepted in 2012."[42]

Having this letter in his possession *István Tarlós* could start the debate over the regulation at the general assembly assured that the taxi business was no longer able to put up any effective resistance. Taxi operators threw in the towel themselves, and of the trade associations it was the National Taxi Association (OTSZ), with questionable power and membership that supported the proposed regulation so much that the mayor announced at a press conference a couple weeks prior to the general assembly that "Even the representatives of the taxi community speaking at the general assembly debate support the position of the municipality of Budapest".[43] He also made some remarks to set the tone for strict regulations: "some taxi drivers do not shrink from methods reminiscent of the mafia, complaints by residents are rampant, they carry passengers in dilapidated vehicles and fares are out of control." Budapest is an oversaturated market – added István Tarlós – "there are as many hackney carriages in Budapest as in London". (According to official British statistics there were 22 thousand licensed taxis in London on March 31, 2011.)[44]

The Regulation is Passed

The draft regulation prepared by the city council of Budapest and discussed and passed at the general assembly meeting on April 9, 2013 clearly contradicted the argument that has been repeated over long years (and originally also shared by the mayor) and according to which taxi activities in Budapest could not be re-regulated because the regulators' hands were tied. It turned out that with government majority

[42] The letter of *Dóra Potsubay,* the president of the Industrial Section of the Budapest Chamber of Industry and Commerce to *István Tarlós,* dated February 5, 2013. (Attached to the draft submitted to the General Assembly of Budapest).

[43] "I have realised that talks are successful if in the end everybody gets something they want. It is important for Mr. Tarlós to have five thousand five hundred uniform yellow taxis running on the streets of Budapest by September 5, 2014, because it will show that they have solved the taxi problem in the capital, which no-one before them was able to do." (Interview with the leader of an association representing the interests of the taxi industry.)

[44] See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/8999/taxi-2011.pdf

all obstacles can be overcome (as it had happened once before, when an amendment made it possible to introduce an administrative price).

The only regulatory measure not taken by the municipality of Budapest was the direct capping of the number of taxis, but it imposed all the other administrative measures. Going against the recommendation and the gloomy forecast issued by the Hungarian Competition Office (GVH), they introduced fixed prices covering all market segments. In addition – also going against the recommendations of GVH and even the position taken by the municipality 18 months earlier – the fixed fare was one and a half times higher than the lowest market price, also used by major transport operators, and 12.5% higher than the highest price available at the time. It is true though that – unlike in the 2005 plan – there were some passages comprehensively regulating the economic and technical conditions that had to be met. So the regulator compensated consumers for the high fixed price by guaranteeing quality. (See *Table 1*)

Table 1

Variations for taxi fares 2000-2013

(in HUF)

	Base fee	per kilometre charge	Waiting
17/2000. Municipality of Budapest General Assembly decree, maximum administrative price, effective: 01/05/2000–01/09/2013	300	240	60
Actual tariff as of December 2011	*300*	*210*[1]	*N/A*
TGFSZ, 2011, calculated	1005	804	201
TGFSZ, 2011, proposed	580	280	70
(*BKIK, 04/2012*).	687	344	86
Municipality draft proposal, 2012[2]	700	270	60
31/2013. Municipality of Budapest General Assembly decree, fixed administrative price, effective as of 01/09/2013	*450*	*280*	70

[1] The non-weighted average of the price per kilometre (HUF 184 to HUF 240) of ten companies. See: http://www.autonavigator.hu/tippek_tanacsadok/melyik_taxitarsasag_a_leggyorsabb_es_melyik_a_legolcsobb-6542

[2] The fixed administrative price in the first draft, in the next one it was the highest administrative price.

The decree applied the strictest standards ever known in taxi regulation regarding the appearance, technical specifications, the technical background of transport operations as well as the requirements for transport operator companies.

The new regulations adopted were indeed a "radical way to establish law and order" by taking into consideration the position/demands of interest groups that were the loudest, and thought to be most powerful at the same time giving an opportunity for the municipality to throw its weight around. However, an articulated, institutional representation of consumer interest was completely left out of the decision-making process. The consumer protection authority made only one remark about the draft: The logo of taxi companies should not only be displayed on the right rear door of the vehicle, but on the other doors as well.[45] (So the consumer protection authority had nothing to say about the draft regulation effectively taking away the right of consumers to choose between service providers based on their prices, and set an administrative price that was 30-50 per cent higher than what consumers were used to.) At the debate over the draft even members of the opposition (except Jobbik, who completely supported stricter regulations) said they wished consumer views had been represented and taken into consideration as well.

The other objection raised concerned the lack of impact studies. Although all representatives speaking at the general assembly stressed they wanted a professional debate, not a political one about the taxi regulations, some very important professional considerations were not taken into account. Although some of them made references to the resolution of the Hungarian Competition Authority, which states that the taxi market is quite segmented, and the regulations should be adapted to this, this important point was not even mentioned. Instead there was a sort of unsubstantiated "debate" about whether prices are too high, and whether demand would decrease and if so, by how much.

During the debate it was only dropped as a hint coming from the tabloid press – a suspicion also lingering in the taxi community – that the ulterior motive for passing the new regulations was actually to strengthen the market position of a specific company or interest group and to establish its dominance. Perhaps the technical specifications and other requirements companies have to meet are tailor-made so that only a specific market player can satisfy them. However, *Gyula Molnár,* speaking for the Hungarian Socialist Party only mentioned it very briefly without substantiating it with data or providing a detailed explanation: "a strong economic

[45] The letter of *Dr Pál Bobál* director (Government Office of the Capital City Budapest) to *Dávid Vitézy,* the CEO of the Centre for Budapest Transport dated August 6, 2012.

player appears on the market, whose interests seem to be behind every new proposal". Hinting continued in the debate over the amendments to the regulation two months later. "With all probability only a handful of financially strong players will be left standing on the market that will carry many fewer passengers at a much higher price than today. It is quite suspicious that all the regulations seem to serve the economic interests of some companies." said *Ágnes Somfai* at the time, also without providing an explanation.

Consumers have been systematically left out of the whole regulation preparation process; in addition the municipality of Budapest had no reliable information about the structure of the demand, consumer needs or customers' opinion of the taxi market. As there had been only one such survey commissioned by the municipality, carried out between April 4 and 7, i.e. two days before the general assembly debate. And its findings were published on June 11 – two days after the regulation was passed – under the title "The Vast Majority of People Living in Budapest Agree with the New Taxi Regulation".[46] The timing of the publication of the survey conducted by Median obviously served propaganda purposes – which came too late to influence the decision making process, and too early to evaluate the final regulation, as it was not yet known. Nevertheless, it satisfied the people in the town hall, who issued the following statement: "Survey findings confirm that after long years of accumulating unsolved problems and mounting anger, the General Assembly of Budapest managed to pass a regulation on the very sensitive issue of the taxi business the great part of which is backed not only by the majority of taxi associations in the capital but also by the majority of the residents as well." But as if nothing had happened, taxi protests continued after April 9, the day the regulation was passed, and the mayor continued the negotiations. Meanwhile, *István Tarlós* – after about two years of consultations and negotiations with the representatives of the taxi business, and having completed the regulation – continued to complain about how chaotic and incomprehensible these people were.[47]

"After the announcement of the Regulation yet another round of talks take place ... as a result of which a new regulation on bringing into force the Regulation with different wording was deemed necessary" – explains the proposal why a new amending regulation has to be passed barely one month after the Regulation was

[46] See: http://budapest.hu/Lapok/A-budapestiek-d%C3%B6nt%C5%91-t%C3%B6bbs%C3%A9ge-egyet%C3%A9rt-az-%C3%BAj-taxirendelettel.aspx

[47] See: http://budapest.hu/kozgyules/Lapok/2013_05_29.aspx

adopted.[48] The proposal reveals that "the final and transitional provisions have to be extended further, given the fact that *one third* of the vehicles used in passenger transportation *are currently more than ten years old"* (emphasis mine – *R. P.*) This, however, was common knowledge in the profession even without any preliminary studies conducted. And the following statement even more so: "as a result of the economic crisis taxi drivers find it quite difficult to replace their vehicles with newer ones". A new feature of the proposal was that it had been realized that the according to the factory specifications of "some station wagons the cargo space was only considered to the edge of the window, which means that for certain type of cars the cargo space was 20-30 litres less than the 430 litres minimum volume set in the Regulation." Case in point, it was the Chevrolet Lacetti SW, a model that had become very popular with taxi drivers over the years, which was made unsuitable to be used as a taxi by the original wording of the Regulation was finally rehabilitated when the capacity requirement was reduced to 390 litres.

Taxi drivers were still unable to achieve the lifting of the 10-year age restriction; however, what they managed to achieve was that this restriction would only apply to new entrants but would not apply to incumbents until the middle of 2015. In like manner, the effective date of regulations on the power of vehicles and their emission classification for incumbents was also extended.

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The implementation of the Budapest taxi regulation radically transformed the market. Of the 21 operators only 11 received a licence to continue their operations.[49] Reportedly the number of licensed taxis decreased from 6 thousand to 5300.[50]

No data is available about the turnover at the time this study was written, but some professionals claim it has fallen, but – as could be expected – it affected each operator differently. Those major operators that have been on the market for a long time and whose tariffs exceeded or were nearly as high as the earlier highest administrative price suffered no more than 20 per cent decrease in turnover (according to other estimates their turnover might even have increased), while the turnover of low-price ones suffered a 30-40 per cent decrease.[51]

[48] The mayor's proposal for the General Assembly, May 2013; FPH061/1865-7/2013

[49] See: http://budapest.hu/Lapok/Folytatjuk-a-taxisok-fokozott-ellen%C5%91rz%C3%A9s%C3%A9t.aspx

[50] Interview with the leader of an association representing the interests of the taxi industry.

[51] "We have fixed tariffs in Budapest because the two biggest companies Főtaxi and City Taxi supported it. … our sources named City Taxi first …The company managed to increase its turnover at

As could be expected in an overregulated market, whose flexibility had been reduced, players of the taxi market also tried to create room for manoeuvre by achieving some favours through lobbying, and by circumventing some regulations. Even before the new regulation entered into force the mayor promised taxi companies affiliated with luxury hotels, which were supposedly quite good at furthering their own interests, that they would be granted some concessions.[52] Easing the fixed fare system started almost at the time it was introduced: some three weeks after the introduction of the regulation the Independent Trade Union of Taxi Drivers pointed out that there had already been three different types of hidden price reductions.[53] Right after the regulation was adopted, a so called transfer service available only by telephone was introduced for half or one third of the administrative fare, and one year later a new type of service advertising itself as a smart phone application – and immediately denounced by both the taxi community and the ministry in charge – which had been very destructive to taxi services worldwide appeared; it is called Uber (*Horváth*, 2014).

Just over a year after its introduction in Budapest – at the beginning of 2016 – the new service was used by 80 thousand people in Budapest, and by May 2016 this figure doubled (reaching 150 thousand).[54] The number of Uber drivers reached 500 after the first seven months, and 1200 in May 2016. Which means that some 20 per cent of taxi cabs in Budapest are now part of the Uber network. (This probably means a less than 20 per cent market share, as most Uber drivers supposedly do it only as a part-time job.)

Traditional taxi drivers have been demanding regulations for Uber ever since it first appeared on the market. "The government must pass a regulation and set the

a time when the number of trips on the Budapest taxi market dropped by 10-30 per cent on average… Although the tariff was introduced as a result of taxi drivers fighting for their livelihood, its most immediate consequence is that the market is redistributed. Five to six big companies are expected to survive." See: http://magyarnarancs.hu/tranzit/hogy-ketyeg-a-taxiora-fovarosi-helyzetkep-az-uj-rendelet-utan-88554

[52] See: Inforádió, August 23, 2013.

[53] See: http://www.hain.hu/wp-content/uploads/2013/11/Lev%C3%A9l-1.-TGFSZ-%C3%A1ll%C3%A1sfoglal%C3%A1s-a-hat%C3%B3s%C3%A1gi-%C3%A1ralkalmaz%C3%A1sr%C3%B3l.pdf

[54] Data about Uber, due to the lack of other sources, come from the media utterances of the representatives of the company. See: http://www.gazmegfek.hu/2016/05/05/ime-az-uber-magyarorszag-valasza-kormany-torvenyjavaslataira and http://www.atv.hu/belfold/20150331-tiltakoznak-a-taxisok-itt-az-uber-valasza

strict conditions for passenger transport that apply to all market players the same way" – they wrote in a letter to the prime minister.[55]

Uber followed the same "tactics" in Budapest as it had in other cities. 1. It suddenly appeared on the market, making it look like it was not even a business activity (paying no taxes, neither the drivers nor the company operating the mobile phone application got any official authorisation or licences, etc.). 2. An aggressive pricing policy made it a popular service in a short time (its price per kilometre being 40 per cent lower than the administrative tariff, and during demonstrations held by taxi drivers it transported passengers at half price).[56] 3. It gradually made some concessions to regulators (introduction of invoicing, drawing up contracts only with drivers who have a tax identification number).

App-based passenger transport angered taxi drivers and provoked strong reactions from them in other cities as well, but to make matters worse in Budapest, a brand new regulation, which had been "matured" for several years guaranteed that such a new technology would not gain any ground legally. The government regulation introduced in 2015 after long years of labour regulated the taxi market in the same spirit; even though by the time it entered into force Uber had become a well-known and popular service in Budapest.

So the administration got into some sort of restriction spiral. As the regulations take no interest in the unique features of the various market segments, and do not wish to change it, they declare any activities that do not fit the mould of the one-size-fits-all type of regulation to be deviant. The administration responded to the demonstrations that became more and more frequent after Uber made its entry onto the market by tighter regulations, stricter control and bans.[57]

Meanwhile every now and then there was news that the government might consider entering into talks with Uber; one sign of this was when a detailed guide appeared on the tax authority's website under the heading "I am a Uber driver, how

[55] The letter of chambers and heads of taxi associations to the prime minister. See: www.hallotaxi.hu

[56] See: http://24.hu/fn/penzugy/2016/01/18/ennyit-keres-ma-egy-uber-sofor-budapesten/

[57] It ordered that the licence plate be removed on the spot from the vehicles of those who provide taxi services illegally and a new fine of HUF 300 thousand is imposed on illegal dispatch services (see: http://24.hu/fn/gazdasag/2016/03/07/uber-ujabb-szankciokat-jelentett-be-a-miniszterium/). A bill put forward in May 2016 would allow the transport authority to block Uber-type mobile applications for a year (Government bill T/10529 on the legal consequences of unlicensed passenger transportation activities by car).

The retaliatory measures were effective: Between January and May 2016 the number of Uber taxis stopped growing, while the demand for the service (the number of registered users) almost doubled in these few months.

do I pay taxes?".[58] Nevertheless, unlike in other countries where a compromise was reached,[59] attitudes on both sides seem to be hardening in Hungary.

On June 13, 2016 the Hungarian Parliament passed a new law enabling authorities to block internet access to dispatchers who do not fulfil the requirements of the government order regulating the taxi business. The latter practically excludes doing business the way Uber does, so Uber announced, it will suspend its services in Hungary from July 24, 2016.

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[58] See: http://nav.gov.hu/nav/ado/szja/Uber_sofor_vagyok__ho20160122.html

[59] See: https://en.wikipedia.org/wiki/Legal_status_of_Uber%27s_service

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The Fiscal compact and the EU's Crisis Management

ISTVÁN BENCZES

*A rules-based economic policy and intensive intergovernmentalism have been the constitutive building blocks of European integration in the past 25 years. It is not surprising, therefore, that the method of crisis management was defined mostly by the presidents and prime ministers of member states and focused almost exclusively on the further limitation of national fiscal spaces. The article aims to demonstrate that the fiscal compact that was adopted in 2012 due to German pressure as an intergovernmental treaty intends to remedy the failures of the existing governance structure by imposing even stricter conditions. Political solidarity, in a general sense, was replaced by a sort of means- and effectiveness-centred view, which seems to place the whole burden of adjustment onto the member states without leaving much room for manoeuvring.**

Journal of Economic Literature (JEL) codes: E02, E62, H60.

When the European sovereign debt crisis hit its lowest point in the spring and summer of 2011, it seemed that the leaders of EU member states would give meaning to the phrase of an "ever closer union" at last and there would be a fundamental shift towards a Europe built on shared responsibility. There was a wide gamut of concepts

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that were given heed at the time: a large common budget, common taxes, bailout fund, Eurobonds, etc. (*Andor*, 2013, *Beetsma and Gradus*, 2012, *Csaba*, 2013, *Fuest and Peichel*, 2012, *Losoncz*, 2014, *Marzinotto, Sapir* and *Wolff*, 2011).[1] A consensus seemed to be developing that to complement the monetary pillar of the Economic and Monetary Union (EMU) – in accordance with the spillover effects of neofunctionalist integration theories (*Haas*, 1958) – the missing economic pillar practically ignored in the Delors report of 1989 (*Delors*, 1989) should be constructed.[2] The crisis itself made the reform of the failed governance structure rather welcomed by member states which were about to lose their economic and political sovereignty to some extent.

