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The efficiency of public spending on education: Lower and higher secondary education

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Abstract

Research on the efficiency of public spending on the education sector hardly addresses the territorial distribution of educational attainment. This paper tries to fill in the gap by verifying whether the analysis of spatial differentiation of educational attainment could provide crucial information on the financial policy in this sphere and assess the impact of the socio-economic factors upon the education level evaluated through school tests. Our article aims to identify the relationship between spending on public education and the degree of educational attainment and inter-regional inequality in Poland. The research results showed that the spatial approach should not be ignored when assessing the relationship between public education expenditure and the degree of educational achievement. We note that the applied public financing of second-level education in Poland does not reduce regional disparities in education but maintains them at a constant level.

Introduction

As presented in the literature, the primary advantage of decentralisation is the increase in management efficiency of public funds and better matching of public expenditure to the needs of the population compared to a centralised system. However, decentralisation can lead to inequality, since access to public goods becomes differentiated across the country. This results from the geographical location, differences in local governments' financial capabilities, or even residents' various expectations regarding the direction of public spending. The structure of the local education system is also important, e.g., the number and dispersion of schools and educational institutions or the teachers' employment structure and qualifications. These factors as well as the importance assigned to education mean that the decentralisation is incomplete (Kopańska and Sztanderska, 2015). Differences in school systems' characteristics across countries, including the organisation of institutional structures, account for a large part of the differences in students' achievements, not only internationally, but also between regions (Woessmanm, 2016, 1). Socioeconomic background and cultural factors are an important part of the variation in students' performance.

The shape of detailed regulations which impact the operation of the education system at the primary and secondary levels, as well as the role of various public entities in this system vary quite substantially from one country to another. The differences in the systems, changes in their functioning in subsequent years, and their impact on the education systems as well as public expenditures related to it have become the subject of several studies. The existing publications provide information on average and global heights of public sector expenditure on education. It is primarily related to using data requiring a minimum level of homogeneity for international comparisons. The availability of OECD data such as Trends in International Mathematics and Science Study (TIMSS) and Programme for International Student Assessment (PISA) allows for comparing educational development levels from an international perspective. Cordero, Polo and Simancas (2020) provided a broad overview of research findings focused on assessing the effectiveness of education systems internationally using OECD data. Aparicio, Cordero and Ortiz (2019) used data from students and schools participating in PISA to point out that measures of school performance based on aggregate data may present an inaccurate picture when compared to the performance of all students in the same school. Therefore, in order to assess the impact of specific policies on educational performance, the broader information provided by all students must be taken into account, as representative values, averaged at the national level, may differ significantly from those found in individual regions, localities, institutions, or representative groups.

Research on the efficiency of public spending on the education sector hardly addresses the issues of the territorial distribution of educational attainment and

the interpretation of the factors determining this variation. A major contributor to that may be the shortage of relevant data taking into account not only financial policy, but also data on educational processes. As a result, the spatial dimension of human capital quality is a persistently ignored issue. However, the analysis of the spatial variation of educational attainment can provide vital information on the education sector efficiency level, particularly in countries with stratified social standards or interregional disparities (Herbst, 2012, 80). It can particularly provide helpful information on the spending efficiency in education, which competes with other areas involving public expenditure in the budget allocation process. Effective use of the existing resources can improve educational outcomes (Cirol and García, 2018). This issue has not been fully explored in the literature, with few studies showing the impact of funding policies on quality, productivity, and equity in access to education at the intra-regional level.

This paper tries to fill in the gap by verifying whether the analysis of spatial differentiation of educational attainment could provide crucial information on the financial policy in this sphere and assess the impact of socio-economic factors upon the education level evaluated through school tests (in second-level education). Our article aims to identify the relationship between the spending on public education and the degree (growth) of educational attainment as well as inter-regional inequality in Poland. We will attempt to assess the impact of socio-economic factors which may be relevant to the allocation of public funds for education in order to increase its efficiency. We seek to verify the hypothesis that the level of second-stage education (lower[1] and upper high schools) is more dependent on socio-economic factors rather than on the amount of public expenditure on education.[2] Simultaneously, we wish to investigate whether the public financing of second-stage education in Poland reduces regional differences in its level. We are interested in examining the impact of these contextual variables on exam outcomes in the analysed regions of the country so that we can see if their impact is the same in all voivodeships. We also want to show that the analysis of spatial variation of educational attainment can bring vital information about the functioning (quality) of education and the links between education or other cultural processes and socio-economic development. Using econometric techniques, we evaluated the education quality variables in different voivodeships. We used the non-parametric DEA method in the

[1] In Poland, *gimnazjum* (lower high school) existed between 1999 and 2018, encompassed grades 7–9, and was the last stage of compulsory education. In accordance with the International Standard Classification of Education standards from 2011, we include *gimnazjum* in lower secondary education and high schools in upper/higher secondary education.

[2] *Gimnazjums* in Poland were abolished in 2019 and we have reverted to the pre-reform education system. That means primary school now spans 8 years (grades 1–8) and the lower high school exam has been replaced by an eighth-grade exam, with no particular changes to the public education funding system. We therefore assume that an analysis of the factors which influence the results of lower high school examinations will also adequately explain the outcomes of the eighth-grade examinations.

input-oriented version to compare the efficiency of expenditure for education in all Polish voivodeships in 2007–2018. The Malmquist index with decomposition was used to measure the change in efficiency over time.

1. Theoretical framework of the research

The efficient use of resources assures the achievement of the educational outcomes desired by society. It is noted, in this context, that efficient use of public expenditures is determined by observable educational results (e.g. results of test, exams) occurring at the lowest level of these expenditures. In this view, the results of education are usually the outcomes of examinations or relevant tests. In contrast, efficiency evaluation can be described as the ability to transfer inputs into outputs (Carrillo and Jorge, 2016, 15).

Commonly used educational quality measures include the average results of standardised aptitude tests administered to students in many countries (Siyongwana and Chanza, 2020). In this view, research cited in the literature tends to attribute at least two desirable effects to public spending on education: stimulating economic growth and reducing income inequality. Hanushek and Woessmann (2007; 2012, 267–321; 2015) analysed the role of education in promoting economic prosperity, focusing on the meaning of education quality. The results showed strong evidence that people's cognitive skills are strongly related to individual earnings, income distribution, and economic growth. This means that the education quality explains the differences in per capita income levels and the rate of economic development better than its "quantity." Relative teacher salaries, class size, teacher education endogenously determine the education quality (teachers' human capital) and affect the economic growth rate (Hanushek and Kimko, 2000, 1184–1208).

Previous attempts to apply school examination results in growth regressions for Polish regions (Herbst, 2007, 204) have yielded rather unexpected results, disclosing a negative correlation between the quality of education and economic growth. This is mainly because historical and cultural circumstances largely determine the geographical distribution of educational attainment of young people in Poland. Furthermore, a close relationship between resource levels and learning outcomes is hard to demonstrate empirically. Cross-sectional data only reveal a weak correlation between national per-pupil expenditure or teaching resources and students' average outcome on standardised tests (Sutherland, Price and Gonand, 2009). Cordero, Polo, Santín and Simancas (2018, 45–60) assumed that it is worthwhile to study the potential impact of heterogeneity between countries by including some additional contextual factors at the national level. Such variables may have a more significant impact on the effectiveness of education systems than environmental factors in schools do. Keller (2010, 51–77) studied the impact of

public spending on first-stage education. In his research, he proved that spending per pupil in primary education significantly improves income distribution, especially in less developed countries. At the same time, he stressed that this expenditure must keep pace with the growth of student cohorts by promoting high school recruitment. It can be interpreted that (increasing) expenditure on education does not determine the level of income differentiation in society; it is rather due to its skilful spending. Public expenditure does not necessarily ensure high-quality education, but it is believed that education of high quality requires resources. Keller (2010, 65) points out that, with limited resources, it is worth undertaking research on how to use them most effectively. To this end, researchers focused on comparing the relative results in particular countries' education systems.

An analysis of the results obtained by the students was to indicate whether the achieved results differ significantly. However, the picture of educational outcomes measured solely by test scores is incomplete, to say the least (Agasisti, 2014). Education is a process which requires taking into account many elements that influence it. That is why education was more and more often perceived as a kind of production process, a production function which should consider the level of inputs, different institutional systems of individual countries, or factors determining the individual achievement of particular students. Allison (1982) presented the educational function of production based on analysing the impact of participation in program activities as well as time devoted to self-education and leisure. From this perspective, she analysed the regression of student results. Herbst (2012) provides a generalisation of views on the educational function of production. The common feature of the presented approaches is the attempt to demonstrate the influence of various factors which may stimulate society's educational results. Consequently, the results of the research taking into account the educational function of production are highly ambiguous. While some studies suggest that the so-called contribution of the school is statistically positively significant on students' educational attainment, others concluded that such an effect does not exist. Hanushek (2020, 169) points out that, taking into account teacher's experience and training or class size, education policies do not systematically relate to students' performance. As a consequence, the author points out that the way of using resources is often more important than their amount. There are also voices that the varied results may be a consequence of errors in the applied econometric techniques (Todd and Wolpin, 2003).

A different approach examines the effectiveness of public spending on education. The resources spent (inputs) are compared with the outputs (results) using the non-parametric Data Envelopment Analysis (DEA). In this perspective, Afonso and St. Aubyn's (2006, 476–491) research contributed significantly to the literature on the subject. Using the DEA method, they modelled the relationship between inputs and outputs and showed that apart from monetary categories, environmental conditions are also essential elements of properly measuring the effectiveness of

public educational spending (e.g. GDP and population education level). Agasisti (2014, 550), when examining the effectiveness of expenditure in the field of education, used data on expenditure per student as the inputs and the results of PISA tests as the outputs. His research confirms that there is no linear relationship between spending and educational performance. At the same time, he emphasised that there are countries which manage to achieve good results even when investing little resources, and countries which, despite (relatively) large financial outlays, do not (Agasisti, 2014, 543–557). Therefore, in research on the effectiveness of public spending, one should look for additional variables on the expenditure side which are characteristic of a given country or region and could potentially impact the obtained results.

2. Research methodology

The paper estimates and analyses the efficiency of expenditure in Poland's 16 voivodeships (NUTS-2) in 2007–2018. Two approaches were followed to assess the effectiveness of government spending on education. The first approach identifies the determinants of education quality in different voivodeships using regression — the classic method of least squares, ordinary least squares (Barro and Lee, 2001, 465–488). In the second approach, the results of the public spending effectiveness are estimated with the DEA procedure. This non-parametric technique treats each educational system as a decision-making unit, using the input data to generate output products. Such an approach showed the relative assessment of effectiveness and the distance between regions as well as the change in effectiveness in 2018 compared to 2007. The use of DEA is widespread in the literature concerning, i.a., the education sector, both for cross-country and country-level analyses. The DEA method was used to evaluate the effectiveness (a standard variant of the DEA method) in the input-oriented version. We used the solution adopted by Guzik (2009). In order to measure the change in efficiency over time and to assess the relative technical effectiveness of public expenditure on secondary education in Poland, the Malmquist Total Factor Productivity Index (TFP) was calculated along with its decomposition (Coelli, Prasada, O'Donnell and Battese, 2005).

The determinants (input) of educational outcomes taken into consideration in these studies include resources allocated to education (public expenditure — by the national government and local authorities — for education per person aged 7–19), as well as other factors such as the number of students per lower high school class or per high school class, GDP per capita (GDPpc), percentage of people with higher education, and the average monthly salary per person in the voivodeship. In the study, we have used variables retrieved from the Central Statistical Office's Local Data Bank (Bank Danych Lokalnych Głównego Urzędu Statystycznego).

The results of lower high school exams (in % of points possible to score, mathematics part) and the pass rate of the baccalaureate examination (in %) were the dependent variables (output). The average number of students per class is the most critical determinant of the unit cost of teaching. Additionally, expenditure on education in Poland varies significantly depending on the level of education, types of schools, and the mode of learning undertaken by students. The educational subsidy, which is the primary source of financing for education in Poland, is granted based on an algorithm which takes into consideration, i.a., kinds and types of schools and institutions operated by LGU, teachers' professional promotion grades, the number of students in schools and institutions, or school location taking into account the number of inhabitants (ustawa z dnia 13 listopada 2003 roku o dochodach jednostek samorządu terytorialnego, Dz.U. z 2017 r., poz. 1453).

GDPpc is a variable showing the wealth of society, and remuneration was used to measure private expenditure on educating children. The above factors are taken into account by the literature as the ones which may affect the output variables. The paper presents models for individual results (Y) separately.

The performance of educational activity according to voivodeships were expressed by the results of junior high school and baccalaureate examinations. The expenditure was measured by outlays on education incurred both by the state budget and LGU, as well as by the average monthly salary as a measure of private expenditure on educating children. The Malmquist index was used to evaluate changes in efficiency over the period under consideration. This indicator is defined by means of technical efficiency measures (Coelli et al., 2005):

$$M\ (x_{t+1}, y_{t+1}, x_t, y_t) = \left[\frac{D^t(x_{t+1},y_{t+1})}{D^t(x_t\ ,y_t)} * \frac{D^{t+1}(x_{t+1},y_{t+1})}{D^{t+1}(x_t\ ,y_t)}\right]^{\frac{1}{2}} \quad (1)$$

where,

$D^t\ (x_t, y_t)$ — technical efficiency in the t period and technology in t period,
$D^{t+1}\ (x_t, y_t)$ — technical efficiency in the t period and technology in t + 1 period,
$D^t\ (x_{t+1}, y_{t+1})$ — technical efficiency in the t + 1 period and technology in t period,
$D^{t+1}\ (x_{t+1}, y_{t+1})$ — technical efficiency in the t + 1 period and technology in t + 1 period.

3. Research results

Table 1 shows the modelling of the results of lower high school exams (in % of points possible to score, mathematics part).

Table 1. Modelling of the results of lower high school exams in 2007–2018

Voivodeship	R^2	p-Value				
		Model parameters				
		higher education	public expenditure	salary	GDP pc	average students per class
Dolnośląskie (DL)	0.61	0.7041	0.4202	0.0520*	0.0667	0.8713
		-52.7470	0.0030	0.0210	-0.0020	0.3770
Kujawsko-pomorskie (KP)	0.75	0.1387	0.8521	0.1257	0.3369	0.0349**
		-187.7731	0.0004	0.0283	-0.0013	4.8093
Lubelskie (LB)	0.18	0.7865	0.3429	0.6924	0.8831	0.9546
		21.0250	-0.0043	0.0119	0.0004	0.1920
Lubuskie (LS)	0.48	0.8672	0.8672	0.8672	0.8672	0.3512
		78.5625	-0.0030	0.0469	-0.0036	2.4513
Łódzkie (LD)	0.63	0.2495	0.0526*	0.0507*	0.1240	0.5753
		106.6765	-0.0067	0.0629	-0.0037	1.3083
Małopolskie (MP)	0.64	0.7859	0.4724	0.1398	0.2614	0.1600
		29.7488	-0.0013	0.0358	-0.0024	3.7628
Mazowieckie (MZ)	0.75	0.5683	0.1895	0.0195**	0.5160	0.2492
		-34.4046	-0.0068	0.0304	-0.0006	-3.8430
Opolskie (OP)	0.24	0.6013	0.2411	0.7110	0.9004	0.9530
		-69.9003	-0.0031	0.0113	0.0003	-0.1862
Podkarpackie (PK)	0.55	0.8706	0.3765	0.6154	0.8745	0.0736
		20.5641	-0.0020	0.0192	-0.0005	4.7967
Podlaskie (PD)	0.71	0.1509	0.1943	0.0137**	0.1060	0.5835
		-208.5320	-0.0027	0.0530	-0.0032	0.9977
Pomorskie (PM)	0.44	0.7982	0.5577	0.1149	0.3087	0.6271
		31.8791	-0.0018	0.0228	-0.0013	1.7432
Śląskie (SL)	0.74	0.6302	0.1174	0.0129**	0.1218	0.2627
		-64.0206	-0.0041	0.0367	-0.0011	2.3345
Świętokrzyskie (SW)	0.24	0.3464	0.7601	0.3771	0.4564	0.4934
		-126.6980	0.0010	0.0270	-0.0030	2.3630
Warmińsko-mazurskie (WM)	0.68	0.1441	0.4006	0.0149**	0.0181**	0.7504
		-111.8070	-0.0020	0.0800	-0.0070	0.6980
Wielkopolskie (WP)	0.56	0.2739	0.2080	0.0950	0.5416	0.7360
		-115.6250	-0.0060	0.0380	-0.0010	-0.7100
Zachodniopomorskie (ZP)	0.63	0.5156	0.0923	0.1093	0.1633	0.5714
		-74.5720	-0.0060	0.0550	-0.0030	1.3500

** $p < 0.05$, * $p < 0.1$

Source: own study basing on data from LDB.

The adjustment of most of the constructed models to the actual data (lower high school exams) was at a weak or medium level. The worst model in this regard was the one for LB, the best — for MZ and KP. At the level of $\alpha = 0.05$, the variable regarding education had a negligible effect on the results of lower high school exams. For 15 of the 16 models examined, the public expenditure, GDPpc, and the number of students generally did not contribute to explaining the effectiveness of the education system. The variable which turned out to be the "most common" was "remuneration." Based on the conducted research, it can be concluded that only remuneration seems to affect the variable Y, which we interpret as the impact of expenses on children's education incurred by parents.

Modelling the pass rate of the baccalaureate examination results is shown in Table 2.

Table 2. Modelling the pass rate of the baccalaureate examination results in 2007–2018

Voivodeship	R^2	p-Value				
		Model parameters				
		higher education	public expenditure	salary	GDP pc	average students per class
Dolnośląskie	0.76	0.2883	0.3670	0.7934	0.4593	0.0423**
		137.0900	0.0020	-0.0020	-0.0010	4.6300
Kujawsko-pomorskie	0.69	0.6567	0.4038	0.7749	0.8734	0.3812
		68.1185	-0.0027	0.0083	-0.0003	1.9410
Lubelskie	0.73	0.1932	0.4185	0.8022	0.3385	0.2447
		-102.6280	-0.0035	-0.0071	0.0026	2.8494
Lubuskie	0.09	0.8665	0.9443	0.7575	0.7970	0.2485
		-39.5820	-0.0003	0.0099	-0.0007	0.2737
Łódzkie	0.79	0.0829	0.8319	0.6944	0.6684	0.2746
		-244.5500	0.0011	0.0111	-0.0009	2.8960
Małopolskie	0.65	0.2816	0.1288	0.4305	0.5603	0.6574
		162.8850	-0.0050	0.0220	-0.0020	-0.9510
Mazowieckie	0.52	0.3508	0.3473	0.9830	0.4025	0.7148
		-112.8900	-0.0040	0.0000	0.0010	1.6960
Opolskie	0.66	0.1855	0.0515*	0.0781	0.3034	0.4920
		-139.6790	-0.0040	0.0410	-0.0020	1.1030
Podkarpackie	0.58	0.7345	0.2060	0.8365	0.6183	0.9069
		66.6489	-0.0048	-0.0113	0.0023	0.2523
Podlaskie	0.75	0.0783	0.1213	0.2764	0.7830	0.8470
		-312.4950	-0.0041	0.0224	0.0005	-0.2471

Pomorskie	0.73	0.8590	0.1288	0.2856	0.1509	0.0957
		15.7071	-0.0028	-0.0124	0.0015	3.5725
Śląskie	0.66	0.3852	0.1078	0.8288	0.5485	0.6051
		144.9038	-0.0056	0.0034	0.0007	0.7807
Świętokrzyskie	0.89	0.0019**	0.0917	0.0420**	0.0313**	0.4969
		-279.1910	0.0022	0.0289	-0.0036	0.6075
Warmińsko-mazurskie	0.85	0.0077**	0.0401**	0.0210**	0.3085	0.0461**
		-280.9400	-0.0101	0.0779	-0.0021	5.6675
Wielkopolskie	0.49	0.9408	0.2648	0.2290	0.5773	0.1870
		-9.7643	-0.0056	0.0316	-0.0008	3.3503
Zachodniopomorskie	0.59	0.3566	0.7643	0.9733	0.8815	0.7397
		148.8725	-0.0012	-0.0013	-0.0004	-0.5617

** $p < 0.05$, * $p < 0.1$

Source: own study based on data from LDB.

The adjustment of most of the constructed models to the actual data (baccalaureate examination) was similar to that of the models presented above — for lower high school examinations. In fact, only one model (LB) virtually did not reflect the changes taking place in the dependent variable. In these models, the parameters were also practically insignificant at the level of $\alpha = 0.05$. As in the case of lower high school examinations, the signs for some parameters in some models can be surprising — in this case, even the salary. The models presented above show that, given the assumed variables, there is no uniform set of indicators describing the quality of education in individual regions of the country. Moreover, as the research shows, the variables in most voivodeships turned out to be statistically insignificant, which reduces their importance in explaining the examinations pass rate. Consequently, both public expenditure on education and other variables did not reflect the changes occurring in the pass rate in particular voivodeships. It may mean that a different set of variables should be used, reflecting the so-called school contribution to a greater extent. Unfortunately, the shortage of statistical data in this area makes it impossible to conduct comparative studies at the regional or local levels. The construction of individual models considering variables reflecting the characteristics of each region, including cultural and social ones, might lead to better results.

In the next stage of the research, the effectiveness of public expenditure on education was estimated using DEA. In the DEA model, expenditure on education incurred both by the state budget and LGU as well as salaries as a measure of private expenditure on educating children were taken as inputs. The results were expressed through the number of points scored by students in the lower high school exam in mathematics and the percentage of people who passed the baccalaure-

ate examination. Therefore, data on technical efficiency was obtained — to what extent the voivodeship transforms the funds into improving examination results. The best voivodeship is considered one where the relatively highest examination results can be obtained with the available resources. The worst one — where the resources are not used effectively (compared to the others).

Table 3. DEA indicators by voivodeships in 2007 and 2018

Voivodeship	2007	2018
Dolnośląskie	0.9582	0.8655
Kujawsko-pomorskie	0.9582	0.9976
Lubelskie	0.9543	0.9563
Lubuskie	0.9358	1.0000
Łódzkie	0.9886	0.9795
Małopolskie	0.9647	1.0000
Mazowieckie	0.8894	0.9127
Opolskie	0.9547	0.9352
Podkarpackie	1.0000	1.0000
Podlaskie	1.0000	0.9587
Pomorskie	0.8968	0.9112
Śląskie	0.9272	0.8963
Świętokrzyskie	0.9627	0.9799
Warmińsko-mazurskie	0.9668	0.9872
Wielkopolskie	0.9524	0.9699
Zachodniopomorskie	0.9032	0.9352

Source: own study.

In 2007, two eastern voivodeships (PD and PK) were characterised by the highest productivity, i.e. the efficiency of transforming outlays into effects. The worst efficiency was recorded in MZ, where the capital city of Poland is located, and at the seaside, in PM. The difference between the studied voivodeships was not significant, but there was a noticeable increase in the coefficient of variation — from 3.4% to 4.2%.

The values of the Malmquist index calculated in the years 2007–2018 show a slight deterioration in the effectiveness of public spending (Table 4). However, the average results differ in particular regions. The highest productivity was recorded in 2018 in LB, where the index was 1.038, i.e. productivity increased by 3.8% compared to 2007. Productivity deteriorated the most in DL, where TFP in 2018 was 5.6% lower than in 2007.

Table 4. Change of rates of TFP and its components (%) in 2007–2018

Voivodeship	TFP	Technical efficiency change	Technological change
Dolnośląskie	0.9441	0.9032	1.0453
Kujawsko-pomorskie	1.0026	1.0411	0.9630
Lubelskie	0.9848	1.0020	0.9828
Lubuskie	1.0377	1.0686	0.9711
Łódzkie	0.9859	0.9908	0.9951
Małopolskie	1.0086	1.0366	0.9730
Mazowieckie	0.9885	1.0261	0.9634
Opolskie	1.0058	0.9795	1.0268
Podkarpackie	1.0000	1.0000	1.0000
Podlaskie	0.9843	0.9587	1.0266
Pomorskie	0.9907	1.0160	0.9751
Śląskie	0.9901	0.9667	1.0242
Świętokrzyskie	1.0021	1.0178	0.9845
Warmińsko-mazurskie	1.0019	1.0210	0.9813
Wielkopolskie	1.0243	1.0183	1.0059
Zachodniopomorskie	0.9906	1.0355	0.9567
mean	0.9962	1.0044	0.9918

Source: own study.

The changes in the average public expenditure and TFP in 2007–2018 are shown in Figure 1. The distribution of points shows that if there was a relationship between public expenditure on education across voivodeships and the effects of educational activity at the average level, it was feeble.

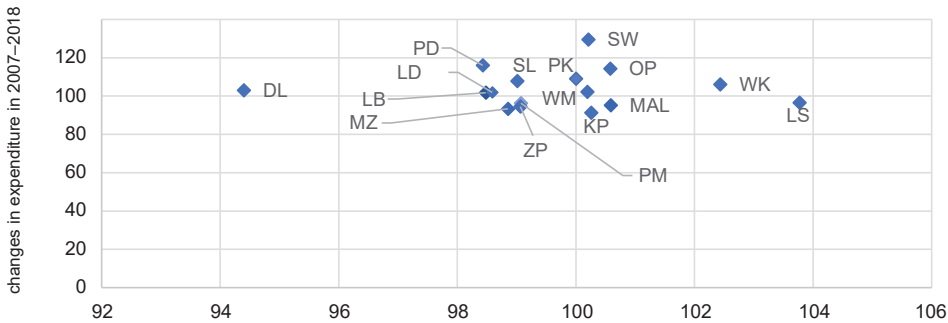

Figure 1. Average change in public expenditure on education and TFP in 2007–2018 by voivodeship (%)

Source: own study.

