

POLICY MEETING ON THE ECONOMIC AND BUSINESS ENVIRONMENT FOR TRADE IN SERVICES IN THE BALTIC STATES

Introduction and opening remarks

The OECD Policy Meeting on the Economic and Business Environment for Trade in Services in the Baltic States, held in Tallinn on 13-14 December, was organised by the Trade Directorate within the activities of the Centre for Co-operation with Non-Members (CCNM) under the OECD Baltic Regional Programme. Over 70 officials and business representatives participated in the event. In addition to representatives of the Baltic countries, participants came from 14 OECD countries and 5 non-member countries (Bulgaria, Croatia, Romania, Russia and Slovenia).

The objective was to identify possible external and internal obstacles inhibiting the full exploitation of comparative advantages of the service sector and trade in services in the Baltic region. Trade officials shared their experience in building an efficient and internationally competitive service sector and explored means to develop further a business-friendly environment for service providers. Participants also examined the role of regional and multilateral disciplines in improving the legal and regulatory framework. Although the exchange of views focused on the specific situation of the service sector in the Baltic States, it contributed to a better understanding of the necessary interaction between the government and the business community and the regulatory challenges faced by governments in other countries.

Mr. Hendrik Hololei, Minister of Economic Affairs of Estonia, welcomed the participants on behalf of the Government of Estonia. He emphasised that co-operation with the OECD is a constant priority of his government, noting the Organisation's major role in tackling the issues critical for economic growth and integration into the international system and world economy. He thanked OECD donor countries for their active involvement in the Baltic Regional Programme and pointed out that the financial contribution of the Baltic countries to these activities evidences the positive evaluation of this co-operation. He also expressed Estonia's continuing support and its commitment to contribute to the programme in the future. He considered the subject of the meeting particularly topical, observing that the Estonian government has assigned high priority to promotion and improved regulation of the service sector.

In his opening remarks, Mr. Kenneth Heydon, Deputy-Director of the OECD Trade Directorate described OECD's co-operation with non-member countries under the CCNM aegis, particularly its activities with the Baltic countries. He noted that the first year of the Trade Directorate direct participation in the Baltic Regional Programme had been fruitful, promoting close contacts with government officials in the region and creating a synergy between the Baltic Regional Programme and other activities of the Trade Directorate. In this context, he gave the main orientations of the Trade Directorate's current work in the area of trade in services, including analyses of the benefits of trade liberalisation, MFN exemptions and labour mobility. He stressed that the agenda of the meeting addressed a number of issues of more general interest and could thus provide useful insights for other countries and further OECD work.

The chairpersons of the three sessions of the meeting were Ms. Signe Ratso, Deputy Secretary-General, Ministry of Economic Affairs, Estonia; Mr. Aivars Gulbis, Deputy Director, Foreign Trade Department, Ministry of the Economy, Latvia and Mr. Romas Švedas, Director of the Economics Department, Ministry

of Foreign Affairs of the Republic of Lithuania. Ms. Birgitta Nygren, Director, Ministry for Foreign Affairs, Sweden chaired the concluding Session.

Session 1: The service sector and trade in services in the Baltic States: A business perspective

Ms. Signe Ratso introduced the session by noting the remarkable progress of the Baltic States in removing domestic trade impediments. She compared the results of the recent surveys with those of business surveys commissioned by the OECD in 1994 and discussed in an OECD meeting in Helsinki in 1995, which she had chaired. She observed that the majority of the respondents to the recent surveys consider most domestic problems that had been highlighted in the earlier surveys, in particular inadequate infrastructure, weak financial facilities and lack of information, now irrelevant, though some new preoccupations seem to emerge.