As the intensity of the crisis started to decline, enthusiasm began to fade, and today no voices can be heard that would expressly argue for a political union, or even for an economic one for that matter. Even the European Stability Mechanism (ESM), functioning as a common bailout fund, which under normal circumstances could have been an institutional solution strengthening supranationalism, was established outside the EU as an intergovernmental treaty. Neither the Six-pack nor the Euro Pact justified the earlier optimism, but much rather reflected that the Maastricht compromise lived on, i.e. that competences were strictly split at supranational and intergovernmental levels (*Fabbrini*, 2013).

Surprisingly – or, in fact, paradoxically – it was a new intergovernmental treaty, the *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union* (hereinafter: the Treaty) that decreased national sovereignty to a greater degree than anything else before it. It will be shown that the Treaty was aimed at catering to German needs much more than to formulate the ideas put forward in the summer of 2011. The new treaty introduced a series of solutions into European Union public policy formulation, the main purpose of which was to correct the flaws of the existing (minimalist) governance system, and to consolidate the achievements. In practice, it meant perfecting proven formulas and mechanisms, under stricter than ever boundary conditions. Political solidarity in the general sense of the word was replaced by some kind of means- and effectiveness-centred approach.

All this perfectly fits into the process that started some 25 years ago, based on the principle of the least common multiple. At the time the Delors-report saw

[1] But it was not only in academic literature where a consensus was emerging. *Angela Merkel* [2011] in a speech given in the lower house of the German parliament said: "We are not just talking about a fiscal union, but starting to create one."

[2] *Péter Ákos Bod* [2015] notes that *Sándor Lámfalussy* as a member of the Delors team did indeed argue for its importance, but it was swept under the rug eventually.

the light of day, as well as in the years leading up to Maastricht (the switch-over to the euro) there was serious professional debate about how discretionary fiscal policy could and should be limited.[3] As of the 1990s countries either 1. committed themselves to reforming fiscal procedures (planning, adopting and executing the budget) by typically strengthening the position of finance minister against sectoral (or so-called spending) ministries as well as by preparing multi-year macroeconomic consolidation action plans or by setting up a fiscal council in order to impose fiscal discipline; or 2. implemented numerical constraints in the form of fiscal rules.

Although it cannot be said that professionals reached an overwhelming consensus in the "policy or institutional reform" debate, the majority of opinion-shapers argued that the most effective way of creating fiscal discipline in the long run would be to transform budgetary institutions and decision-making procedures and mechanisms (see *Hagen*, 1992 or *Wyplosz*, 2002). They argue that under democratic conditions a fragmented, multilateral decision-making process will produce external effects, resulting in politically motivated preservation of the annual deficit and the continuous growth of the debt ratio (*Drazen*, 2000, *Persson* and *Tabellini*, 2000). These authors see the process of planning, adopting and executing the annual budget as a series of bargains, and point to the fact that those who participate in the bargaining process tend to face the same so-called common-pool problem, which perpetuates deficit and keeps public debt at a high level. The aim of rationalising the budget bargaining process is to curb the deficit bias by internalizing external effects (*Alesina* and *Perotti*, 1996, *Hagen* and *Harden*, 1996). The majority of authors consider fiscal rules defined in numerical format only the second (or third) best solution, because by their very nature they function as a straitjacket tying the hands of governments. And if flexibility allows for too many loopholes, the credibility of the rule is called into question (*Kennedy, Robbins* and *Delorme*, 2001).

In spite of all this, the majority of advanced and developing economies chose to adopt fiscal rules, as they are more easily implemented and generate fewer conflicts (in the short run), instead of imposing constraints on fiscal policy (IMF, 2009). Only a handful of countries (typically English-speaking ones) chose the rationalisation of the planning process. The proposed institutional solutions (i.e., reforming the member state budgetary bargaining process) at the time the Economic and Monetary

[3] In the early years of its launch, distrust in fiscal policy being left at national level was fuelled primarily by that fact that unsubstantiated degree of deficit financing and incurrence of debt would lead to inflation, which, if it spread to all those countries that use the common currency, would undermine the stability of the eurozone.

Union was created provided no real alternative for European Union member states. Reforming the decision-making procedures of the budget process and setting up new institutional forms would have posed a challenge to member states as well as European Union organisations. For either certain national jurisdictions should have been delegated to supranational level, further curbing the sovereignty of member states, e.g. by increasing the common budget or strengthening one of the Community bodies (like the European Commission) – or without strengthening the supranational level, the budget planning, decision-making and implementation processes at national level should have been converged or standardised (*Benczes*, 2004).

However, in the early 1990s the European Union – more specifically its member states – were not receptive to either the former (strengthening the supranational level) or the latter (comprehensive reforms in member states). Increasing the common budget or further strengthening the role of the Commission would have been a step towards political union, which was not on the agenda in the EU at the time, and the prospective enlargement of the EU counting 12, and later 15 member states at the time, created even greater uncertainty in this regard. The second solution, which seemed more realistic and the majority of the above cited authors argued for, would not have consisted of merely the harmonisation or standardisation of budget process procedures by the parties. The procedures and decision-making processes of national budgeting cannot be considered exogeneous in the sense that they are determined by historic particularities, the constitutional structure, such as election and party system of the specific country.[4] So institutional reforms in the majority of countries would have been tantamount to – with certain limitations – a constitutional process. However, there was no receptivity to this (just think of the French referendum on the Maastricht Treaty where the outcome was decided by just a few thousand votes). Therefore it seemed easier to build only the monetary pillar of the Economic and

[4] It is, therefore, not an accident that there are typically two different reform solutions offered by these authors (see especially *Alesina and Perotti*, 1996). For single-party governments (in plurality voting systems) they propose the so-called delegation procedure, where the finance minister or the prime minister has the right to supervise the whole budget process. In such an arrangement spending ministers are strictly controlled by the finance minister, and are organised in a clear hierarchy. The other solution may be more suitable for coalition governments, typical of countries with proportional electoral systems. Coalition parties do not organise the functioning of the government in an ad hoc manner, but put it on a contractual basis clearly defining rights and liabilities. The contract may explicitly set some numerical targets for the fiscal policy, which the stakeholders may adopt as part of a so-called multi-year programme.

Monetary Union, which is currently represented by the European Central Bank. In consequence, the economic pillar was kept at a minimum.[5]

Crisis management and fiscal rigour: the Fiscal Compact

The financial and economic crisis that hit Europe in 2008 showed once and for all that member states are unable to seal themselves off from an epidemic. The negative effects of a shock might spread from one member state to the other, undermining the stability of the whole eurozone. On May 9, 2010 a decision was made that instead of ad hoc bailouts the EU would implement a three-pillar financial infrastructure in the future (ECOFIN, 2010).[6] The European Financial Stabilisation Facility was set up as a corporation (with the shareholders being the eurozone member countries), while the European Financial Stabilisation Mechanism was created by council regulation to increase the lending capacity of the EU directly (Council Regulation [EU] No 407/2010). In addition, the International Monetary Fund joined in the bailout as the third pillar.[7] In return for financial assistance failing states had to say what corrective measures they planned to implement, and they had to say it already at the time they applied for financial assistance. On October 8, 2012 these provisional measures were replaced by a permanent rescue mechanism, the European Stability Mechanism. Its peculiarity is that its resources can be used to bail out banks directly (this is exactly what happened in the case of Spain).

In this new governance system prevention (as well as dissuasion) is also supported by a multi-pillar system. Prior to this the European Council approved the so-called European Semester. To date this can be said to be the only single concrete action where the European Union clearly supported fiscal institutions and the alignment and enhancement of mechanisms in the "rules or institutions" debate. Nevertheless, the newly adopted preventive elements clearly show support for the earlier tradition, the rules-based economic policy. The so-called Six-pack,

[5] However, this "necessary minimum" was not insignificant. The parties agreed to mutually monitor the fiscal performance of member states, and not resort to either monetisation or the bailout of member states (the famous-infamous no bailout clause) even at times of distress, and they also institutionalised the excessive deficit procedure, which includes setting a ceiling for both budgetary deficit and public debt.

[6] Section 2 of Article 122 of TFEU made this possible by providing that a Member State may be granted financial assistance if it is in serious difficulties caused by exceptional occurrences beyond its control.

[7] This three-pillar mechanism provided financial assistance to Ireland, Greece and Portugal.

a package of five regulations and a directive, entered into force in December 2011. Its objectives were twofold: strengthening the preventive and dissuasive arms of the Stability and Growth Pact substantially, as well as extending EU monitoring, checking and sanctioning mechanisms to areas beyond public finances in order to improve competitiveness.[8] As of May 2013 the so-called Two-pack (basically two EU regulations: EU Regulations 472/2013 and 473/2013) has been in force, requiring failing states to adopt strict adjustment programmes according to the instructions of the Commission in order not to threaten the stability of the eurozone as a whole. A member state can get financial assistance only if it undertakes the fiscal, structural and financial-market reforms the Commission deems necessary.

The rules-based economic policy coordination is reflected most clearly in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, or more specifically in Title III of it, the Fiscal Compact, adopted in March 2012 and entering into effect on January 1, 2013 (Treaty, 2012).[9] The treaty went beyond the Stability and Growth Pact updated by the Six-pack, as it made the application of rules at national level mandatory as well. However, its application did not simply make new economic governance even more complex, but also – as it will be shown – it was fraught with contradictions.

The provisions of the Fiscal Compact

The new treaty introduced changes in three areas: firstly it created a fiscal rule that was stricter than any former one intended to create a balanced budget; secondly it asked for transposing the rules into high-level national legislation, and thirdly it authorised the European Court of Justice to step in in case of non-compliance. The Treaty explicitly lists the following rules: "the budgetary position of the general government of a Contracting Party shall be balanced or in surplus" [Article 3 (1a) of the Treaty]. This in itself is nothing new as the original, 1997 version of the Stability and Growth Pact (Council Regulation [EC] No 1467/1997) was couched in similar terms. What is new, is that the balanced position is defined very clearly: "the rule under point (a) shall be deemed to be respected if the annual structural balance of the general government is at its country-specific medium-term objective, as defined in the revised Stability and Growth Pact, with a lower limit of a structural deficit of 0.5% of the gross domestic product at market prices" [Article 3 (1*b*) of the

[8] The latter is referred to as the macroeconomic imbalances mechanism.
[9] Hereinafter the Treaty is referred to by its better-known name: Fiscal Compact.

Treaty].[10] The member states shall ensure rapid convergence towards their respective medium-term objective; the time frame for the convergence will be proposed by the European Commission taking into consideration country-specific sustainability risks. Eurozone member states can deviate from their medium-term objectives only in exceptional circumstances [see Article 3 (3b) of the Treaty] and only temporarily.

In addition to the balanced budget rule the Fiscal Compact also contains a debt rule, which as a matter of fact echoes the requirements for debt reduction set out in the renewed Stability Pact. The biggest breakthrough of the 2011 reform was that while earlier the EU when deciding about fiscal austerity based its decision exclusively on the annual balance, the provisions of the Fiscal Compact, being implemented as part of the Six-pack, concentrated more on sustainable public finances and required the stabilisation of the debt. Accordingly, the Treaty requires Contracting Parties whose general government debt exceeds 60% to reduce it at an average rate of one twentieth per year.[11]

However, the Fiscal Compact did not simply impose a more stringent and more complex set of rules. The Treaty forces contracting states to incorporate the fiscal rules by binding force and permanent character into their national law, preferably constitutional [Article 3 (2) of the Treaty]: "The rules set out in paragraph 1 shall take effect in the national law of the Contracting Parties at the latest one year after the entry into force of this Treaty through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes." So this ends the previous practice of forcing budgetary discipline on member states by supranational, i.e. EU rules only; instead, from then onwards, all contracting member states are obliged to transpose fiscal rules into their national legislation directly.

As we have already mentioned, member states in the early eighties did not support institutional reforms because they would have raised constitutional issues, which the parties simply were not willing to deal with. It seemed to be a much easier and less

[10] In the case of member states whose gross debt is "significantly below 60% and where risks in terms of long-term sustainability of public finances are low" the structural deficit target is 1%. [Article 3 (1*d*) of the Treaty]

[11] When the ratio of a Contracting Party's general government debt to gross domestic product exceeds the 60% reference value referred to in Article 1 of the Protocol (No 12) on the excessive deficit procedure, annexed to the European Union Treaties, that Contracting Party shall reduce it at an average rate of one twentieth per year as a benchmark, as provided for in Article 2 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, as amended by Council Regulation (EU) No 1177/2011 of 8 November 2011." (Article 4 of the Treaty)

conflict-ridden solution to limit fiscal policy by using numerical rules, and let the market (which was expected to penalise any deviation by higher premium prices) ensure that they are abided on the one hand, and make ECOFIN, the council made up of economics and finance ministers on the other. Now, however, an intergovernmental treaty (i.e. not even an EU source of law) forces the participating member states to lay down fiscal rules that are obviously less flexible than institutional reforms in their constitution or in other binding provisions.

Another peculiarity of the Treaty is that in case of non-compliance (i.e. if the rule is not transposed into national legislation) the matter will be brought to the supranational Court of Justice of the European Union. Any of the parties involved has the right to appeal to the Luxembourg-based court. And the court's ruling is binding; furthermore, member states can be fined to up to 0.1% of their GDP. The involvement of the court clearly shows a desire to break with the past (*Dehousse,* 2012). The aim of the previous regime that had been set up in Maastricht was specifically to leave member state competences with the states themselves; in turn, supranational institutions and mechanisms were almost powerless in limiting fiscal policy. This is why member states did prefer rules to institutional changes. In the excessive deficit procedure the Court of Justice of the EU had not been assigned any role in the founding treaty. Additionally, the room for manoeuvre of the European Commission was limited to monitoring, reporting and making recommendations only (Article 126 TFEU). This is how the excessive deficit procedure could become a political issue in the ECOFIN, and as of 2003 the stability pact became practically pointless and useless.[12]

The new intergovernmental treaty intends to break with the past, it aims instead to implement a real fiscal discipline obligation by drastically limiting the room for manoeuvre in discretionary fiscal policy on the one hand and increase the importance of such supranational institutions as the European Commission and the Court of Justice of the EU on the other hand.[13] The Fiscal Compact is a clear admission that neither ECOFIN nor the European Council has the capacity and ability to be able to monitor or enforce the new rules aimed at tightening fiscal discipline. However, such mixing (or a combination) of intergovernmentalism and the community method may result in unclear, non-transparent decision-making in the future. In addition to this,

[12] It is a well-known fact that ECOFIN helped Germany and France escape the excessive deficit procedures in 2003.

[13] According to the original plans, the European Parliament was also going to participate, as it was said that the President of the European Parliament could be invited to the eurozone leaders' meeting, and the leader of the Eurogroup himself could also report to the Parliament.

the unusually strict fiscal rules would clearly cause intense political strife among members, and they would have to take sides in them.

The evaluation of the Fiscal Compact according to five criteria

Whose interest is it?

As with the Stability and Growth Pact adopted back in 1997 the Fiscal Compact also came under harsh criticism for not representing the interests of the eurozone as a whole but it is merely the means of representing German interests. But is such criticism justified, and if so, what exactly are these German interests?

It has been clear since day one of the European sovereign debt crisis that Germany was to play a major role in overcoming the crisis. Germany seemingly unwilling to participate in the management of the crisis finally agreed to use its own taxpayers' money to bail out failing states (especially Greece), and thereby go against the no bailout clause, under some strict conditions. And by "conditions" it meant not only strict adjustment policy by the states requiring financial assistance but (much more) the provision of institutional guarantees for crisis prevention. For the European economic governance reform is just as much about the appropriate ways of crisis management and the development of its forms, as about creating effective preventive and deterrence mechanisms.

The Fiscal Compact caters to both of these German needs in a special manner by introducing even stricter rules of prevention in a way that any later bailout is contingent on the party having joined the pact (only those failing member states can get ESM funding who have ratified the Treaty). It might be surprising news but Germany came up with the idea of combining these two criteria as a result of the sovereign debt crisis affecting the European Union. This member state, which is widely considered to be the engine of the European Union, sacrificed the fiscal rule (the German Golden Rule) it had been using for nearly four decades in order to first implement what it later required the other members to implement in the EU.