4. Discussion

Students' academic achievements are widely accepted as a measure of the quality of education systems to which an increasing amount of both public and private resources are allocated. The analysis of educational public spending effectiveness is also important due to the shortage of public funds and the growing pressure to improve their allocation (Afonso and St. Aubyn, 2010; Aristovnik, 2013).

The regression analysis used in the paper did not show a significant impact of the analysed socio-economic factors on improving the quality of examination results. The signs present by some parameters in the presented regression models are sometimes surprising — e.g. in MZ or WP, the fewer people with higher education, lower public expenditure, lower GDP, and more students per unit, the better the results of lower high school examinations. In particular, we observe that in many voivodeships, both public expenditure, GDPpc, and parents' education negatively affect the improvement of examination results and, consequently, the effectiveness of public educational funds. On the one hand, these results seem to be counter-intuitive, as the literature has consistently shown a positive correlation between, for instance, education and economic development (Hanushek and Kimko, 2000, 1184–1208; Sutherland et al., 2009). On the other hand, there are also studies showing examination results disproportionate to the level of resources involved. Ciro and Garcia (2018) showed that income and education negatively affect examination results. The results of numerous studies suggest that not only the level of public funding allocated, but also the so-called family contributions and school resources are critical factors in improving academic performance. It has been observed that higher investment in education in wealthier countries does not translate into improved examination results. As more prosperous countries have higher GDPpc, the relationship between GDPpc and academic performance is usually negative (Agasisti, 2014, 16). This leads to the conclusion that an increase in resources does not automatically lead to better outcomes. However, it is worth emphasising that Poland is not one of the countries considered "rich."

The average number of students per class is the most critical determinant of the unit cost of teaching. It may express local and regional conditions or the local authorities' educational policy, which deliberately maintains small classes, taking into account higher costs covered from the budget. Such a situation may occur, especially in areas with low population density with a small number of children and adolescents in their area. The decreasing number of students in institutions and growing the distance to transport them to school escalate the costs. Research shows a negative relationship between population density and expenditure per capita on education (Herbst, Herczyński and Levitas, 2009). It should also be added that the educational subsidy, which is the primary source of financing education in Poland, takes into account in its algorithm several weights regarding the location of schools or their various types. Thus, the financing policy of

first- and second-degree education in Poland should minimise regional disparities. The problem is that the so-called rural weight, used in relation to the location of a given educational institution, raises much controversy. It reaches all rural municipalities and small towns regardless of the fundamental problems of the school network and notwithstanding their wealth. As a result, a significant part of public funds is allocated ineffectively and unfairly (Herczyński and Siwińska-Gorzelak, 2012; Misiąg and Tomalak, 2010).

Based on the results of the DEA method, the ranking of the public spending effectiveness revealed existing differences between the analysed voivodeships. This discrepancy at the regional level is not high, although a slight increase in the coefficient of variation from 3.4% to 4.2% is noticeable. That means the applied public financing of second-level education in Poland does not reduce regional disparities in education but maintains them at a constant level. The multi-period analysis carried out using the Malmquist index shows that there was no increase in overall efficiency in Poland. The results are consistent with our previous research on the impact of government spending on reducing interregional social inequalities in Poland. At the same time, it is difficult to say whether it comes from a well-designed government strategy or from accidental actions of the government. Given the numerous criticisms of the algorithm (Galiński, 2016, 711), which is the basis for distributing public funds within the essential source of financing education in Poland (the educational part of the general subsidy), we rather agree with the latter interpretation.

Conclusion

Based on the conducted research, we conclude that there is no universal set of socio-economic factors for all the surveyed voivodeships. We note that the influence of individual factors included in our model seems to be in line with previous evidence in the literature on determinants of students' performance and outcomes. However, due to the varied results characterising the individual regions we studied, and at the same time the lack of consistency in the literature as to the impact of the analysed factors on the effectiveness of educational systems, further research on this topic is necessary, especially on the national and lower levels. Understanding these relationships requires taking into account the diversity present in the system and other features which may affect educational outcomes at the lowest possible level of aggregation (municipalities and counties). The level of schools is even better for studying this topic in municipalities and counties, but it is difficult to access socioeconomic data. We are aware of the numerous simplifications used in the article, which largely resulted from the lack of data.

At the same time, we reckon that regardless of the factors selected for the models, one should consider the region-specific characteristics. Ultimately, the re-

search results showed that the spatial approach should not be ignored when assessing the relationship between public education expenditure and the degree (growth) of educational achievement.

Abbreviations

DL — dolnośląskie
KP — kujawsko-pomorskie
LB — lubelskie
LS — lubuskie
LD — łódzkie
MP — małopolskie
MZ — mazowieckie
OP — opolskie
PK — podkarpackie
PD — podlaskie
PM — pomorskie
SL — śląskie
SW — świętokrzyskie
WM — warmińsko-mazurskie
WK — wielkopolskie
ZP — zachodniopomorskie

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The ethical structure of production

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Abstract

The main contention of the present paper is that the capital structure of production, the preservation of which is often regarded as the essence of economic sustainability, needs to be grounded in the parallel ethical structure of production in order to remain intact. The article identifies several tendencies conducive to the erosion of the ethical production structure. Subsequently, it suggests that some of these tendencies may well be strongly present in today's economic and cultural climate in the so-called developed world, thereby jeopardizing its prospects for continued economic growth and progress. Finally, the author indicates that only a widespread and well-established understanding of the relationship between the capital structure of production and its ethical counterpart can prevent a retrogression from the current, historically unprecedented level of global economic well-being.

Introduction

There are two major errors which can be made while considering the relationship between economics and ethics. The first of these is to regard economics as necessarily value-laden and thus incapable of discovering objective laws of human action, detached from one's personal normative commitments. The other is to regard economics as value-free and thus supposedly irrelevant to any substantive ethical considerations.

Both of these errors need to be avoided if the relationship between economics and ethics is to be fruitful and capable of enhancing the explanatory capacity of both these disciplines while allowing them to retain their explanatory distinctness.

In what follows, I shall suggest a "third way," which is the only pertinent approach allowing for appreciating the degree to which consistent economic growth and development requires a mutually reinforcing interaction between an appropriately constructed capital structure of production and its more intangible ethical counterpart. More importantly, I shall subsequently indicate that the present period of socioeconomic history is characterized by an unprecedented divergence between the respective levels of maintenance of these two structures, which makes the current global prosperity unsustainable in the longer run. More specifically, I shall argue that the ethical structure of production — the embedded hierarchy of values and virtues which underlies and conditions the productive potential of the economy — is in dire need of restoration if the potential in question is not to be rapidly wasted.

1. Theoretical framework of the research

Since the advent of the marginalist revolution, there has been a near-unanimous agreement within the economics field that individual value scales must be treated as given and the focus should remain on tracing out the logical consequences of acting upon them (Menger, 1976). Hence, there is a widespread consensus among specialists that economics is, indeed, value-free, since the logical structure of human action is immutable, universally applicable, and independent of the specific normative views of any given individual (Mises, 2006). While I consider this contention to be true and important, I also believe that, more often than not, it leads to the mistaken conclusion that the value-free nature of economics implies its value-irrelevance.

Thus, it seems all the more crucial to emphasize the point that an understanding of sound economic principles is a necessary prerequisite of sound ethical theorizing. Since sensible ethical thinking is predicated on the notion that "ought" implies "can," and sensible economic reasoning describes the logical structure of the "can" of human action, economics appears to be uniquely suitable to delimit and constrain the realm of reasonable ethical ambitions. As such, it also seems uniquely capable of grounding ethical reasoning in an appropriately informed conception of human nature (Casey, 2003). Thus, for instance, it takes an economically-informed social ethicist to realize that increasing social well-being through the establishment of a socialist society cannot be thought of as anyone's moral duty, since a rationally functioning socialist economy is a logical impossibility as far as human agency is concerned (Mises, 1996, Ch. 26).

In other words, while firmly value-free, economics is also crucially value-relevant. However, what is perhaps an even more underappreciated aspect of the relationship between economics and ethics is that the latter is fact-relevant in the economic sense. What I mean here is that ethical considerations, while in-

capable of overriding the principles of economics, nonetheless constitute an essential part of the full picture presenting the extended social order of catallactic relations. Hence, it is true that economics constrains the realm of the ethically possible, but it is equally true that ethics describes the realm of the economically possible. The critical distinction here is between descriptive and normative ethics: whereas the latter is logically posterior to economic theory and has to remain subordinate to its validly deduced conclusions, the former complements economic theory by pointing to the essential normative prerequisites of various catallactic phenomena.

To take an example, normative ethics cannot justifiably claim that we should strive for the establishment of a natural zero-interest-rate economy (since such a concept is a praxeological absurdity [Salerno, 2001]), but descriptive ethics can justifiably claim that establishing a natural low-interest-rate economy requires its members to develop the virtues of prudence and temperance. Likewise, normative ethics cannot justifiably contend that entrepreneurial initiative can and should be detached from the pursuit of profit (since, again, the concept of profitless entrepreneurship is internally incoherent [Mises, 1974; Carden, 2009]), but descriptive ethics can justifiably contend that the virtue of courage is a necessary prerequisite of entrepreneurial profit-seeking.

In sum, while economic descriptions of various catallactic phenomena are logically self-sufficient, it must be remembered that they implicitly contain certain crucial ethical observations and assumptions. Hence, in order to understand the broader presuppositions and ramifications of such phenomena, one needs to be a competent ethicist in addition to being a competent economist. In particular, as I shall try to show, one needs this dual competence in order to determine under what conditions the developmental potential of such phenomena can be consistently actualized, and under what conditions it is bound to be wasted. In other words, I believe that the dual competence in question lies at the very heart of conducting a sound analysis of the perennially engrossing issue of economic growth and development.

2. Research methodology

In the following section, I shall elaborate on the extent to which various economic theories pertinent to the issue of growth and development contain implicit ethical presuppositions which, while treated in a value-free, purely descriptive manner, are nonetheless essential to these theories' real-world relevance. Through this, I will attempt to demonstrate that the capital structure of production, the preservation of which is often regarded as the essence of economic sustainability, needs to be grounded in the parallel ethical structure of production in order to remain intact. Next, I shall identify several tendencies conducive to the erosion of the ethical pro-

duction structure and suggest that some of them may well be strongly present in today's economic and cultural climate. These tendencies thereby jeopardize the prospects for continued economic growth and progress of the so-called developed world. Finally, I indicate that only a widespread and well-established understanding of the relationship between the capital structure of production and its ethical counterpart can prevent a retrogression from the current historically unprecedented level of global economic well-being.

3. The ethical foundations of the institutional structure of production

Several notable economic traditions are well-known for emphasizing the point that sustainable social and economic development requires strict intertemporal coordination and institutional robustness. For instance, the theory of capital elaborated within the Austrian school of economics suggests that creating more roundabout and more physically productive structures of production requires a preceding accumulation of savings, i.e., a preceding deferment of consumption (Garrison, 2001). By the same token, the Austrian school teaches that creating such structures of production on the basis of fiat credit expansion is bound to generate economically destructive boom-bust cycles (Salerno, 2012). Moreover, it emphasizes that the complementarity of capital goods employed in various stages of production requires that the overall capital structure of production be intertemporally equilibrated through the operation of the interest rate and the corresponding entrepreneurial expectations (Lachmann, 1956).

In other words, the Austrian theory of capital suggests, albeit only implicitly and indirectly, that the virtue of temperance is a necessary prerequisite of capital accumulation, the virtue of diligence — of capital conservation, and the virtue of prudence — of rational capital deployment. By the same token, it issues an implicit ethical warning that there are no shortcuts to economic well-being and that trying to achieve or sustain such well-being in the absence of relevant virtues amounts to an attempt at circumventing the laws of economics, and thus the immutable logic of human action.

Hence, just as the capital structure of production has its ethical counterpart (or at least its ethical aspect), the business cycle theory elaborated by the Austrian school can be reconceived in terms of the intertemporal disequilibrium of ethical resources. More specifically, it might be said that even if entrepreneurs have a sufficient amount of real savings at their disposal, and thus are able to carry their production plans to completion in a strictly technical sense, these plans may nonetheless fail if it eventually turns out that no complementary ethical capital is available. If, for instance, a given production plan or business development strategy is sufficiently roundabout to span generations and it turns out that new generations

entering the workforce are far more entitled, irresponsible, and undependable than their predecessors, then such a plan or strategy will be impossible to implement, thus turning out to be a malinvestment.

Similarly, just as interest rate manipulations by central banks distort entrepreneurial judgments regarding the supply of real social savings available for investment purposes, certain phenomena may mislead employers in regards to the ethical capacity of their potential future employees. It may be the case, for instance, that subsidized higher education, while ostensibly increasing the ethical sensitivity of students by exposing them to sophisticated intellectual problems, in fact serves primarily to certify their conformity (Caplan, 2018) or increase their emotional fragility and intellectual timidity (Lukianoff and Haidt, 2018). In other words, just as systemically falsified price signals lead to clusters of entrepreneurial miscalculations, systemically falsified signals of competence, including ethical competence, may lead to clusters of hiring misjudgments.

A related implicit lesson about the importance of the ethical underpinnings of sustainable economic development stems from the insights of new institutional economics. According to this tradition, every well-functioning social system consists of a multi-level hierarchy of institutional forms (Williamson, 1998; 2000). The highest levels of this hierarchy — ones related to the everyday process of resource allocation and the regular process of aligning governance structures with transactions — are crucially conditioned by the underlying lower levels — ones related to the hard institutional framework of formal laws, especially those associated with the enforcement of property rights. These, in turn, are fundamentally dependent on the lowest level of the hierarchy in question, related to the soft institutional framework of norms, traditions, customs, religious beliefs, and cultural expectations.

In other words, widespread and well-internalized moral virtues are a necessary prerequisite for the emergence of stable institutions capable of safeguarding civilized social interactions, and such institutions are a necessary prerequisite for the emergence of advanced specialization, division of labor, capital accumulation, technological innovation, entrepreneurship, and other phenomena which drive consistent economic growth and development.

Thus, a particularly important variety of the ethical production structure turns out to be the institutional structure of ethical capital. This conclusion finds support in a number of mutually reinforcing historical narratives which identify ethical beliefs and practices as the fundamental driving force behind the eventual materialization of the contemporary, historically unprecedented level of global economic prosperity. Among the relevant factors in this category one can place phenomena such as the uniquely individualistic spirit of Christianity (Siedentop, 2014), the medieval European respect for organizational diversity and radical decentralization of governance (Raico, 1994), and the early modern dignification of the bourgeoisie (McCloskey, 2010).

One might notice that not only is each of the abovementioned elements a good candidate for a significant ethical foundation of the institutional structure of production, but also that all of them taken together constitute an ethical structure of production unfolding over time, where particular religious beliefs give rise to a particular kind of organizational culture. This in turn gives rise to a particular normative attitude towards the pioneers of large-scale social cooperation based on productive specialization and division of labor. This is yet another indication of ethical capital being — just like every other kind of capital — crucially characterized by structural and diachronic complementarity. Furthermore, this is yet another manifestation of the fact that, while remaining value-free, economics has to recognize and explore the implicit normative presuppositions of its theorems in order to retain not only its logical cogency, but also its empirical relevance in the context of a causal-realist analysis (Salerno, 2010).

The new institutional insights concerning the ethical structure of production also help to explain the persistent failure of foreign aid programs (Easterly, 2006) and the infeasibility of constructivist institutional development (Hayek, 1967). If the poverty of a given society is ultimately the result of its ethical shortcomings — its tolerance for theft and fraud, its aversion to entrepreneurial success, etc. — then pouring aid money into it, instead of allowing it to build robust, growth-enhancing institutions, is only likely to entrench its kleptocratic tendencies and conserve its economic backwardness (Klitgaard, 1990). Thus, it is not without justification that politically orchestrated foreign aid has often been lampooned as the transfer of resources from poor people in rich countries to rich people in poor countries.

Similarly, if certain hard institutional frameworks are conceptually designed by a self-appointed technocratic elite, especially of foreign provenance, then their implementation is likely to be unsuccessful at best and counterproductive at worst. In the absence of any organic connection to the underlying structure of cultural norms, traditions, and expectations, such frameworks are incapable of exhibiting institutional "stickiness" (Boettke, Coyne and Leeson, 2008). That is, they are incapable of constituting goods which are meaningfully complementary to the goods produced in an earlier stage of the institutional production structure.

In sum, economic theorists whose conception of value freedom involves making their chains of reasoning free of not only any ethical judgments, but also any references to ethical values, virtues, or practices, are bound to arrive at an analytically deficient and fatally reductive picture of some of the central economic processes and phenomena. In particular, they are bound to lack a clear understanding of the conditions under which such processes and phenomena can enjoy sustainable development, and ones under which they can be predicted to retrogress. In the following section, I shall illustrate some of the ways in which such understanding is essential to make an informed assessment of the degree to which the current level of global economic prosperity can be reasonably expected to last in the current socio-cultural atmosphere.

4. Can the Great Enrichment continue?

According to a number of recently published books, global economic and social well-being, insofar as such phenomena can be captured by objective indicators, is currently at an all-time high (Norberg, 2016; Rosling, 2018). Furthermore, the books in question suggest that, despite some major bumps along the way, over the last two hundred years humankind has generally enjoyed consistent and significant improvement in wealth, health, security, and other reliable measures of the quality of life. They also predict that, if the data from the previous two centuries and the first two decades of the present one are to be extrapolated into the future, then humankind can look forward to even brighter times. In other words, as the authors of these books would have it, it is not only the case that what has been called the "Great Enrichment" (McCloskey, 2016) happened after 1800, but also that even more spectacular iterations of this unprecedented event are to be expected in the years to come.

It is not my intention here to dispute the data presented in such works. I agree that the Great Enrichment happened and that it was a unique event in economic history. I also generally agree with the interpretations of its causes typically favored by the authors of these works — interpretations centered primarily on the influence of ideas and their capacity to unlock the productive potential of large-scale social cooperation. However, I also believe that the rosy outlook for the future espoused by these authors, while far from being unjustified, may nonetheless be somewhat too facile in the virtue of ignoring some of the deeper interconnections between the ideas directly responsible for the Great Enrichment and the ones ultimately responsible for creating an environment conducive to its emergence.

The ideas belonging to the former category are chiefly economic and institutional in nature. Those belonging to the latter are chiefly ethical, cultural, and spiritual. The latter are causally more fundamental, but their essence is far more intangible and their influence much more elusive. Thus, functional disequilibria in the ethical structure of production may be particularly difficult to notice — in other words, it may be exceptionally easy to overlook the unsustainability of a situation where the productive capacity of the economy is at an all-time high, but the ethical foundations of the underlying institutional framework are becoming increasingly eroded.

Since the most essential data to be studied in this context are strictly qualitative and culturally mediated, their effective analysis needs to incorporate a substantial degree of interpretive insight (Mises, 2003). Hence, the identification of the ultimate rather than the proximate social causes of the Great Enrichment, as well as the extent to which they can be said to become increasingly inoperative, are bound to remain highly debatable issues. In view of this, perhaps the best way to justify the choice of a particular explanatory narrative in this area is to demonstrate the diachronic and synchronic coherence of its constituent elements, in addition

to linking it to as much "hard" data as possible. This is precisely what I intend to do regarding the narrative mentioned in the previous section — one that includes Christian individualism, medieval European decentralization, and dignified treatment of the bourgeoisie as the ultimate key factors behind the Great Enrichment, and that sees their diminishing influence as potentially leading to the corresponding Great Impoverishment.

Starting with the first element from the above list, it would be hardly a controversial claim that the Christianity of today, though still nominally an important cultural force, is a pale shadow of the strong civilizational nexus known as Christendom. Declining church attendance, diminishing understanding of the nature of sacraments, waning missionary zeal, and dwindling commitment to the dogmas of faith and the corresponding moral principles all testify to the fact that the average Christian today treats their religious obligations not in a robustly supernatural, but a blandly festive and vaguely therapeutic manner (Dreher, 2017).

It is far beyond the scope of this paper to identify and explicate the root causes of the abovementioned processes. It should suffice to suggest that the intellectual and cultural destruction brought about by the world wars of the 20th century and their main ideological undercurrents, combined with the material and technological complacency of the post-World War II era, provided an unprecedentedly strong impetus for, to quote Chesterton, leaving the Christian ideal untried.

Consequently, the unique Christian individualism has lost much of its influence. The individualism in question, in contradistinction to other doctrines referred to by the same name, not only postulates the existence of inalienable natural rights to life, liberty, and property, but also sees all of these as gifts to be used wisely in pursuit of personal holiness. Furthermore, unlike those religions that either divinize the material world or reject is as altogether depraved, Christianity encourages its adherents to "subdue the earth" — that is, adore God by engaging in transformative, entrepreneurially-driven acts of "sub-creation" (Roundy, 2021). Thus, it is unsurprising that Christendom was an exceptionally vibrant source of civilizational development, including its economic dimension. It is likewise not unexpected that its enfeeblement has brought about a marked decrease in human accomplishment, at least insofar as various historiometric indicators allow for the quantification of excellence in the arts and sciences (Murray, 2003).

Since the opposite of excellence is mediocrity and failure, the declining influence of genuine Christian individualism has weakened an essential bulwark against the expansion of totalitarian collectivisms, ranging from tribal to international, from populist to technocratic, and from Orwellian (hard) to Tocquevillian (soft). In addition, as the message of Christian individualism has become increasingly hazy and spiritually enfeebled, its influence has become more and more intercepted by very different kinds of individualism, which, many would argue, are designated by this name without any solid logical or historical justification. This concerns those doctrines which decouple individual liberty from personal

responsibility and the notion of the natural telos of human development, regarding it instead as a means of arbitrarily defined desire-satisfaction or "self-expression," which should be promoted via political action (Van Dun, 2001).

In keeping with the emphasis on the ethical elements of the institutional structure of production, we may confidently observe that the spiritual erosion described above has gone hand in hand with persistent political centralization, fiscal expansion, and bureaucratic bloat. From the High Middle Ages up until the latter part of the 19th century, the spiritual culture of robust Christian individualism was an essential safeguard of political and, in particular, legal polycentricity, as well as the corresponding local self-determination and regulatory competition within much of Europe (Raico, 2012, 59). In the meantime, however, the Great Enrichment associated with the industrial revolution, the achievements of technological progress, and the advent of subjectivist philosophies created an atmosphere of political hubris which proved an exceedingly fertile ground for the emergence of aggressive collectivisms, both class- and nation-based. In other words, in the absence of a sufficient degree of the Jeffersonian "eternal vigilance," the material fruits and intellectual offshoots of classical liberalism — itself, as argued above, a fruit of Christian individualism combined with medieval European decentralization — began to poison the roots from which they had grown.[1]

Consequently, since the early 20th century, we have witnessed a consistent long-term advance of political centralization, punctuated by a self-perpetuating spiral of crises and the subsequent expansions of bureaucratic control, with only brief periods of temporary retrenchment (Higgs, 1987). Moreover, the centralization under consideration has been advancing both intra- and internationally, the most characteristic manifestation of the latter being the empowerment of supranational bodies to upwardly harmonize taxes, regulations, and other forms of political interference in the economy (Hülsmann, 1997). Unsurprisingly, these developments have caused even further deterioration of the spiritual culture of erstwhile Christendom, crowding out or corrupting the intermediary institutions of family, church, and virtuous civil society (Murray, 2012).

Finally, just as the spiritual erosion of the nominally Christian world has gone hand in hand with persistent political centralization and bureaucratic expansion, these phenomena have, in turn, contributed to the destruction of the entrepreneurial ethos and other constitutive elements of mature bourgeoisie culture.

As indicated earlier, the unique individualism of Christian morality, coupled with the organizational decentralization of pre-late-19th-century Europe (as well as the early United States), eventually gave rise to a mature understanding of the

[1] This is, admittedly, just one of many possible explanations of the decline of classical liberalism towards the end of the 19th century, but it is beyond the scope of this paper to defend this particular narrative in greater detail. For the present, it must suffice to note that it is fully compatible with the claim that maintaining the ethical structure of production is a crucial condition of consistent economic growth and development.

great benefits of unhampered commercial activity. The widespread, even if often philosophically unconscious, embrace of concepts such as the labor theory of property, the invisible hand, spontaneous order, economic harmonies, and enlightened self-interest was typical of the intellectual milieu of that era, stretching in particular from the late 18th to the early–mid 19th century. As a result, for the first time in human history, entrepreneurs attained the kind of dignity and social respect that had previously been the privilege of nobles, scholars, ecclesiastics, and other high-ranking members of pre-modern societies. However, this state of affairs lasted relatively briefly, and the deterioration of the lower levels of the ethical structure of production over the last two centuries culminated in the significant moral degradation of the entrepreneurial class, especially its upper echelons.