The main speakers in this session were three experts, who conducted the business surveys in the Baltic States. Ms. Elin Saks from Estonia [CCNM/TD(2001)6] observed that, though the domestic legal environment is viewed as stable by most firms in Estonia, some complained that the government does not consult sufficiently with business associations when drafting new legislation and does not provide enough financial support to strategic sectors. Ms. Erika Sumilo from Latvia [CCNM/TD(2001)7] presented several figures showing clearly that the Baltic States had largely overcome the handicap of an underdeveloped service sector that they and other former socialist countries had inherited. Mr. Saulius Martinenas from Lithuania (replacing Mr. Jonas Butautis, the author of the survey) confirmed that many of the problems raised in the survey [CCNM/TD(2001)8] were not considered serious by most firms. Important exceptions, he said, were complaints about inadequate consultation procedures, uneven enforcement of laws, and inconsistency of government regulations.

The three experts agreed that the surveys provide a basis for comparing developments in the service sectors of the three countries over a period of time and help to identify the main achievements and remaining problems. They noted that the results could be further exploited by using econometric techniques to capture the linkages between the different categories of firms and their problems so as to draw more concrete lessons for governmental policy. It was also felt that, given the heterogeneity of the service sector, future business surveys should be more sector-specific.

To supplement the three surveys, Mr. Hans Jeppson, Secretary of the Business Advisory Council of the Council of Baltic Sea States, presented the main findings of his organisation's study "The Baltic Sea Business Summit Report on Conditions for Growth and Development in the Baltic Sea Region," published in 2000. The report discusses in particular complaints about lack of prior consultations, red tape, poor enforcement of legislation, unfair competition and lack of fiscal support. He observed that prior consultations could be hindered by an insufficient competence and capacities of business groups. Excessive administrative burden, he said, could result from the fact that government officials often have mainly legal backgrounds and less experience with administrative procedures. He advised government officials to differentiate their approach to regulation (introduction of new regulations or deregulation) according to the specific needs of various service industries and take into account the heterogeneity of the service sector and the important role the services play in other sectors, including manufacturing. Mr. Jeppson also suggested that governments carefully weigh the costs and benefits of using special support or incentives: the experience in most countries shows their limited effectiveness.

Many of the participants emphasised the positive results of the three surveys, noting that they reflected substantial progress in developing the service sector. The three countries had experienced a similar evolution, marked by a rapid increase in the domestic demand for services and more recently, increasing contribution of services to the trade balance. The successful expansion of the service sector was attributed

largely to the improvement of the economic and regulatory environment for service providers. Some participants emphasised the positive influence of the three countries' recent accession to the WTO and parallel negotiations on EU membership in the development of a favourable regulatory framework.

The discussion of obstacles to the development of the service sector focussed on internal barriers, particularly the issue of prior consultations on new legislation, which was identified in each of the surveys as a significant problem. The Baltic representatives described the experiences of their respective countries. Estonia uses the Internet extensively to inform the public about all draft laws and offer affected businesses the opportunity to comment. In addition, working groups have been regularly established to discuss draft legislation with business representatives. In Latvia, the Ministry of Economy created a special unit for dialogue with the business community. Draft legislation is presented to the business representatives for consultation, but in some cases their full participation in the process is limited by their lack of expertise. This situation clearly indicates the need for training and education of business representatives, which is perhaps even more pressing in the area of services than in manufacturing, where the business organisations seem to be better organised and knowledgeable.

The overall process of consultations is further complicated by the extremely intensive legal activity in the Baltic countries, resulting from the application of WTO commitments and the efforts to adopt in a short period of time the EU *acquis communautaire*. Given the amount of activity, the demand for extensive consultations has sometimes stretched the administrative capacity, especially of governments in small countries. Consultations are often made difficult not because of the lack of available information, but because of the large amount of very complex information. One government representative noted, for example, that his country's WTO commitments are described in 700 pages of text, which often require specialised expertise to comprehend. Another participant observed that companies that include foreign investors generally have more experience in this area and are better prepared to take part in consultations. For example, the recent Latvian experience with the Foreign Investors' Council has resulted in useful consultation on legislative proposals.