The German debt brake of 2009, which is practically equivalent to the budget balance rule of the Fiscal Compact, limited the room of manoeuvre of German fiscal policy – with two thirds majority political support – following a thorough and comprehensive constitutional process. The German constitutional court had called on German parties repeatedly to change the earlier golden rule, as well as

some provisions of the fiscal constitution, as they had caused legal disputes more and more frequently. The basis for the reform was that several German states especially Saarland, Bremen, and Berlin were hoping to get bailout funds from federal sources. In these legal disputes it was the constitutional court that had to decide which federal land could get fiscal transfer and which could not (for example Berlin did not get financial assistance). In 2006 the parties CDU/CSU and SDP jointly initiated the review of the constitution, which was then carried out in two rounds. In Germany the reason for a comprehensive constitutional reform was thus not just overspending on the regional level and the consequent request of particular states for bailout funds from the federal government, but also the risk of such behaviour becoming the accepted norm in the country and the moral hazard it would bring about (*Feld* and *Baskaran*, 2010).[14]

The parties had a substantive debate over whether some modified version of the golden rule which had been applied earlier should be used, or they should switch to the debt brake which had been introduced in Switzerland. As the latter was more akin to the fiscal rule used already in the EU in both concept and content, the Germans finally decided in favour of this stricter rule. It was the crisis hitting Europe in 2008 that brought a sweeping change in the protracted constitutional process. Germany committed itself to deficit financing, but by laying down the new rule in the constitution it communicated the message to the markets that this extravagancy is only temporary. Combining crisis resolution with the introduction of the new rule laid down in 2009 was to demonstrate that Germany does have an exit strategy.[15] However, as a result of constitutional reform a new so-called Stability Council was set up (instead of the former Financial Affairs Council, which proved to be inefficient), which was basically a council of German finance misters, with its main responsibility being prevention. This council is also responsible for penalizing states if necessary, i.e. to withdraw transfers from states that do not satisfy the conditions laid down in the constitution.

Basically, Germany wanted to transplant this mechanism on a higher level, i.e., in the European Union as well. By 2011 the Spanish, Portuguese and Irish risk

[14] Originally the Germans wanted to reform the whole transfer mechanism among states, but this finally did not happen, so the question is expected to be raised again in 2019.

[15] The German debt brake caps the structural deficit at 0.35 percent at federal level, as opposed to 0.5 percent in the Fiscal Compact. Originally, the new rule was not to be applied to the individual federal states, only at federal level. However, due to the crisis it was also extended to them as well (requiring them to have a balanced budget). The difference however is that while at federal level the starting date is 2016, at state level the new rule is to be applied from 2020 onwards. The proportion of total debt in Germany between federal level and state (and local) level is: two thirds to one third.

premia were so high that they were threatening the stability of the whole eurozone. Although the stabilisation policy based on restrictive policies and structural reforms, supported by both the EU and the IMF, was a requirement in countries hit by the crisis, high yield spreads made it clear that financial markets needed to be addressed systematically. By 2011 Germany no longer objected to setting up a permanent bailout fund (*Beach*, 2013). The Fiscal Compact was the solution, as it has connected two pillars that have been considered to be important for economic governance in the eyes of Germany. The compact has introduced strict rules, and afforded the opportunity to lay down the foundations of transfer mechanisms. It is beyond doubt that the Treaty is about the tightening up of fiscal rules, but from a German perspective it was just as important to make sure that only countries that join the Treaty should be eligible for financial assistance. Only those member states could receive anything from the European Stability Mechanism, the eurozone bailout fund, who had ratified the Treaty. With this measure the Germans wanted to make sure that those member states that were unwilling to sign the intergovernmental treaty, join voluntarily. The German (and Swiss) type of brakes laid down in the constitutions also helped to make it easier to sell future bailouts more easily to the German public politically. This way the message of the Treaty could be more in accordance with German intentions, i.e., that any bailout or the possibility thereof could not under any circumstances carry the moral hazard of becoming inherent.

The lack of national ownership

What would mean the representation of German interests on the one hand, could also be translated into the lack of national ownership – from the perspective of other member states – on the other hand. Studies of federal countries find that rules that are forced from above tend to be ineffective (*Bordo* et al, 2011, *Henning–Kessler,* 2012). In the USA which is often used as an example for the EU almost all states use some type of numerical rule, even though there is no federal law that forces them, or for that matter any federal law that could force them to do so.

As it has been mentioned earlier, the debt rule has replaced the earlier golden rule following a lengthy constitutional process, and got wide political and social support in Germany. In other member states however, it was not a decision coming from within, but the transposition of the provisions of an intergovernmental treaty into national legislation. And this is quite unfortunate, because rules in themselves never create discipline. It is much more likely that governments committed to the

sustainability of public finances will apply rules as part of a wider reform programme or package to indicate that their commitment is beyond the political business cycle (*Benczes*, 2011).

Table 1

Fiscal rules in EMU countries (year of introduction)

	Balanced-budget rule	Debt rule	Expenditure rule	Revenue rule
Austria	2008, 2011, **2012**		**2009**	
Belgium	**2012, 2014**			
Cyprus	**2013**			
Germany	**2009, 2011, 2013**		2008	
Estonia		**2010**		
Greece	**2012**			
Spain	**2012**	**2012**	2011, **2012**	
Finland		**2011**	**2012**	
France	**2013**	**2008**	**2011**	**2009, 2011**
Ireland	**2013**	**2013**	**2012, 2013**	
Italy	**2010, 2014**	**2014**	2008, 2011, 2012, **2013, 2014**	
Lithuania		**2012**	**2008**	2008, 2012
Luxembourg	**2012, 2013**		2010, 2012	
Latvia	**2013**	**2013**	**2014**	
Netherlands			**2012**	
Portugal	**2012, 2015**	**2013**		
Slovenia			2010	
Slovakia	**2014**	**2012**	**2012**	

Note: The rules still in force are in bold. The rules apply to federal and member state (provincial, regional) levels as well as to social security funds. (Rules applicable to local governments are not included in the table). Rules introduced after 2012 were typically adopted following the ratification of the Fiscal Compact.

Source: Compiled by author using European Commission data [2015].

In EU member states it is not at all uncommon to introduce fiscal rules as a separate initiative. For instance, prior to the crisis all EU-15 countries – with the exception of Greece – used some fiscal rules (usually balanced budget rules and/ or expenditure rules, see for example: European Commission, 2008). And not even the financial and economic crisis itself could discourage European countries from introducing such rules. While as of 2008 European countries were busy minimising the negative effects of the crisis itself, they, almost without exception, tried to introduce fiscal rules at various levels of the general government, which were or could be parts of the exit strategy later on. *Table 1* shows this process in EMU member states.

Of the programme countries (generally referred to as periphery countries) *Ireland* consolidated its public finances most successfully. It reduced the annual deficit from 23.3 percent in 2010 to 3.9 in 2014, and it dropped well below the 3 percent threshold in 2015. Its debt which had increased by nearly 100 percentage points due to bank bailouts, decreased from a record high 120.1 percent in 2012 to 93.8 percent in 2015. The development was due not only to the improving international environment but increasing revenues and the considerable reduction of public expenditure (IMF, 2015a). As part of the consolidation programme, Ireland first passed the Fiscal Responsibility Act in 2012 (with new fiscal rules and a new, independent fiscal council), then complemented it with a medium-term budgetary plan in 2013 (see *Kopits, 2014*). (However, the rules were not laid down in the constitution, as that would have required holding a referendum about it first.) In addition, due to Irish efforts the country may soon get out of the excessive deficit procedure.[16]

Spain had been using one of the strictest national regimes even before the crisis, but with the set of rules (balanced budget rule, debt rule and expenditure rule) adopted in 2011 and 2012 the Iberian country's rules have become by far the strictest ones. The rules cover the central government as well as the regions, and even local governments. This way the regime covered practically the whole of public finances. What is unique about the structural balance rule is that if there should be any deficit in the social security systems, on the one hand the government is to reduce the room for manoeuvre of the central government to the same degree, and on the other it has to reform the social security system in order to prevent it from occurring again in the future. And the 60 percent debt to GDP limit was split into three parts: the central

[16] In connection with Ireland it should be said that in the "rules or institutional reforms" debate Ireland opted for both as a solution. It fulfilled its obligations under the Fiscal Compact as part of a general medium-term budgetary framework programme.

government can have a debt of 44 percent, the autonomous regions 13 percent, while local governments can have no more than 3 percent of the GDP. The new rules are stated in the Spanish constitution and sanctioned automatically. In 2013 they also set up an independent fiscal council. So in general it can be argued that Spain's remarkable rebound from the crisis (IMF, 2015b) is due to enormous efforts to harmonise the provisions of the Fiscal Compact with his own national requirements.

Italy introduced a strict balanced budget rule into its constitution at its own discretion back in 2012, before joining the Fiscal Compact. (Although the rules actually entered into force in 2014.) In addition to the constitution they also passed two implementation acts as well, which added an expenditure rule to the constitutional debt and balanced budget rules required by the Fiscal Compact. In addition, the new Italian regime also contains a golden rule, which concerns regional and local governments specifically. Here, too, a newly established fiscal council monitors if rules are being adhered to.

In *Portugal* the constitution could not be amended to include the new rules (it would have required a two-third majority support in parliament); nevertheless, the country managed to limit the room for manoeuvre of fiscal policy in all areas of public finance via a complex system by passing a simple law. They even passed a golden rule applicable to local governments. As in other countries a fiscal council was set up in Portugal (it is called the Portuguese Public Finance Council).

The most controversial situation developed in *Greece,* the country where the eurozone crisis erupted.[17] The southern state was the only one that did not use any rules of its own prior to the crisis. In return for the bailout the Greek government in power in 2010 committed itself to introduce strict rules, but in the end it only ratified the Fiscal Compact in May 2012 accepting that it would be bound by the balanced budget rule and the debt rule. So it did not provide for the adoption of other rules in its own jurisdiction. One possible explanation for Greece's unwillingness is that in return for financial assistance the country already had to commit to implement strict consolidation policies, making any further voluntary restrictions unnecessary, and the joint forces of the IMF and EU are a much stronger disciplinary force than any type of internal rule could be (*Marketou,* 2015).[18]

[17] On the history of the Greek crisis see *Győrffy* [2014].

[18] *Marketou* believes this is why no substantive debate could be held in the Greek parliament about the Fiscal Compact. The parties considered it to be the means of serving German interests, and the further encroachment of neoliberal ideology that is against the interests of their country.

Just an intergovernmental treaty?

Although the fiscal treaty was clearly to cater for German needs, Germany had originally initiated the introduction of new and strict rules jointly with the French in August 2011 – in a letter addressed to the President of the European Council. The October 2011 European Council meeting called for the adoption of the Stability and Growth pact upgraded by the Six-pack, stating that the parties concerned should transpose the fiscal rule on balanced budget in structural terms into their national legislation, preferably at constitutional level (European Council, 2011).

However, there were several factors that hindered the agreement. On the one hand the European Commission, going against German plans, put forward the proposal of Eurobonds to strengthen solidarity.[19] On the other hand, Great Britain clearly indicated that it would not join the new regime (even if they were only obligatory in eurozone countries), and rejected outright any amendments to the Treaty that the Germans were pushing for. The island state did this in spite of the fact that it had been operating perhaps the most sophisticated regime and institutional system in the EU at its own discretion to create fiscal sustainability. So it is very unfortunate that the country did not join the Treaty, because it could provide invaluable help due to its extensive experience for participating states.

From the German aspect it was crucial to attach the strictest conditions to the bailout fund, and to put greater emphasis on prevention, so they put forward a proposal to create a treaty similar to Schengen, i.e. an intergovernmental treaty – cognisant of the fact that they would get the backing of France as well.

After extensive negotiations in December 2011 and January 2012 a compromise was reached on the intergovernmental treaty. One such compromise was that while in the first version it was argued that it should be translated into the constitution, in the final version it was diluted mainly because of the objections raised by Denmark, Finland, Ireland and Romania (requiring a referendum). French expectations were not fully met as the treaty they wanted to make only eurozone member states could have entered into, promoting the concept of a multi-speed Europe. However, those who opposed the idea, especially Poland, argued successfully against the French position aimed at exclusivity.[20]

However, it is an undeniable fact that the Fiscal Compact is not part of the legal framework of the EU. Due to its nature it strengthens the undesirable

[19] To learn more about the concept and its evaluation see *Losoncz* [2014].

[20] On the circumstances surrounding the birth of the Treaty see *Beach* [2013].

tendency that makes intergovernmental negotiations, deals and in general intensive intergovernmentalism the main governance and decision-making mechanism of the EU. As an intergovernmental treaty, the contracting parties (or the governments thereof) are the only actors with decision-making power. However, the preamble of the Treaty expresses the desire “to incorporate the provisions of this Treaty as soon as possible into the Treaties on which the European Union is founded” (preamble to the Treaty).[21]

Consistency, transparency, enforceability

The Treaty on the Functioning of the European Union, the reformed Stability and Growth Pact and now the latest Fiscal Compact all try to set the fiscal policy of member states in a numerical form. Therefore, their consistency, traceability and transparency may become questionable.

Although the fiscal policy regime of the EU has by now become really complex, this does not necessarily imply inconsistencies (see for instance *Marzinotto* and *Sapir,* 2012, or *Verhelst,* 2012). The fiscal rules laid down in the Fiscal Compact are much stricter than earlier regulations, so from this perspective it does not conflict the earlier EU protocol.[22] The existing and new rules are in a clear hierarchy with the new rule on structural balance to be introduced at member state level at the top of the hierarchy.[23] And EU rules (like the deficit and public debt rule in the Lisbon treaty itself or the fiscal rules of the Six-pack requiring a balanced budget position) serve as some sort of safety net (*Blizkovsky,* 2012).

The Fiscal Compact adopted in March 2012 was clearly based on the Stability and Growth Pact, an integral part of European Union legislation, which was renewed in 2011. Although the Six-pack was a clear move to ensure the sustainability of public finance, Germany deemed it imperative to take further measures to improve

[21] The parties also saw to it to declare that it shall not be contrary to EU requirements “the treaty shall not encroach upon the competence of the Union” [Article 2 (2) of the Treaty]. The text itself strongly refers back to – wherever it is possible – the primary and secondary sources of legislation of the European Union.

[22] In its preamble it was put down in writing that the parties are aware of EU standards: “Conscious of the need to ensure that their general government deficit does not exceed 3% of their gross domestic product at market prices and that their general government debt does not exceed, or is sufficiently declining towards, 60% of their gross domestic product at market prices…” Elsewhere – but also in the preamble: “to further strengthen the Stability and Growth Pact by introducing, for Member States whose currency is the euro, a new range for medium-term objectives in line with the limits established in this Treaty”.

[23] The annual structural balance of the general government refers to the annual cyclically-adjusted balance net of one-off and temporary measures [Article 3 (3a) of the Treaty].

discipline. The Stability and Growth Pact does not make it possible for European authorities (or other countries for that matter) to interfere with the shaping of the fiscal policy of states in difficulty. However, the Fiscal Compact is aimed at such strict bailout mechanism in case of serious trouble (this is frequently – but incorrectly – referred to as transfer union), which the afflicted country can only get, if it gives up part of its sovereignty. A paradox situation has been created: this intergovernmental treaty (mind you not EU legislation) makes pressure by other member states (but not necessarily pan European pressure) on national economies much more formidable, limiting the decision-making competence of such countries with regard to what taxes they levy, and how to spend them.

However, the enforcement of the rule and sanctioning – considering that it is an intergovernmental treaty – may pose a challenge. In this regard the reference point is the new law package, the so-called Six-pack, which – through automatic sanctions – introduced much stricter conditions than those applied prior to 2011. Accordingly, the new treaty also uses a great degree of rigour. On the one hand it adopts an automatically triggered correction mechanism that allows the Contracting Party concerned "to implement measures to correct the deviations over a defined period of time" [Article 3 (1*e*) of the Treaty]. According to the rules of reverse qualified majority voting they have to vote about not whether to initiate the procedure against a country in violation but whether *not* to. And qualified in this case means 80 percent of votes, but since Germany itself has over quarter of the weights in the council, without it the sanction process cannot be stopped.

Another strength of the Treaty is that it calls on member states under excessive deficit procedure to put in place a "budgetary and economic partnership programme", which defines the measures to be implemented – with special regard to structural reforms – that can ensure the correction of excessive deficit [Article 5 (1) of the Treaty]. The programmes are to be submitted to the Council and Commission, and their monitoring will take place within the context of the existing surveillance procedures under the Stability and Growth Pact. It is interesting to note that in addition to monitoring the programmes the Council and the Commission may monitor the implementation of annual budgetary plans consistent with it as well [Article 5(2) of the Treaty].

Clearly, the biggest weakness of the pre-crisis governance framework was enforceability. Greece systematically misinformed Brussels, providing false data, while Germany and France abused their power to block excessive deficit procedures against them. The parties now hope that the involvement of the Court of Justice of

the European Union and the binding nature of the Court's decision are the guarantee that the process will be depoliticised.

Sovereign debt, private debt, competitiveness

The admission that the Fiscal Compact complemented the provisions of the substantially revised Stability and Growth Pact of 2011 raises other issues as well. *Creel* et al. [2012, p. 538] for example states that by this the European Union asserts irrevocably that public deficit and debt are not means by which governments smoothen the cycle, but are to be considered an objective in themselves. This means that the Treaty has transformed an economic policy instrument, namely fiscal policy – which for lack of any other alternative is the only real means of intervention in the EMU – into an objective.