The ascendancy of welfare statism, Keynesian interventionism, and fiat money regimes entrenched and perfected the socioeconomic system that had been prophetically described by Frederic Bastiat as "the great fiction by which everyone endeavors to live at the expense of everyone else" (Bastiat, 2012, p. 97). The system in question is one in which entrepreneurship is not so much suppressed, but corrupted, meaning that entrepreneurially skilled individuals are incentivized to circumvent the meritocracy of market competition by engaging in various forms of rent-seeking and maintaining their influence through political favoritism. Needless to say, in the absence of appropriate cultural and spiritual restraints — that is, restraints which constitute the most fundamental level of the ethical structure of production — this kind of incentive structure is bound to generate a demoralizing rush to the bottom among businesspeople, driving out those who are unwilling to compromise their principles (Smith and Alvarez, 2017).

Moreover, it might be argued — again, drawing on the business cycle theory of the Austrian school — that there is an important element of delayed reckoning built into the process whereby the essential normative core of the institutional production structure is increasingly eroded while its higher strata seem to remain intact. More specifically, in addition to the economic downturns that inevitably follow periods of fiat credit expansion, one might identify in this context a more comprehensive cyclical relationship — one in which the demoralization of crucial economic decision-makers translates into the replacement of sustainable, fundamentally driven growth and development with its artificial, inflation- and deficit-driven counterpart (Stockman, 2013). In other words, when the institutional structure of production is undermined on its bottommost level, the apparent prosperity of the economy may seem to be at an all-time high just before entering a phase of deep and protracted decline.

In sum, it is a dubious proposition to make a simple extrapolation into the future on the basis of recent decades or even centuries of sustained wealth enhancement. This is because there are cogent grounds for supposing that the most essential and, at the same time, most inconspicuous element of the complex, multi-tier framework which drives genuine economic advancement has become deeply dys-

functional. Furthermore, it is unlikely that this particular element, the deterioration of which has taken place over an extended period of time, can be restored through quick institutional reform or even a rapid "moral awakening." Since what we are dealing with here is an intricately harmonious synthesis of spiritual, organizational, and cultural ideas which matured over many centuries, it is to be expected that its conscious recreation is a work for generations.

I should hasten to add that I do not intend to suggest that what the near future has in store is a retrogression to Malthusian conditions. The amount of accumulated physical, intellectual, and social capital is likely enough to keep the developed world operating at the post-Malthusian level for a period of time necessary to restore the ethical structure of production, provided that the restoration in question starts soon and continues uninterrupted until completion. In the meantime, however, it would be advisable to keep one's expectations humble and to reckon with the likelihood that the Great Enrichment (culminating in the misnamed "Great Moderation" [Garrison, 2009]) will be followed by a prolonged great stagnation.

In this context, it should be borne in mind that, as the present paper argues, the reasons for this stagnation may be much deeper than the ones identified by the law of diminishing returns and other narrowly economic considerations.[2] Nonetheless, it should also be noted that such reasons, insofar as they highlight the importance of various specifically qualitative and normative goods, whose value is notoriously difficult to capture in standard macroeconomic indicators, point to the fact that even a substantial drop in the purely physical productivity of the economy need not necessarily be construed as recessionary. This is because such a drop may be more than made up for by an increasing awareness of the necessity of conserving (or, if need be, almost completely recreating) the ethical structure of production. In other words, if a great stagnation does indeed materialize, it could be turned into a great awakening, which, in turn, could eventually lead to an increase in social well-being on the most subtly vital level — one having to do with cultural robustness and spiritual discipline.

Having made the above observations, let me now conclude by offering a few additional remarks concerning some specific methods which might be employed to aid the all-too-needed spiritual, cultural, and institutional restoration hinted at in the preceding paragraphs.

[2] For a representative analysis that examines the issue of future economic growth and development primarily in reference to the effects of the law of diminishing returns, especially in the technological sphere, see, e.g., Cowen (2011).

Conclusion: Turning a great stagnation into a great awakening

As I suggested in the Introduction, in order to grasp the broader presuppositions and ramifications of phenomena such as economic growth and development, one needs to be well-versed both in ethics and in economics. As demonstrated in the foregoing sections, this is because the most institutionally fundamental level of the capital structure of production consists primarily of normative resources.

Thus, making the productive capacity of the economy more sustainable, let alone restoring it from scratch, requires ensuring not only that sound economic knowledge is widespread among laypeople, but also that the same applies to economically informed ethical awareness. In particular, it requires a common understanding of the fact that various supposed shortcuts to general prosperity are both economically and ethically defective, there being a natural complementarity between observations drawn from these two disciplines.

Increasing the understanding in question necessitates employing both of the abovementioned perspectives in highlighting the ways in which various apparently seductive proposals erode the foundations of the institutional production structure. Explaining, for instance, that the notion of eliminating the scarcity of capital through the expansion of the money supply fatally equivocates between monetary capital and capital goods (produced factors of production) may be complemented by pointing out that, by the same token, it vainly attempts to circumvent the necessity of accumulating savings and displaying the corresponding virtues of temperance and frugality. Likewise, criticizing the concept of "universal basic income" as a counterproductive and economically harmful proposition (Iglesias and Block, 2019) may be reinforced by emphasizing that it is deeply demoralizing as well, running squarely afoul of warnings against idleness such as the Pauline injunction: "If a man will not work, he shall not eat."

Moreover, it might be advisable to reflect on the moral challenges which would have to be met even if the ethical structure of production were presently in a perfectly intact form, thus allowing economic growth and development to continue unimpeded. One such challenge might be the need to enlarge one's capacity for patience, generosity, and intellectual charity in an environment of ever-increasing specialization and versatility. More specifically, if such an environment is not to fall victim to a process of rapidly diminishing returns, then those who operate in it cannot content themselves with being narrowly focused experts, but must become effective communicators of their expertise and equally effective learners of their colleagues' expertise. This, however, requires possessing not merely appropriate technical skills, but also, and far more importantly, the moral virtues mentioned above.

It is also worth noting that the observation in question applies all the more strongly to individuals in managerial roles, whose task is to coordinate the activ-

ities of various specialists and facilitate their fruitful cooperation. After all, being in a leadership position always necessitates displaying moral excellence, but this is especially so when an interpersonally skilled generalist is needed to create a robust atmosphere of collaborative camaraderie among individuals who naturally tend toward self-absorption.

In conclusion, as the capital structure of production becomes more complex and internally differentiated, the parallel ethical production structure has to become correspondingly more advanced and qualitatively sturdier. This, I believe, is the crucial lesson which should guide us as we strive to both rebuild the existing, badly depleted stock of ethical capital and ensure that future economic growth and development will not become similarly handicapped due to a lack of appropriate normative foundations. In other words, heeding this lesson should allow us to both turn a possibly looming great stagnation into a great awakening and avert the prospects of similar stagnations (let alone retrogressions) in the future.

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The impact of the COVID-19 pandemic on the assets and reserves of the banking sector

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Abstract

The banking sector is a very important part of the financial market. That is why banks, along with the spread of the pandemic, began to implement various strategies and solutions to protect people's finances against the negative effects of the coronavirus crisis (Flotyński, 2020, 20). Today, it is clear that the pandemic has surprised everyone and the solutions used so far have not been perfect. Therefore, the banking sector requires corrections in current forecasts as well as the preparation of new forecasting models for the financial market. This is particularly important in times of economic, social, and financial instability caused by random events such as the COVID-19 pandemic. The present article examines the distribution mechanisms shaping and influencing the selection of the appropriate class of models depending on the current economic situation of chosen processes important for the banking sector, that is assets and reserves. The author recognizes the mechanisms shaping both processes during a stable period as well as the way in which the pandemic changed these mechanisms, thus affecting the prognostic abilities of the models used. The analysis shows that the Polish banking sector was well prepared for the economic slowdown, but despite this, the COVID-19 pandemic caused some perturbations.

Introduction

The pandemic caused by the SARS-CoV-2 virus has changed a lot in the modern world. People were forced to reshape their lives to protect themselves from a dan-

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gerous disease. The changes which took place during this time mainly concerned interpersonal relationships, ways of doing work, studying, and communication. Financial markets have also started taking action to limit the negative effects caused by the pandemic — most of all, the banking sector, whose assets constitute about 75% of the entire financial system in Poland. The central bank took quick and radical measures to maintain the liquidity and stability of banking in Poland. The Polish National Bank (Narodowy Bank Polski, hereinafter: NBP) began to implement the policy of quantitative easing and asset purchases, which resulted in a significant increase in the assets of the entire financial sector (Zaleska, 2021, 38–46). However, not all activities undertaken by the banking sector enjoy a positive reception from specialists. A reduction in interest rates was considered unnecessary and contributed to the negative effects of monetary policy, including an increase in demand for credit. This reduction also did not help recover the weakened economic growth, as was initially assumed (Sieroń, 14.03.2020). At the end of 2021, interest rates began to be significantly raised, which also indicates a withdrawal from previously-made decisions (www3).

The coronavirus pandemic has come as a surprise to most people around the world. However, at the start of the crisis, the Polish banking sector was in a very good shape. The banks had effective safeguards, a high level of equity, assets, and reserves, and the overall financial situation was evaluated as stable (Łasak, 2020, 80–93). Typical financial crises are very different from ones caused by a pandemic. In the case of the former, the activities of banks are limited by financial losses and the size of capital, while in the case of the corona crisis, banks can conduct free lending activities, provided that this does not lead to a financial crisis (Hryckiewicz and Olszak, 2021, 153–183).

The pandemic has significantly affected various economic sectors around the world. People thought first and foremost about their health and their families. However, with the continuously uncertain situation, more and more people began to also focus their attention on the condition of the financial sector.

The aim of the article is to analyse the impact of the pandemic on the situation occurring in the Polish banking sector during the COVID-19 crisis by means of verifying econometric models imitating the mechanisms of shaping assets and reserves in the period of stable economic situation and maintaining their forecasting properties during the pandemic. To verify the hypothesis that the models correctly imitating the mechanism of shaping assets and reserves in a period of stable economy retain their prognostic properties during the pandemic, a study was conducted. The article has been divided into two parts; the first includes a theoretical part and a description of the banking sector in times of crisis in Poland. Then, the author describes and analyses variables which were used to create econometric models. The second part presents the modelling and forecasting of the analysed processes, divided into a period of calm — that is, before the pandemic — and a period during the pandemic. It also includes an analysis of the research conclusions.

Stability of the Polish banking sector in a period of unstable economic situation

The economic situation reflects the circumstances prevailing in a given country or market sector. These are all changes in the indicators of economic life, such as the basic components of, e.g., the Gross Domestic Product, inflation, unemployment rate, or investment (www2). Stability of the financial sector is understood as a state in which this system performs its functions in a continuous and effective manner, even when unexpected and unfavourable disturbances of a significant scale occur (www4). The NBP conducts ongoing analyses of the stability of various segments comprising the financial system, including the banking sector. These analyses are carried out for preventive purposes, in order to identify the factors which may cause the instability of the financial system and to assess its resilience to shocks caused by real threats. The period of unstable economic situation is primarily a time of crisis. The first half of the twentieth century, shortly after Poland regained independence, was a challenge for the national economy. Both the rising inflation and the reconstructions necessary to rebuild the destroyed country contributed to the deepening financial crisis. During this period, the Polish banking sector began to take shape (Skrzyński, 2004, 73–76). The second important and at the same time difficult time for the Polish financial sector occurred in the 1980s. The regulations introduced by the government during the times of the People's Republic of Poland (PRL) were aimed at subordinating the country's emission and credit policy to the NBP and in particular, thanks to the bank's support, financing the budget deficit (Kaszubski, 1994). Since that time, the main objectives of this sector were primarily to strengthen the Polish currency, support the country's economic policy, as well as supervise and manage monetary and credit policy (ustawa z dnia 31 stycznia 1989 roku o Narodowym Banku Polskim, Dz.U. z 2022 r. Nr 4, poz. 22). The purpose to be implemented primarily by the NBP was to prevent a crisis — that is, to reduce inflation (Leszczyńska, 2010, 54–61).

The financial crisis of 2008 affected many economies around the world. Poland during this period was described as a "green island" of sorts. The situation in our country did not seem too dire, as the Polish economy was slightly stronger than in the neighbouring countries. However, at the beginning of 2009, GDP growth decreased by about 4–5% compared to the period from 2007 to June 2008, which is about 2% in 2009. A decline in investment was also recorded as a result of fears regarding the near future (Wierzba, Gostomski, Penczar, Liszewska, Górski, Giżyński and Małecka, 2014, 58–62). In particular, the weakened economy has affected many aspects of the banking sector, which, until that time, was in a proper financial condition. According to the Polish Financial Supervision Authority, as a result of the crisis, there has been a decrease in mutual trust among financial institutions (Komisja Nadzoru Finansowego, 2010). This situation proves that issues

in the banking sector affect both businesses and individuals (Wierzba et al., 2014, 62–66). It is worth considering how the current pandemic, which has had an impact on the whole world, will affect the Polish banking sector.

Banks, like businessmen, are obliged to publish information about their economic and financial situation in the form of a balance sheet. An important part of it are financial assets, which testify to the capital and potential of the banking sector — and are, above all, the basis for its functioning (Zaleska, 2007, 594–596). In times of an economic crisis, asset quality is a key issue, as many borrowers are not repaying their liabilities and the volume of non-performing loans is increasing. Banks' assets include, i.a., money in hand and funds intended for trading; an important part are also loans granted to companies and households, which are designed to bring profits. However, sometimes, when the risk of non-payment of loans by consumers increases, banks can generate losses. When asset quality declines, banks need to maintain more capital to cover the existing credit risk and create higher reserves to prepare for expected losses (www1). According to Art. 3 point 1 para. 21 of the Accounting Act, reserves are liabilities whose date or amount is uncertain (ustawa z dnia 29 września 1994 roku o rachunkowości, Dz.U. z 2021 r. poz. 217). Bank reserves are cash which banks are required to deposit in dedicated accounts with the central bank. They also often serve as a monetary policy tool. When a central bank lowers the reserve requirement, banks have the opportunity to take out new loans and in this way increase economic activity. In contrast, when they increase their reserves, the economic growth slows.

In June 2021, a report was published on the stability of the financial system during the COVID-19 pandemic in Poland. At the very beginning, we can learn that, although the coronavirus had a significant impact on the country's economy, these effects do not threaten the stability of the domestic banking sector. However, the legal risk regarding the portfolio of mortgage loans denominated in foreign currencies is high and may pose a significant threat to the financial system. A noticeable increase in reserves and write-offs for credit risk contributes to a continuous decline in the profitability of banks in the European Union (NBP, 2021). According to a study by Deloitte (2020) on the impact of the pandemic on the banking sector in Eastern Europe, banks have significantly improved their asset quality since the global financial crisis in 2008. They built larger capital buffers and strengthened their liquidity, thus entering the economic slowdown in a better condition than during the previous financial crisis. Although the COVID-19 pandemic is still ongoing, several publications have already described its effects on the financial market in Poland. Professors Hryckiewicz and Olszak (2021) in their article analyse the quality of the loan portfolio during two different crises. They noted that, both during the Great Recession and the corona crisis, the quality of the total credit portfolio for enterprises and households has been gradually deteriorating. Professor Waliszewski (2021, 209–227) in his article attempted to analyse the impact of the pandemic on the financial sector, in particular the credit market.

Loans constitute a significant part of the banking sector's assets. The author noted that the pandemic had a negative impact on the financial situation of Poles and increased the level of uncertainty as well as credit risk.

Methods and materials

The empirical analysis of the banking sector in Poland was based mainly on econometric models. The first one used in the article is the model with delays — autoregressive distributed lag model (ADL). An ADL(p, q) model assumes that a time series can be represented by a linear function of p of its lagged values and q lags of another time series :

$$Y_t = f(Y_{t-1}, Y_{t-2}, \ldots, \quad Y_{t-p}, X_t, X_{t-1}, \ldots \ , X_{t-q}, \varepsilon_t) \tag{1}$$

The model parameters are estimated using the least squares method. Like many statistical analyses, ordinary least squares (OLS) regression has underlying assumptions. When these classical assumptions for linear regression are true, ordinary least squares produces the best estimates. However, if some of these assumptions are not true, one might need to employ remedial measures or use other estimation methods to improve the results. Therefore, it is always necessary to verify the assumptions for OLS regression:

1. The independent variables should not be correlated to residuals.
2. The expected value of the residuals is zero.
3. The residuals have homogeneous variance.
4. The residuals have autocorrelation equal to zero.
5. The residuals follow a normal distribution.

The model is used when there are reaction delays in the process under test. The autoregressive process is one in which the present value results from the values in previous periods (Kufel, 2022, 91–97). Another autoregressive model considered in the paper is the autoregressive integrated moving average model (ARIMA), used for non-stationary processes which that can be reduced to a stationary form following the structure:

$$Y_t = \alpha_0 + \alpha_1 v\, Y_{t-1} + \alpha_2 Y_{t-2} + \ldots + \alpha_p Y_{t-p} + \beta_1 \varepsilon_{t-1} + \beta_2 \varepsilon_{t-2} + \ldots + \beta_q \varepsilon_{t-q} + \varepsilon_t \tag{2}$$

The AR part of ARIMA indicates that the evolving variable of interest is regressed on its own lagged values. The MA part indicates that the regression error is actually a linear combination of error terms whose values occurred contemporaneously and at various times in the past (Box, 2015). In this case, the model parameters are estimated using the maximum likelihood method (Stock and Watson, 2020, 607). The ARIMA model was estimated by setting its initial parameters p = q = 1 and d = 1, which will be presented in detail further.

Two main variables which play an important role in the banking sector, i.e., assets and reserves of the entire banking sector in Poland, were adopted for the empirical analysis. These variables were captured respectively in the period before and during the pandemic. The assets and reserves of banks are processes whose mechanism and formation depends on the situation prevailing in the economy. Because of that, their development in the Polish banking sector was examined, with the distinction of two periods: from 2011 to November 2019 (December 2019 marking the coronavirus outbreak in the world) and from December 2019, assuming March 2020 as the moment of the outbreak in Poland (Figure 1).[2]

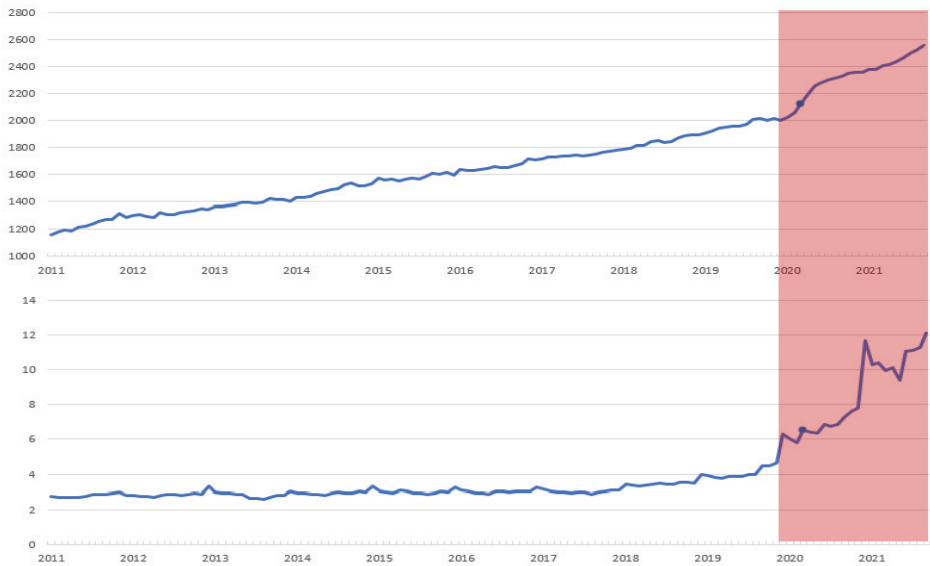

Figure 1. Assets and reserves of the banking sector in Poland (in bln PLN)[3]

Source: own study.

[2] The data on the basis of which the analysis was conducted come from the Polish Financial Supervision Authority website. Data by the PFSA are obtained from banks through the NBP. "Dane finansowe sektora bankowego prezentowane są na podstawie sprawozdawczości FINREP jednostkowy (FINPL) przekazywanej przez banki i oddziały instytucji kredytowych zgodnie z załącznikiem nr 4 Uchwały nr 52/2017 Zarządu Narodowego Banku Polskiego z dnia 14 grudnia 2017 roku."

[3] Assets and reserves of the banking sector in Poland in the entire period covered by the analysis, highlighting the pandemic period (December 2019–2021).

Analysing the above charts, it can be seen that in the period before the COVID-19 outbreak, both processes were characterized by a stable long-term upward development trend with minor disturbances (fluctuations). In the case of assets, the outbreak of the pandemic affected the greater growth dynamics, while in the case of reserves, the volatility of the analysed process increased further. When analysing the chart of time series regarding assets, it is possible to notice, above all, their sudden increase since the end of 2019. This was when the world began to hear about the first cases of SARS-CoV-2. The first cases in Poland appeared in March 2020 — the time series chart shows a continuous dynamic increase in the assets of the banking sector during this period. If we also look at the reserve time series graph, we can observe a sudden increase and more significant fluctuations since the beginning of the pandemic. Since March 2020, the reserves of the banking sector in Poland have increased significantly and one can notice greater volatility, which indicates the uncertainty which prevailed in the financial market. The fluctuations observed during the COVID-19 pandemic are accidental and a consequence of an unstable situation. The above results confirm that while the Polish banking sector entered the pandemic period well capitalised and liquid, the outbreak caused significant perturbations in this area, particularly regarding the need to maintain higher reserves. Table 1 and Figure 2 show how the pandemic has affected the basic statistics and distribution of assets.

Table 1. The impact of the pandemic on the basic statistics of the distribution of the analysed processes: assets and reserves of the banking sector in Poland (in bln PLN)

	Assets		Reserves	
	stable period	COVID-19	stable period	COVID-19
Average	1577.00000	2316.50000	3.10170	8.55200
Median	1572.60000	2351.60000	2.97470	7.71850
Standard deviation	233.35000	155.22000	0.40477	2.17440
Skewness	0.12373	-0.65073	1.79070	0.25521
Kurtosis	-1.05910	-0.39360	3.06370	-1.55190

Source: own study.

The above results confirm that the existing mechanisms shaping the processes of the banking sector have lost their validity. Due to this, the financial and credit plans of banks as well as their strategies need to be reformulated. The COVID-19 pandemic has changed long-term trends, increased the dynamics of processes, and, above all, affected their variability. This means that risk is a huge problem for the banking sector during the pandemic, which is why banks will be forced to make further adjustments, especially in terms of reserves.

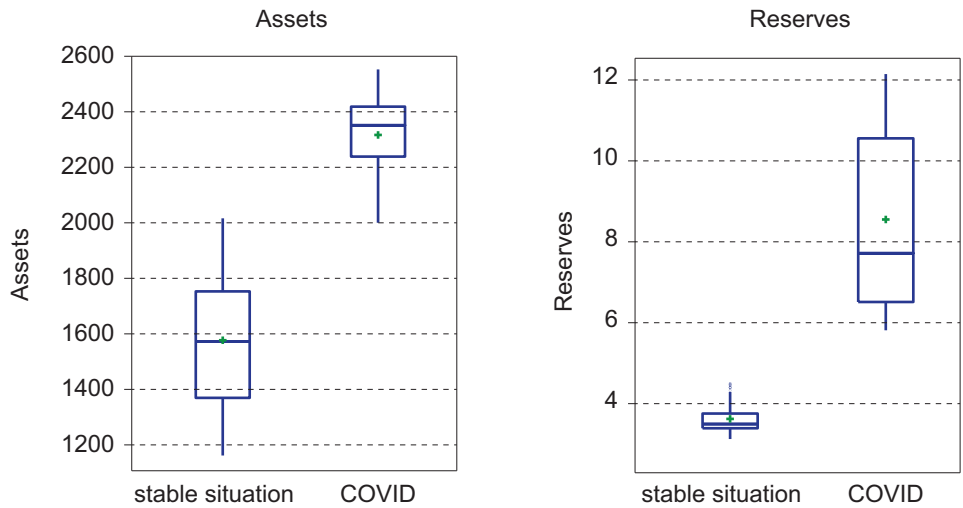

Figure 2. The impact of the pandemic on the change in the distribution of assets and reserves in the Polish banking sector (box charts)

Source: own study.

Results of modelling and forecasting of the analysed processes in a period of calm

The observed mechanisms shaping the two main processes of the banking sector covered by the analysis: assets and reserves, form the basis of macroeconomic forecasts. Because of the changes taking place in the economy and in the market have a significant, albeit somewhat delayed impact on the banking sector, the use of dynamic autoregressive models has been proposed. The occurrence of the autoregressive component in the econometric model manifests itself in the form of delayed processes that play a double role in the model as:

— a casual factor,

— a factor determining the harmonic structure.

In the case of the banking sector, it can be suspected that delays in reactions are the result of, i.a., the action of institutional factors, and this is a signal indicating that models should be considered ADL(p, q). The paper takes into consideration a linear model of the following form:

$$Y_t = \alpha_0 + \alpha_1 Y_{t-1} + \alpha_2 Y_{t-2} + \ldots + \alpha_p Y_{t-p} + \beta_0 X_t + \beta_1 X_{t-1} + \beta_2 X_{t-2} + \ldots + \beta_q X_{t-q} + \varepsilon_t \quad (3)$$

In order to recognise the frequency and intensity of fluctuation, a periodogram of the so-called process spectrum was used. To correctly determine the delay order, a correlogram was used in the identification phase (Figures 3 and 4).