Some participants expressed surprise that the surveys had found that *external* barriers to service providers are generally less important than domestic barriers. One possible explanation is the success of the three governments in avoiding obstacles to trade in services. For example, they have developed regional consultation procedures, especially in the area of non-tariff barriers, providing that any new legislation that might affect trade flows should be sent two weeks before its enforcement to other Baltic States' partners. Such an approach reflects recognition that, while in some areas, the removal of trade barriers should start at the national level, it is increasingly necessary to seek the solution through regional and sometimes even international co-ordination. Another explanation for the apparent lack of concern about external barriers relates to the nature of the surveys, which may not adequately differentiate between the views of companies according to their activities, size and their orientation to the domestic or international markets. It is likely that as companies become more involved in foreign trade, they will become more sensitive to market access conditions in other countries.

Discussions during the first session confirmed the general findings of the business surveys with regard to domestic impediments, highlighting the overall impressive progress of the service sector in the Baltic States. Participants concluded that this comparative exercise was useful in assessing the best practices and drawing attention to remaining problems. In general, the economic strategy and policy orientations adopted by the Baltic States represent a valuable example, especially for other transition countries still at the intermediary stage of the development of their service sector. Some shortcomings noted in the surveys, in particular regarding prior consultations, are partly due to the specific situation of the Baltic States, such as the lack of experience and adequate expertise of recently established business associations in these countries. However, other problems, such as the limited administrative capacity of governments in small

countries to adequately consult with the business community about rapidly changing regulatory measures, may be of a more general nature.

Session 2: Economic and regulatory environment for trade in services: The Baltic States' experience

The Chairman, Mr. Aivars Gulbis from Latvia introduced two main speakers for this session - Mr. Kari Jalas, Managing Director, the Central Chamber of Commerce of Finland, and Professor Inna Steinbuka, Chair of Latvia's Public Utilities Commission.

Mr. Jalas presented the survey "Poland and Estonia on the road to EU membership: Finnish companies' experience on the applicant country markets". The general conclusion of the survey is that, largely due to the privatisation process, significant FDI inflows and growing market demand, the business environment and market conditions in these countries have evolved favourably. In line with findings in other similar surveys, foreign companies have been nevertheless more critical than domestic companies, especially regarding the situation in infrastructures, customs administration, and corruption and, in some cases, the problems in interpreting existing laws and regulations.

Professor Steinbuka used the example of the Public Utilities Commission to explain multi-regulatory challenges and possible ways to tackle them. Latvia has established two regulatory agencies - the Financial and Capital Market Regulatory Commission and the Public Utilities Commission. The latter oversees the energy, telecommunications, post and railway sectors. The main goals of the Public Utilities Commission, which enjoys political, financial and institutional independence, is to promote competition in these regulated sectors, protect the consumers' interests and ensure quality control, encourage investment-driven development and determine the pricing methods and approve tariffs applied in these sectors. The Commission attempts to ensuring accountability and transparency of its decisions, and to maintain an "arm's length" distance from government, regulated utilities and consumers. Professor Steinbuka responded to several questions concerning the status and functions of the Commissions. She indicated in particular that, in contrast to competition authorities responsible for all sectors, the Public Utilities Commission focuses on recently demonopolised or still monopolised sectors, which is of particular importance in former centralised economies.

Lithuania's representative responded to some general issues raised in the agenda for the meeting. He stressed that the improvement in the regulatory system in the Baltic States has been due to both external and domestic factors. WTO commitments and the changes in legislation required by the EU accession process have been the decisive external elements. The major internal factor has been the radical reform strategy to shift to a market economy, including rapid privatisation, a high degree of trade liberalisation and opening to FDI and a relatively rapid achievement of macroeconomic stability. The governments have also been aware that economic and trade liberalisation, including in the service sector, is not a concession to other countries but a crucial pre-condition for future development. Finally, he observed that despite relatively fewer complaints about external barriers, some Baltic firms, especially providers of transport and construction services and companies trying to participate in government tenders in other countries, face significant market access problems.