It is a fact that the Fiscal Compact treats the causal link which mainly characterised the first generation models of the crises almost like an axiom: distorted macroeconomic fundamentals (like the worsening position of the public finances) lead to other distortions (like inflation, external debt, worsening competitiveness), which then may culminate in a crisis. The Fiscal Compact affirms the belief that an economic downturn is not the cause but the consequence of sustained government deficit.

However, second- and third-generation crisis models reflected a shift from government (mainly fiscal) policies towards changes in the private sector – inducing that even if fiscal positions are relatively balanced, an economic crisis may still develop. It is well known that prior to the economic crisis all EMU member states with the exception of Greece pursued relatively strict fiscal policy (*Losoncz,* 2014). The increase in deficit (even to an extreme degree like it happened in Ireland) was the result of the write-offs of bad assets of the bank sector and the recapitalisation of the financial sector using state funds. The EMU was established as a special construction: the common currency was introduced on the common market without the implementation of uniform regulation for the financial intermediary system. However, such a decentralised approach poses systemic risks, which *De Grave* [2013] quite aptly calls the "deadly embrace" between the sovereigns and the banks.

Following the bankruptcy and collapse of Lehman Brothers the decision made by EU heads of state and heads of government in October 2008 conferred bank bailouts to member states. With a benefit of hindsight, it can be safely argued that it was a bad decision to make, since all of these banks were operating on the common

market of the EU (without uniform rules), there were a lot of foreign assets and liabilities in their balance sheets. Before the crisis the aggregate asset of the banking sector in Ireland was nearly eight times the Irish GDP. (The ratio in other member states: in Spain three times higher, in Portugal two and a half times higher, while in Austria and France it was nearly four times higher – ECB, 2014.) Addressing the crisis at the level of member states put the governments hit by the crisis into a difficult situation, as fiscal positions deteriorated dramatically. The banking crisis soon developed into a public finance crisis. In this sense it is not appropriate to talk about a European debt crisis, as it manifested itself only as a consequence (see among others: *Baldwin* and *Giavazzi,* 2015). With the exception of Greece the crisis was not caused by irresponsible overspending in the public sector, but excessive borrowing in the private sector.

Table 2

Changes in real effective exchange rate and labour productivity

	Changes in real effective exchange rate			Changes in labour productivity		
	2002–2008	2008–2013	2002–2013	2002–2008	2008–2013	2002–2013
Germany	–2.5	2.5	0.0	3.3	0.8	4.1
Ireland	34.2	–20.1	14.1	3.0	3.8	6.8
Greece	10.9	–10.9	0.0	3.6	–2.0	1.6
Spain	19.8	–13.3	6.5	1.3	3.4	4.7
France	9.8	–0.4	9.4	2.1	1.2	3.3
Italy	15.8	–0.1	15.7	0.3	–0.2	0.1
Portugal	5.2	–7.1	–2.0	0.9	1.0	1.9

Note: In case of the real effective exchange rate a negative sign shows that competitiveness has improved. The base year was 2005 (i.e. 2005 = 100). For labour productivity: the value created per hour worked expressed in euros.

Source: Calculated by author using AMECO database.

In addition to the sudden stop and the risk of the collapsing of the bank system, the loss of competitiveness (the appreciation of the real exchange rate, the relative deterioration of the productivity of labour, etc.) also posed a major challenge to member states (*Bird* and *Mandilaras,* 2013). In the absence of a national currency

the good old Keynesian method of depreciation could not ensure adaptation. And creating demand in internal markets in small open economies is an unrealistic idea, especially at times of deflation. The EMU is a very unique institutional structure in which the only solution to worsening competitiveness would be the further deregulation of the labour, product and services markets, which would bring an element of flexibility to them. However, in this area no real changes were made in the years following the crisis either, see *Table 2*.

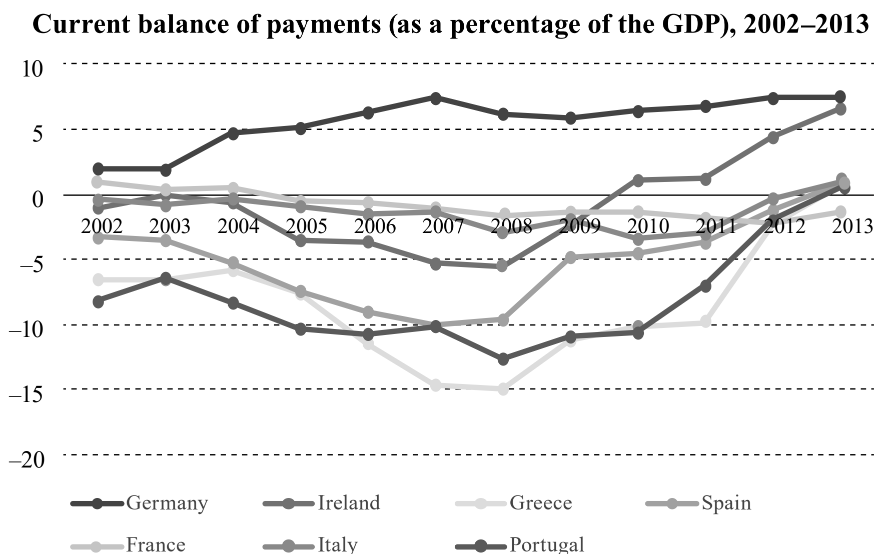
As for the most part the deterioration of budgetary positions of member states is merely the consequence and not the trigger for other crisis phenomena, it may be that the Fiscal Compact has preventive and dissuasive power, but it cannot completely avert a crisis that originates from outside the public sector. Based on a simple relation well known in the macroeconomics of open economies:

$$(X–M) = (S–I) + (T–G) \tag{1}$$

where: X stands for export, *M* for import, *S* and *I* for private-sector savings, and investment respectively, *T* for taxes and *G* for government expenditure.

Figure 1

Current balance of payments (as a percentage of the GDP), 2002–2013



Source: AMECO database.

Equation (1) indicates that despite the fiscal rigour introduced, the external position can deteriorate due to private investments exceeding domestic savings – as has happened in periphery states (see *Figure 1*). It is no accident that the Six-pack has introduced a new element, a new regulation about the need to create macroeconomic equilibrium. The Commission monitors the macroeconomic situation in member states, and to do so it uses a scoreboard for competitiveness as well as external imbalances. The new law package also introduced the excessive imbalance procedure, which is similar to the excessive deficit procedure, which is launched if the country in question ignores the recommendations of the Commission.

So if both the external position and the public finances are balanced (or are close to equilibrium), the private sector will also be balanced, i.e. (domestic) savings will match investments. But how realistic is the assumption that there are balanced positions in both the public and private sectors? In federal states (and more extensively in monetary entities using a single currency) it is by no means unusual, in fact quite typical, that the different regions (provinces, member states) take different positions due to differences in economic development, etc. So the eurozone either accepts that imbalances do become permanent and carries out a transfer mechanism that is self-evident in federal states, or finds such institutional solutions that can influence all three parts of equation (1), not only the position of public finances.

From this aspect the key (practical) issue is whether Germany, which is the largest creditor, is willing to decrease the surplus of its external trade balance to improve the positions of other states in the monetary union. Although this idea is not at all unrealistic based on equation (1) (as the creditor position of Germany – and the Netherlands, Austria or Finland for that matter – from another aspect means that other member states need to borrow), it should be examined under what conditions would Germany be willing to make its own position worse. Judging from the way Germany behaved during the crisis, as well as during crisis resolution, it seems clear that the solution for Germany would not be to make its own position worse voluntarily and unconditionally (which in practice means increasing German wages significantly compared to productivity), but by improving the structural factors (especially the labour market) of partner countries. The export share of intra EU trade of Germany decreased slightly from 22.8 percent in 2008 to 21.9 percent in 2013, while its extra EU trade – in relation to EU 28 – remained practically the same at 27 percent. *Antalóczy* and *Naszádos* [2015] argue that Germany responded to the crisis remarkably quickly and effectively. (But they also add that the external trade balance of Germany has showed a surplus every year since 1952.) On the other hand,

with the exception of Spain (whose share of export within the EU increased form 4.9 to 5.3 percent); no other periphery state could increase its share of export within the EU. (*Table 3* shows the trade balance of countries in relation to Germany. The table also demonstrates that it was again only Spain that was successful in repositioning.)

Table 3

Member state import-export values in relation to Germany
(Billion euros)

	Import from Germany			Export to Germany		
	2002	2008	2013	2002	2008	2013
Ireland	3.76	4.9	4.24	6.7	5.9	6.3
Greece	4.03	7.96	4.54	1.14	2.08	1.8
Spain	29.11	41.95	31.19	15.3	20.2	24.4
France	67.45	93.3	98.43	52.7	65.8	71
Italy	46.84	61.18	53.3	37.3	47.1	48.4
Portugal	6.35	8.59	6.49	4.8	4.9	5.5

Source: Eurostat.

The practice till now was to treat such distortions as part of the conditionalities attached to financial bailout, but delegated the concrete measures to the member states eventually. This approach – while it complies with the principle of subsidiarity and has democratic legitimacy (provided that the reform agenda is established jointly by the national legislation and the executive) – has not yielded the desired results so far. Therefore, in addition to the Fiscal Compact and the Sixpack, complementing them (and thereby underlining their importance), the Community could implement regulations that show the EU does support the structural reforms.

The requirement of the Fiscal Compact about balance can only achieve the desired results if complemented by a similar requirement for the private sector as well. This is why signing a new pact aimed specifically at improving competitiveness is justified. *Mody* [2013] for example, puts forward a proposal for a banking sector compact and a competitiveness compact as well. The parties would have to adopt a common position for all three elements of equation (1). By now, of all the concepts aimed at

creating and maintaining stability in the eurozone, the need for creating a banking union has become widely accepted.[24] It is actually the single most important element that shapes discussions about economic governance, overshadowing concepts of the establishment of a fiscal union or ideas about how to improve competitiveness.[25] In connection to the latter, the Euro Plus Pact supported by the Franco-German was concluded also only as an intergovernmental treaty in the spring of 2011, its stated objectives being: improving competitiveness, increasing employment and pushing through structural reforms and their adoption at national level. However, its effect is dubious to say the least.[26]

Conclusion

The European Stability Mechanism in its current form is the explicit acknowledgement that the European Union is not planning to become a transfer union in the near future. And if this is so, the permanent transfer mechanism characterizing federal countries supported by the concept of optimum currency areas cannot be expected to relieve internal tensions in the European Union.

In the absence of a national currency and monetary policy member states in principle can recover from an external shock by using fiscal policy, that is, by adjusting taxes and public expenditures. However, the recently adopted Fiscal Compact significantly reduced the playing field of countries. With the new regulations those member states can expect the fiscal policy to act as a lightning conductor that have powerful automatic stabilisers in place. Interestingly, this can lead to the creation of fiscal discipline (at least with regard to government debt and annual deficit) by the states increasing the size of public finances, and within them those items that are sensitive to economic cycles.

The Fiscal Compact was clearly intended to guide member states that had competitiveness issues in the direction of internal depreciation by limiting the room for manoeuvre of fiscal policy. This meant making labour, goods and services markets more flexible. However, this realisation is not new at all, as ever since the ECB was established, that is, even in the years of great moderation, it underlined

[24] The heads of states and governments agreed in 2012 to create a banking union. As part of the banking union, a single supervisory mechanism, which is supervised by the ECB, and the single resolution mechanism were created. The third pillar of the banking union will be the European Deposit Insurance Scheme (Five Presidents' Report, 2015).

[25] For more about competitiveness see *Halmai* [2014], and *Kutasi* [2015].

[26] A recent study practically calls it dead (or seemingly dead), for more see EPSC [2015].

how important the ability to adapt was for survival (*Allsopp* and *Artis,* 2003). However, it is still a question whether the Fiscal Compact as an intergovernmental treaty in itself will be sufficient to guide or modify government conduct, or whether the stakeholders have to find other solutions that are also outside the jurisdiction of the EU.

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Mega-Regional Free Trade Negotiations

GYÖRGY CSÁKI

*World trade has vigorously expanded since WWII, and it is also true that international trade has never been so free as nowadays. However, the twenty-year history of the World Trade Organisation (WTO) has not been a success story at all. Since 1995, no major trade agreement has been achieved. The Doha Round, launched in late 2001, was officially suspended in 2006, and since then it has not been concluded – not even formally. Therefore, it is not surprising that so-called mega-regional free trade negotiations (that is, negotiations between large regions) have been launched in the very early 2010s, aiming to solve problems that were unsolvable under the auspices of the WTO. Taking into account the Trans-Pacific Partnership (TPP, already signed, but not yet entered into force), as well as the Regional Comprehensive Economic Partnership (RCEP) and Trans-Atlantic Trade and Investment Partnership (TTIP), which are under negotiation, the question remains: what kind of role will be left for the WTO (except for dispute settlement)? Is there any future for global (multilateral) trade negotiations?**

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In global economics, the period after the second word war was marked by the rapid expansion of international trade, the dynamic of which has become spectacular since the 1980–1990s, since the evolution of globalisation. In parallel with this, liberal tendencies have also strengthened. It is clear that this attitude of the developed countries has created the opportunity for the escalation of export-dynamics in the developing countries. It can be claimed that international trade is more free than ever before, because the custom level of products in the processing industry is negligibly

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low, quotas have been reduced, steel is not a sensitive product and the sensitivity of textile and clothing products has also decreased in international trade. The World Trade Organisation (WTO) has 162 members, including China (joining in 2001) and Russia (joining in 2012).

Nevertheless, the two-decade history of the WTO has not been a story of success. While the General Agreement on Tariffs and Trade (GATT) – additionally to reaching important trade policy agreements – concluded eight Rounds between 1948 and 1994, and during its existence the custom level of products in manufacturing has decreased below 3-4 percent from the particular height of the period before WWII, the WTO could not conclude a single Round during its twenty years history. The Doha Round, launched in 2001, was suspended in 2006 and it has never been relaunched or concluded ever since. Then in the second half of the year 2013 events started to accelerate.

The Doha Round and the limits of the functioning of the WTO

In November 2001, the Ministerial Conference in Qatar decided the timetable of the Round: negotiation "understanding" until May 2003; the creation of a multilateral register for the geographic indicators of international trade until 2003 (during the ministerial meeting in Cancún); the conclusion of all negotiations of the Round by January 1, 2005. However, in September 2003 the Ministerial Conference in Cancún has resulted in a complete failure. During the first 22 months of the Doha Round not a single agreement has been reached, and the Ministerial Conference agreed on a concluding ministerial statement consisting of 6 points and hardly 21 lines. As opposed to the planned time-line, the Doha working plan was only adopted on November 11, 2004, which categorised the most important trade policy issues around 17 questions.

The Sixth WTO Ministerial Conference was held in Hong Kong between December 13–18, 2005, where 149 members of the international organisation were represented. In Hong Kong, the member states were able to reach decisions on several questions, while the undecided ones were given a deadline: at this point the deadline for concluding the Doha Round was the end of 2006. However, the round was suspended "temporarily" on July 28, 2006, due to the unresolvable conflicts between the negotiating parties concerning the most important questions – agricultural customs and subsidies, industrial customs (*Cho,* 2006).

As a result of the 2007–2009 global financial crisis, in the global recession of 2009, international trade decreased. This was unprecedented since 1946. However, the sudden rise of protectionist pressure perished quickly, and international trade rapidly regained consciousness, which largely helped the world economy as a whole to get out of the recession (*Elekes,* 2012).

Negotiations about the Trans-Pacific Partnership and the Trans-Atlantic Trade and Investment Partnership between the US and the EU put pressure on the WTO and made it clear that the US and the EU are ready to go along with Japan and China, countries that have traditionally favoured bilateral trade policy agreements. Additionally, it has also become clear that a consolidation after a recession requires the expansion of international trade. And if the abolition of obstacles is not possible in a multilateral framework, then bilateral and group agreements have to be put forward. A new terminology evolved: beyond bilateral and multilateral trade policy negotiations, the new category of plurilateral agreements emerged, referring to negotiations in which more than two but not all WTO member states participate. Despite the optimistic statements of the leaders, neither the Ninth Ministerial Conference in December 2013 held in Bali, nor the Tenth Ministerial Conference in December 2015 held in Nairobi has brought the conclusion of the Doha Round significantly closer. Thus the future of multilateral trade policy negotiations is more uncertain than ever, including the fate of the WTO.

Mega-regional free trade negotiations

More and more regional trade agreements have emerged among WTO member states, which are both free trade agreements and custom unions. (The WTO has registered 267 regional trade agreements, including the custom unions with the new member states in the course of EU enlargements, and the similar enlargements of other regional integrations.) In recent years, however, larger negotiations have started to set up regional agreements among more countries than before, and some of these initiatives may be of great significance. These negotiations with potential world trade/word economic significance are called mega-regional trade negotiations, from which we will focus on three hereinafter.