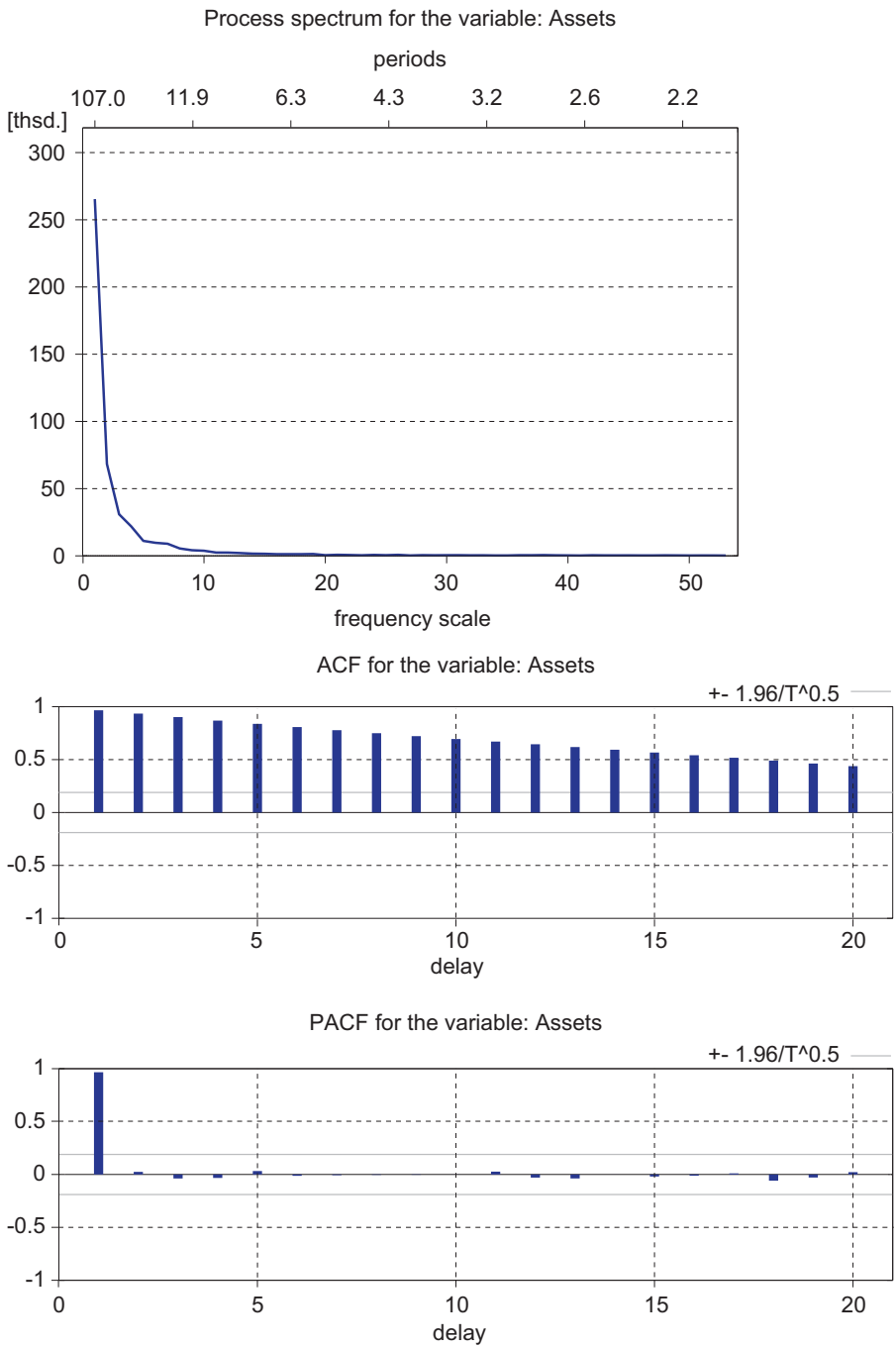

Figure 3. Periodogram and correlogram of the assets process in a period of calm (before the COVID-19 pandemic)

Source: own study.

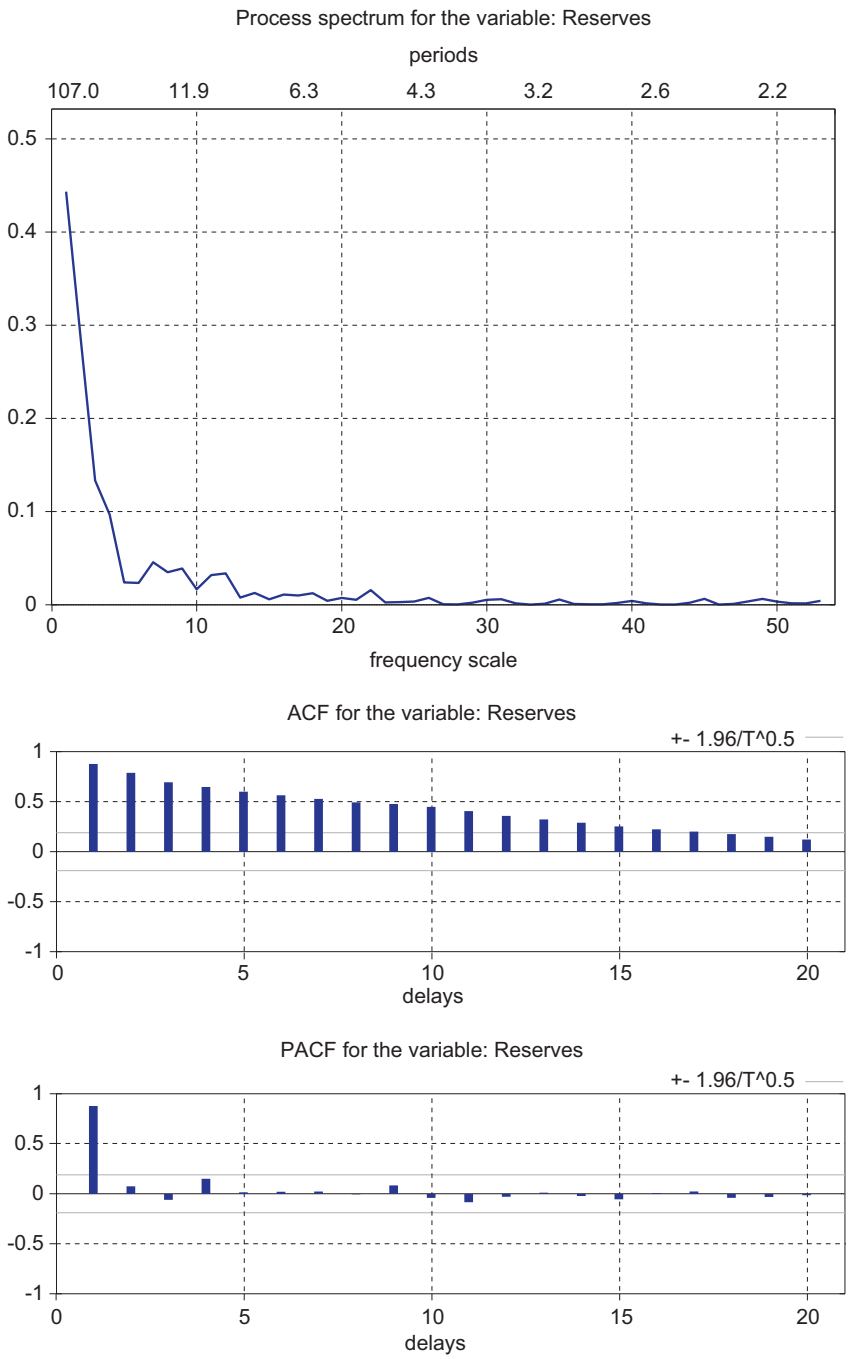

Figure 4. Periodogram and correlogram of the reserves process during the period of calm (before the COVID-19 pandemic)

Source: own study.

The graphs above indicate that both processes in the period of calm (before the pandemic) are characterised by a long-term development trend without random fluctuations and a delay in the reactions of processes of row 1 and 4, respectively. This suggests a short memory of the asset process and a long memory of the reserve process. In addition, in the case of reserves, fluctuations are also observed, which may be of a different nature than harmonics. In order to confirm these conclusions, in both cases ADL(1, 0) and ADL(4, 0) models were proposed as the correct model classes. The results of estimating model parameters are presented below.

Model 1. Least squares method (LSM) estimation, observations used February 2011 – November 2019 (N = 106)

Dependent variable (Y): assets

	Factor	Standard error	t-Student test	p-Value
Assets_1	1.00502	0.000859404	1169	< 0.0001

Arithmetic mean of the dependent variable	1580.893000	Standard deviation of the dependent variable	230.898700
Uncentred R-square	0.999923	Centred R-square	0.996290
Logarithm of the likelihood function	-430.127300	Akaike information criterion	862.254700
Autocorr.rest — rho1	-0.318576	Durbin h statistics	-3.280074

Model 2. LSM estimation, observations used March 2011 – November 2019 (N = 105)

Dependent variable (Y): reserves

	Factor	Standard error	t-Student test	p-Value
Reserves_1	0.776431	0.0961723	8.073	< 0.0001
Reserves_2	0.231330	0.0967643	2.391	0.0186

Arithmetic mean of the dependent variable	3.108649	Standard deviation of the dependent variable	0.405372
Uncentred R-square	0.998466	Centred R-square	0.907406
Logarithm of the likelihood function	71.248670	Akaike information criterion	-138.497300
Autocorr.rest — rho1	-0.007789	Durbin h statistics	-0.469963

Finally, eliminating the irrelevance of the parameters, the ADL(1, 0) and ADL(2, 0) models were obtained as the correct asset model. In both cases, the used autoregressive model reflects the variability of the analysed processes in 99%, which means a very good match. In order to confirm the correctness of the models, a verification of the properties of the model residues — i.e. the assumptions of the least squares method (LSM) — was carried out. The results of the verification are presented in Table 2.

Table 2. Verification of the assumptions of the LSM for autoregressive models (p-value)

Assumption	Test	Assets Model 1 — ADL(1, 0)	Reserves Model 2 — ADL(2, 0)
$\rho(\varepsilon, X) = 0$	correlation significance t-test	0.401000	0.2405 and 0.2116
$E(\varepsilon) = 0$	t-test for dependent tests	0.902200	0.8861000000
$\rho(\varepsilon_t, \varepsilon_{t-1}) = 0$	Durbin-h test	0.361619	0.9399260000
$\sigma^2 = \text{const}$	White test	0.593315	0.2974070000
$\varepsilon \sim N(0, \sigma^2)$	Shapiro-Wolf test	0.457537	3.83573e-007

Source: own study.

On the basis of the obtained p-values, it can be concluded that in the case of the asset model, the assumptions of the LSM were met, therefore the ADL(1, 0) model is correct and can be the basis for macroeconomic forecasts. However, in the case of reserves, the assumption of the normality of the distribution was not met, which means that the model requires modification and checking whether other important components of the process apart from the deterministic trend should be distinguished. For this purpose, an augmented Dick–Fuller unit root test (ADF) was performed for the reserve process, and the results are shown below:

Test without constant term (const): asymptotic p-value = 0.9888.
Test with constant term (const): asymptotic p-value = 1.
Test with constant term and linear trend: asymptotic p-value = 0.996.

In all variants of the ADF test, the value of $p > 0.05$ indicates no grounds for rejecting the null hypothesis, which means that the reserve process is non-stationary — this can result from not only the deterministic trend, but also the stochastic one. This means that the successive values of the variable are sums of the disturbances realized up to the moment marked as t, so that each disturbance is permanently present in the value of the variable.

In this case, the ARIMA class model should be used as an autoregressive model, and the maximum likelihood estimation method (MLE) — to estimate its parameters. Therefore, in order to verify the validity of this approach for the reserve process, an estimation of the ARIMA(p, d, q) model was carried out, setting its initial parameters as: $p = q = 2$ once $d = 1$, because the reserve process is integrated in level 1. In the end, the model with the relevant parameters and the lowest Akaike criterion was chosen as the best — the ARIMA(1, 1, 0) model taking the form:

Finally, the ADL(1, 0) and ARIMA(1, 1, 0) respectively were obtained as correct models of the processes of assets and reserves in the pre-pandemic period, describing the mechanism shaping these processes in the period of calm, as illustrated by the charts in Figure 5.

Model 3. ARIMA estimation, observations used February 2011 – November 2019 (N = 106)
Estimation using method AS 197 (proper ML)

Dependent variable (Y): (1-L) reserves

	Factor	Standard error	Z	p-Value
const	0.017539	0.009793	1.791	0.0733
phi_1	-0.220357	0.095022	-2.319	0.0204

Arithmetic mean of the dependent variable	0.017621	Standard deviation of the dependent variable	0.12654
Arithmetic random disorders	-0.000168	Standard deviation of the random disorders	0.12284
Determination coefficient R-square	0.909223	Corrected R-square	0.90922
Logarithm of the likelihood function	71.838280	Akaike information criterion	-137.67660
Schwarz's Bayesian criterion	-129.686300	Hannan-Quinn criterion	-134.43800

Results of modelling and forecasting of the analysed processes during the pandemic

As was shown, the period of the COVID-19 pandemic has caused a change in the characteristics of the processes in the banking sector. It is therefore necessary to learn about their specificity in new conditions, the most important characteristic of which is uncertainty. In this context, correct modelling and forecasting is particularly important during unstable situations, which is why an attempt was made to investigate the impact of the COVID-19 pandemic on the correct way of modelling these processes. So, the hypothesis was verified — models which correctly imitate the mechanism of formation of assets and reserves in a period of stable economy retain their prognostic properties during the pandemic. Hence, autoregressive models considered to be correct during the calm period were evaluated. Again, a periodogram and a correlogram were used to recognize the frequency and intensity of fluctuations and delays (Figures 6 and 7).

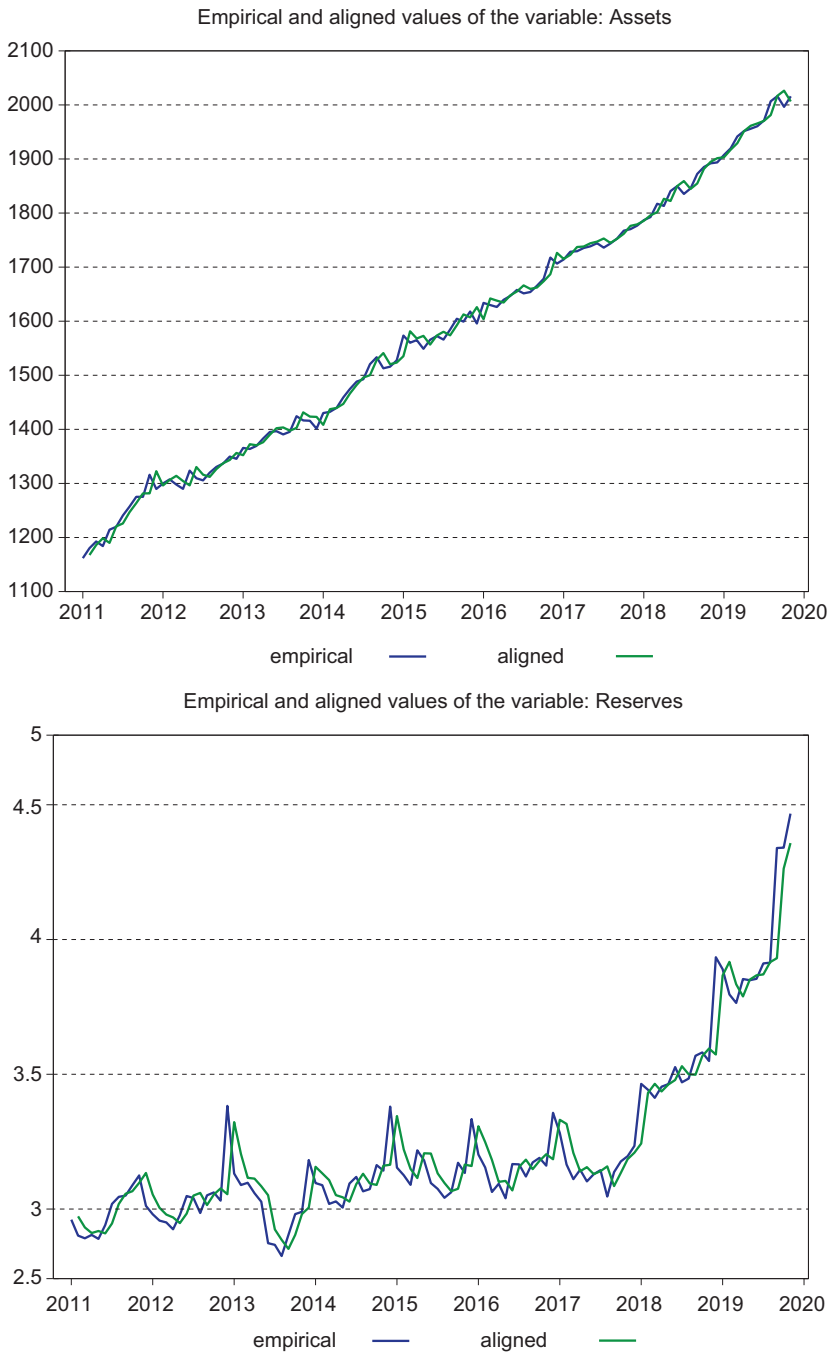

Figure 5. Correct recognition of the pattern of analysed processes and implementation resulting from their models (2011–2020)

Source: own study.

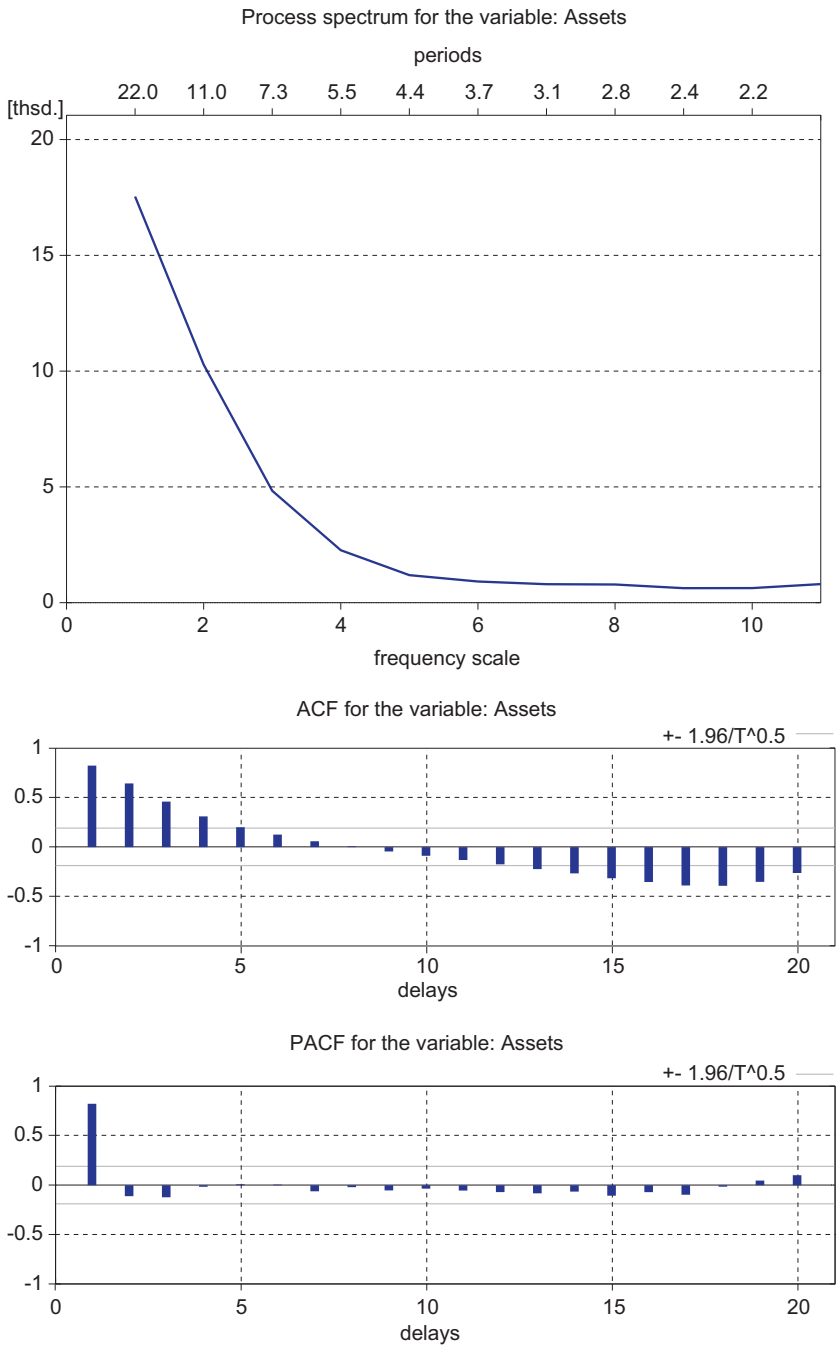

Figure 6. Periodogram and correlogram of the asset process during the COVID-19 pandemic (monthly data)

Source: own study.

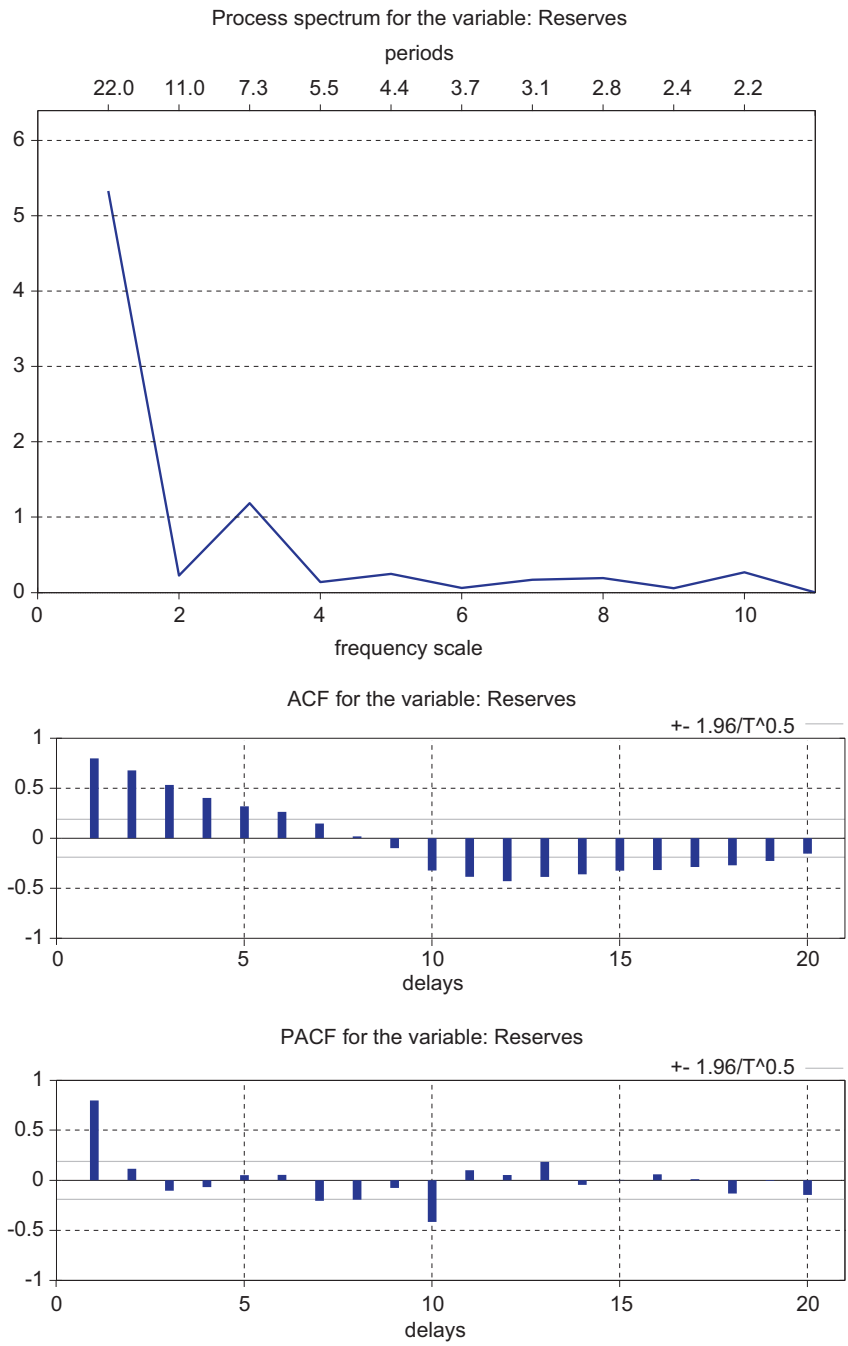

Figure 7. Periodogram and correlogram of the reserve process during the COVID-19 pandemic (monthly data)

Source: own study.

Based on the graphs above, it can be seen that the pattern of development of both processes is changing, as there are significant fluctuations of a short and medium-term nature, which were not observed during the calm period. In addition, in the case of the reserve process, a significant delay of 10 is observed, which may indicate the impact of the pandemic on the "memory" of the process. Therefore, variability and the "long memory" resulting from the uncertainty emerging in the banking sector is becoming an important component of processes during the pandemic. In order to confirm the hypothesis, the correctness of the following model classes was verified:

— for assets: the ADL(1, 0) model;

— for reserves: the ARIMA model, but with a higher latency reflecting the observed effect of long memory.