Participants expressed their interest in the approach employed in the OECD country examinations of regulatory reform, in particular the experience with the implementation of efficient regulation principles such as transparency and openness of decision making and the promotion of internationally harmonised measures. Most agreed that, although the access to Internet and electronic availability of information are important, they are not sufficient to guarantee general understanding and good use of the information by public and economic operators concerned. Special expertise, education and training continue to be required. The representatives of the Baltic States noted the difficulties in establishing and operating

enquiry points as requested in the GATS, due mainly to limited administrative capacities. The importance of consultation with other stakeholders, especially consumers, was also acknowledged, but it was admitted that the dialogue in this area is still in its initial stage in these countries.

In concluding the first day of the meeting, the Chairman emphasised the contribution of the WTO disciplines, the EU accession process to favourable development of the business environment for the service sector in the region. In spite of the remarkable progress in this area, the Baltic countries, like other economies, continue to face many new regulatory challenges. OECD work, in particular findings of the regulatory reform exercises, could provide some useful insights for dealing with these problems.

Session 3: Regional and multilateral commitments for trade in services: The Baltic States' experience

The third session, chaired by Mr. Romas Svedas from Lithuania, was introduced by Ms. Julia Nielson's presentation on OECD's activities on trade in services. This work, much of which has been made available to OECD non-members, aims at filling the "knowledge gaps" in the issues subject to the current services negotiations in the WTO. The OECD has examined barriers to trade in specific service sectors (i.e. financial information services, tourism, wholesale and retail services, air cargo and environmental services), as well as possible modalities for their removal in WTO negotiations, such as cluster or formula approaches. Initial work was also undertaken on quantifying the benefits of services trade liberalisation. Current work is focused on four main areas:

- domestic regulation: good regulatory practices and the GATS role in promoting regulatory reform without limiting regulatory freedom;
- GATS and labour mobility: current commitments and their possible improvement;
- advocacy for benefits of services liberalisation: economic benefits and specific concerns of different stakeholders; and
- a request-offer template, which would assist countries in their preparations for service negotiations in the WTO.

Mr. Paul Elberg, Ministry of Economic Affairs of Estonia, explained Estonia's experience with liberalisation of trade in services in the context of the accession to the WTO and the EU. He pointed out that the related ambitious commitments have been implemented at the same time as other far-reaching economic reforms in the country. In many cases, Estonia adopted legislation and institutional settings that were largely inspired by other countries' laws and approaches, without always taking into consideration its specific situation and needs. Moreover, some proposals on further liberalisation of trade in services in the multilateral and regional frameworks may pose new challenges to countries like Estonia. Of particular concern is the compatibility of new requirements with the government's existing financial and administrative capacity and the future competitiveness of Estonian producers.

Mr. Ilya Petrichenko, from the Russian Ministry of Economic Development and Trade, highlighted recent developments in the service sector in Russia and the possible costs and benefits of the country's integration into the international trading system. He stressed that, after the financial and economic crisis in 1998, some Russian services providers have succeeded in developing their activities and attracting FDI, while others, such as road and maritime transport, have been confronted with strong foreign competition. Despite the recent adoption of several key measures favourable to business in Russia (e.g. the Land Code, tax reform, de-bureaucratisation), some sectors continue to operate in an institutional and regulatory vacuum. The most critical areas, for which draft legislation has been prepared, are laws on banking, bankruptcy, State insurance surveillance, investment funds, television and tourism. This intensive legal and regulatory

activity, which is helping to improve the business environment in Russia, demonstrates the country's efforts to implement international commitments.