Trans-Pacific Partnership

The Trans-Pacific Partnership (TPP) aims at expanding the trade relations of the Asian-Pacific region. It evolved from the Trans-Pacific Strategic Economic Partnership Agreement (TPSEP), which was a free trade agreement among Brunei, Chile, Singapore and New Zealand in 2005. However, the TPP covers a much wider range of topics, and its significance increased with the accession of the US. 12 countries participated in the negotiations: Australia, Brunei, Chile, the United States, Japan, Canada, Malaysia, Mexico, Peru, Singapore, New Zealand and Vietnam. According to the official American wording, the goal of the TPP is to expand trade and investment activities among the partners, enhance innovation and economic growth and facilitate job-creation and -preservation. The negotiations were held behind closed doors, which served as a base for the criticism of non-governmental organisations: for them these were neither transparent, nor controllable. The TPP agreement was signed on October 5, 2015.[1]

The negotiations took a severe turn, when Japan joined in 2013. The reason for this was that Prime Minister Abe Sinzo has attempted to revitalise the Japanese economy, which has stagnated since 1990, and the TPP may have a crucial role in its liberalisation (*Koike,* 2015). Nevertheless, the ratification of the TPP will not be easy in Japan either; the farming lobby finds it hard to accept that the current 38.5 percent custom levy on beef has to be reduced to 9 percent within 16 years (!).[2] Similarly endangered are the rice field terraces determining the Japanese landscape. However, the advantages are also apparent: meat-soup with noodles and the traditional beef dish, sukiyaki, prepared in closed ceramic pots, will become drastically cheaper for consumers, and it could not have been supposed that the unrealistically high anti-dumping tariffs could be maintained forever. The preservation of rice field terraces is feasible for touristism purposes, at the same time they can have an important role in the fight against climate change (*Koike,* 2015).

It seems that through the TPP, the US is able to achieve its main goals in the pacific region, namely the reduction of agricultural protectionism, the protection of intellectual property and the reduction of restrictions in some sub-sectors of manufacturing (such as vehicle production). Some may say that “the US is catching

[1] Without the necessary ratifications, it had not yet entered into force by June 2016 – and before the inauguration of the new President of the United States in January 2017, it is unlikely that the two houses of the Legislative will deal with it.

[2] Japan imports 870.000 tonnes of beef annually, from which 520.000 tonnes come from TPP signatories US, Australia and New Zealand (*Koike,* 2015).

a big fish with small bait" (*Hamada,* 2015, p. 2). Naturally, there were serious conflicts in relation to the US proposals to strengthen intellectual property rights, patents and copyrights. Also, the dispute settlement mechanism between investors and states was debated. According to the critics, traditional investment agreements are generally incompatible with the aspects of environmental protection and the protection of human rights, just as with the welfare regulations of states, thus it is to be feared that TPP will be weakened by environmental or labour laws and by the rules of damages of the signatory states. Trade unions, for example the AFL-CIO (the most significant US trade union federation), worry that the interests of large enterprise-empires will overshadow all other interests, including their employees'. The Washington DC based Public Citizen (a non-governmental organisation founded in 1971 for the protection of health, security and democracy) fears that due to the pressure of large companies, employment and wages will decrease, while the price of medicine will increase.

Although the TPP has been signed, its "ratification is far from certain, especially in the US. The concentrated interests that oppose the agreement may turn out to be more influential than the diffuse interests of all consumers" (*Boskin,* 2015, p. 3). The Japanese ratification can be trusted so long as the liberal democrats led by Abe Sinzo are governing (*Hamada,* 2015). However, the power relations are not clear in the US Congress, since Republicans – although theoretically always promote free trade – are not keen on promoting one of the greatest foreign successes of the soon-ending Obama-regime. The future international trade effects of the TPP could be completely different, if India joined the agreement – let alone, if China were to do the same!

Regional Comprehensive Economic Partnership

The members of the Association of South-East Asian Nations (ASEAN: Brunei, the Philippines, Indonesia, Cambodia, Laos, Malaysia, Myanmar, Singapore, Thailand, and Vietnam), and the six states which have free trade agreement with it (Australia, South-Korea, India, Japan, China, and New Zealand) are negotiating on the Regional Comprehensive Economic Partnership (RCEP). The sixteen negotiating countries have more than 3 billion inhabitants altogether (almost half of the world population!), in 2013 their aggregated GDP was 21,000 billion dollars according to the IMF, and in 2010 their trade amongst each other was up to 27 percent of the world trade according to the WTO. (NZMFAT, 2014) Model calculations based on general

equilibrium models suggest that in a decade, the RCEP could generate 260–644 billion dollar income gains in the world economy (*Wignaraja,* 2013).

The RCEP negotiations have officially been launched on November 20, 2012, during the East-Asia Summit with 16 heads of state and government leaders involved. The Joint Declaration by the Leaders, published on this occasion, promises the establishment of a "high-quality and mutually beneficial economic partnership agreement establishing an open trade and investment environment" (RCEP, 2012*b*). The Guiding Principles published before the launch of the RCEP stated in the introduction that the RCEP "will be consistent with the WTO, including GATT Article XXIV and GATS[3] Article V." and will go beyond the current free trade agreements, "while recognizing the individual and diverse circumstances of the participating countries" (RCEP, 2012*a*).

Seven questions have become part of the agenda of the RCEP: trade in goods, trade in services, investments, economic and technical cooperation, intellectual property, competition and dispute settlement. The agenda is open, other questions may be raised during the negotiations. The negotiations started in 2013 in the capital of Brunei, and according to the original plans, they should have been concluded by the end of 2015. From an optimistic perception, the RCEP could lead to a new paradigm in economic regionalism, and could be the basis for an Asian-Pacific free trade zone. Nevertheless, the negotiations are going to be particularly difficult: in theory all participating countries are aware of the advantages gained from the liberalisation of market access, but a lot of them have to face strong market protection pressure on their national markets. In the cases of India, Indonesia and Singapore even the question of market access is expected to create complications. The difficulties are increased, as it is particularly burdensome to create and maintain common market type integrations among countries with highly different levels of development: the deeper economic integration could cause serious social costs to the less developed countries. The participants of the RCEP negotiations must keep in mind that "the RCEP agreement is not the only option available for Asia Pacific regionalism. The ongoing TPP negotiations can also serve as an FTAAP model, giving the US a lead role in setting the agenda for a future regional architecture". (*Das,* 2014, p. 2)

The RCEP could help to regionalise global production networks, which could make Asia even more the world's industrial plant. It could reduce the overlap between

[3] General Agreement on Trade in Services (= GATS, in the framework of the WTO; the agreement was signed in 1994 as part of the Uruguay Round and GATS is part of the WTO since the January 1, 1995).

Asian free trade zones, the confusing diversity of trade laws, and – in line with the WTO rules – the Asian trade restrictions could be abolished.

The RCEP and the TPP: together or competing?

Due to the similarities of the two agreements, the RCEP poses a challenge to the TPP, even though the latter declared deeper integration goals, as it not only aims at establishing the free flow of goods and service, but it also intends to ease the free movement of investment and intellectual property. The RCEP declared more restrictive goals, apart from the free movement of goods, it only aims at removing the obstacles from the regional trade in certain services.

The main source of the potential conflict between the TPP and the RCEP could derive from the relationship between the US and China. Both powers want to be the leader of the East Asian and South-East Asian economic cooperation, in order to secure their economic interests. Consequently, the rivalry between the US and China will fundamentally determine the directions of the future development of the regional economic architecture. The competition between the TPP and the RCEP could also lead to a division within the ASEAN: Malaysia, Singapore and Vietnam focus on the promotion of the TPP, while the other ASEAN members favour the RCEP (*Pakpahan,* 2012). This division and the rivalry between the US and China could undermine the leading role of the ASEAN in the region. If the ASEAN wishes to preserve its central role in facilitating political and economic agreements in East- and South-East Asia, it should rather promote the RCEP – with the constant consolidation of its own regional role.

A further interesting element of the competition between the TPP and the RCEP is the role of an increasingly important actor of regional trade and world economy, India, and its ambitions in the mega-regional trade negotiations. India, after decades of passivity, has become more and more active in the last decade, and it has taken a more determined position in the international trade policy negotiations. This is nicely shown (also proving India's importance at the international level) by the fact that at the WTO Ministerial Conference in Bali, the concluding document could only be adopted after the US and India agreed with each other at the last minute (one day after the planned closure!), after the former respected India's concerns on questions of food security. Only so was the Bali package, touching on issues of trade facilitation, agriculture and on issues of the least developed countries, adoptable: this "has restored some degree of faith in the WTO". (*Lehmann–Fernandes,* 2014, p. 2)

The successful conclusion of the TPP may have a trade-diversion effect on India, but more likely, the danger of being side-lined from the global value-chains of transnational corporations in manufacturing and in the service sector is posing a bigger threat: the only alternative could be, if India introduces the TPP rules itself, in order for its companies to remain active in the countries joining the agreement.

Considering that the US takes part in two free trade negotiations crossing oceans, it is feasible that these mega-regional systems will function based on similar rules. This could lead to a higher regulatory convergence in level and quality than ever before: if India stays outside, then it will be left out from the rule-makers and will be condemned to follow the rules.

The RCEP is vital for India: it may rationalise her trade regulation system, it could lead to greater economic integration in East- and South-East Asia – from Japan to Australia. Through the RCEP, India could be more deeply integrated into those regional production networks that make Asia the world's industrial plant. India has a significant comparative advantage in information technologies and IT-based services – the RCEP could enable her to enter new markets. "It is vital for India to ensure that the RCEP is truly comprehensive and does not just focus on market access for goods. Keeping these benefits in mind, India will need second-generation reforms of its domestic economic policies, including those that reform its factor markets, to make its trade more competitive. These reforms will help India better access other markets, and will mitigate some of the repercussions for the Indian economy of the other two mega regionals." (*Chatterjee–Singh,* 2015, p. 3) The RCEP could mean a 2.4 percent income gain for India, primarily because the companies of the service sector – due to their existing comparative advantages in information technologies, business services, educational-vocational services and financial services – could enter the Chinese and other East Asian markets (*Wignaraja,* 2014. p. 1).

However, India – relying on her increasing role in international trade policy negotiations and especially on her leading role among the developing countries in the WTO negotiations – could choose another option. In the event she is left out from the leading countries of the mega-regional free trade negotiations, then the WTO could be the one and only existing and functioning forum for India that could connect her national considerations and her global trade ambitions.[4]

[4] "Thus the risks of trade isolation and of ending up as a rule taker are reason enough for India, in a post-Bali scenario, to play a more proactive role in the multilateral rules-based system. India can, and in our opinion should, play a greater role commensurate with its aspirations to be a major actor in the global arena." (*Lechmann–Fernandes,* 2014, p. 3.)

Meanwhile, trade policy cooperation between India and China could rearrange the almost eighty-year-old system of multilateral trade policy cooperation, or it could also completely paralyse them, along with the functioning mechanisms of the WTO, by dramatically changing its inner power relations.

Trans-Atlantic Trade and Investment Partnership

The trade between the EU and the US has the largest "two-way" turnover in the world; its value exceeds 2 billion Euros per day. Even though, they are particularly valuable trade partners for each other, within the WTO they are the two "members" initiating the most complaints against each other. The EU has made 96 complaints at the dispute settlement body against other WTO members, out of which 33 were against the US. 82 complaints were issued against the EU, and 19 times this was initiated by the US. In total, the US has made 109 complaints, 19 times against the EU and 23 times against one of the EU Member States. Out of the conflicts reaching the dispute settlement body of the WTO, the ones between the US and the EC/EU has represented the largest value. In 2002, the WTO authorised 2.4 billion dollars in sanctions against the US after the "steel war", while in the Airbus-Boeing subvention dispute the US was condemned for 5.3 billion dollars for subsidies violating WTO rules.

After such a prelude, it was surprising that in the summer of 2013 intensive negotiations started between the US and the EU with the aim of creating a comprehensive free trade agreement that would also cover investment rules. The goal of the Transatlantic Trade and Investment Partnership (TTIP) is to abolish the restrictions on trade in several production and service sectors. Beyond decreasing customs, the negotiations also deal with the easing and abolishment of non-tariff barriers, for example with the harmonisation of technical rules, standards and other procedures. The elimination of restrictions on the mutual flow of services and investments, as well as on public procurement procedures is also on the agenda of the negotiations.

The negotiations cover the following six topics: regulatory issues, the technical obstacles of trade, rules on food and agricultural products, public procurement, raw materials and energy, trade and sustainable development. The topics of the negotiations are divided into three main pillars: market access, cooperation between EU and US regulators and trade rules.

The launch of the actual negotiations in 2013 came as a surprise, even though the parties had started the preparations in a working group in 2011, which was led by

either the EU Trade Commissioner or the United States Trade Representative. The working group reached the conclusion, after carefully assessing the options provided by the Treaty and the potential difficulties, that a comprehensive agreement covering all sectors would lead to rather positive results, accelerating growth and increasing employment on both sides of the Atlantic-Ocean. Officially,[5] the prolonging world economic crisis, the multilateral negotiations in the WTO, the failure of the Doha Round, and the reform of the EU common agricultural policy; the high product prices all contributed to the launch of the negotiations.

According to an analysis prepared by the Centre for Economic Policy Research for the European Commission (*Francois,* 2013), the economy of the EU may annually gain 119 billion Euros of income due to the elimination of trade restrictions (545 Euros per household), while the annual gain of the US would be 95 billion Euros (655 Euros per family). The rest of the world could gain a profit of 100 billion Euros as a result of this grandiose free trade agreement. As stated in a most recent analysis (European Commission, 2016) the GDP of all EU Member States would increase by reaching the TTIP agreement, while the increase in the total export from the EU to the US would reach 27 percent.[6] The profits will be accompanied by negligible costs, since it would be resulting from the elimination of tariffs and other non-tariff barriers.

Considering that the tariff rates between the US and the EU are already low (4 percent on average), the abolishment of trade restrictions primarily means the elimination of non-tariff barriers (diverging rules, technical and plant-, animal-, and human health regulation, etc.), 80 percent of the gains would come from this.[7] "The case of drug approvals is a good example of how an issue like this has been addressed in the past. Here EU-US cooperation has reduced unnecessary duplication while maintaining, and even reinforcing, a high level of consumer protection. On both sides of the Atlantic – and for good reason – the approval process for new drugs is very thorough. As a result it's expensive and takes time. In the past, the fact that EU and US approval procedures were separate and different made the costs even higher. However, in recent years regulators have made huge strides towards bringing these procedures much into line with each other, meaning costs have been greatly reduced." (European Commission, 2013, p. 8.)

[5] See: http://ec.europa.eu/trade/policy/in-focus/ttip/

[6] The 400-page report open for public consultation will officially be finalised after comprehensive debates.

[7] The negotiation agenda of the TTIP also includes the mutual opening of public procurement procedures.

The first round of TTIP negotiations was held in Washington DC in July 2013.[8] If the negotiations are successfully concluded, the largest free trade zone in economic history would be created, eliminating trade and investment barriers between two developed market economies with 500 and 300 million inhabitants. This alone would be a huge step towards the creation of freedom of trade, which the world has been seeking to ensure for seventy years. This trade agreement would result in an enormous, connected free market, but the question remains: what would be its consequences for the rest of the world? Would it mean the exclusion/restriction of developing countries from this great "uniform" market? Also, would such a "bilateral" agreement endanger the strengthening efforts of the multilateral trade policy cooperation, which has been in existence since the foundation of GATT in 1947? (See on this: *Akman–Evenett–Low,* 2014).

The question is naturally very complex, and it is difficult to talk about common effects on third parties, especially those common to all the developing countries: for example, in Latin-America Chile, Mexico and Paraguay are part of the TPP and Mexico would be keen on joining the TTIP as well; Costa Rica, Colombia, and Panama officially expressed their intention to join the TPP. The Dominican Republic, Guatemala, Honduras, Nicaragua and Salvador have signed bilateral free trade agreements with the EU and the US (just as with other countries), but they are rather reserved when it comes to the mega-regional and plurilateral negotiations.

"Though Latin American countries may benefit from the additional growth that the mega-regional negotiations – if successfully concluded – may bring to the global economy, the impact on each country will be as varied as its position towards them. The more or less a country is connected to global value chains or the more or less reliant it is on exports of natural resources or on its own domestic market, may determine the direction and magnitude of the impact. Whether each country opts to resist or embrace these changes will also define its future standing in global trade. In thinking about a post-TTIP world, it is essential that TTIP be crafted as an inclusive agreement, where other nations may be invited to become members. If this were to be the case, several Latin American countries would be good candidates." (*González,* 2014, p. 2.)

Primarily, the TTIP is aiming at the elimination of non-tariff barriers, including first and foremost the harmonisation of rules and technical, or plant-, animal-, and human health regulations. In a number of cases, this harmonisation would simply

[8] The 14th TTIP Negotiation Round took place as of July 15, 2016 (European Commission, 2016*b*).

mean that the main actors of world trade would uniformly interpret the obvious results of natural sciences. These rules, however, require proper analytical and control systems (and products with proper quality!) from everyone, who wishes to enter the markets protected by these rules. Thus, one of the main questions from the perspective of world trade is, what effects these shared standards could have on the trade opportunities of third countries.