The results of estimating the parameters of the ADL(1, 0) model are presented below.

Model 1A. KMNK estimation, observations used December 2019 – September 2021 (N = 22)

Dependent variable (Y): assets

	Factor	Standard error	t-Student test	p-Value
Assets_1	1.01046	0.00197	512	< 0.0001

Arithmetic mean of the dependent variable	2316.525000	Standard deviation of the dependent variable	155.217500
Sum of squares rests	9495.705000	Standard error of rests	21.264440
Uncentred R-square	0.999920	Centred R-square	0.981232
Logarithm of the likelihood function	-97.959720	Akaike information criterion	197.919400
Autocorr.rest — rho1	0.560772	Durbin-h statistics	2.630364

In order to confirm the correctness of the above models, the assumptions of the LSM were verified, the verification results of which are presented in Table 3.

Table 3. Verification of the assumptions of the LSM for autoregressive models (p-value)

Assumption	Test	Assets Model 1 — ADL(1, 0)
$\rho(\varepsilon, X) = 0$	correlation significance t-test	0.92820000
$E(\varepsilon) = 0$	t-test for dependent tests	0.18350000
$\rho(\varepsilon_t, \varepsilon_{t-1}) = 0$	Durbin-h test	0.00852935
$\sigma^2 = \text{const}$	White test	0.04513100
$\varepsilon \sim N(0, \sigma^2)$	Shapiro-Wolf test	0.05904540

Source: own study.

In the case of the asset model, we can see that the ADL(1, 0) model, which correctly described the mechanism shaping the analysed phenomenon — bank assets during a period of calm — is unfortunately not a correct model during a pandemic. This is due to the fact that the LSM assumptions were violated in terms of non-autocorrelation and homoscedasticity, and because of it the model was verified negatively.

In the case of the reserves process, the ARIMA model was assessed, and the results of the LSM estimation of its parameters in the pandemic period are presented below.

Model 2A. ARIMA estimation, observations used December 2019–September 2021 (N = 22)
Estimation using method AS 197 (proper ML)

Dependent variable (Y): (1-L) reserves
Standard errors based on Hessian

	Factor	Standard error	Z	p-Value
const	0.317492	0.145621	2.180	0.0292
phi_1	-0.386918	0.200333	-1.931	0.0534

Arithmetic mean of the dependent variable	0.341201	Standard deviation of the dependent variable	1.03552
Arithmetic random disorders	0.019086	Standard deviation of the random disorders	0.93339
Determination coefficient R-square	0.812446	Corrected R-square	0.81245
Logarithm of the likelihood function	-29.781100	Akaike information criterion	65.56220
Schwarz's Bayesian criterion	68.835320	Hannan-Quinn criterion	66.33330

Model 2B: ARIMA estimation, observations used December 2019–September 2021 (N = 22)
Estimation using method AS 197 (proper ML)

Dependent variable (Y): (1-L) reserves
Standard errors based on Hessian

	Factor	Standard error	Z	p-Value
const	0.312327	0.0261434	11.950	6.76e-033
theta_1	-1.000000	0.1603510	-6.236	4.48e-010

Arithmetic mean of the dependent variable	0.341201	Standard deviation of the dependent variable	1.03552
Arithmetic random disorders	-0.032822	Standard deviation of the random disorders	0.83167
Determination coefficient R-square	0.847716	Corrected R-square	0.84772
Logarithm of the likelihood function	-28.729440	Akaike information criterion	63.45890
Schwarz's Bayesian criterion	66.732010	Hannan-Quinn criterion	64.22990

Based on the above results, it should be concluded that the ARIMA(1, 1, 0) model, which was the correct model of reserves during the calm period, is not the appropriate model during the pandemic. Since uncertainty has proven to be an important component, the ARIMA(0, 1, 1) model is a better one, which confirms that during the pandemic, disturbances over time affect the value of the dependent variable more and more significantly. Therefore, the hypothesis has been verified negatively, which means that models which correctly imitate the mechanism of shaping assets and reserves in the period of a stable economy do *not* retain their forecasting properties during the pandemic.

Conclusions

Analysing the results, it can be seen that the mechanisms which shape the processes of the banking sector in Poland have lost their relevance and differ significantly depending on the situation in the economy. During the development of the corona crisis, there were mainly changes in long-term trends, increased dynamics of processes, and their variability. Predictions and actions made in the initial phase of the COVID-19 pandemic have changed. New solutions are currently being introduced to contain the negative impact of the crisis on the banking sector. The analysis conducted in the article and the inability to confirm the hypothesis indicate the instability of prognostic properties depending on the period. The time of the pandemic is characterised primarily by uncertainty and risk, and because of it the banking sector has undergone considerable changes in the characteristics of processes.

At the end of 2021, we were on the threshold of another wave of coronavirus. We still do not know what exact effects the pandemic has brought and what awaits us in the near future. The long-term development of the pandemic and the emergence of new coronavirus variants bring a lot of uncertainty. A great unknown is also the current situation on the financial markets, above all in the banking sector and in the economy, where an increase in inflation is still noticeable. What is certain at present is that we still know too little about these processes.

The article analysed the situation of the banking sector during the corona crisis on the basis of two main processes: assets and reserves, which form the basis of macroeconomic forecasts. In the first part, a review of the most up-to-date literature presented the influence of the pandemic on the banking sector and proposed solutions to reduce the negative effects. The author also described the visible symptoms of the crisis in Poland as well as the ways in which the banking sector coped in times of unstable economic situation. Finally, a preliminary analysis was launched using the two processes demonstrating the health of the banking sector. The detailed study covered a stable period and the times of COVID-19, respectively. The hypothesis presented earlier has been verified negatively — while the autoregressive model of the ADL class correctly describes the mechanism shaping bank assets in the period of calm, unfortunately it is not a correct model in the

pandemic period and thus loses its prognostic properties. However, in the case of reserves, the correct prognostic model in the period of calm is the autoregressive model of the ARIMA class, which, in order to maintain its prognostic properties during a pandemic, required modification consisting in taking into account a higher delay reflecting the observed effect of long memory. This is undoubtedly confirmed by the fact that in times of instability, such as the COVID-19 pandemic, disruptions over time increasingly affect the values of the analysed processes and thus the entire banking sector. The results of the conducted analysis confirmed the usefulness of ADL and ARIMA autoregressive models in analyses and forecasts in periods of calm. At the same time, ADL models lose their prognostic properties in periods of unstable economy, while ARIMA models taking into account the long memory effect retain their properties and can be used.

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The company control threshold in Poland after the reform of mandatory takeover bids

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JEL classification: G12, G14, G18, K22

Keywords: takeover bids, investor protection, control threshold

Abstract

This article is devoted to the problem of mandatory takeover bids in Poland on the grounds of previously binding regulations and the new legal provisions. After many years of waiting by the Polish investors, on 30 May 2022, amendments to the Public Offering Act came into force. They primarily concern changes in the rules regarding conducting mandatory takover bids for the sale or exchange of shares in public companies on a regulated market. The most important change, which also constitutes the main subject of this article's discussion, is the introduction of the so-called control threshold for companies, at the level of 50%. The aim of this article is to present the former regime on takeover bids as well as to critically analyze the newly adopted one. Moreover, the author gives comparative insight into the matter and criticizes the current Polish regulation as inconsistent with the European law. The paper concludes with a *de lege ferenda* call for revision of the control threshold under Polish capital market laws in order to ensure investor protection safeguards compliant with the EU law.

Introduction

After several years of waiting by the Polish investors, on 30 May 2022, the provisions of the Act on amendments to the Act on mortgage bills and mortgage banks and certain other Acts concerning amendments to the Public Offering Act (ustawa z dnia 7 kwietnia 2022 roku o zmianie ustawy o listach zastawnych i bankach hipotecznych oraz niektórych innych ustaw, Dz.U. z 2022 r. poz. 872; hereinafter:

the Amendment) came into force in Poland. The amendment to the Public Offer of Financial Instruments Act (ustawa z dnia 29 lipca 2005 roku o ofercie publicznej i warunkach wprowadzania instrumentów finansowych do zorganizowanego systemu obrotu oraz o spółkach publicznych, Dz.U. Nr 184, poz. 1539 ze zm.; hereinafter: the POA) is crucial from the perspective of individual investor protection and a great victory for investment circles (especially the SII — the Association of Individual Investors). Several solutions introduced to the POA aimed, i.a., at improving the protection of individual investors and the security of the entire Polish capital market. They primarily concern changes in the rules of announcing and conducting tender offers for the sale or exchange of shares in public companies admitted to trading on a regulated market (hereinafter: bids / tender offers). The most important change, which is the main subject of this article's discussion, concerns the introduction of the so-called control threshold for companies, at the level of 50% instead of the previous two thresholds at 33% and 66%. Exceeding the threshold obliges a company to announce a mandatory bid for the sale or exchange of all shares.

The previous regulations have been heavily criticized by the doctrine, practice, and investors, who have accused them of being inconsistent with the EU law, especially with the so-called 13th Directive (Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, OJ L 142 from 30 April 2004; hereinafter: the Directive). The current structure of tender offers for the sale or exchange of shares in public companies has led to numerous pathological situations in which the interests of minority shareholders have been significantly marginalized. Previous experience of the Financial Supervision Authority also shows that the institution of tender offers was not very clear for capital market participants and inadequately protected their interests (Ministerstwo Finansów, 2014; SII, 2021A). The hitherto regulations did not fulfill their purpose, as they allowed entities acquiring control over public companies to meet the obligations related to this institution only formally, which posed a real threat to the interests of minority shareholders.

This article is devoted to discussing the issue of mandatory bids on the grounds of previously binding regulations and the new legal provisions. Moreover, the paper gives comparative insight into the matter.

1. Research methodology

The work uses methods mostly known to legal studies: the formal-dogmatic (legal-analytical) and legal-historical methods, the economic analysis of law, comparative legal research, critical and systematic analysis, and critical-legal dogmatics. The formal-dogmatic (legal-analytical) method is based on the exegesis of normative material and is used to study the law from a static perspective. The

provisions of takeover bids law are subject to a detailed critical analysis and interpretation, taking into account the views expressed in the doctrine and the achievements of judicial decisions, as well as decisions of market supervision authorities. A comparative method is used to study law from a dynamic perspective. In the work, it is primarily applicable to the legal-comparative analysis of the relationship between the quasi-harmonized European legal systems regarding the implementation of the Directive. This method will allow the author to answer the question whether given institutions and solutions fulfill their role in the legal system and to assess the effectiveness of a given regulation in comparison to another legal system. The economic analysis of law helps to understand the problems and motives for the regulator's specific actions from different perspectives — especially from the perspective of investor protection. The legal-historical method is used to analyze the interpretation of law from a chronological standpoint in order to evaluate the dynamics within the legal framework of takeover bids as well as the direction in which the regulator is going.

2. The role of mandatory bids in the legal and economic background

A safe and effective capital market is a significant segment of the economy. It enables economic entities to raise funds for financing investments and business ventures. At the same time, a capital market is a place which creates an opportunity for investors to attractively invest part of their savings (Ministerstwo Finansów, 2014, 1).

An institution of the law which is aimed at ensuring the proper functioning of the capital market is the institution of mandatory tender offers for the sale or exchange of shares in public companies (the so-called mandatory bids) (Ministerstwo Finansów, 2014, 1). A tender offer or a bid can be defined as an offer to purchase a certain number of shares addressed to all existing shareholders (Regucki, 2012, 69).

The obligation to announce a bid for the sale or exchange of shares is one of the most important consequences of a company becoming a public company in the first place (Regucki, 2012, 69). As a rule, this obligation arises in connection with an acquisition of control over a public company. Therefore, as a rule, bids are announced by significant investors who seek to acquire a significant block of shares in a public company (Ministerstwo Finansów, 2014). The main aim of a mandatory bid is to protect the interests of minority shareholders in a situation when the position of dominant persons in the company is considerably strengthened. The purpose of a mandatory bid is to enable the remaining minority shareholders of a public company which is being acquired to "exit" from the company and withdraw their investment by selling shares at a fair, equitable price (Regucki, 2012, 71). The

point of departure is the assumption that in the case of acquisition of control, certain changes in the company's management strategy may — and often in fact do — take place, which has a potential impact on the market price of the shares (Opalski, 2010, 487). It is worth pointing out that the regulation of mandatory bids itself is sometimes subject to criticism from the doctrine (Hansen, 2018; Enriques, 2004).

The notion of *control premium* is inherently relevant to mandatory bids. It is assumed in the literature that control in itself has a certainly added value, influencing the share price. At the moment of acquiring a controlling block of shares, a shareholder pays not only for a fraction of the share capital, but also for the possibility to decide on the future fate of the company and direct its strategy. Therefore, the institution of a mandatory call is complemented by regulations concerning the minimum price the calling party should offer. The assumption is that this price has to be at least equivalent to the price paid by the dominant shareholder for a block of shares giving real control of the company. In pure market conditions, the absence of mandatory bids at a certain price would threaten a significant drop in price after a sucessful takeover, e.g., due to the risk of majority shareholders using techniques obstructing the minority investors (tunneling, withholding of dividend, poor information policy), or even potential delisting. Moreover, many empirical studies point out the phenomenon of an instant decrease in the real value of the remaining shares at the moment of taking control over the company due to the consumption of such control premium (Opalski, 2010, 487).

Some recognize the control premium as an expected added value for the majority/dominant investor, resulting from the possibility to use the full potential of the acquired company more efficiently (Lewandowski, 2008, 131; Moska, 2018). The value of the control premium varies and depends on several factors, such as the company's financial condition, size, industry (Bem and Bącal, 2014, 267–278), prospects, or even its prestige, among others. For example, a larger premium will, as a rule, be offered if the company wants to delist (KPMG, 2021). It can also be assumed that the amount of the control premium will depend on the degree of information efficiency of the capital market in question. The value of the control premium may also be dictated by subjective factors, e.g., when the acquired company becomes a crown jewel in the capital group or the functional synergy between numerous companies arises.

A Polish study, based on 56 public bids for shares announced between 2006 and 2013, showed that the average level of the control premium proposed to shareholders was about 20% (Bem and Bącal, 2014, 267–278). Another empirical study based on 92 bids for the acquisition of shares announced in 2008–2012 showed that the average bonus proposed to shareholders was around 25% (Regucki, 2013, 455). It is noteworthy that there has been a clear decrease in the control premium in recent years in Poland. Research conducted in Poland on the basis of public calls for the acquisition of shares announced in 2010–2019 showed that the average level of the bonus proposed to shareholders was already only about 11% (KPMG, 2021).

For the sake of comparison, it is worth adding that in mature capital markets, such as the United Kingdom or the United States, premiums at the level of 20–30% are not uncommon (Paćkowski, 2020).

In theory, in addition to protecting investors, the institution of mandatory bids fulfills yet another important role: an opportunity to exit from the company increases the confidence of individual investors in the capital market and, for many, provides an incentive to place their savings there, which indirectly increases the attractiveness of the market, also on the part of issuers and capital formation (Spyra, 2016, 64). The basis for Polish legal solutions concerning mandatory bids is European law — the relevant provisions of the POA implement the Directive. The provisions of the Directive introduced minimum standards concerning the acquisition of control over companies with securities admitted to trading on a regulated market. Its enactment was primarily aimed at creating a uniform, transparent regulations in case of taking control over public companies, and protecting the interests of minority shareholders (Mataczyński, 2010; Kuska-Żak and Żak, 2006). The objectives of the Directive (cf. recitals 1–3, 9) are therefore to create an effective control market by coordinating the safeguards required to protect the interests of shareholders of companies whose securities are admitted to trading on regulated markets in the EU, as well as of the holders of securities of those companies when they are subject to takeover bids or control changes (Oplustil and Bobrzyński, 2004, 47).

When a natural or legal person as a result of his/her acquisition or the acquisition by persons acting in concert with him/her holds securities of a company which, added to any existing holdings of those securities of his/her and the holdings of those securities of persons acting in concert with him/her, directly or indirectly give him/her a specified percentage of voting rights in that company, giving him/her control of it, pursuant to Art. 5(1) of the Directive the member states shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company. Such a bid shall be addressed at the earliest opportunity to all the holders of those securities for all their holdings at an equitable price. In other words, the institution of a mandatory bid, introduced by the EU law, thus allows minority shareholders to "exit" from a dominant company by selling all their shares at a fair price and undertake other investments instead (Oplustil, 2005, 45). A bid under the provisions of the Directive must be addressed to all remaining shareholders and involve all remaining shares (it would be incompatible with European law to carry out any form of reduction) (Regucki, 2013, 446).

Pursuant to Art. 5(4) of the Directive, the equitable price is the highest paid for the same securities by the offeror — or by persons acting in concert with him/her — over a period to be determined by the member states, but of no less than six months and no more than 12 before the bid. If, after the bid has been made public and before the offer closes for acceptance, the offeror or any person acting in con-

cert with him/her purchases securities at a price higher than the offer price, the offeror shall increase his/her offer so that it is not less than the highest price paid for the securities so acquired.

To summarize, European bidding law is based on two assumptions. First, it allows investors to sell their shares in case of a change of control in the company. Second, it allows the determination of a fair price, which is the highest price paid by the offeror for the shares of the targeted company. It is worth noting that the Directive does not define the very notion of control and thus does not establish a control threshold (threshold of the number of votes at the general meeting) which would cause the obligation to carry out a mandatory bid. The Directive only creates a framework for which member states are free to set national regulations, such as the control threshold or the determination of a fair and equitable price (Regucki, 2013, 447). However, as the doctrine aptly points out, this threshold should be determined in such a way so that the acquirer of control is subject to the said obligations (Domański and Goszczyk, 2008, 7; Opalski, 2010, 500).

3. The existing provisions on mandatory bids in Poland

Polish regulations have been significantly expanded compared to the European normative model (Regucki, 2013, 447). The issue of mandatory bids has been regulated primarily in the provisions of Art. 73–81 of the POA. Under the previous legal status (from October 2005) there were two thresholds — 33% of votes and 66% of votes. Pursuant to Art. 73.1 of the POA, an entity exceeding the 33% threshold shall announce a mandatory bid to exchange or sell only such a number of shares which will enable it to reach the 66% threshold (a possible bid to sell or exchange all shares was only optional). Meanwhile, under Art. 74 of the POA, it was only upon exceeding the 66% threshold that the obligation to announce a mandatory bid for all remaining shares arose. According to POA, failure to comply with the obligation to carry out a mandatory call would result in deprivation of the voting right attached to all shares. The rule was the announcement of so-called *ex-ante* bids, i.e., an acquisition of control resulting from a prior bid. The provisions of Art. 73 sec. 2 and Art. 74 sec. 2 of the POA, however, regulated the so-called *ex-post* bids, where a mandatory call was a consequence of becoming a dominant shareholder in a public company. A follow-up call may have taken place as a result of various legal actions and events, including, but not limited to, acquisition of newly issued shares, merger or division, or change of the articles of association. But the most important practical case was an indirect acquisition of shares — this consists in taking control of a public company through the acquisition of shares, outside the regulated market, in another company which holds a block of shares in the public company. Indirect acquisitions have been associated with the widespread problem

of circumventing the rules on mandatory bids (more on this furthers). It is worth noting that in European law, it is the *ex-post* calls that are the rule and the *ex-ante* calls that are the exception (Regucki, 2013, 448).

For years, the Polish regulations have been subjected to enormous criticism from the doctrine, which has accused them of being incompatible with EU law as well as of failing to meet their primary objective of protecting minority investors (Oplustil, 2005; Domański and Goszczyk, 2008; Romanowski, 2008; Mataczyński, 2010; Regucki, 2012; 2013; Moska, 2018). So far, the construction of mandatory bids has led to numerous pathological situations in which their interest was significantly marginalized. First of all, none of the above-mentioned thresholds constitutes a proper implementation of Art. 5 of the Directive (Oplustil, 2005, 52). Exceeding the 33% threshold only imposes an obligation to announce a bid for the number of shares leading to the 66% threshold — instead of all remaining shares. This means that an important part of the shareholders will not have a viable option to exit the company at a fair price. At the same time, exceeding the 66% threshold leads to the obligation to carry out a mandatory bid offer for all shares, but on the grounds of the Polish capital market realities the acquisition of control over a company requires a much smaller block of shares than the said 66% (Oplustil, 2005, 53). Unfortunately, the EU law does not contain any definition of effective control, leaving this issue to the discretion of the member states. This, however, is not an oversight on the part of the EU legislator, but a deliberate nod to the relevant authorities.

The issue of control varies from one member state to another and depends on a number of legal and economic factors such as local company law, the degree of development of the capital market concerned, etc. Moreover, in each company, the control threshold will depend on the articles of association, the specific structure, and activity of the shareholders. A one-size-fits-all approach will therefore always be highly questionable and the threshold should be set at a level which reconciles the legitimate interests of the potential majority and minority investors. In case of doubt, the issue should be resolved in favor of minority shareholders, among whom the most vulnerable are individual investors who bear the greatest risk of investment failure (too many to fail).

On the grounds of Polish law, it is not possible to define unequivocally what constitutes actual control in a company. Pursuant to the Polish Commercial Companies Code (ustawa z dnia 15 września 2000 roku — Kodeks spółek handlowych, Dz.U. Nr 94, poz. 1037 ze zm.; hereinafter: KSH), as a rule, resolutions are adopted by an absolute majority of votes (Art. 414 of the KSH). This applies to appointing members of managerial bodies as well as to decisions concerning the payment of dividends. However, in some crucial matters, a qualified majority is required. A substantial change of the subject matter of the company's business activity requires a two-thirds majority (Art. 416 of the KSH), and a number of decisions of a systemic nature (such as amendment of the articles of association, merger, or

division of the company, dissolution of the company, or disposal of the enterprise) require a 3/4 majority (Art. 415, 506, 522, 541 of the KSH). Taking into account only the provisions of law, it should be assumed that an absolute majority of votes (over 50%) is in each case sufficient enough to exercise actual control over the company and freely create the direction of its further development.

As mentioned above, effective control in a company also depends on factors other than the prerogatives granted by law. Theoretically, from the point of view of corporate governance, a dispersed and diverse shareholding is preferable — provided that it is an active and well-organized one. However, the Polish capital market is characterized by a small number of significant shareholders (above 5% at the general meeting) and a relatively high concentration of capital — which *de facto* means the power of the main shareholder prevails (Regucki, 2012, 79; 2013, 450). In Poland, significant shareholdings of several percent are held by institutional investors who actively participate in general meetings of shareholders and often have a decisive influence on the activities of companies, which often leads to the violation of minority shareholders' interests (Ministerstwo Finansów, 2014, 2).

An empirical study from 2011 of 400 listed companies showed that only in 16% of the companies the main shareholder exceeded the control threshold set by the Polish legislator at 66% (Regucki, 2012, 80). Moreover, in half of the analyzed companies, the strongest shareholders held less than 40% of the votes. This situation has not changed significantly over the last 10 years. As of 26 March 2020, in the case of the 140 largest companies listed on the Warsaw Stock Exchange (included in the WIG20, mWIG40, and sWIG80 indices), the threshold of 66% share in the total votes was exceeded only in about 16% of the companies (Komisja Prawna, 2021, 56). Interestingly, in 2015–2020, out of 169 calls announced for all remaining shares of a public company, only 54 bids (about 1/3) were related to the obligation to announce a mandatory bid after exceeding 66% of the total number of votes (Komisja Prawna, 2021, 56). Thus, it can be assumed that, in order to achieve actual control over the company, major shareholders did not need to exceed the 66% threshold which would force them to carry out a costly mandatory bid.

It is worth noting that the Polish capital market is characterized by a low activity of individual shareholders, who rarely decide to participate in shareholders' meetings, and even if they do, their voting power is negligible when adopting any resolutions. A survey of individual investors in 2021 showed that about 95% of small shareholders do not participate in annual general meetings (the main reasons cited were lack of time and influence on the course of the meeting) (SII, 2021B). At the same time, investors declare that they would participate in general meetings if they were more investor-friendly. About 73% of investors believe that companies should be obliged to enable investors to participate in general meetings remotely. Unfortunately, even the Polish soft law in the form of the Companies Code of Best Practice (GPW, 2021) does not impose any obligation on issuers to organize a general meeting or to broadcast its sessions in real-time.

Disregarding the voting power of small shareholders, it may be safely concluded that in 65% of the companies the main shareholder had at least simple control (absolute majority of votes), and in more than 40% it enjoyed "full control," which allows adopting resolutions on matters requiring a qualified majority of votes (Regucki, 2012, 82). Thus, although, as indicated above, only in 16% of the companies the main shareholder exceed the control threshold of 66%, in as many as 40% of the companies the main shareholder had the real voting power at the level of over 75%, which gave him/her full control over the company. This makes the 66% control threshold all the more incomprehensible. The study also showed that among the companies where the main shareholder exercised ordinary control, the average number of his/her votes was 41%, and among the companies where he/she exercised full control — 59% (Regucki, 2012, 83). It is worth mentioning here that the exercise of simple control should already be equated with the exercise of control within the meaning of Art. 5(1) of the Directive.