Mr. Sergey Naryshkin, Chairman of the Committee for External Economic and International Relations of Leningrad Region Administration, gave an overview of the service sector in North-West Russia, particularly in St. Petersburg and Leningrad Region. He noted that the area, which ten years ago specialised primarily in manufacturing, is increasingly involved in services, which now represents 44 per cent of GDP of the region. Mr Sergey Balanov, General Director of the St Petersburg Foundation for SME development, also confirmed the increasing role of services, in particular small and medium service enterprises in the region. According to a survey conducted recently by the Foundation, regional SME identified inadequate legislation, lack of client and marketing research and insufficient financing and credit facilities as the main obstacles to develop their activities.

The presentations raised many questions and remarks. Participants appreciated the OECD's analytical approach to barriers and regulatory aspects in the service sector. One participant noted that there is not always a consensus on some regulatory issues, even among international organisations, and this can lead to mutual incompatibility in regulatory approaches adopted in different countries, for example in the energy sector.

The Baltic States' representatives commented on their experiences with regional and multilateral commitments in the area of services, in particular the accession to the WTO, negotiations with the EU, sectoral co-operation within the region and the adoption of specific instruments, for example within the OECD. The acceptance of these various disciplines required the creation of the new legislative basis and regulatory instruments. These transformations, implemented in a very short time period, resulted in a considerably liberalised trade regime for services, especially regarding commercial presence. Substantial progress has also been made in the regulatory area, where the Baltic States have in some cases adopted innovative approaches. Lithuania, for example, established two specialised commissions - a "sunset" commission to phase out unnecessary regulations and a "sunrise" commission to suggest new regulations adapted to changing conditions. Some important challenges nevertheless remain, especially the need to achieve a better coherence among different accepted instruments, pursue harmonisation between regional and multilateral commitments and the implementation of adequate domestic regulations.

The ambitious regional and multilateral commitments already undertaken by the Baltic States seem to limit considerably the room for further trade liberalisation in the near future. Discussions on the FTA for services in the Baltic context showed that there are no substantial obstacles to trade in services within the region. The Baltic States concluded the EU negotiations on the chapter on services, but discussions on free movement of persons have been more difficult, also because of worries of some candidate countries about the threat of a brain drain. The Baltic States' representatives emphasised their strong support for the Doha process, but expressed their concerns on some specific issues. First, due consideration should be given to the fact that, as recent WTO Members, the Baltic States accepted very liberal commitments for trade in services, sometimes more far-reaching than the Uruguay Round negotiating countries. This fact was acknowledged in the Doha Ministerial declaration. Second, transition economies face to some extent problems similar to developing countries with the implementation of existing international commitments. Some new measures, currently discussed in the WTO, would put their limited administrative capacities under additional pressures. For example administration of new protective measures applied on trade in services, such as safeguards, would be financially expensive and represent a further drain on the countries' limited administrative capacities, especially for small economies.

Several Baltic countries' representatives said that they considered the OECD Baltic Regional Programme, one of the most effective OECD co-operation programmes. In particular, it allows the Baltic States to benefit from OECD analytical expertise and participate in policy dialogues in several critical areas, such as

competition policy, company law, capital movement liberalisation and anti-bribery measures. The exchange of views on trade policy and specific trade-related issues, they said, has also proved to be fruitful. Such discussions could also help to draw attention to other problems, such as the lack of administrative capacities in small economies and social implications of the movement of labour, that deserve further analysis and co-operation efforts.

A representative from the OECD Secretariat pointed out that the discussions during the meeting provided some interesting input and suggestions for the Organisation's ongoing and future work, in particular the need to take into account certain regional aspects of service trade liberalisation, the link between the mode 4 and labour standards and the challenges of building administrative capacities. In concluding Session 3, the Chairman highlighted the impressive trade liberalisation efforts of the Baltic States, which had been accomplished in a very short time and consolidated in ambitious international commitments. He agreed that the meeting confirmed the usefulness of the trade policy dialogue as a part of the OECD Baltic Regional Programme and the need to continue it in the future.

Concluding remarks

Based on the exchange of views, Ms. Birgitta Nygren, Director, Ministry for Foreign Affairs, Sweden, highlighted the main points raised during discussions, drew some policy recommendations and outlined the possible future orientation for co-operation between the OECD and the Baltic States in the trade policy area.