The elimination of the technical obstacles of trade can be divided into three main categories. The easiest, but at the same time the toughest option is the mutual recognition of the existing rules, in this case a country provides restriction-free market access to all the products that fulfil the standards of one of the interested countries. The second option is a certain harmonisation of standards. (In the EU this resulted in a forced adjustment to the strict standards of the most developed countries in case of health and safety standards.) The third option is the mutual recognition of each other's conformity assessment procedures. In this case country *"A"* accepts country *"B"'s* certifications that the product is in line with the requirements of country *"A"*. (Such are the mutual compliance agreements within the EU.)[9]

The US and the EU could take two important steps towards avoiding the harmful consequences of the TTIP on third countries (especially on developing countries). Firstly, mutual recognition should be favoured, which is a stronger liberalisation tool, but it does not contain any restricting rules of origin. In this case, not only the producers of the US and the EU would be able to provide for both markets by following the rules of any sub-market, but also producers of third countries would be afforded the same chance. Secondly, when harmonising rules, the less stringent original standard should be kept in force. If the stricter rules are made mandatory, then acceptable proof should be given that the less strict rule does not fulfil the original regulatory goal. (A similar principle is enforced by the WTO for the deviation from the existing rules.) If these two conditions were to be met, then the rest of the world, outside the US and the EU, could follow the TTIP negotiations with hope (*Matto,* 2013).

A similarly crucial question is the harmonisation of rules, and the convergence of regulatory systems. The share of the trade between the EU and the US within the world trade is declining, and this tendency is unlikely to change even with the

[9] A good example of the probable effects of TTIP on third countries could be the case, when in the late 1990s the EU decided to harmonise standards for aflatoxins in food: since eight member states – including Spain, Italy, and the Netherlands – had raised their national standards substantially, the African exports of cereals, dried fruits, and nuts to Europe declined by as much as $670 million annually (*Matto,* 2013).

signing and successful functioning of the TTIP: according to estimates, in 20 years the common share of the EU and the US of the world trade will be 22 percent, while the share of the ASEAN-6 group will reach 37 percent. The success of the TTIP would mean that the Euro-Atlantic region could preserve its leading role in adopting international trade norms, standards and other rules. "This is precisely what the TTIP is about – establishing coherence among existing rules and finding ways of defining new rules in common." (*Fontagné–Jean,* 2014, p. 1.)

The creation of coherence in rules and the adoption of new rules through the TTIP could also be highly important, as in this regard the WTO has been spectacularly unsuccessful in the last two decades. Thus the harmonised new rules of the TTIP could serve as an example for the countries outside the agreement, and it could also create pressure for convergence. This is the greatest global responsibility of the TTIP: the harmonised standards could become the new rulebook for 21th century world trade (*Novy,* 2014).

From a geopolitical standpoint, the TTIP – if it is signed and enters into force – could be an economic supplement to the NATO, thus its global significance would exceed its importance for world trade (House of Lords, 2014, p. 20.). Geopolitically, the openness of the TTIP is also highly important – especially if we consider the world economic significance and perspectives of China and India (and Brazil, South-Africa, Indonesia), none of which have even joined the TPP. However, without the involvement of the most important developing countries, the adoption of new rules can neither be truly effective, nor global!

The TTIP is in crossfire, it is attacked by many, from many directions. Some, for example the Nobel-prize winner *Joseph Stiglitz,* criticise it (along with the TPP) because according to them, it primarily serves corporate interests. *Stiglitz* claims that it is not about a free trade agreement, but about the occupation of international trade negotiations by corporations (*Stiglitz,* 2015*a* and *Stiglitz,* 2015*b*). On an internet site for Nobel-prize winners, he stated: "The TTIP is a particularly bad agreement".[10] Others contest that under a cost-benefit analysis, the TTIP shows only moderate results. Based on economic impact studies, an international trade union research institute reached the conclusion that "at the end of the day, the potential loss of democratic control over regulations and the consequences this might have for the benefits from regulations needs to be weighed up against the economic gains from

[10] See: http://www.nobelweb.org/joseph-stiglitz-2015-ttip-is-a-especially-bad-settlement/

the TTIP, which can be summed up as the equivalent of the cup of coffee per week for each person on both sides of the Atlantic." (*Myant–O'Bryen,* 2015, p. 32.)

A common subject of criticism was the lack of information, the unknown character of the planned treaty. Considering these criticisms, the European Commission published 30 fact sheets following the negotiation topics in a transparent manner, along with 20 EU position papers, 32 textual proposals, and 3 technical guidance documents on its website by May 31, 2016.[11]

After Bali: multilateralism or "plurilateralism"?

At the convocation of the 9th Ministerial Conference (March 2013), it was clear for the experts that the Doha Round and the WTO itself stand at a crossroads. Previously, a distinction could be made between bilateral and multilateral negotiations, where multilateral was automatically understood as a negotiation with all the WTO members participating. As the TPP and the TTIP negotiations have advanced, the category of plurilateral negotiations was established. This also indicates that in the future the significance of trade negotiations and possible agreements between certain groups of countries will increase, which naturally also means that the multilateral negotiations in the WTO, consisting of all the WTO member states, will be overshadowed.

Following the informal Ministerial Conference in July 2008, the Doha Round was still malfunctioning, and then the 8th Ministerial Conference in 2011 (in Geneva) officially declared that it had "reached an impasse". The negotiations restarted at the beginning of 2013, when the delegations contemplated a mini-package and an "early harvest" for the 9th Ministerial Conference. "In contrast to analysts' wishful claims, however, WTO members have repeatedly stressed that any early package would not be the end of the line, but rather a milestone to gather momentum for the full conclusion of the Doha Round." (*Karmakar,* 2013, p. 4.) Many experts evaluate the

[11] The Hungarian Parliament adopted a decision (under the number H-9798/12) on June 13, 2016 under the title *On the circumstances related to the trade and investment agreements between the European Union and third countries.* The decision directs the government that it shall consequently represent at the relevant EU forums the position that the CETA, the TTIP, and the TiSA are "mixed international agreements, which shall be ratified in each member state according to the constitutional rules and they cannot enter into force provisionally so long as all the EU member states have not ratified them." The 2nd point of the decision states that "the Parliament calls on the Executive not to support a free trade agreement, which endangers environment- and health-protection, food security, the current level of human rights- or labour law guaranties, and contains an antidemocratic dispute resolution procedure." It is clear from the text of the decision that it is an act without any real substantial significance, which is only able to create political uproar against the TTIP – and which was adopted by the Hungarian Parliament unanimously.

outcome of the Doha Round pessimistically, claiming that its programme is out-of-date, it should be concluded and a new round should be initiated that better reflects the present challenges of the world.

Most of the problems still concentrate on agricultural trade. The developing countries do not generally attack the agricultural subsidies schemes of the developed countries any more; their most important current claim is (with the previously rather passive India as the most determined actor) that the imbalances between the agricultural subsidy systems of the developed and developing systems should be corrected.

Nevertheless, not agricultural trade is the only problematic issue of global trade policy negotiations. Preparing for the post-Doha period, the questions of trade related to the global value-chains should be put forward, instead of the traditional North-South divide; the protectionism attached to the export sectors of developing countries shall also be eliminated; the also important, but non-trade problems should be excluded from the trade policy negotiations. Energy supply, exchange rate problems and sustainable development – these are crucial issues from the perspective of global governance, but should be put on the agenda of other, multilateral inter-governmental organisations.

The Ministerial Conference held in Bali avoided an embarrassing failure of the WTO, but we cannot say that due to Bali the international organisation has regained its central role in multilateral international trade policy negotiations. It is obvious that as the TPP and TTIP negotiations proceed, the WTO could easily loose control over international trade. The 10th Ministerial Conference held in Nairobi in December 2015 did not bring any substantial results either.

Mega-regional/plurilateral trade negotiations: the end of WTO?

Without doubt, the intensification of mega-regional/plurilateral free trade negotiations create(d) a new situation in the history of international trade policy negotiations that has been continuous since the second world war. Since only one mega-regional agreement has been signed, the easiest, and even that has not yet been ratified, it is early to talk about a new era of international trade policy cooperation, or about the end of the WTO, nevertheless, these two issues have never arisen in such a concrete form since the foundation of GATT in 1947 as it constantly has since 2013.

- The analysed trade policy/free trade negotiations make it clear that the bilateral versus multilateral categories of trade negotiations used so far have to be

supplemented with a third category, which can be called plurilateral. These are multi-actor, plurilateral negotiation series, in which not all WTO member states participate however. Considering that these are often negotiations between regions, they are also commonly described as mega-regional.

- It is also clear that the plurilateral/mega-regional free trade negotiations in progress are feeding on the failures of the WTO in the last two decades. The questions on their agendas are all the same as the unsolved problems of the WTO: non-custom restrictions, the problems of service-trade, global anti-discrimination, the encouragement of investments and the harmonisation of trade policy instruments, the protection of intellectual property, the connection of international trade and environment, the abolishment of protectionism of public procurements, etc. According to very optimistic views, mega-regional negotiations could lead to global free trade (*Palacio*, 2013). However, we must keep in mind that the expansion of world trade has permanently slowed down after the 2007–2009 financial crisis and global recession, thus the solutions have to be found in an adverse world trade environment for the old problems, which could not be solved multilaterally under the previous, much better conditions.
- It is a fact that for twenty years the WTO has been unable to conclude a single world trade round successfully – or at all! The Ministerial Conference at Bali in December 2013 (the ninth since the start of the WTO in 1995) "despite being sold as a success, does little more than accelerate the collection of customs duties." (*Sinn,* 2014, p. 1.)
- In the system of world trade of the 21st century, regionalism applies in three forms: the unilateral steps towards trade liberalisation do not pose a systematic threat to the WTO; bilateral investment protection agreements through trade agreements have been existing along the WTO for the last two decades, and so far have not caused any disturbance to the universal rules of international trade; the real threat is posed by the "deep" regional free trade agreements, which force the WTO out of its central rule-making role. Regional free trade agreements also undermine the role of the WTO in global rule setting (Baldwin–Nakatomi, 2015, p. 12).
- If the TPP and the TTIP will really be the rule-makers of the 21st century world trade, then they may undermine the only substantially and effectively functioning institution of the WTO: dispute settlement, and thus the functioning of the body responsible for dispute settlement. The ones that are left out (for example China, India, Brazil, Indonesia, South-Africa) have to accommodate to the rules of the

TTIP and TPP to some – clearly very large – extent, but the dispute settlement body of the WTO can neither be held responsible, nor thus sanction any rules adopted outside the WTO.

– The significance of the mega-regional negotiations from the perspective of the main actors, especially the US and the EU, goes beyond trade or economic questions in a wider sense – their geo-strategic significance is also dominant! "The Asia-Pacific region is increasingly influencing global developments, economic and otherwise. The TPP (…) would most likely accelerate this shift (all the more so if China eventually joins). (…) Europe must work to secure its position in the new world order – beginning by enhancing its own trade and investment ties with the US." (*Bildt–Solana*, 2015, p. 2.) *Jiři Šedivý* former Czech minister of defence considers the TTIP to be such an important fortress of the trans-Atlantic relations that can be only compared to the significance of the NATO (and it would provide a new meaning to the existence of NATO through strengthening the connection for the mutual defence cooperation of countries with shared values). "TTIP's strategic potential can hardly be overstated. It is crucial that technical objections, tactical considerations, or protectionist instincts not be allowed to eclipse the project's geopolitical importance. Failure to realize the possibilities created by the treaty would be a terrible economic mistake. It would also represent a major setback for transatlantic relations at a time when the West can least afford it." (*Šedivý,* 2015, p. 3.)

– The fundamental question is naturally the following: does the progress of plurilateral negotiations mean the end of multilateral, comprehensive trade policy negotiations covering virtually the whole world economy, or at least that these become irrelevant? What remains of the WTO beyond dispute settlement? *Pascal Lamy,* who previously led the WTO for ten years, thinks that the free trade system evolving from the rules and norms of the GATT/WTO has been one of the main pillars of the dynamic development in the post world war two era, while the lack of coherence among the mega-regional free trade negotiations could become an obstacle of development, meanwhile a functioning multilateral trade system would still be of crucial importance. "To be sure, the agreement reached at the WTO's recent ministerial conference in Bali represents a boon for world trade and multilateral cooperation." (*Lamy,* 2014, p. 3.)

– If the plurilateral/mega-regional free trade negotiations are concluded successfully, what effects will they have on non-concerned third countries? Is it possible that the two-third of the world countries, mainly the developing

countries, will be excluded from the substantial international trade policy negotiations? *Michael Boskin* states with a little euphemism that the free trade negotiations have largely contributed to the acceleration of economic growth, "regional free-trade agreements (FTAs), such as the TTIP, do so as well, but some of the gains may come at the expense of other trade partners." (*Boskin,* 2013, p. 2.) Also in the affected countries – despite the gains of the national economy – there may be some losers. "The best way to deal with the economic, political, and humanitarian concerns raised by trade agreements is via transition rules, temporary income support, and retraining, as opposed to maintaining protectionist barriers." (Ibid)

– Is the TTIP sensible in itself? Could a plurilateral trade and investment protection agreement be effective, which excludes the BRIC countries? "One of the most important, and equally ambiguous, objectives of these agreements relates to a subject that will not make any appearance in the texts: China. Both the US and Europe would like China to play the trade game by their rules. Negotiating these rules without China's participation can be viewed as part of a strategy aimed at eventually coaxing China into a liberal global system. But this approach can also be considered a way to isolate China and erect discriminating barriers against it in lucrative markets." (*Rodrik,* 2015, p.3.) In relation to the TPP, it can also be mentioned that one of its main goals is exactly the exclusion of China – since the main provisions of the TPP (labour rules, environmental standards, the protection of intellectual property, the reform of state-owned companies) prevent China from joining in the medium term. (See: *Serfati,* 2015, p. 19.)
– Assuming that from the discussed plurilateral/mega-regional negotiations more will be concluded successfully, with an agreement, the time-line of these conclusions is crucial (which is finished first, which fails?). How will the power relations of the world economy or world trade be effected by the failure of one or other of the multi-regional negotiations? This question has become highly important in light of the fact that the TPP was signed in September 2015. The power-players of the world trade possess different chances and opportunities in the mega-regional negotiations. The position of the US is the best, which is part of the already signed TPP and also the TTIP, which is considered to be the most important: thus it can play a key role in the harmonisation of the two great agreements, but it can also play them off against each other. This latter case would strike a blow against the chance of creating a global rule-based trade system (*Palacio*, 2013). After Japan joined the TPP, the power relations were

transformed: the island state is a primary trade and investment target of the EU, thus its devotion may be extremely useful for the creation and enactment of a balanced and progressive trade programme.

– The shared standards contained in the programme of the TTIP could mean a large step towards the mutual elimination of non-custom restrictions – but how will they affect third countries? How do they influence the export opportunities and market-access chances of the developing countries? Will the mutual recognition of the existing rules, the harmonisation of standards or the mutual acceptance of each other's conformity assessment procedures prevail? If mutual recognition is not coupled with restrictive rules of origin, and if the less stringent standard will be the governing one in the case of the harmonisation of standards, then the multi-regional free trade negotiations, especially the TTIP, could serve as some kind of a test for the creation of international standards adopted by the WTO, and then the effect on trans-Atlantic trade could really be favourable for all third parties (*Mattoo*, 2013).

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The Economic Sanctions Imposed by the European Union on the Russian Federation and the Law of the World Trade Organization

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*The escalation of the crisis in Ukraine reached a tipping point upon the annexation of Crimea by the Russian Federation, resulting in the European Union showing greater-than-ever capacity to demonstrate a cohesive foreign policy and to opt for the introduction of economic sanctions against the Russian Federation. Beyond general restrictive economic and commercial measures, these sanctions also include specific measures imposed on individuals as well as punitive economic diplomacy. Since the EU, its Member States and Russia are all members of the World Trade Organization, this raises the question of how these sanctions can be interpreted in the framework of WTO law. To this end, this paper intends to examine the general background to the sanctions, place them in the context of WTO law, and consider how these measures might claim to be justified.**

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1. Introduction

The escalation of the crisis in Ukraine reached a tipping point upon the annexation of Crimea by the Russian Federation, resulting in the European Union showing greater-than-ever capacity to demonstrate a cohesive foreign policy and to opt for the introduction of economic sanctions against the Russian Federation. The restrictive measures imposed by the Union are considered unilateral economic sanctions[1] – i.e. lacking a United Nations mandate – that suggest a combination of heterogeneous measures. Beyond general restrictive economic and commercial measures, such as the ban on military goods, dual-use products and technologies as well as the restriction of investment activity, the sanctions also include specific measures imposed on individuals as well as punitive economic diplomacy.