Another problem of the current regulation was the abuse of Art. 73 and 74 of the POA by using the institution of the aforementioned indirect acquisition of shares to circumvent the EU regulations on mandatory bids for all remaining shares of minority shareholders (Art. 5(1)) and the minimum price offered to them (Art. 5(4)) (SII, 2020A, 3). Avoiding the obligation of a mandatory bid for a block of 66% of shares was possible through the use of investment vehicles (special purpose vehicles). The entity intending to sell a significant block of shares made an in-kind contribution to the established Special Purpose Vehicle (SPV) in the form of public company shares, the number of which was close to the 66% control threshold (e.g. constituting 65.9% of votes) and then sold all shares in the SPV to the entity which acquired a significant block of shares in the public company (Ministerstwo Finansów, 2014, 2). As a result, an obligation arose to announce a follow-up bid for shares constituting only 0.1% of the total number of votes (the purpose of the call for shares corresponding to 66%, according to Art. 73 of the POA), which led to such a significant reduction in subscriptions that *de facto* minority shareholders could not exit and the whole institution was nothing more than a fiction.

Numerous empirical studies confirmed that this problem was not purely theoretical. A study of companies conducted by Tomasz Regucki between 2008 and 2012 showed that among 40 mandatory bids under Art. 74 (a call for all shares after exceeding 66% of votes), 30 were *ex-ante* bids and only 10 — *ex-post* bids (Regucki, 2013, 450). Meanwhile, among the 42 bids under Art. 73 (a bid for a stake of up to 66% in connection with exceeding the 33% threshold), only 17 were *ex-ante* bids, but as many as 26 were *ex-post* ones, resulting from indirect acquisitions. Moreover, the study showed that among such *ex-post* bids, the average share of votes covered by the bid remained within the range of 3% only, the median share of votes — 2%, and the first quartile — only 0.05%. Incredibly, in one out of every four cases, shares representing up to 0.05% of the votes were covered by the call — making the institution completely illusory. In the most extreme case, in

2013, a company called LU Chemie made a call for 1 Permedia Company share, which represented 0.000044% of the total number of votes at the company's general meeting (Asyngier, 2017, 9). The above-mentioned study also showed that in the case of follow-up bids under Art. 73(2), the average reduction rate was 79% and the median was as high as 94%. At the same time, it is worth remembering that in numerous cases, no subscriptions were submitted — most often because investors, seeing such a minimal number of shares, resigned from subscription altogether (Regucki, 2013, 454). One may even be tempted to conclude that if in some individual cases the bids fulfilled their role, it was either due to the goodwill of the bidder or other investment motives that guided their decision. In effect, the problem of the low control premium in Poland (at ca. 25% in 2008–2012 and ca. 10% in recent years) was only the tip of the iceberg in the case of *ex-post* bids (exceeding the 33% voting threshold). Indeed, the massive reduction made it impossible for any shareholder to exit in line with EU law.

According to the research of the Ministry of Finance, between 2008 and 2010, out of 12 cases in which the obligation to announce a follow-up bid to obtain 66% of the votes in public companies arose, in 8 of them the obligation was fulfilled by announcing bids for shares representing 2% or less of the total number of votes in the acquired public companies (Ministerstwo Finansów, 2014, 3). Thus, the right of minority shareholders to sell their shares so far has been significantly limited in practice.

If that were not enough, the flawed indirect acquisition mechanism also led to the notorious circumvention of the minimum price in the mandatory bid, to the detriment of minority shareholders. This issue was regulated by Art. 79 of the POA, which specified in detail the manner of calculating the minimum price in a bid, which formally extended the minimum protection of European law with additional price requirements, but introduced incomprehensible differentiated protection of shareholders regarding the fair price depending on the type of bid (Regucki, 2013, 449). The best guarantee for minority shareholders was the implementation of Art. 5(4) of the Directive in the form of the provision of Art. 79(2). According to this provision, the share price proposed in a mandatory bid may not be lower than the highest price paid for the shares in the public company within 12 months prior to the announcement of the bid. This regulation, however, did not apply to indirect acquisition of shares, because in such a case, shares of another company — which is in possession of shares in the relevant public company — are acquired. As a result, the actual value of the shares and the control premium paid for the shares of the company in which the change of control occurs was regularly concealed in the transaction of indirect acquisition of shares over the counter (Ministerstwo Finansów, 2014, 3).

As a result of the above controversies, the former legislation failed to achieve its primary objective of investor protection and was a rare example of bad implementation of the EU law in this regard. Consequently, the Polish law has been subjected to constant criticism from the doctrine, practice, and, above all, the invest-

ors' community, which has unsuccessfully attempted to change the regulations in a direction consistent with the Directive. Particularly active in this respect was the Association of Individual Investors (SII) led by its chairman, Jarosław Dominiak, which submitted numerous petitions and appeals to the Ministry of Finance, the Financial Supervision Authority, and other authorities. In the years 2012–2014, SII complained, i.a., twice to the European Commission about the defectiveness of regulations in force in Poland and their contradiction with the EU regulations (SII, 2022). It also referred to the solutions in other EU countries, which pursued their goals of investor protection much more actively (more on this further).

This problem was finally recognized by the Polish legislator, which in 2014 resulted in a draft of the Act amending the Public Offering Act by the Ministry of Finance (Rządowe Centrum Legislacji, 2014). It assumed, i.a., establishing 33% and 66% of the total number of votes in a company as the thresholds for taking control of a public company. Exceeding one of these thresholds was to result in the obligation to announce a mandatory bid for all remaining shares in that company, and thus it would mean the introduction of the so-called *ex-post* bids in place of the so-called *ex-ante* bids.

Unfortunately, as a result of the Treasury Ministry's objections, the draft was abandoned by the Council of Ministers in 2015. This happened despite the explicit acknowledgment in the project's explanatory memorandum that the existing provisions are detrimental to minority shareholders and constitute a flawed implementation of the Directive (Ministerstwo Finansów, 2014).

4. New rules on mandatory bids — analysis

The breakthrough came in 2019 when the Supreme Court's judgment of 18 July 2019 was issued (case number I CSK 587/17). The Supreme Court unequivocally sided with minority shareholders, reminding us that the institution of a mandatory bid is intended to protect them by allowing them to exit the company on financially favorable terms (the so-called control premium). When interpreting Art. 79 sec. 2 item 1 of the POA, the court stressed that omitting in the bid the price paid for the indirect acquisition of shares constitutes a direct violation of the regulations (SII, 2020A).

Finally, as a result of numerous actions of the investors' community — including the SII petition of 23 March 2020 (SII, 2020A) and the draft amendment initiated by the Financial Supervision Authority (KNF) — work began on the draft amendment, which became effective on May 30, 2022. The amendment revised the approach to the institution of mandatory bids and introduced a number of significant changes, including:

1. liquidating the hitherto 33% and 66% mandatory bid thresholds and establishing in their place a single threshold of 50% of the total number of votes at the

general meeting as the threshold for taking control (amendment of Art. 73 and liquidation of Art. 74 of the POA). It creates the obligation to announce a bid to sell or exchange all remaining shares within three months;

2. eliminating the existing dualism of bids with the division into *ex-ante* and *ex-post* bids, as well as introducing a uniform model of *ex-post* bids;

3. taking into account the price of indirect acquisition of shares in a public company when determining the minimum price in a bid;

4. introducing an optional voluntary bidding mechanism for all remaining shares in a public company;

5. determining the minimum price in the bid based on the fair value determined on the basis of a valuation performed by an independent auditing company at the request of the bidding party in the event of insufficient turnover in the shares subject to the bid (previously there were serious legal doubts in this respect).

The most significant change resulting from the amendment, which is the main subject of interest in this article, is undoubtedly the introduction of a single 50% control threshold. This change was welcomed by experts and investors as a decisive step in the right direction. However, doubts remain over the level of the threshold, as — in the opinion of market participants — in practice, control is usually already acquired in the case of holding as many as 33% of the total number of votes (SII, 2021A). This is particularly puzzling in the face of a lower control threshold which has been adopted in the majority of EU countries (more on that further). Perhaps the rationale for adopting a relatively high threshold was the specific nature of the Polish capital market, which is dominated by small companies with a concentrated ownership structure. This argument was already invoked during the 2014 discussion of the previously binding 66% threshold. According to the Ministry of Finance, it was aimed at protecting the developing capital market, maintaining liquidity, and reducing the number of issuers by countering the dematerialization of shares (Komisja Prawna, 2021). It is hard to agree with this argument — artificially maintaining public companies with a low free float in the Polish market realities by creating the illusion of dispersed shareholders and corporate governance leads to disadvantaging minority shareholders and them losing trust in the public market. A public market aspiring to sustainable growth should not be concerned with the liquidity of companies. The argument involving dematerialization, on the other hand, is reminiscent of a situation in which the state agrees to disregard the rights of minority shareholders in favor of majority shareholders so long as the latter group does not delist it.

In an explanatory memorandum to the statute, the legislator draws attention to the definitions of a dominant entity and control contained in the EU regulations and national legislation. According to them, it is assumed that a controlled undertaking is an undertaking in which a majority of voting rights belongs to one natural or legal person, and this majority is understood as a level exceeding 50%, including 50% plus 1 vote (it is worth noting, by the way, that in the case of an odd

number of votes the definition of 50% plus 1 vote will not be adequate). However, these provisions are more concerned with inter-company relations within a holding than with intra-corporate relations. In practice, Polish public companies are often controlled by shareholders holding even less than 33% of the votes.[1]

Another argument cited by the Ministry in defense of the 50% threshold is the recent change introduced to the Polish Commercial Companies Code which promotes holding general meetings remotely, using electronic communication means. These modifications are supposed to contribute to changing the perception of participation of dispersed shareholders in the life of the company: "The frequently raised logistical barrier of attending a general meeting in person will be broken down, which should significantly increase the number of votes represented at the AGM, and thus also significantly increase the number of votes necessary to take effective control of the company" (Komisja Prawna, 2021, 57). The legislator is therefore convinced that also the hitherto widely used EU control thresholds of 30–33% may soon become highly unjustifiable in the light of the Directive.

This argument is also misplaced. For years, the main reasons for poor investor turnout at general meetings have been indicated by surveyed investors as lack of time (ca. 50%), lack of influence on the proceedings (ca. 35%), high travel costs (ca. 20%), and lack of possibility to participate online (ca. 20%). The amendment to the Companies Act promoting the organization of general meetings remotely, using electronic means of communication, has not changed the turnout at general meetings. The reason is that this solution is optional. The lack of a mandatory general e-meeting has been and will continue to be a factor in the low participation of minority shareholders in general meetings (Ławrowski, 18.08.2021). In practice, public companies have been very reluctant to hold general meetings using various means of communication, virtually limiting themselves only to cases when they were forced to do so by the pandemic — and even then, it was not that common a practice (SII, 2020C). It would be naive in this context to count on the goodwill of the companies' management boards — the Polish market is already characterized by a long history of making it difficult for minority shareholders to participate in general meetings (Tychmanowicz and Dzierżanowski, 2017). At the same time, the reservations raised to the draft amendment by SII (2021A), which pointed out that "in matters as important as the acquisition of control over a company, one should not expect the management board to organize a general meeting in a manner which could deplete its voting power against the largest shareholder," are also justified. It should be noted with regret that the amendments to the Code of Companies Best Practices of the Warsaw Stock Exchange of 2021 did not take into ac-

[1] A good example of such a situation is PKN Orlen controlled by the State Treasury, which, thanks to favorable provisions in its articles of association, has full control over the company despite holding less than 28% of the votes at the general meeting.

count the demand for the absolute necessity of holding a general e-meeting, introducing only a directional directive.[2]

In the context of considering the height of the threshold, it is worth analyzing the solutions which have been in place for years in other EU countries (ESMA, 2019). Poland, next to only Estonia, Latvia, and Malta, is one of the few countries where the percentage of voting rights which confers control of the company under Art. 5(1) of the Directive (the "primary control threshold") has been set at 50% (50% + 1 in Malta). However, Estonian law provides another alternative method to define a controlling influence — that is, as a shareholder who has the right to appoint or remove a majority of the management or supervisory board members or has a dominant influence or control over the company, or the possibility of exercising it.

In 11 member states, the primary control threshold has been set at 33% or 1/3. These include: Bulgaria, Denmark, Greece, Hungary, Lithuania, Luxembourg, Norway, Portugal, Romania, Slovak Republic, and Slovenia. In 14 member states,[3] the threshold has been set at around 30%. These include: Austria, Belgium, Cyprus, Czech Republic, Finland, France, Germany, Iceland, Ireland, Italy, the Netherlands, Spain, Sweden, and the UK. In one member state (Croatia), the primary control threshold is set at 25%. Interestingly, in Italy, when it comes to SMEs (Small and Medium Enterprises), the threshold of 25% applies if no other shareholder holds a higher stake. It may also be voluntarily included by SMEs in their articles of association as a minority shareholder safeguard. In Hungary, the threshold is 25% if no other shareholder holds at least a 10% interest.

In addition, 11 member states have introduced some additional measures to ensure proper minority shareholder protection. In some, a shareholder who, together with persons acting in concert, holds securities carrying a percentage of the voting rights in a company equal to or exceeding the primary threshold, may also trigger a mandatory bid to all remaining shareholders if he/she acquires further securities carrying a specified additional percentage of voting rights, in some cases within a specified period ("creep-in" threshold). For instance, in Austria, any increase of at least 2% of voting rights between 30% and 50% within 12 months triggers yet another mandatory bid to all remaining shareholders. The creep-in threshold in France is at least 1% within 12 months, in Spain and Italy — 5%, in Slovenia — 10%, and in the UK any increase between 30% and 50% will trigger a mandatory bid. These kinds of measures also apply in Bulgaria, Cyprus, Denmark, Greece, and Ireland. These provisions aim to further ensure that minority shareholders can

[2] A company should enable its shareholders to participate in a general meeting using electronic means of communication (general e-meeting) if this is justified by the shareholders' expectations communicated to the company, supposing that the company is in a position to provide the technical infrastructure necessary for holding such a general meeting.

[3] Including Iceland, Norway, and the UK.

exit from the company by selling securities for all of their holdings at an equitable price. The creep-in threshold does not apply under Polish law.

Moreover, six countries introduced an additional, secondary threshold which also triggers an obligation to conduct a mandatory bid for all remaining shares. It varies between 40% and 90% and can be found in Bulgaria (2/3), Finland (50%), Iceland (90%), Norway (40% and 50%), Portugal (66%), and Slovenia (75%). Such a measure aims to provide shareholders with yet another opportunity to exit shall the majority shareholders further solidify their control over the company.

Keeping in mind that the control threshold will always be somehow arbitrary, some countries have decided that, when national thresholds are reached or exceeded, a mandatory bid may not always be necessary — because the national definition of control requires additional conditions to be met or because some kind of an exemption is available. A good example of such a solution is Portugal — if the 1/3 threshold is exceeded, the mandatory bid when the acquiring entity is able to provide evidence to the Portuguese Security Markets Commission (CMVM) that it does not control the target company or is not in a holding relation with such a company (CMS, 2017). In such a case, the 50% threshold is applicable. This solution is a kind of the inverse of the Estonian one, where despite not reaching the 50% votes threshold, the mandatory bid would be triggered if the majority shareholder does in fact have a controlling influence. Such flexible solutions for control threshold determination seem more viable than the one-size-fits-all approach known in most jurisdictions.

Taking the above into consideration, it can be concluded that the Polish solution is the least competitive in the whole European Union and does not take into account the due interest of investors. With the exception of Latvia and Malta, all member states have set control thresholds of a maximum of 1/3 of the votes. Moreover, half of the countries (15) have established additional safeguards for minority shareholder interests in the form of creep-in thresholds and secondary thresholds, exceeding which triggers the mandatory bid for all remaining shares. One may wonder whether this solution changes anything in the Polish capital market, taking into account the fact that many entities exercising actual control over the company hold less than 50% of the votes. One may also wonder whether this solution will not lead to the opposite. So far, a shareholder holding more than 33% of votes at least had to make a more or less creative effort and raise sufficient funds to satisfy the obligation to make a mandatory bid for a number of shares amounting to a 66% stake. In the current legal state, the majority shareholder may safely dispose of a 35%, 40%, or 49% block, which will certainly ensure his/her control over the company and at the same time does not expose him/her to unnecessary "costs" connected with mandatory bids. Time will tell whether or not the Polish legislator has done minority shareholders a disservice regarding the level of the control threshold.

Conclusions

In conclusion, the amendment of the takover bids law in Poland regarding the control threshold in a publicly listed company is a step in the right direction. Undoubtedly, the removal of two control thresholds will significantly reduce pathological phenomena in the bidding market, especially in the form of *ex-post* calls following indirect acquisition of shares with the help of SPVs. At the same time, the efficiency of the amendment is undermined by the fact that the control threshold was set at an exceptionally high level of 50+%, while in the vast majority of European countries it is set at between 25–33%. Among all EU and EEA countries, the Polish control threshold, alongside Latvia and Malta, was set at the highest level (with the level not being as noticeable there due to the sizes and other specifics of those markets). Given the size and structure of the Polish capital market, one might be tempted to conclude that the Polish solution is one of the worst in the entire EU.

It is difficult to understand the Polish legislator's insistence on the high control threshold level, especially given the numerous appeals from doctrine, practice, and investors, as well as empirical studies showing the impact of the threshold level on the protection of vulnerable individual investors. Instead, it would be worth considering the establishment of a control threshold at a level similar to other EU countries, that is, a maximum of 33%. In addition, it would be beneficial to introduce an alternative method of determining the control threshold in the form of, e.g., the possibility of appointing a certain number of company body members. Alternatively, bearing in mind the interests of the majority shareholder, it would be worthwhile to enable him/her to prove that — despite exceeding the control threshold at, for instance, 25% — he/she does not exercise control in the company. For example, a rebuttable control threshold of 25% and an absolute control threshold of 50% could be established. In addition, it would be a good idea to introduce, following the example of other countries, creep-in thresholds which would trigger a renewed obligation to issue a mandatory tender bid for all the remaining shares. This would increase the opportunities for individual investors to exit their investments as the dominant shareholder successively accumulates capital.

The above changes require a decisive and courageous stance on the part of the legislator, who must simultaneously reckon with the consequences in the form of a potential wave of delisting during the transition period, as well as limited demand for entry into the stock market by entities remaining in the hands of highly concentrated capital. However, the legislator should realize that only consistent and certain protection of the minority shareholders' interests will encourage individual investors to invest in the stock market long-term. After all, the possibility of exiting on fair terms is the *sine qua non* condition for making an informed decision to invest one's savings in the stock market. Restoring the individual investor's faith in a transparent financial system is the only way forward for the Polish

stock market, and effective mandatory call provisions are one of the crucial pillars of investor protection.

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The institution of entering into a lease of a dwelling after the death of the current tenant (Art. 691 of the Civil Code) in the light of the jurisprudence

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Abstract

The aim of this study is to explain how an institution can enter into a lease after the death of the tenant in accordance with Art. 691 of the the Polish Civil Code. The author tries to clarify the wording of Art. 691, which raises questions of interpretation on the basis of case law. In particular, the author undertook the examination of the conditions for entering into the rental relationship of a dwelling after the deceased tenant. Subsequently, the focus was on approximating the premises covered by this standard, then on clarifying the terms "residence" and "other persons to whom the tenant owed maintenance," and on actual cohabitation with the tenant. The legal proceedings relating to the regulation in question are dealt with next, while the final part describes the possibility of terminating the contract by the rightholder and briefly refers to the provision of Art. 691 para. 5 of the Civil Code.

Introduction

The currently applicable Art. 691 of the Polish Civil Code (ustawa z dnia 23 kwietnia 1964 roku — Kodeks cywilny, tekst jedn. Dz.U. z 2020 r. poz. 1740 ze zm.; hereinafter: CC) governs the succession of tenancy rights after the death of the tenant. This mechanism was introduced to ensure the stability of the dwelling and the permanence of the rental (Bończak-Kucharczyk, 2011). Since the law of suc-

cession is not applicable here, it is irrelevant whether the relatives are heirs (Biały, 2018; Jezioro, 2013; Pietrzykowski, 2011) — entering into a tenancy relationship does not constitute an inheritance, persons who entered into a tenancy relationship after the death of the tenant do not incur inheritance and gift tax (wyrok NSA z dnia 22 stycznia 2015 roku, II FSK 3093/12, LEX nr 1769592). The standard under review does not differentiate between the basis of the deceased tenant's obligation, so Art. 691 of the CC applies both to the conclusion of a lease on the basis of a lease contract and to an administrative decision on the allocation (uchwała SN z dnia 23 października 1978 roku, III CZP 52/78, OSNC 1979, Nr 5, poz. 89). Entry into the rental relationship according to Art. 691 of the CC concerns the entire apartment, not for its individual rooms (uchwała SN z dnia 18 kwietnia 1986 roku, III CZP 15/86, OSNC 1987, Nr 2–3, poz. 33). The vicarious agent and the landlord are not obliged to conclude a new lease (Kozieł, 2014), since only the personal scope of the lease is changed by the death of the tenant. The persons who have entered into the same legal relationship pursuant to Art. 691 of the CC acquire the rights and obligations of the previous tenant, i.e., are bound by different contract provisions (wyrok NSA z dnia 5 października 2011 roku, I OSK 1222/11, LEX nr 1149136). If there are several close persons who lived together with the tenant until his/her death, all entitled persons become co-tenants (Biały, 2018). This creates a community of housing tenants. In this case, the rules on joint ownership of fractions apply, with certain exceptions, e.g., marital joint property (Kozieł, 2014), which is governed by Art. 31 ff. of the Law of 25 February 1964 — Family and Guardianship Code (ustawa z dnia 25 lutego 1964 roku — Kodeks rodzinny i opiekuńczy, tekst jedn. Dz.U. z 2020 r. poz. 1359; hereinafter: k.r.o.). Excluded from the application of Art. 691 para. 1 of the CC are premises which are at the disposal of the police (wyrok WSA w Krakowie z dnia 24 kwietnia 2018 roku, III SA/Kr 98/18, LEX nr 2482193). It is noteworthy that in the event of terminating the tenancy of the tenant before his/her death, it is not possible to enter the deceased's tenancy relationship on the basis of Art. 691 of the CC (wyrok SO we Wrocławiu z dnia 4 grudnia 2015 roku, I C 1047/15, LEX nr 2032059).

Theoretical framework of the research

The lease ratio has been the subject of research for many years. Civil law, including the law of obligations, has been widely analyzed by representatives of the legal doctrine. This article is based on the previous achievements of this doctrine and opinions from the jurisprudence, in particular the jurisprudence of the Supreme Court, which is a broad basis for the formulated research conclusions. The paper is also based on legal comments containing the conclusions assessed in the article, and outlines the historical aspect of the matter under study. Moreover, the article attempts to provide a new perspective on the subject matter as well as an up-to-date approach to the issue of the lease relationship.

Research methodology

In preparing the material which served as the basis for the arguments discussed in the article, extensive reviews were carried out, publications on the subject were collected and court decisions relating to the subject matter were thoroughly analysed. The conclusions of the article are drawn from a combined analysis of doctrine and case law. The paper attempts to describe both the theoretical and the practical implementations of the legislation. An essential element of the research methodology was the formulation of conclusions reached by a correct interpretation of law.

1. Prerequisites for entering into a lease of a dwelling after the tenant's death

Art. 691 para. 1 of the CC indicates a narrow circle of people who are entitled to enter into a tenancy relationship after the tenant's death. Accession to a lease is *ex lege* if two conditions are jointly met. The first involves belonging to a group indicated directly in Art. 691 para. 1 of the CC — the category of entities which, according to the wording of the provision, includes: a spouse who is not a joint tenant of the premises, children of the tenant and his/her spouse, other persons to whom the tenant was obliged to provide maintenance, and a person who was actually cohabiting with the tenant. A clear subject is a spouse who is not a co-tenant of the premises. The term "other persons to whom the tenant was obliged to pay maintenance and a person who was actually in cohabitation with the tenant" will be discussed later in this article. However, the literature does not define the term "children of the tenant and his/her spouse" in a uniform way. Some authors are of the opinion that this catalog includes the tenant's own children, adopted children and his/her spouse, children of the deceased tenant (Biały, 2018). According to another view, these are joint children (own and adopted) of the tenant and his/her current spouse, as well as the children of the deceased tenant's spouse. Therefore, it is controversial in the doctrine whether the catalog of Art. 691 para. 1 of the CC should include only the children of the deceased tenant or also of the deceased tenant's spouse (Kozieł, 2014). It is essential that the above-mentioned persons cannot be joint tenants of the premises, as the discussed regulation cannot be applied to joint tenants, therefore the provision will not apply to a spouse if the deceased tenant entered into a tenancy relationship during the marriage, because in such a situation, pursuant to Art. 680^1 of the CC, the spouses are jointly tenants.