- The business surveys, the synthesis report, and comments from business representatives facilitated a much clearer picture of the current situation of service providers operating in the Baltic States. The comparison with earlier surveys showed that the region has made the considerable progress in improving the business environment, particularly with respect to the availability of infrastructure required for business activities, the transparency of procedures and regulations and the accessibility of relevant information about laws and government policies. By allowing comparisons through time and among the countries, the business surveys helped to measure the achievements and identify remaining problems.
- The exchange of views between trade officials and business spokespersons contributed to a better understanding of regulatory challenges faced by the governments and the obstacles encountered by the business community. Discussions showed that while some issues are specific to the region, many are in fact familiar to other countries as well. This could be illustrated by shortcomings related to prior consultations with the business community. These problems are partly due to the lack of experience and expertise of recently established business associations in transition economies, but they also reflect the limited administrative capacities of governments in small countries.
- The discussions highlighted the importance of regional and multilateral disciplines in developing the regulatory framework for the service sectors of the three countries. The Baltic States' governments accepted substantial trade liberalisation commitments, which they considered not as a concession to other countries but as a key element in their economic strategy.

Despite the overall positive assessment of the economic and business environment in the Baltic States, the Chair suggested two main categories of policy recommendations:

- *Domestic obstacles:* The governments have enacted sound laws, but have sometimes enforced them unevenly. They should take steps to ensure that institutions and procedures are in place to provide effective implementation of competition laws, adequate appeals and arbitration facilities, and other enforcement measures. To facilitate prior consultation of new legislation and regulations with various stakeholders would require further training and education by business representatives and consumer associations. Such support should be increased especially in the case of small and medium sized enterprises, which usually lack the knowledge and resources to interpret complex regulations.
- *External obstacles:* Although the three business surveys have not identified external barriers as major impediments to trade, it is likely that they will become more serious as companies increase their external exposure and involvement in international markets. At present, the main complaints concern the regional transportation network and access of the Baltic countries' transport and construction firms to government tenders in other countries. The governments should address these problems through existing regional and multilateral arrangements or in bilateral negotiations with trading partners.

Ms. Nygren remarked that the government authorities in Estonia, Latvia, and Lithuania have of course the main responsibility in tackling these different issues. However, their efforts can be facilitated by an exchange of views between the government and business community and through the comparison of different solutions adopted by individual countries. This approach, sometimes referred to as an exchange of "best practices", is often used among the OECD countries, and it is important that the Baltic countries also actively participate in this process. Furthermore, the Baltic countries, which have had considerable success in creating a business-friendly environment for their service providers, should share their experience with other countries that are struggling with similar issues and take part in the current debate on further liberalisation of trade in services.

There are several areas in which the OECD could also usefully contribute by its analytical work. Of particular interest would be to examine the impact of multilateral disciplines (under the GATS) and regional commitments (within the EU accession process) on the development of the service sector. The main aspect to be considered would be the contribution of multilateral and regional commitments to the quality of domestic regulatory regimes, the efficiency of service providers, and trade and investment in services. Given the complexity of such an analysis and the heterogeneity of the service sector, it might be useful to focus on specific sectors, such as telecommunications or transportation. In several other areas the Baltic countries share some important preoccupations with other countries and they should be closely associated with the related OECD activities, for example the work on the better quality and reliability of statistics on services and trade in services, discussions on capacity building in small economies and social implication of the movement of labour.

In his concluding remarks, Mr. Heydon stressed that the focussed discussions were made possible by the active co-operation of Estonian, Latvian and Lithuanian government officials, who helped to define the agenda of the conference and participated actively in the exchange of views. The success of the meeting was also due to the excellent written and oral contributions of the consultants and main speakers and the outstanding contributions of the Chairs, who succeeded in making discussions lively, interesting and of immediate relevance for policy formulation in the Baltic countries, and beyond.