Since the EU, its Member States and Russia are all members of the World Trade Organization, this raises the question of how these sanctions can be interpreted in the framework of WTO law, and thereby how the EU's measures can be qualified. The article will attempt to investigate this relationship. Following the presentation of the general background to the economic sanctions imposed by the EU (*2. Background to the economic sanctions imposed by the European Union*) it places the sanctions into the context of World Trade Organization law (*3. The economic sanctions in light of WTO law*), and classifies the measures on the basis of WTO obligations, then hypothetically examines on what legal grounds they could be justified. A summary of the conclusions of the analysis follows in closing. (*4. Conclusions*).

2. Background to the economic sanctions imposed by the European Union

2.1 The introduction, goals and legal characteristics of the EU sanctions

The European Union's diplomatic efforts – intended to compel the Russian Federation to act decisively to prevent the further unravelling of the Ukrainian crisis, and to abandon its policy promoting escalation – had been proven ineffective by March 2014.[2] As a result, the Council decided to implement a new round of sanctions.

[1] The concepts of economic sanctions and embargoes will not be comprehensively discussed here due to space constraints and the applied nature of this article. See also: *Alexander* [2009], pp 8–28.; *Palásti* [2005].

[2] On the historic context of the escalation of the Russia-Ukraine crisis and the imposition of EU sanctions, see: *Mátyás* [2015a]; pp. 189–204; *Mátyás* [2015b]; pp. 157–174; *Horváthy–Nyírcsák* [2014];

The legislation passed as part of economic sanctions primarily contained restrictions on Russian and Ukrainian individuals (freezing of private assets and travel bans)[3], but subsequently, as the deepening conflict between Russia and Ukraine became almost reminiscent of war, the Council repeatedly amended the sanction legislation and expanded both the types and scope of application of the restrictive measures. The most recent substantive amendments were effected at the end of 2014[4] and the sanctions have been recently extended until September 15, 2016.[5]

The aim of the economic sanctions imposed by the European Union was to condemn and punish Russia for its role in the escalation of the Ukrainian crisis and the related legal measures build on two main objectives. First, as a general objective, the sanctions put pressure on Russia to abandon policies that escalate the Ukrainian crisis, i.e. any actions that undermine the territorial integrity and sovereignty of Ukraine, thereby endangering the stability and security of the region (e.g. cessation of military support for pro-Russian separatists). Second, the economic sanctions also constitute a response to the violations of human rights committed in Ukraine and to the annexation of part of Ukraine and are aimed at decision-makers, politicians, companies and other legal entities that can be held liable for the occurrence of these infringements. On the basis of these objectives, it is therefore evident that the economic sanctions imposed by the European Union serve the purpose of achieving broader foreign policy and security policy goals, and should be considered relevant not merely on the basis of their economic content. Hermann van Rompuy, former President of the European Council was therefore apt when he described the nature of the EU sanctions as belonging to the arsenal of foreign policy, and representing "not an objective in themselves, but a means of achieving an objective".[6]

and *Lekhadia* [2015], pp. 151–176. For an analysis of the background of Russian-Ukrainian relations, see: *Karácsony–Kocsis–Kovály–Molnár–Póti* [2014], pp. 99–134.

[3] See: Council Decision 2014/145/CFSP (OJ L 78/16, 17/03/2014); and Council Regulation (EU) No 269/2014 (OJ L 78/16, 17/03/2014).

[4] See: Council Decision 2014/855/CFSP (OJ L 344/29, 29/11/2014); and Council Regulation (EU) No 1290/2014 (OJ L 349, 05/12/2014).

[5] See: Ukraine territorial integrity: EU extends sanctions by 6 months (Press Release of the Council, 10/03/2016). Downloadable: http://www.consilium.europa.eu/en/press/press-releases/2016/03/10-ukraine-territorial-integrity/; and *Lester* [2016].

[6] EU strengthens sanctions against actions undermining Ukraine's territorial integrity (Council of the European Union; Press Release 8049/14; 21 March 2014). Downloadable: http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/141741.pdf.

2.2 Types of EU sanctions

According to the above, therefore, the economic sanctions are markedly easier to interpret as instruments of foreign policy rather than as legal instruments. However, it cannot be disputed that the Treaties lay down the basic legal framework, and thereby limit the European Union's scope for policy action when it comes to applying economic sanctions. In line with this, since no international (UN) embargo is in force relating to the Ukrainian crisis, the economic sanctions studied here may be considered autonomous instruments of the European Union (connected to its common foreign and security policy).

Three types of sanctions imposed by the European Union can be distinguished. Some are general economic and trade restrictions, others are restrictive measures on the assets and movement of individuals, and there are particular provisions of economic diplomacy.

The first category, namely economic and trade sanctions against the Russian Federation and the Crimean Peninsula entails the introduction by the EU of a general export and import ban on products on the Common Military List of the European Union.[7] These restrictions were subsequently extended to include the export of so-called dual-use goods and technologies, and special import restrictions were imposed on products from the Crimean region. An exception to these rules are cases where the "clean" origin of a product is certified by official Ukrainian documents.[8] In addition, certain investment activities are also subject to restrictions. These restrictions impact investments in Russia in the transport, telecommunications and energy sectors, including projects in oil and gas production as well as mining. The hold on investment was augmented by a ban on the export of vital products and technologies for these strategic sectors, with the provision of financial and insurance services related to such projects also being prohibited. The second category of sanctions includes the freezing of certain assets and shares as well as travel bans for individuals (natural persons and companies). According to the latest data (March 10, 2016), asset freezes and travel bans are in force against 146 persons and 37 companies, which includes a number of companies in the Crimean region whose ownership changed – in the wake of the annexation – in contravention of Ukrainian

[7] See: Common Military List of the European Union (equipment covered by Council Common Position 2008/944/CFSP defining common rules governing the control of exports of military technology and equipment, 17 March 2014), OJ C 107/1 (09/04/2014).

[8] See: Council Decision 2014/386/CFSP.

law.[9] Measures aimed at the freezing of assets include investments and economic interests of any kind of the persons designated by the EU provisions, including cash, cheques, bank deposits, stocks and shares, etc. In practice, this means that the persons concerned do not have access to, and cannot sell or transfer these assets. Travel restrictions affect individuals in that the person is denied entry into the European Union. The Council maintains the list of sanctioned persons in addenda to the legislation while also providing for legal remedy: the persons concerned have the right to comment on the list, as well as the opportunity to challenge the Council decision at the European Court of Justice.[10] In addition to the previously discussed types, the second category also includes specific restrictions imposing obligations on EU citizens and businesses in the context of the action against Russia. Of particular note are restrictions on Russian state-owned banks, based on which EU citizens and businesses may not conduct financial transactions with the banks under sanctions, nor trade in financial instruments (bonds, etc.). Consequently, economic sanctions in this category do not only impact foreign persons, but may also restrict the activities of EU citizens and economic entities.

The third category includes specific punitive measures of economic diplomacy against Russia, which were introduced by the European Union in order to enhance the political clout and effects of the economic sanctions. This includes the Council decision requesting that the European Commission reassess, on a case by case basis, partnership programmes between the EU and Russia, and to suspend certain programs.[11] Exempt from this review are programmes implementing cross-border cooperation, as well as those involving Russian civil society. Furthermore, the Union

[9] See: The current list of persons and entities under EU restrictive measures is available in the Annex of the consolidated version of Council Decision 2014/145/CFSP. Downloadable: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02014D0145-20160313&from=EN.

[10] Of the procedures started, a decision has so far been reached in the case of Andriy Portnov, former deputy leader of the Ukrainian president's administration: the Court upheld Portnov's appeal, annulled the freezing of his assets and stated that listing Portnov's name had not complied with the criteria for listing a person subject to the freezing of assets. See also other cases before the Tribunal involving well-known persons: T-331/14 Mykola Yanovych Azarov v. Council (Prime Minister of Ukraine 2010 to 2014); T-339/14 Serhiy Vitaliyovych Kurchenko v. Council (Ukrainian businessman); T-347/14 Viktor Fedorovych Yanukovych v. Council (President of Ukraine 2010 to 2014); T-434/14 Sergej Arbuzov v. Council (Prime Minister of Ukraine February to January 2014); T-717/14 and T-720/14 Arkady Rotenberg v. Council (Russian businessman). The cases involving companies include the proceedings initiated by the Russian oil company Rosneft: T-715/14. NK Rosneft et al v. Council.

[11] See: EU sanctions against Russia over Ukraine crisis. European Union Newsroom. Downloadable: http://europa.eu/newsroom/highlights/special-coverage/eu_sanctions/index_en.htm.

last year cancelled a planned EU-Russia summit[12] and decided against holding the usual bilateral negotiations, among others suspending negotiations on visa policy cooperation and on a new partnership agreement. As a joint diplomatic move, EU Member States prompted the suspension of accession negotiations between Russia and the OECD, as well as its associated International Energy Agency. In addition, the 40th G8 summit, originally planned for Sochi last year was cancelled, and instead, a G7 meeting without Russia was held in Brussels on June 4–5, 2014.[13] Also of significance is that the European Council on July 16, 2014 urged the European Investment Bank to postpone the signing of a new financing scheme for Russia,[14] with Member States indicating that they would be taking similar steps before the Board of Directors of the EBRD regarding approval of new funding schemes.

3. The economic sanctions in light of WTO law

3.1 Preliminary legal classification of the sanctions

Out of the components of the economic sanctions imposed by the European Union discussed above, of primary significance are those trade related provisions that can be shown to fall under the scope of WTO law. For this reason, we cannot assess here the measures of economic diplomacy, presented above, and aimed at limiting Russia's room to manoeuvre within international economic relations; similarly, sanctions limiting movement of individuals also bear no relevance here. Consequently, in terms of WTO law, what may be assessed are the restrictions on weapons, dual-use products, goods and services related to special investments, the import ban on goods from the Crimean and breakaway territories, as well as restrictions on business transactions involving certain companies on blacklists.

[12] See: EU restrictive measures in view of the situation in Eastern Ukraine and the illegal annexation of Crimea (Council of the European Union, Background Note, Brussels, July 29, 2014). Downloadable: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/144159.pdf.

[13] See: The Brussels G7 Summit Declaration (European Commission, Memo, Brussels, 5 June 2014). Downloadable: http://europa.eu/rapid/press-release_MEMO-14-402_en.htm.

[14] See: EU restrictive measures in view of the situation in Eastern Ukraine and the illegal annexation of Crimea (Council of the European Union, Background Note, July 29, 2014). Downloadable: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/144159.pdf.

At first glance, these sanction measures are contrary to the principle of *most favoured nation treatment*[15] that requires a Member State of the WTO to grant, in respect to its provisions on imports and exports, other Member States any discount immediately and without conditions, which the Member State in question provides to third-party states. Stated another way, this means that a Member State of the WTO must not give less favourable treatment to another Member's product than that which it gives similar products of other countries, i.e. underlying this is the principle of non-discrimination. GATS also incorporates the principle of most favoured nation treatment,[16] therefore the principle also involves the aspects of the EU sanctions on trade in services, such as the ban on oil industry investments or the activities of banks. In addition, the sanctions imposed by the EU are not compatible with the principle of *national treatment* (equal treatment). Under this principle, WTO members may not give products of other Member States inferior treatment from a regulatory perspective, than they do their own domestic products.[17] Therefore, upon initial assessment, it can be concluded without any doubt that certain elements of the economic sanctions imposed by the European Union are in breach of the above principles, i.e. the EU's obligations based on GATT 1994 and GATS. Thus the question arises of whether or not WTO law provides a legal basis for the exemption of such measures, that is, if it indeed justifies, by way of exception, the economic sanctions introduced by the EU in breach of the above principles. Putting aside exceptions that can be excluded *prima facie*,[18] the only exceptional provision whose application could reasonably be considered within the framework of the facts is a reference to the essential security interest.[19] We will subsequently focus on this exception provision.

[15] See: Article I of the General Agreement on Tariffs and Trade ("GATT"). If there is express significance of the citing of the earlier revision of the GATT text, this will be indicated by the expression "GATT 1947"); Published in: Council Decision 94/800/EC concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay Round multilateral negotiations (1986-1994) (hereinafter: "WTO Treaty"), Appendix 1 (b), OJ L 336 (23/12/1994) page 1.

[16] WTO Treaty, Appendix 1 (b): General Agreement on Trade in Services (GATS) Article II paragraph (1). GATS defines the principle of most favoured nation treatment as follows: "With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country."

[17] See: GATT Article III.

[18] Because of the special facts of the case, the general exceptions (GATT Article XX) do not apply and any other exemption allowing deviation from the principles is also logically excluded, such as free trade zones and customs unions (GATT Article XXIV).

[19] See: GATT Article XXI and GATS Article XIV*bis*.

3.2 National security exceptions in GATT and GATS

The provision on *essential security interest* had been present in the original 1947 text of GATT, and was left unchanged by the 1994 revision. This same text was also used in Article XIV*bis* of GATS. On the whole, this exception provides Member States vital leeway in cases where their essential security and their national security or security policy interest is at stake, and in such cases authorizes them to derogate from the obligations laid down by GATT 1994 and GATS. It identifies three types of justification for this. First, Member States may refuse any provisions that would oblige them to issue information the disclosure of which would be contrary to the security interests of the Member State.[20] Second, it authorizes Member States to freely take measures necessary for the protection of their national security interests, specifically referring to the trade in arms, munitions and war material, as well as to times of war and to other emergencies in international relations.[21] As the third option, it reaffirms that Member States may take measures to implement their tasks serving the maintenance of international peace and security under the UN Charter.[22] Of these three cases, the second bears substantive significance in the context of EU sanctions, with the applicability of the third option requiring further analysis.

3.3 Justification of the essential security interest based on past practice

Past practice involving national security exceptions is restricted to a few concrete disputes, and so far no final decision has ever been issued in any dispute settlement procedure where a Member State has successfully based its justification of restrictive measures on the exception provisions of GATT Article XXI or GATS Article XIV*bis*. However, some concrete cases in practice – without exception involving

[20] See: GATT Article XXI section (a): " [Nothing in this Agreement shall be construed] to require any contracting party to furnish any information the disclosure of which it considers contrary to its essential security interests […]".

[21] See: GATT Article XXI section (b): "[Nothing in this Agreement shall be construed] to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests (i) relating to fissionable materials or the materials from which they are derived; (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment; (iii) taken in time of war or other emergency in international relations (…)."

[22] See: GATT Article XXI section (c): "[Nothing in this Agreement shall be construed] to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security."

GATT Article XXI – where consideration of national security interests was raised, suggest criteria that are relevant to the evaluation of the case in point.

Applicability of GATT Article XXI was raised for the first time in proceedings[23] brought by Czechoslovakia against the United States in 1949, the subject of which were export controls and a licensing system introduced by the USA. According to the United States, these restrictive measures were needed for national security reasons, and were applicable only to a narrow range of goods usable for military purposes. The basis of the measures was cited to be GATT Article XXI section (b) paragraph (iii), i.e. it referred to an emergency in international relations to justify the measures. The contracting parties to GATT subsequently rejected Czechoslovakia's application[24] and did not set up a working group for an inquiry into the dispute.[25] In addition, no definition of the essence of the essential security interest had been formulated, which at the end of the negotiations Czechoslovakia interpreted as Member States themselves being able to determine what measures they consider necessary for the protection their security interests.[26] While not considered formal dispute resolution, the relevance of GATT Article XXI was broached in connection with Portugal's accession in 1961. At that time, Ghana maintained a boycott of goods originating from Portugal, in response to the Portuguese Government's policy towards Africa, specifically in reference to the crisis in Angola. Similarly to the previously discussed case, Ghana also cited GATT Article XXI section (b) paragraph (iii) as the basis for its restrictive measures and concluded that both concrete or potential dangers may threaten the security interests of a state.[27] In 1975, in the case of a ban introduced by Sweden on footwear used by the military,[28] reference was also made to GATT Article XXI, however, that case also did not make it to formal dispute resolution. Sweden argued that the import ban served to maintain – in reality, protect – its crisis-hit domestic production, a measure necessary for Swedish national security policy.[29] Member States made an important determination to the effect that GATT Article

[23] See: US – Export Restrictions, GATT/CP. 3/SR.22 (8 June 1949), Third Session – Summary Record of the Twenty-Second Meeting, pp. 4–10. Downloadable: https://www.wto.org/gatt_docs/English/SULPDF/90060100.pdf. Case cited by: *WTO* [2012]; *Lekhadia* [2015], p160.

[24] See: US – Export Restrictions, pp. 8–10.

[25] This initial case arose before the establishment of the WTO panel.

[26] See: US – Export Restrictions, p. 10.

[27] Summary Record of the Eleventh Meeting, SR.19/11/Corr.1 (28 December 1961), p. 196. Downloadable: https://www.wto.org/gatt_docs/English/SULPDF/90280183.pdf.

[28] Sweden – Import Restrictions on Certain Footwear, L/4250, November 17, 1975. Downloadable: https://www.wto.org/gatt_docs/English/SULPDF/90920073.pdf.