The second — and the last — condition is that the indicated people shall stay with the tenant permanently until his/her death. If both conditions are not met, *ex lege* the lease agreement expires upon the tenant's death. *De lege lata* provision of Art. 691 para. 3 of the CC is incomplete, because the lease expires if there are no eligible persons specified in Art. 691 para. 1 of the CC, or if there are such persons, but they do not meet the condition of joint residence in the apartment with the ten-

ant at the time of his/her death, as expressed in Art. 691 para. 2 of the CC (Kozieł, 2014). The moment of assessing the occurrence of the premises is the date of the tenant's death (wyrok TK z dnia 1 lipca 2003 roku, P 31/02, OTK-A 2003, Nr 6, poz. 58), therefore the provisions in force on that date apply (Bończak-Kucharczyk, 2011; uchwała SN z dnia 5 lipca 2002 roku, III CZP 36/02, OSNC 2003, Nr 4, poz. 45; wyrok SN z dnia 8 stycznia 2002 roku, I CKN 723/99, LEX nr 53132). The circumstances arising after the tenant's death are irrelevant to the assessment of entering into the lease relationship (wyrok SA w Szczecinie z dnia 28 marca 2013 roku, I ACa 879/12, LEX nr 1353835). Having a legal title to another apartment by a close person does not currently constitute an obstacle to entering into a relationship (uchwała SN z dnia 4 stycznia 1979 roku, III CZP 86/78, OSNC 1979, Nr 7–8, poz. 13). However, in accordance with the position of the Supreme Court, it should be considered justified to say that an action assumed in advance and subordinated to this assumption, aimed at acquiring the right to enter into a lease relationship, combined with the omission of the possibility of satisfying housing needs in a different way, is contrary to the principles of social coexistence (wyrok SN z dnia 8 lipca 1999 roku, I CKN 1367/98, OSP 2000, Nr 5, poz. 69).

At the time of residence, a stranger may also enter into a tenancy relationship if, during the period of residence, he/she became a person close to the tenant (wyrok SN z dnia 15 stycznia 1981 roku, III CRN 314/80, OSNC 1981, Nr 6, poz. 119), which under the applicable law may only mean cohabitation between the tenant and such a person. The analyzed regulation applies only when the tenant dies. It should be pointed out that the fact that a child regularly stays with a person other than the parents, in conjunction with an overnight stay with him/her, is not sufficient to conclude a rental agreement, because the necessary condition for such assessment is to establish that the child remains under full care with that person, except for parental custody (wyrok SN z dnia 17 lutego 1978 roku, II CR 24/78, OSNC 1979, Nr 1–2, poz. 32). It is also important that when changing the place of residence, one should not perceive a temporary — justified by specific reasons — stay outside the place of permanent residence, as this does not mean that the tenant has ceased to live in "his/her" premises (wyrok SN z dnia 20 czerwca 2001 roku, I CKN 1179/98, LEX nr 110589). When discussing this provision, it is impossible to ignore Art. 31 of the Act of 21 June 2001 on the protection of tenants' rights, municipal housing stock, and amendment of the CC (ustawa z dnia 21 czerwca 2001 roku o ochronie praw lokatorów, mieszkaniowym zasobie gminy i o zmianie kodeksu cywilnego, tekst jedn. Dz.U. z 2020 r. poz. 611 ze zm.), according to which until the death of the tenant he/she takes care of the tenant on the basis of a contract concluded with the tenant before 12 November 1994, meeting the requirements set out in Art. 9 para. 2 of the Act of 10 April 1974 — Housing Law (ustawa z dnia 10 kwietnia 1974 roku — Prawo lokalowe, Dz.U. z 1987 r. poz. 165 ze zm.), Art. 691 of the CC in the version in force before 12 November 1994 (wyrok SN z dnia 29 kwietnia 1997 roku, I CKU 47/97, LEX nr 30384). This

standard provided that in the event of the tenant's death, the tenant's relatives who lived with him/her continuously until his/her death entered into a tenancy relationship (non-binding standard from the CC [Dz.U. Nr 16, poz. 93]).

Considering the premises of the regulation, it should be added that the Constitutional Tribunal ruled that the exclusion of a child's right to lease a flat in the event of the death of one of the parents — co-tenants of that flat, is consistent with Art. 32 sec. 1 of the Constitution of the Republic of Poland (wyrok TK z dnia 12 grudnia 2017 roku, P 13/16, OTK-A 2017, Nr 84). Referring to constitutional reasons, it requires noting that the literature expresses the view that there is no possibility of influencing the selection of the next tenant of the premises who entered the lease under Art. 691 of the CC, because it is inconsistent with the Constitution of the Republic of Poland, in particular with Art. 64 sec. 1 and 3 in connection with Art. 31 sec. 3, as the landlord's property rights are significantly limited (Kociubiński, 2012). It cannot be ignored that pursuant to Art. 922 para. 2 of the CC, the right to lease the premises was excluded from the inheritance. However, it is important that the inheritance debts include obligations resulting from an expired lease.

2. Types of premises covered by the regulation and the term "permanent residence"

The analyzed Art. 691 of the CC applies only to residential premises, and the lease of other premises for other purposes after the death of the tenant is regulated by Art. 922 of the CC determining the inheritance of property rights and obligations in connection with the death of a natural person (Radwański, 1981). This provision applies to both private premises and those belonging to public resources (Bończak-Kucharczyk, 2011). Entering into a lease under Art. 691 of the CC does not apply to social housing (uchwała SN z dnia 23 września 2010 roku, III CZP 51/10, OSNC 2011, Nr 3, poz. 25), because in accordance with the Act of 21 June 2001 (tekst jedn. Dz.U. z 2020 r. poz. 611 ze zm.), the concepts of social housing and housing are different, therefore there is no necessary premise from the regulation in question, namely the rental of a flat that is a residential premises.

Moving on to explaning the term "permanent residence," in the first place it is worth emphasizing that the provision of Art. 691 para. 2 of the CC is not the same as the concept of the place of residence regulated in Art. 25–28 of the CC. At the same time, it means permanent stay in a given premises (Kozieł, 2014; Jezioro, 2013; Pietrzkowski, 2011; cf. Stecki, 1989) in a situation in which the premises is the life center of a loved one (wyrok SN z dnia 3 lutego 2000 roku, I CKN 40/99, LEX nr 811808). In other words: it is a state in which a person close to the tenant actually had all his/her life activity concentrated in the tenant's premises at the time of the tenant's death (wyrok SN z dnia 28 października 1980 roku, III CRN 230/80, MP 1994, Nr 9, poz. 273). The jurisprudence gives as an example of such

a condition the life of children with their parents — the person who is helpless with the person who looks after them (wyrok SN z dnia 8 stycznia 1976 roku, I CR 926/75, OSP 1977, Nr 11, poz. 193). However, another judgment indicated that it should be assessed to what extent the permanent stay in the premises determines whether this is the sole center of a given person's life — in particular that these premises are a permanent focus of his/her current affairs, i.e., that he/she is staying in it as a household member (wyrok SN z dnia 13 lutego 1976 roku, I CR 930/75, OSNC 1977, Nr 1, poz. 5).

The jurisprudence also presents the view that, as a rule, the stay of a relative in order to provide emergency, though even longer-lasting assistance to the tenant of the apartment, will not constitute permanent residence (wyrok SN z dnia 6 maja 1980 roku, III CRN 61/80, MP 1994, Nr 9, poz. 273). Moreover, the Supreme Court pointed out that providing assistance in everyday matters to the previous tenant, due to the relationship with him/her and therefore staying in the above-mentioned premises, and even the fact of being registered in it, do not mean that the person lived in the premises constantly and that they would be the center of his/her life, family, and property matters (wyrok SN z dnia 29 kwietnia 1998 roku, I CKN 637/97, LEX nr 1225362). It should be noted that the registration of the entitled person is irrelevant, because the condition for entering into a tenancy relationship after the death of the deceased tenant is the fact of living together with the tenant, so a specific factual state, and not the legal status resulting from the content of the administrative decision on registration (wyrok SN z dnia 29 września 1998 roku, II CKN 910/97, LEX nr 50753).

3. Other persons to whom the tenant was obliged to pay maintenance

Some doubts are raised regarding the interpretation of the phrase "other persons to whom the tenant was obliged to provide maintenance," because the legislator did not specify whether this includes the persons to whom the tenant could be obliged to pay maintenance, or only the persons to whom the benefits were actually paid. Another controversial issue is whether the maintenance obligation resulting from the applicable legal provisions should be taken into account, or if people who have a court decision obliging the tenant to these benefits should also be included. In addition, the term "maintenance obligation" also covers civil claims arising from a contractual legal relationship, such as sureties (Bończak-Kucharczyk, 2011).

Therefore, the maintenance obligation is regulated in Art. 128–144[1] of the k.r.o. as well as Art. 27, 60, and 61 of the k.r.o. The provision of Art. 128 defines the maintenance obligation indicating that it is an obligation to provide means of subsistence and, if necessary, also means of upbringing, burdening relatives in

a straight line and siblings. At the same time, Art. 141–143 of the k.r.o. constitute the father's maintenance obligation towards a child born out of wedlock, and Art. 144 of the k.r.o. concerns maintenance between a stepfather or stepmother and a stepchild. Art. 27 of the k.r.o. regulates the spouses' obligation to contribute to satisfying the needs of the family, while Art. 60 and 61 concern the obligation to provide the divorced spouse with a means of subsistence. In relation to full adoption, in which case — in accordance with Art. 121 of the k.r.o. — a relationship such as that between parents and children arises between the adopter and the adoptee, the above-mentioned Art. 128 of the Code of Criminal Procedure applies, which leads to the inclusion of the adoptee's descendants in the circle of persons under this provision. The maintenance obligation in incomplete adoption is governed by Art. 131 of the k.r.o. In the event of terminating the adoption relationship, pursuant to Art. 125 para. 1 sentence 3 of the k.r.o., the court may, depending on the circumstances, uphold the maintenance obligations arising therefrom. At this point, it should be remembered that there are relatives in the ascending line (e.g., mother, grandmother, great-grandmother) and descending relatives (daughter, granddaughter, great-granddaughter). A sibling is defined as a collateral relative (sister, brother) who has at least one of the parents as a common ancestor, so the term also includes step-siblings. At the same time, the order of maintenance is regulated by Art. 129 of the CC. Guidelines on the interpretation of the law and court practice in matters relating to maintenance are included in the Resolution of the Supreme Court of 16 December 1987 (uchwała SN z dnia 16 grudnia 1987 roku, III CZP 91/86, OSNC 1988, Nr 4, poz. 42).

Despite the conducted analysis of the provisions on maintenance obligations, there are still doubts as regards to which persons are entitled to enter into a lease under the discussed regulation. If the legislator used the phrase "to whom the tenant was liable for maintenance," this would indicate that the tenant's relatives belonging to the circle of persons to whom the tenant was not, but could have been obliged to pay maintenance, entered into the tenancy relationship. From this, it follows that only persons who have a court decision confirming the tenant's actual maintenance obligation towards them are authorized to enter into a lease. It is worth emphasizing that not only may a court decision testify to the actual maintenance obligation, but also the maintenance obligation may be established by way of a court settlement or contract, or be provided voluntarily. Hence, Art. 691 of the CC should not be limited only to persons for whom the court has ruled a maintenance obligation (Bończak-Kucharczyk, 2011).

In view of the above analysis, it seems accuratw that under Art. 691 of the CC the tenancy relationship should be entered into by all persons permanently residing with the tenant until his/her death, to whom the deceased tenant was actually obliged to pay maintenance, regardless of the basis for this obligation.

4. Actual cohabitation with the tenant

Currently, there is no legal definition of the term "actual cohabitation," although it is also used in Art. 4 point 13 of the Act of 21 August 1997 on real estate management (ustawa z dnia 21 sierpnia 1997 roku o gospodarce nieruchomościami, tekst jedn. Dz.U. z 2021 r. poz. 1899 ze zm.). The wording used by the legislator, "cohabiting person," should be interpreted only as a cohabitant of the tenant (wyrok TK z dnia 1 lipca 2003 roku, P 31/02, OTK-A 2003, Nr 6, poz. 58) connected with the tenant by a spiritual, economic, and physical bond, and not as the tenant's further descendants (uchwała SN z dnia 21 maja 2002 roku, III CZP 26/02, OSNC 2003, Nr 2, poz. 20). At the same time, the term "cohabitation" should be defined as a stable, actual personal and property community of two people, regardless of gender (Nazar, 2008). In recent years, the European Court of Human Rights (hereinafter: ECHR) has emphasized that sexual orientation as one of the most intimate parts of private life is protected by Art. 8 of the Convention for the Protection of Human Rights and Fundamental Freedoms (konwencja o ochronie praw człowieka i podstawowych wolności sporządzona w Rzymie dnia 4 listopada 1950 r., zmieniona następnie Protokołami nr 3, 5 i 8 oraz uzupełniona Protokołem nr 2, Dz.U. z 1993 r. Nr 61, poz. 284 ze zm.; hereinafter: the Convention). Due to this, it ruled that cohabitation also applies to homosexual persons (wyrok ETPC z dnia 2 marca 2010 roku w sprawie Kozak przeciwko Polsce, skarga nr 13102/02, LEX nr 560824) and is treated as family life (wyrok ETPC z dnia 24 czerwca 2010 roku w sprawie Kopf i Schalk przeciwko Austrii, skarga nr 30141/04, LEX nr 584459). Art. 32 of the Constitution of the Republic of Poland also speaks in favor of not differentiating between the cohabitation of same-sex and heterosexual couples, as it contains the requirement of equal treatment and, at the same time, the prohibition of any discrimination, including on the basis of sexual orientation (Ciepła, 2017).

In 2012, the Supreme Court adopted a resolution of crucial importance for the society and judicature, in which it shared the view expressed in the doctrine that, in the absence from Art. 691 of the CC the restriction of the notion of "cohabitation" with the attribute "marital" — i.e. in view of the obvious breaking of the link between this concept and the pattern of marriage — the provision of Art. 691 of the CC it applies not only to heterosexual unmarried relationships, but also to homosexual relationships in which the same ties are created as between cohabitants (uchwała SN z dnia 28 listopada 2012 roku, III CZP 65/12, OSNC 2013, Nr 5, poz. 57). The emotional, physical, and economic ties arising from such a relationship are identical in both cases and can create an equally strong join. In the justification of the resolution, the Supreme Court defined the understanding of this provision in a manner consistent with the content of Art. 8 and 14 of the Convention and the jurisprudence of the ECHR, setting a new direction for the interpretation of other legal institutions in which the concept of actual cohabitation occurs (Cebula, 2013). Due to the above, in another resolution, the Supreme Court stated

that Art. 691 of the CC applies not only to heterosexual relationships (uchwała SN z dnia 28 listopada 2012 roku, III CZP 65/12, OSNC 2013, Nr 5, poz. 57), as there is no legal distinction between the consequences of living together by heterosexual and homosexual persons (wyrok SA w Warszawie z dnia 26 czerwca 2014 roku, I ACa 40/14, LEX nr 1496122). The dominant position in the judicature of common courts includes an action for a homosexual partner to enter into a tenancy relationship (Konarska, 2016). Despite this, some parts of the doctrine still do not recognize the scope of the aforementioned expression of homosexual relationships (Panowicz-Lipska, 2016; Kozieł, 2014; Biały, 2018).

Moving on to another approach to the meaning of cohabitation, it should be noted that representatives of the doctrine, contrary to the case law, hold the position that the actual cohabitation should also be treated as the existence of a domestic, spiritual, and economic bond, without the necessity of physical people actually living together with the tenant, e.g., grandchildren, great-grandchildren, siblings, a child placed in a foster family, or ascendants (Panowicz-Lipska, 2016; Kozieł, 2014; Jezioro, 2006). This seems to be the correct position, therefore the *de lege ferenda* postulate is to add to the provision of Art. 691 para. 1 of the CC further descendants, ascendants, siblings, and adoptive parents (Kozieł, 2014). The opposite view, dominant in the case law, is presented in, e.g., a resolution in which the Supreme Court decided that the deceased tenant's grandson does not belong to the persons mentioned in Art. 691 para. 1 of the CC even when he and the tenant had an economic and emotional bond (uchwała SN z dnia 21 maja 2002 roku, III CZP 26/02, OSNC 2003, Nr 2, poz. 20).

In summary, Art. 691 para. 1 of the CC applies to people in informal heterosexual and homosexual relationships, because it results from the linguistic interpretation and *ratio legis* of this provision, despite the legislator's tendency to narrow the circle of people entitled to enter into a lease (Konarska, 2016). In the literature, legislative changes are proposed to cover further relatives — e.g., grandson, sisters — living with the tenant at the time of his/her death.

5. Court proceedings to determine the accession to the lease, pursuant to the Art. 691 of the CC

When considering court proceedings to enter into a lease contract under Art. 691 of the CC, first it should be pointed out that the plaintiff seeking a determination that he/she entered into a lease under Art. 691 of the CC should prove the existence of a legal interest (uchwała SN z dnia 19 listopada 1996 roku, III CZP 115/96, OSNC 1997, Nr 4, poz. 35) within the meaning of Art. 189 of the Act of 17 November 1964 — Code of Civil Procedure (ustawa z dnia 17 listopada 1964 roku — Kodeks postępowania cywilnego, tekst jedn. Dz.U. z 2021 r. poz. 1805 ze zm.). After the death of the tenant, precisely on the basis of Art. 189 of the Code of Civil Proced-

ure, everyone who has a legal interest in this may demand that the court agree to enter into the lease relationship. In such a case, it is useful to refer to the case-law in which the term "interest in law" has been defined. Pursuant to the judgment of the Court of Appeal in Szczecin (wyrok SA w Szczecinie z dnia 30 maja 2019 roku, I ACa 89/19, LEX nr 2718998), a legal interest arises if the very effect caused by the coming into force of the ruling will ensure the plaintiff's protection of his/her legally protected interests, i.e., definitively end the existing dispute or prevent the occurrence of such a dispute in the future.

At the same time, according to the Supreme Court's ruling, the legal interest should be interpreted taking into account broadly understood access to courts in order to ensure legal protection (wyrok SN z dnia 22 października 2014 roku, II CSK 687/13, LEX nr 1566718). Therefore, such an interest is surely enjoyed by a person close to the deceased tenant, if due to the date of death of the previous tenant there is uncertainty (dispute) as to the subjective or objective scope of that person's accession to the lease (wyrok SN z dnia 15 grudnia 2000 roku, IV CKN 205/00, LEX nr 537011). Under no circumstances can Art. 5 of the CC be the basis for an action to establish that the defendant has lost the right to lease (wyrok SN z dnia 8 lipca 1999 roku, I CKN 1367/98, OSP 2000, Nr 5, poz. 69).

The landlord has a passive legal standing in such proceedings, and when the premises are jointly owned, then all co-owners, pursuant to Art. 195 of the Civil Procedure Code, become necessary participants in such conduct (wyrok SN z dnia 28 października 1980 roku, III CRN 188/80, MP 1994, Nr 9, poz. 273). Each of the entitled persons may, in separate court proceedings, demand that they enter into the lease relationship, so no necessary participation occurs between the relatives of the deceased. It is important that the court cannot make a decision on etering into a lease relationship with only one of the entitled persons, selecting on the basis of the degree of closeness or the time of living with the deceased tenant (wyrok SN z dnia 4 stycznia 1979 roku, III CRN 271/78, OSNC 1979, Nr 9, poz. 178). The process of establishing the existence or non-existence of a lease relationship is subject to examination in ordinary proceedings (uchwała SN z dnia 20 listopada 2003 roku, III CZP 77/03, OSNC 2004, Nr 7–8, poz. 109). It is also significant that the request to enter into a lease under Art. 691 of the CC does not expire (wyrok SN z dnia 12 lutego 2002 roku, I CKN 527/00, OSNC 2002/12, poz. 159). It is worth mentioning that the declaration of entering into a lease contract pursuant to Art. 691 of the CC may also, upon the defendant's objection, take place in an eviction case, as a prerequisite for the decision (wyrok SN z dnia 5 grudnia 1995 roku, II CRN 128/95, LEX nr 209345). From a practical point of view, it is important that the claim for accession to the lease is a property claim, and therefore the possibility of challenging the decision of the appellate court with cassation depends on the value of the subject of the appeal (Civil Procedure Code, Art. 392 para.1). Therefore, in a dispute on entering into a tenancy relationship after the deceased tenant, the conditions laid down in Art. 23 of the Code of Civil Procedure — as

ones most closely resembling the nature of the case — apply during an assessment of the value of the appeal subject (postanowienie SN z dnia 19 grudnia 2002 roku, V CZ 186/02, LEX nr 583928).

6. Termination of the contract by the entitled party and Art. 691 para. 5 of the CC

The deceased tenant's successor has the option to terminate the lease using the statutory deadlines. The duration of the contract and contractual provisions are irrelevant (Kostański, 2006). Upon the passing of the statutory notice period, the lease expires. In the event of several people joining the lease, each of the co-tenants has the right to terminate the lease with effect only for the denouncing party (Kozieł, 2014). The possibility of terminating a lease concluded for a fixed period by persons who entered into a lease relationship is an exception to Art. 673 para. 3 of the CC stating that if the duration of the lease is fixed, both the landlord and the lessee may terminate the lease in the cases specified in the contract. There is a lack of regulation in the literature concerning the possibility of renouncing the lease by authorized persons (Bończak-Kucharczyk, 2011). Therefore, the *de lega ferenda* motion added to such a provision in Art. 691 of the CC seems appropriate.

Finally, it is worth discussing the provision of Art. 691 para. 5 of the CC, which stated that the provisions of Art. 691 para. 1–4 of the CC do not apply in the event of the death of one of the joint tenants of the apartment. However, since the lease is a divisible right, this type of regulation may raise various doubts (Bończak-Kucharczyk, 2011). The exemption from Art. 691 para. 5 of the CC applies irrespective of whether the right to lease the premises is shared in fractional parts or jointly. Of course, the effect of one of the co-tenants dying is the termination of the lease with the deceased (Bończak-Kucharczyk, 2011). The doctrine rightly questions the different treatment of the consequences following the death of one of the co-tenants, because the lack of application of Art. 691 para. 1–4 of the CC separates the protection of the housing interests of tenants and co-tenants who, after all, have the legal status of tenants (Nazar, 2008).

Conclusions

To summarize, Art. 691 of the CC applies only to residential premises. In order to enter into a tenancy relationship after the tenant's death, it is necessary to meet two conditions jointly, namely: 1. being a spouse who is not a joint tenant of the premises, a child of the tenant and his/her spouse, another person to whom the tenant was obliged to provide maintenance, or a person who actually cohabited with the tenant; 2. permanent residence with the tenant in the premises until his/her death.

Permanent residence in the premises means that one's all life activities are concentrated in the tenant's premises. At the same time, the person to whom the tenant was obliged to pay maintenance should be treated as the entity to whom the deceased tenant was actually obliged to pay maintenance, without any distinction between the bases of this obligation. Under the current legal status, a cohabiting person should be considered a cohabiting tenant, without differentiating between heterosexual and homosexual relationships.

Moving on to the court proceedings regarding the analyzed regulation, it should be pointed out that the necessary procedural premise is having a legal interest which must exist objectively. It is a precondition for further examination of the claim in terms of the existence or non-existence of the established right or legal relationship (wyrok SA w Warszawie z dnia 5 września 2018 roku, VII AGa 485/18, LEX nr 2566773). Due to the content of Art. 316 para. 1 of the Code of Civil Procedure, a legal interest must exist at the time the court adjudicates (wyrok SN z dnia 7 grudnia 2012 roku, II CSK 143/12, LEX nr 1288628). From the point of view of legal protection of entitled persons, it is advantageous that the claim under Art. 691 of the CC does not expire. A unique regulation is the possibility of terminating a lease concluded for a fixed period by persons who entered into a lease relationship after the death of the tenant.

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Legal acts

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Konwencja o ochronie praw człowieka i podstawowych wolności sporządzona w Rzymie dnia 4 listopada 1950 r., zmieniona następnie Protokołami nr 3, 5 i 8 oraz uzupełniona Protokołem nr 2 (Dz.U. z 1993 r. Nr 61, poz. 284 ze zm.) [Convention for the Protection of Human Rights and Fundamental Freedoms, signed in Rome on 4 November 1950, amended by Protocols No. 3, 5 and 8 and supplemented by Protocol No. 2 (Journal of Laws of 1993, No. 61, item 284, as amended)].

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Ustawa z dnia 23 kwietnia 1964 roku — Kodeks cywilny (tekst jedn. Dz.U. z 2020 r. poz. 1740 ze zm.) [The Act of 23 April 1964 — Civil Code (consolidated text Journal of Laws of 2020, item 1740, as amended)].

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Uchwała SN z dnia 19 listopada 1996 roku, III CZP 115/96, OSNC 1997, Nr 4, poz. 35 [Resolution of the Supreme Court of 19 November 1996, III CZP 115/96, OSNC 1997, No. 4, item 35].
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Wyrok SN z dnia 17 lutego 1978 roku, II CR 24/78, OSNC 1979, Nr 1–2, poz. 32 [Judgment of the Supreme Court of 17 February 1978, II CR 24/78, OSNC 1979, No. 1–2, item 32].
Wyrok SN z dnia 4 stycznia 1979 roku, III CRN 271/78, OSNC 1979, Nr 9, poz. 178 [Judgment of the Supreme Court of 4 January 1979, III CRN 271/78, OSNC 1979, No. 9, item 178].
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Wyrok SN z dnia 28 października 1980 roku, III CRN 188/80, MP 1994, Nr 9, poz. 273 [Judgment of the Supreme Court of 28 October 1980, III CRN 188/80, MP 1994, No. 9, item 273].
Wyrok SN z dnia 28 października 1980 roku, III CRN 230/80, MP 1994, Nr 9, poz. 273 [Judgment of the Supreme Court of 28 October 1980, III CRN 230/80, MP 1994, No. 9, item 273].
Wyrok SN z dnia 15 stycznia 1981 roku, III CRN 314/80, OSNC 1981, Nr 6, poz. 119 [Judgment of the Supreme Court of 15 January 1981, III CRN 314/80, OSNC 1981, No. 6, item 11].
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Wyrok SN z dnia 15 października 1984 roku, I CR 309/84, OSNC 1985, Nr 8, poz. 113 [Judgment of the Supreme Court of 15 October 1984, I CR 309/84, OSNC 1985, No. 8, item 113].
Wyrok SN z dnia 5 grudnia 1995 roku, II CRN 128/95, LEX nr 209345 [Judgment of the Supreme Court of 5 December 1995, II CRN 128/95, LEX No. 209345].
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Wyrok SN z dnia 8 stycznia 2002 roku, I CKN 723/99, LEX nr 53132 [Judgment of the Supreme Court of 8 January 2002, I CKN 723/99, LEX No. 53132].