[29] See: Sweden – Import Restrictions on Certain Footwear, p. 3.

XXI does not require consultation, i.e. a state whose interest is served by restrictions may take the necessary measures unilaterally.[30] As elsewhere, it is apparent in this case that the applicability of the article is greatly influenced by who is able to interpret the scope of GATT Article XXI, i.e. in this case, for what types of military-use footwear a restriction could be acceptably justified. In other words, whether the Member State itself is allowed to autonomously determine the scope of goods considered national security risks, or whether there are objective conditions for that.[31] These questions still remain unanswered.[32] The past case closest to the current sanctions against Russia concerns the economic sanctions imposed on Argentina by the EEC, Canada and Australia, the background to which was the armed conflict in the Falkland Islands between the United Kingdom and Argentina, as well as the implementation of the subsequent UN Security Council decision 502 of 1982.[33] As a result of the negotiations of the GATT contracting parties, a separate decision was adopted on issues concerning the application of GATT Article XXI.[34] The importance of the decision lay in that it clarified several procedural issues around the application of the national security exception. First, it stated that signatories subject to restrictions must be provided the broadest possible information by the sanctioning state about the measures implemented. Above all, this was meant to clarify the application of the exception referred to by GATT Article XXI section (a). In other words, it sought to prevent interpretation of the above-mentioned GATT Article XXI section (a) in a way that allowed the sanctioning state to fully restrict the disclosure to the affected state of information relating to the sanctions. Second, it also made it clear that states subject to sanctions retain all their rights deriving from their GATT membership. Last, the decision authorized the GATT Council to specify, on request, further criteria with reference to specific economic sanctions. The decision did not address the substantive issues, however, two additional aspects are evident from the text. Firstly, the wording of the document implied that judging the existence

[30] See: GATT Council Meeting, Minutes of Meeting (November 10, 1975), C/M/109. p9. Downloadable: https://www.wto.org/gatt_docs/English/SULPDF/90430147.pdf.

[31] To use a concrete example: the connection between army boots and the essential security interest is palpable, but it is questionable whether a state should be able to restrict trade, for example, in slippers used by the military.

[32] *Alford* [2011], pp. 704–705.

[33] The decision acknowledged that the UK may cite self-defence if Argentine troops did not leave the Falkland Islands. See: Resolution 502 (1982) of April 3, 1982. Downloadable: http://www.un.org/ga/search/view_doc.asp?symbol=S/RES/502%281982%29.

[34] See: Decision concerning Article XXI of the General Agreement (November 30, 1982), L/5426 (2 December 1982). Downloadable: https://www.wto.org/gatt_docs/english/SULPDF/91000212.pdf.

of national security interests is at the full discretion of Member States.[35] Secondly, the decision clearly stated that signatories introducing restrictions must take into account the interests of affected third states.[36] It is also worth mentioning the dispute in the wake of the embargo imposed by the United States on Nicaragua in 1985. The United States cited GATT Article XXI as justification for the economic sanctions on the grounds that the revolutionary Sandinista leadership governing Nicaragua at the time posed a real threat to US national security and foreign policy.[37] Nicaragua rejected this argument, and requested that a panel be set up. However, since the panel's authority did not allow it to examine the USA's justification referencing GATT Article XXI, i.e. it had to take for granted the existence of the national security interest cited by the USA, the panel in its conclusions could not state that the USA had complied with the requirements arising from GATT Article XXI, nor that it was in violation of its obligations under GATT.[38] The limited authority of the panel and its self-restriction allows us to conclude that GATT Article XXI leaves to Member States the justification of the existence of the national security interest, i.e. it is up to each Member State's judgement and discretion what it considers circumstances essential to its security. After the establishment of the WTO, there has been one case under the new dispute settlement proceedings where the possibility of exemption based on GATT Article XXI was raised: the dispute settlement procedure initiated by the EC against the United States,[39] in the wake of the sanctions introduced by the Helms Burton Act.[40] The restrictions imposed by the USA included sanctions on goods of Cuban origin, entry restrictions on Cuban nationals and other economic sanctions against Cuban companies. The EC argued that the embargo measures violated several obligations arising from GATT. According to the US, imposition of

[35] See: Decision concerning Article XXI of the General Agreement, first paragraph of the preamble: "Considering that the exceptions envisaged in Article XXI of the General Agreement constitute an important element for safeguarding the rights of contracting parties when they consider that reasons of security are involved"

[36] See: Decision concerning Article XXI of the General Agreement, third paragraph of the preamble.

[37] *Lekhadia* [2015], pp162–163. and *Bossche–Zdouc* [2013], pp. 597–598.

[38] US – Trade Measures Affecting Nicaragua (Report by the Panel, L/6053, October 13, 1986), 5.3. Downloadable: https://www.wto.org/gatt_docs/English/SULPDF/91240197.pdf.

[39] US – The Cuban Liberty and Democratic Solidarity Act (Helms Burton) (DS38).

[40] See: The Cuban Liberty and Democratic Solidarity (Libertad) Act of 1996 (Helms–Burton Act, Pub.L. 104–114, 110 Stat. 785, 22 U.S.C. §§ 6021–6091). The federal law was intended to further tighten the embargo on Cuba. A 1996 incident in which the Cuban air force downed two private aircraft flying American colours played a part in the bolstering of the legislation. The aircraft were operated by an association established by Cuban refugees, and which they used to regularly fly into Cuban airspace to spread flyers.

sanctions served its essential security interests, and also cited the fact that it was not considered entirely commercial in nature, so it argued that the dispute did not fall within the scope of the provisions of GATT-WTO.[41] After consultation, the Dispute Settlement Body set up a panel, but later suspended its proceedings at the request of the EC, and eventually the proceedings ended without a decision on the case's merits. Lastly we should note that the facts in GATT Article XXI section (c), i.e. taking measures to implement tasks serving the maintenance of international peace and security under the UN Charter has not been cited in any dispute settlement case so far. Similarly, there has not been any past practice to date involving the exception provision in GATS Article XIV*bis*, however, since the text of that article is identical to GATT Article XXI, the past practice examined above is also applicable to GATS.

3.4 The application of the national security exception to the EU sanctions against Russia

Taking into account the criteria set out above from past practice, the relevance of the national security exception for trading in goods arises for GATT Article XXI sections (b) and (c), whereas for trading in services, the application of GATS Article XIV*bis* may be relevant. The exception in GATT Article XXI section (a) does not bear significant relevance, since the economic sanctions imposed by the EU were adopted and published in a transparent way as part of the foreign and security policy decision-making process, so justification on the retention of information is likely not necessary. It is important to note, moreover, that GATT Article XXI – and also similarly GATS Article XIV*bis* – does not define additional criteria beyond the aforementioned exceptions, i.e. it does not contain requirements like the introductory provisions of GATT Article XX (the so-called *chapeau*). Accordingly, the application of the exception provisions and justification of the EU's restrictive provisions – hypothetically – could unfold in the following way.

3.4.1 Applicability of GATT Article XXI section (b)

When applying the exceptions under GATT Article XXI section (b), the EU must justify the existence of national security interests, the necessity of the action and the circumstances of any special cases (trade in fissile material or weapons and war or emergency). Justification of the existence of the national security interest

[41] See: Minutes of DSB meeting of October 16, 1996 (WT/DSB/M/24), p. 7. Downloadable: https://docs.wto.org/dol2fe/Pages/FE_Search/DDFDocuments/21715/Q/WT/DSB/M24.pdf.

in the case of the European Union sanctions provides much leeway, since on the basis of the above-mentioned practice (above all, the Czechoslovakia–USA trade dispute and the decision issued on the embargo by the EEC, Canada and Australia on Argentina) the determination of the national security interest is at the discretion of the state concerned. In particular, the argument appearing in the US-Nicaragua dispute implies that the merits of such a decision on the existence of the security interest cannot be examined from above.

As a result, it is up to the discretion of the EU to determine the extent to which the Russian-Ukrainian crisis, deepening in the wake of the annexation of Crimea, is considered a threatening circumstance to the national security and foreign policy of Member States. Such a circumstance could be the fact that the Russian Federation had violated the sovereignty of Ukraine, had engaged armed forces, something the heads of state and government condemned in their declaration of March 6, 2014 and also called on Russia to immediately recall its forces to their permanent bases in accordance with the relevant agreements.[42] In addition, the aspects emerging from the Portugal–Ghana dispute further expand the room for manoeuvre in that according to the arguments therein, not only actual but potential security risks may also be cited as circumstances threatening the national security interest. Another question is what requirements to apply for the justification of necessity. In contrast with GATT Article XX, which in the case of several facts requires the express justification of necessity, it is a plausible interpretation of GATT Article XXI that proof of necessity is merely a formal requirement. This can be deduced grammatically from the wording of the text, which refers to a national security interest "*which [the contracting party] considers necessary*". It also follows logically from the above that if the definition of a national security interest is entirely at the discretion of the Member State, then the national security interest thus freely declared also in itself implies that the sanctions imposed are necessary for the protection of this interest. Thus if we accept broad discretion, the latter interpretation seems probable.

Finally, it should be noted that in justifying the special circumstances in the context of the application of the EU sanctions, GATT Article XXI section (b) paragraph (i), which justifies restrictions on fissile materials, is irrelevant for the case in point. In contrast, either of the other two options may be considered as the legal basis for justification. In the cited paragraph (ii) the provisions on the traffic in arms, ammunition and implements of war for the purpose of supplying a military

[42] See: Council decision of 2014/145/CFSP, first paragraph of the preamble (OJ L 78/16, 17/03/2014).

establishment are related to the parts of the EU economic sanctions dealing with the arms embargo. Due to the aspects of past practice, however, it is not determined whether this exception is applicable to dual-use goods such as war supplies serving, among others, military establishments. Fundamentally, deciding this point is not necessarily essential, since of the third basis for exception, i.e. the special circumstances in paragraph (iii), namely war or other emergency in international relations, the latter appears to be justifiable in the context of the escalation of the Russian-Ukrainian conflict. This exception allows for the justification of provisions with substantially broader and general scope and without specific focus on particular goods and, could therefore, if necessary be applied to restrictions on dual-use products. The interpretation of "other emergency" is not clear, but as before, the grammatical interpretation here also allows for a great degree of discretion. In addition to war, "other emergency" could mean a broader set of international conflicts, however, on the basis of the context, these are supposedly serious conflicts in essence comparable to war.[43] In cases relying on this as the legal basis for justification, it is therefore assumed that the grave nature of the crisis cited would play a role, however we could not find examples in past practice which would provide guidance for this issue. Of the previously cited examples, the boycott imposed by Ghana on Portuguese goods is comparable to the Russia–Ukraine crisis. In this case, Ghana claimed that the crisis afoot in Angola constituted a continued threat to peace and security in the whole of Africa, and used this to cite GATT Article XXI section (b) paragraph (iii), but as mentioned above, the proceedings did not result in a decision on the merits of the case. Consequently, in justifying the EU sanctions, the events following the annexation of the Crimean peninsula, tacit support for armed resistance in breakaway areas and the consequent crisis may be argued to support the reference to "other emergency".

3.4.2 Applicability of GATT Article XXI section (c)

Although, in contrast to the legal basis for justification discussed in the previous section, GATT Article XXI section (c) has no substantive past practice, the interpretation of the exception regulated in this section leaves fewer questions unanswered. This exception concerns restrictive measures by WTO Member States which are taken in pursuance of their obligations under the United Nations Charter for the maintenance of international peace and security. Thus, this section exempts Member States' commercial embargo provisions that are introduced on the basis

[43] *Singh* [2012], p. 20.

of Article 41 of the UN Charter,[44] with the authorization of the Security Council. These sanctions are binding on UN Member States according to Article 25 of the UN Charter,[45] therefore GATT Article XXI section (c) serves to resolve the conflict arising from this.[46] In contrast with the facts discussed in the previous section, this ground for exception is substantially more precise since its applicability depends solely in the existence of a UN mandate. However, since the economic sanctions imposed by the European Union on the Russian Federation were introduced unilaterally rather than on the basis of a UN mandate, this possibility for exception has no consequence in this case.

3.5 Counter-sanctions introduced by the Russian Federation

Although the analysis is aimed primarily at evaluating sanctions introduced by the EU, Russia's counter-sanctions must be mentioned. Vladimir Putin signed a presidential decree[47] on August 6, 2014, banning the import of foodstuffs from the European Union – and not incidentally, from the United States, Australia, Canada and Norway – in response to the economic sanctions imposed by the West. The ban affects the import of beef, pork, poultry, fish, vegetables, fruit, cheese, milk and other dairy products to Russia. Since Russia is the EU's second largest export market for foodstuffs with a 10% share,[48] the full ban seriously impacted the EU's food industry; the agricultural sector in particular faced severe negative effects with Russia being the largest importer of EU vegetable and fruit.[49] The European

[44] UN Charter Article 41: "The Security Council may decide what measures not involving the use of armed force are to be employed to give effect to its decisions, and it may call upon the Members of the United Nations to apply such measures. These may include complete or partial interruption of economic relations and of rail, sea, air, postal, telegraphic, radio, and other means of communication, and the severance of diplomatic relations."

[45] UN Charter Article 25: "The Members of the United Nations agree to accept and carry out the decisions of the Security Council in accordance with the present Charter."

[46] Note that no substantive conflict arises, since the UN Charter itself sets this out in Article 103: in the event of a conflict between the obligations of the Members of the United Nations under the Charter and their obligations under any other international agreement, their obligations under the Charter shall prevail.

[47] See: Government meeting – On measures to implement the Presidential Executive Order On Applying Certain Special Economic Measures to Ensure the Security of the Russian Federation. (7 August 2014). Downloadable: http://government.ru/en/news/14199/.

[48] See: Russia hits West with food import ban in sanctions row. BBC News, (August 7, 2014). Downloadable: http://www.bbc.com/news/world-europe-28687172.

[49] See: Moscow retaliates with import ban on EU, US food. Euractiv, (August 7, 2014). Downloadable: http://www.euractiv.com/sections/europes-east/moscow-retaliates-import-ban-eu-us-food-307770.

Commission tried to react quickly and took immediate measures to aid the dairy, vegetable and fruit sectors, while as a medium-term measure, boosting by EUR 30 million[50] the funding for financing schemes launching this year under the auspices of the Common Agricultural Policy. In addition to the compensatory measures, the Foreign Affairs Council on August 15, 2014, politically condemned[51] the Russian sanctions and – using somewhat more diplomatic wording – expressed its expectation of third party states and of candidate countries for EU membership to refrain from taking measures that could exploit the economic sanctions imposed against the EU. Even without detailed legal examination of the Russian counter-sanctions, it can be surmised that based on WTO law, the Russian measures raise the same issues that we analysed above in connection with the EU sanctions. Specifically, the Russian measures also violate GATT principles and this is unchanged by the fact that these measures were brought by Russia – effectively as retaliatory instruments – in response to the EU sanctions. Neither would it affect the merits of the classification if we assumed – by way of a thought experiment – that justification of the sanctions was not sufficient. Differently put, the EU economic sanctions, even if hypothetically considered infringing, do not grant legal authorization for Russia to automatically and immediately introduce countermeasures. Such sanctions should only be imposed if the European Union was ruled against in a dispute settlement procedure, after which the EU did not comply with the decision of the dispute resolution proceedings and finally, the Russian Federation received express authorization from the Dispute Settlement Body to introduce counter-sanctions. Because these conditions are not met, justification of Russia's measures is only possible in the manner mentioned above, principally on the basis of the essential security exception.

4. Conclusions

Justification of the sanctions imposed by the EU may be possible by reference to the essential security interest. GATT Article XXI grants great discretion for

[50] See: Boost for promotion of EU agricultural products as medium-term response to Russian embargo (European Commission, Press release, September 3, 2014). Downloadable: http://europa.eu/rapid/press-release_IP-14-961_en.htm.

[51] See: Council conclusions on Ukraine (Council of the European Union, Press release, August 15, 2014).
Downloadable: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/144314.pdf.

justifying the existence of an essential security interest and of special circumstances, but fundamentally due to the slight significance of relevant case history, the correct interpretation of the specific provisions of the exception clauses is not clear in all respects. In addition, both past practice as described above and the case in point clearly demonstrate that economic sanctions are considered instruments that can be interpreted by way of trade policy considerations, but in practice their fundamental objectives unavoidably stretch considerably beyond trade policy, and viewed from that perspective, they may appear to merely serve foreign policy. That is important because this nature of economic sanctions inherently makes legal review difficult and hard for these instruments to be legally "transformed" into WTO proceedings. A direct consequence of this is that Member States instead opt to manage their disputes on economic sanctions outside the WTO. The above notwithstanding, it is questionable whether the dispute settlement mechanism is in fact capable of deciding on the merits of Member States' disputes involving sanctions, since behind each one is a disagreement of a political or foreign policy nature. Based on all of this, it is likely that the questions raised by the EU economic sanctions introduced against the Russian Federation will not be answered by dispute resolution proceedings, but will instead be settled through international negotiations.

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