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Wyrok SN z dnia 22 października 2014 roku, II CSK 687/13, LEX nr 1566718 [Judgment of the Supreme Court of 22 October 2014, II CSK 687/13, LEX No. 1566718].
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Rejoinder to Dominiak on bagels and donuts

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Abstract

This is but the latest in a series of debates I have been having with my friend and colleague, Łukasz Dominiak. Included are the following texts: Block (2021), Dominiak (2017; 2019; 2021). We have been agreeing and disagreeing with each other concerning the implications of the bagel and donut theory for a while. The present paper continues this tradition: both agreeing and disagreeing with each other in regards to libertarian theory and trespass on private property.

Introduction

Think of a three-level bull's eye diagram with land area A in the middle of it, the middle ring features zone B, and an outer layer, the rest of the world, which depicts area C. The issue arises: would it be legitimate to homestead in zone B? The answer I have long given to this question is that no, this would be illegitimate. Why? This is because the person who did so, call him Mr. B, would then control area A, even though he had not mixed his labor[1] with any of it.[2] That is, he can preclude

[1] For libertarian homesteading theory, see Block, 1990; 2002A; 2002B; Block and Edelstein, 2012; Block and Yeatts, 1999–2000; Block and Epstein, 2005; Bylund, 2005; 2012; Grotius, 1814 [1625]; Hoppe, 1993; 2011; Kinsella, 2003; 7.09.2006; 22.05.2009; 21.08.2009; Locke, 1948, 17–19; 1955, Ch. 5; Paul, 1987; Pufendorf, 1927 [1673]; Rothbard, 1973, 32; Rozeff, 1.09.2005; Watner, 1982.

[2] To make this example more realistic, I assume that there are no helicopters, no bridges, no tunnels; the only way Mr. C, now located in area C, can have access to A would be to trespass on Mr. B's territory.

entry to A by all outsiders. He will not own A, to be sure. Ownership implies both the ability to use the terrain and to preclude others from so doing; with his homesteading in pattern B, he has the latter power, but not the former.[3] But still, this is unwarranted control. The "Blockian Proviso" maintains that this would be illicit under libertarian law.[4] If Mr. B wants to do this, he must open up a path for access to A for Mr. C, the resident of area C.

Dominiak (2017; 2019) has some problems with all of this. However, in his latest contribution to this dialogue he and I have been having (2021), he also turns things around. He does not only examine whether Mr. B may properly preclude Mr. C from access to A anymore. Rather, he turns things inside out. He posits that Mr. C has now taken possession of area A, and maintains that the Blockian Proviso be extended. In his view, it is not sufficient for Mr. B to allow outsiders into area A. Now that Mr. A[5] has taken possession of A, Mr. B must, further, allow Mr. A access to and egress from A; he calls this territory, A, "landlocked property." When Mr. A utilizes area B for the purpose of access, either going in or disembarking, Mr. B may not properly accuse him of trespass. My debating partner claims that if the Blockian Proviso is not interpreted in this manner, there will be a conflict in rights, anathema to libertarian theory,[6] and we should strive mightily to address this issue.

1. Theoretical framework of the research

The theories and concepts that were followed in the research involve homesteading, property rights, and the Blockian Proviso.

2. Research methodology

I critically analyze Dominiak's latest offering. I quote him widely and then respond to his claims.

3. The background

Dominiak (2021)[7] sets for himself the following challenge:

[3] This is always reserved to him, since he can homestead A whenever he wishes, secure that no one else can beat him to it.

[4] For more on the Blockian Proviso, see Block, 2016B; Kinsella, 11.09.2007.

[5] He is the ex Mr. C. I name people based upon the land they occupy. There are only three land masses in this analysis: A, B, and C.

[6] I wholeheartedly support him in this contention.

[7] Unless otherwise indicated.

whether landlocked property generates conflicts of rights and what to do with such conflicts […] So, without any further ado, let me begin with easements. Block claims that necessity easements are justified only if landlocked area A is unowned […] How then can this pattern of appropriation be anything else than "a contradiction to libertarian theory"? Is it not the case that then the investor is "controlling A, even though he never mixed an ounce of labor with that territory"? After all, he and only he decides whether C can enter B's (sic)[8] homesteaded area, A. Hence, it seems obvious to me that if there is "a contradiction to libertarian theory" when the landlocked area is unowned, there must also be "a contradiction to libertarian theory" when the landlocked area is homesteaded, for also in this case, the investor, "without ever laid a finger or toe on territory A," still controls it.

Yes, I agree, there indeed is a contradiction to libertarian theory here, but that is because we allowed Mr. B to engage in this anti-libertarian behavior: control over A without ever having homesteaded it. Ownership consists of the right to utilize one's own property without a by your leave from anyone else,[9] and, also, to prevent others from so doing. Mr. B clearly has the latter benefit. He even has some of the former: he can contemplate A to his heart's content, secure in the knowledge that no one can stop him from so doing.

Dominiak continues:

if there is an easement in the case of land-locked virgin area (as Block claims), there must also be an easement in the case of landlocked property (as I claim). And if accessing landlocked property without permission amounts to a trespass (as Block claims), then accessing landlocked virgin land must be a trespass, too. It is clear to me that with his fancy donuts, Block spotted a very important thing indeed; namely, conflicts of rights that can be generated by libertarian theory (in this case, by the homestead principle of justice specifically), despite its promise to avoid any such conflicts. And Block's reaction to his sad discovery was a proper one; that is, to propose a slight revision of the libertarian theory in the form of a very small cap put on the absoluteness of private property rights.

My learned colleague and I have a parting of the ways here. In my view, private property rights are still absolute. They are now ever *more* absolute than before the Blockian Proviso. Previously, they were not absolute in that they were excessive: Mr. B had a right to partially control area A without homesteading it. Now, with this proviso, Mr. B has no such right. Dominiak's point is that with the proviso, Mr. B now has less than absolute private property rights in his own area B. I would say instead that the *doctrine* of absolute private property rights is still secure, even more so with the proviso, but that yes, our author is correct, Mr. B himself now has less than full property rights in his own territory B.

But the reason for that is entirely compatible with the doctrine of private property rights! It is just that Mr. B has violated this doctrine, and thus must be made to pay the appropriate penalty for his misbehavior: he must allow Mr. C to transverse his property so as to have access to area A.

But this is not the first time on record that people have had less than full private property rights over what would otherwise be considered their own land —

[8] At this point Dominiak says "C's." I think this is a typographical error on this part and I have corrected it.

[9] Assuming, of course, the owner does not violate the rights of others in so doing.

for example, if they signed a restrictive covenant, disallowing them from certain activities. Or, if they agreed, for sufficient consideration, not to build a high fence, allow trees to grow past a certain height, so as to protect a neighbors' view. Or if they voluntarily joined a homeowners' association. As none of these cases would constitute "a very small cap put on the absoluteness of private property rights," neither, then, should the Blockian proviso be described in this manner.

Dominiak next avers as follows:

> the unowned center of the bagel may (is permitted to) traverse the investor's land in order to reach the virgin parcel and mix his labor with it. I like it. Before the Blockian Proviso, there was a conflict of rights: potential homesteaders had duties not to traverse the investor's property and they had liberty-rights to enter the virgin land, but since they could not enter the virgin land without traversing the investor's property, it followed that they also had no liberty-rights to enter the virgin land, which was a plain contradiction rightly identified by Block. After the Blockian Proviso, there is no such conflict of rights anymore; potential homesteaders no longer have duties not to traverse the investor's property. They have easements for homesteading purposes. But this strictly analogous conflict of rights takes place in the case of land-locked property, and unless the Blockian Proviso is extended to such cases, a contradiction ensues. Thus, without the Blockian Proviso, the owner of the center of the bagel has a duty not to traverse the investor's property, and being equipped with a right to control his own center parcel, he also has a liberty-right to enter this parcel, but since he cannot enter it without traversing the investor's property, it follows that he has no liberty-right to enter his own center parcel.

Or to leave it. Aha, this is the blockade objection to private roads. This was dealt with in Block (2009B). How does Mr. A get there in the first place? He first homesteads A, leaving B entirely alone. But, how did Mr. A get to area A in the first place? B was at that time virgin land. Mr. A traversed area B before Mr. B was there, in order to get to area A to homestead it in the first place. Thus, Mr. A at the very least has a homestead right to access and egress from his own land A, since he established this before Mr. B came on the scene. So, there is no contradiction to libertarian theory involved here.

Continues Dominiak:

> [Block] gives us a series of hypothetical scenarios in which owners go travelling and cannot come back home because they got flat tires or do not have money. Block believes that from the fact that they now lack the where-withal to travel home, it does not follow that they have a right to such wherewith-al. And I agree with this author. Under libertarianism, they do not have any such rights. But this is entirely beside the point. Notice that these scenarios were supposed to prove the non-existence of a very different right, namely the right that A has "[a]s the owner of the land" to his own land, that is, "a right to possess and use the land." Now from the lack of rights to the wherewithal, it decidedly does not follow that these poor travelers also lack rights to possess and use their own home bases.

I do not see why not. If these travelers lack bus fare to return home and it is too far to walk to get there, then they certainly do not have a right to get there. There are no positive rights in libertarianism. Well, I spoke too soon. They still have a right to "possess" their land, in the sense that they could call the police to

evict trespassers. But they would have no right to "use their own home bases," since by stipulation they lack the means to get back there.

Dominiak now launches a three-pronged critique of my perspective:

> As I see it, there are at least three things that cause Block's analogies to misfire. First, it is suggested in their very formulation (e.g. a flat tire) that there are various means available (after a bit of effort) to the poor traveler by which he can come back home, possibilities explicitly assumed away in the bagel scenario. Second, even if he really could not get himself any money to pay for any of these various means and literally no one could give him a lift or whatever, there would still be innumerable property owners whose money could make it possible for the traveler to access his home base, whereas in the bagel scenario, there is only one owner whose property is eligible for an easement. Third, none of these innumerable people does anything to make the poor traveler's return impossible, whereas in the bagel scenario, it is a specific person who homesteads the land in a way that makes it impossible for the landlocked owner to access his property. And this is exactly this very person that should suffer the servitude […] Should the investor be compensated for giving easements to potential homesteaders and landlocked owners? I cannot see why not. After all, compensating owners for their land being trodden on by others seems like strengthening their ownership, not weakening it.

There is nothing at all wrong with Mr. B being paid by Mr. A so that the former will allow the latter access to his property, B. All mutually voluntary commercial interaction is certainly compatible with and supported by libertarian theory. However, suppose Mr. B refuses for any price to allow Mr. A access to his land, B.[10] My debating partner would see great problems in this eventuality. He might even see a "contradiction" or a "conflict in rights" should this scenario come to pass. I take a different position. If Mr. B will not allow Mr. A access to territory B, well, that is just too bad for Mr. A. He will have to do without property A, which would otherwise be owned by him. Can he be trapped there, and forced to die, without any food coming in?[11] Of course not. How did he get in there in the first place? Presumably, through area B. Well, then, he has thereby homesteaded at least the right to leave, if B was unowned at the time. However, if Mr. B was the proprietor of that terrain at the time, the only way then Mr. C, now Mr. A, could have arrived at A would have been via trespassing through B. He would have been a criminal. But, surely, any civilized punishment law would not allow the death penalty for so relatively minor a crime. Thus, he would have been allowed to escape.

[10] I confess I cannot see this eventuality ever arising as a practical matter. Right now, purchasers of real estate commonly — make that almost certainly — also buy title insurance. This assures them that what they are obtaining from the vendor is actually owned by him. Similarly, in the free society, this "blockade" that Dominiak poses would also never arise; before consummating a deal, the shopper would avail himself of access insurance, both ingress and egress. Or, would legally tie up the vendor, Mr. B in our case, so that the latter could not blockade him, prohibiting him from entering or leaving the property he is now obtaining, A. For more on this see Block, 2009A; 2009B.

[11] As I write this, there are truckers in convoy in Ottawa, Canada, protesting COVID policies. The government is contemplating just this tactic in order to quell them.

Continues Dominiak:

It seems like putting still a smaller cap on the absoluteness of private property rights. It seems more libertarian than no compensation at all. So, let me make my thesis more explicit and see whether now it is more palatable for Block: yes to necessity-easements for landlocked proprietors, but only with compensation to the servient owners.

Compensation schmompensation. This would be akin to eminent domain coupled with the stipulation that the government is compelled to "compensate" the victim. But eminent domain is unjustified[12] in the first place, whether undertaken by the state or privately, as advocated by this author. Further, who sets the level of compensation? If Mr. B, the owner of land B, does, he can demand an infinite price. That is, he is not willing to be paid any amount to have trespassers utilize his land. That is what "the absoluteness of private property rights" really means. It does not, as per Dominiak, mean that the owner's property rights may be abrogated and then he is paid for this violation of rights. Rather, it means that his property rights cannot be violated in the first place.

But Dominiak has several other arrows in his quiver:

if Block prefers the language of trespass to the language of easements (with compensation), then I am happy with that. And it seems that he does, for he says that according to NAP, the land-locked person traversing the land of his neighbor commits a trespass. If so, I am also ready to admit that the landlocked owner who traverses the investor's land without authorization commits the tort of trespass and ought to compensate the investor. But nothing more! Decidedly, he should not be prevented from traversing the investor's land or punished for doing it, for the landlocked owner has a justification for his act in the form of exercising his ownership rights. So, in a sense, I would agree with Block when he says that "[t]o Dominiak it seems that, surely, in that world a landlocked person still acts morally permissibly in crossing other people's property without permission if necessary to survive" and to exercise his ownership rights. But the moral permission with which the landlocked person acts is not full permission, for it does not magically extinguish the investor's property rights; thus, the tort of trespass is committed nonetheless, and so compensation is due.

My response is that trespass is trespass. It is still trespass even if the trespasser does so for reasons very important to him. Now, I go along with Dominiak to this extent: it is better that the trespasser pay the landholder compensation for this crime than not do so and violate private property rights scot-free. But this is hardly the libertarian answer. Rather, it is that no trespass at all occurs. It is the same with any other crime: murder, rape, theft, kidnapping, fraud; the ideal libertarian solution is that none of these acts take place, and if they do, the malefactor be imprisoned and the rights violation be stopped in its tracks. However, and this seems to be the only point on which I can agree with Dominiak — if for some reason these wrongdoings cannot be stopped, then yes, it is better that the criminals pay

[12] See the following for libertarian opposition to eminent domain: Benson, 2005; Block, 1998; Block and Block, 1996; Block and Epstein, 2005; Gordon, 27.03.2020; Gregory, 5.12.2006; Nedzel and Block, 2007; 2008; Paul, 1987; Speiser, 27.07.2005; Ward, 22.11.2012. For the case in favor of eminent domain made by otherwise supporters of free enterprise and private property rights, see Epstein, 1985; Tullock, 1996.

compensation to their victims[13] than if they are not forced to do so. But why this should be considered to be fully compatible with libertarianism is very unclear.

Dominiak now poses the case of a ship captain, A, who is forced to jettison cargo in his care belonging to C due to a storm at sea which will capsize the vessel unless he does so.[14] According to our author, this sets up yet another conflict in rights. He continues:

> what Block says in his rejoinder, it seems that there is no answer to this question on libertarian grounds. Whatever A does, he is damned. Whatever he does, he is blameworthy. Or, paraphrasing Block: whatever he does, this captain "commits a crime and should be duly punished for it." But "we should not be deterred by it, no matter how dramatic, if we wish to uphold the pure libertarian position." That is a failure, for it is obvious what A ought to do: he should jettison the cargo. Yet it does not mean that C's rights are thereby automatically extinguished (that would be in 'a contradiction to libertarian theory').

I do not see any clash in rights here. Presumably, there would be an explicit contract between A and C in this case such that if an emergency arises at sea, C's cargo is jettisoned. If there is no such explicit contract, surely, there is an implicit one to this effect. Consider this case: X is choking to death, or about to be hit by an onrushing truck. Y sees this and successfully provides the Heimlich maneuver on X or pushes him out of the path of the truck and into safety. However, in so doing, Y breaks X's ribs. Dominiak would see this as a conflict in rights, since Y has no right to break X's ribs. I see his point, but I just cannot see my way into agreeing with it. Surely, there is no rights conflict in this story; Y is a hero. And the same thing applies to the captain of the ship who jettisons cargo to save his vessel and all the lives of his shipmates.

But Dominiak rejects this response of mine. He maintains:

> After all, crime is never what one ought to do, and throwing the cargo overboard is what A ought to do. Similarly, crime is something for which one is blameworthy, and no one is ever blame-worthy for doing what one ought to do. So, it is not a crime, and A should not be punished. However, he should pay compensation to the cargo owner, C.

Possibly, the explicit contract between the boat owner A and the cargo owner C would stipulate whether the former owed the latter compensation.[15] It all depends upon who the risk bearer of storms at sea is. But let us posit that this is the case: A owes C money for jettisoning his cargo. I still do not see how this proves that the trespasser should not be stopped by the forces of law and order from continuing his depredations in our bagel case. Yes, the intruder should have to pay compensation, but why not also be prevented from continuing his crime spree? Moreover, there seems to be a disanalogy between the two cases. In the encroachment example, the crime is ongoing; my learned colleague does not object to its continuation. He only insists, quite properly, that the squatter should be made to

[13] Or to the heirs of the victims in the case of murder.

[14] B is mentioned here, but I am not sure who he is. Perhaps the sailors on the ship.

[15] But surely Y owes no compensation to X?

pay compensation to the landowner. How much, he does not say. Nor does he imply the aggrieved property owner would voluntarily accept this payment. Dominiak does not object to the continuation of this rights violation. The storm at sea example is very different. Here, all parties would agree that the ship captain should abandon the cargo. There is no blame. Again, my debating partner calls for compensation. Here, it is clear what the upper bound of that would be: the value of the freight. Nor can anyone object to a continuation of this practice: whenever there is a mighty storm, it is legitimate, even obligatory, to throw the consignment into the ocean. No one would disagree with that. But there is plenty of discord concerning the interloping in the donut case.

Our author then launches into the case where the ship captain proceeds into the storm, where he had the option of doing no such thing. I fail to see the benefit of this example.

At this point, Dominiak attempts to refute the *reductio ad absurdum* I utilized against his position.

> If it is justifiable for people to trespass in order to save their lives, what else might become compatible with libertarian law for this life saving purpose. How about people who do not save for a rainy day; they are now going to starve (we abstract from private charity in all these cases), so government welfare programs would now be defensible on private property grounds.

What is his defense against this reductio of mine for trespassing in order to save lives? He offers the following:

> However, landlocked owners do not have easements "in order to save their lives," although they may exercise them also for this purpose. They have easements because otherwise, we would have an insurmountable conflict of rights which libertarianism promised to avoid and because, therefore, someone's property rights simply have to partly give.

Perhaps I am being obtuse, but I still do not see any conflict in rights. Not in the cargo jettisoning case, nor when Y saves X's life but breaks his ribs in the process. Yes, ordinarily, breaking an innocent person's ribs constitutes assault and battery. But this assessment no longer prevails in the context of saving the victim's life. Similarly, throwing someone's cargo into the ocean in ordinary circumstances should be a crime. But not when we take into account proper international law, implicit if not explicit contracts, and the hoary law of the sea traditions.

A better case for Dominiak would be two bedraggled ship-wrecked sailors hanging on for dear life to a wooden board that can only support one of them. But even here there is no conflict in rights. For the owner of the ship, now reduced to this one piece of timber, would have to decide, perhaps in advance, which one of these sailors should stay alive and which must drown. Posit that no such ruling has been made in advance, and/or that the owner is not one of the two contending parties and cannot be found to make any such determination in the first place. Again, libertarian theory makes good this omission. We resort to homesteading theory[16]:

[16] See fn. 12

whichever of them first touched the wooden board is the proper owner of it. It is only in the case there they each came into contact with this life saving piece of wood that there can be a conflict. But not a conflict of rights. For here, too, libertarian theory comes to the rescue: they can flip a coin, or bet on the next seagull, or resort to any other such fair determination process.[17]

Nothing loath, my scholarly colleague continues his intellectual sally against me:

So, there is a clear disanalogy between Block's reductions (sic)[18] and cases of landlocked property and cargo. In the former case, there is no conflict of rights. In the latter case, someone's rights have to give. Now, what to do in such lifeboat cases? Contrary to the libertarian promise, there is a conflict of rights. What should we do? My answer: put a cap on the absoluteness of libertarian rights, give an easement and allow a breach, but with compensation.

I appreciate Dominiak's concern and his fear that our mutually beloved libertarian theory is not up to snuff. I welcome his attempt to ameliorate it with his compensation analysis. Where we part company is that I do not see the problem in the first place, and I do not understand how a continued rights violation, even a compensated one, can be even compatible with libertarian theory, let alone suffice to patch it up.

Conclusions

Dominiak ends his essay on a difficult note for libertarian theory. He avers:

Yet, I take it to be pretty uncontroversial that what the father (of the starving child) ought to do in this case is to steal the bread. Unless we thought so, there would be no dilemma to start with. And there is a dilemma to start with. Unless Block thought so, there would be no good reason why his 'heart would go out' to the father. And his heart goes out to the father. Moreover, I also take it to be uncontroversial that saving the child's life is a good much greater than leaving the baker's stock of bread intact — or alternatively, letting the child die is an evil much heavier than stealing a loaf of bread. So, it seems to me that the father has a ready justification for his action: the balance of evils. He committed a petty theft because that was necessary to avoid a great evil. He did what he ought to have done. Now, it would be both conceptually weird and morally unfair to hold him blameworthy for doing what he ought to have done. I therefore conclude that he should not be punished. However, because he infringed upon the baker's property rights, he should pay compensation to the baker. After all, the baker's rights are not only *prima facie* claims that disappear in the face of weightier considerations. They are absolute. But not as absolute as to condemn the father for saving his starving children.

[17] In baseball, when the runner and the baseball arrive at first base at the exact same moment, the "tie goes to the runner." This is perhaps because less than 50% of batters can successfully hit the ball. Or, maybe, this rule was declared in order to make the game more interesting. Whatever the cause, this is not arbitrary from a libertarian point of view, since the process under which this rule was selected did not violate any rights.

[18] I spy a typographical error here; this should be reductios, not reductions

Dominiak and I also part company concerning the father's theft of bread from the baker to feed his starving child. My heart still goes out to the father. But my libertarian "head" is on the side of the baker.[19] Nor can we acquiesce in Dominiak's demand that the father "pay compensation to the baker." If he could have done so, he would have already paid the purchase price and had no need to steal.[20]

Libertarianism does not ask what the father should have done in the face of this dilemma.[21] That is a question for the discipline of morality to wrestle with. Libertarianism is only a small branch of that discipline: the subset concerned with the proper use of violence. And, here, it was the father who engaged in a rights violation, not the baker by stopping him.[22]

My research results are that Dominiak's and my views of private property rights greatly diverge.

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[19] And, also, on the side of all the multitude of children who will starve if bakers cannot earn a profit and are forced into bankruptcy. Then, no bread for any children, nor adults. Hazlitt (2008 [1946]) teaches us to analyze the effects of a public policy not just on one person, but on all people involved; not just at the present time, but in the future as well. Dominiak does not take Hazlitt seriously enough. It is no accident that to the degree that private property rights are respected is the degree to which there are fewer starving children.

[20] In any case, compensation under libertarianism would be far in excess of the purchase price of bread. If the father cannot pay the latter, he certainly could not pay the former. On libertarian punishment theory, Rothbard (1998, 88, fn. 6) states: "It should be evident that our theory of proportional punishment—that people may be punished by losing their rights to the extent that they have invaded the rights of others—is frankly a retributive theory of punishment, a 'tooth (or two teeth) for a tooth' theory. Retribution is in bad repute among philosophers, who generally dismiss the concept quickly as 'primitive' or 'barbaric' and then race on to a discussion of the two other major theories of punishment: deterrence and rehabilitation. But simply to dismiss a concept as 'barbaric' can hardly suffice; after all, it is possible that in this case, the 'barbarians' hit on a concept that was superior to the more modern creeds." See also Block, 2009A; 2009B; 2016A; 2018; Gordon, 4.09.2020; Kinsella, 1996; 1997; Loo and Block, 2017–2018; Olson, 1979; Rothbard, 1977; 1998; Whitehead and Block, 17.02.2003.

[21] See Block (2003) on a case where a hapless person is hanging onto a flagpole 15 floors above ground level and the owner demands that he drop to his death.

[22] We assume that the father first sought charity to keep his child alive but that this option failed.

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