Relations with Non Member Countries

THE IMPACT OF EU ACCESSION ON THE BALTIC STATES’ TRADE IN SERVICES

The document was discussed by the Working Party of the Trade Committee at its meeting on 13 December 2004 and revised in light of these discussions and written comments submitted by Delegations and the Baltic countries.

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TABLE OF CONTENTS

Introduction and Executive Summary ........................................................................................................ 3
1. General assessment of the service sector in the Baltic States .............................................................. 4
2. Baltic States’ trade in services ................................................................................................................. 5
3. Major services sectors and the impact of EU accession ...................................................................... 6
   3.1 Cross-border trade in services and consumption abroad .............................................................. 6
   3.2 Commercial presence and FDI in services .................................................................................... 12
   3.3 The movement of natural persons ............................................................................................... 19
4. Conclusions ............................................................................................................................................ 22

Tables

Table 1. Share of selected services in GDP in 2002, % ............................................................................ 5
Table 2. Trade in services, USD mn ......................................................................................................... 5
Table 3. Ports of the Eastern part of the Baltic Sea. Cargo loaded, mn t .................................................. 6
Table 4. FDI flows in the Baltic states, 1985-2002, USD mn ................................................................ 12
Table 5. FDI in the Baltic States, beginning of 2004 ............................................................................ 13
Table 6. Major Countries Investors, end of 2002, % .......................................................................... 13
Table 7. Overview of cases of labour movement and their respective regulatory regimes .................... 20
Table 8. Stock of residents from the CEECs in old EU countries ......................................................... 20
Table 9. Per capita GDP of New Members in relative and absolute terms ........................................... 21
Table 10. Average GDP growth rates, real annual percentage change .................................................. 22

Diagrams

Diagram 1. Cargo-loaded in ports, mnt ..................................................................................................... 6
Diagram 2. Foreign visitors, thous ........................................................................................................... 10
Diagram 3. Mobile subscribers per 100 population .............................................................................. 16
Diagram 4. Internet users for 100 population ...................................................................................... 16
Diagram 5. Dynamics of the retail trade turnover, % ........................................................................ 18
Introduction and Executive Summary

1. In May 2004, eight Central and Eastern European countries (plus Malta and Cyprus) became members of the European Union (EU). The “four freedoms” of the EU Single Market have direct effects on the development of trade in services in and between the Member States. The preparation of the Central and Eastern European candidate countries for the EU membership has been one of the key factors in providing opportunities for the development of service sectors in these previously heavily manufacturing-based economies. The initial development of services has been mostly influenced by the transition reforms in these countries which paved the way for the development of new services to meet fast-growing demand. The process of integration into the EU has provided new opportunities for the further development and provision of services supported by a strong regulatory framework.

2. Indeed, over time, the EU has developed an extensive body of legislation governing the provision of services in the Single Market. In addition to general rules and disciplines such as non-discrimination, EU legislation establishes norms on the right of establishment and self-employment, and has also sector specific regulatory norms which are important for the development of services in the Single Market. The sectors regulated by the EU’s *acquis communautaire* include transport, financial services, telecommunications and other sectors. The energy and postal services have also been brought under the EU regulatory framework, although the process of creating the internal market in these areas is still under way.

3. The actual accession in May 2004 had brought the elimination of remaining barriers between old and new Member States and full fledged participation in EU institutions. Since the economic integration and regulatory harmonisation have been a gradual process initiated a decade ago, the major impact and possible adjustment problems of the EU accession have already mostly taken place. Some temporary barriers to trade and provision of services as well as restrictions on movement of labour remain. At the same time, transition periods for adopting gradually a number of EU regulatory norms granted to the new Member States illustrate the costs required for the regulatory adjustment. The implementation of EU regulations has also influenced trade relations of new EU Members with neighbouring third countries. While in the long-run services trade with third countries will also benefit from the large unified market and related FDI opportunities, for certain small and medium sized firms regulatory differences can be considerable barriers to services trade with these markets.

4. The accession into the EU has had two important implications for the economies of the new Member States. First, the gradual removal of trade barriers has provided more opportunities for the development of competitive service sectors and the provision of services in the other Member States, increasing at the same time competitive pressure on market participants. Second, integration into the EU has required the adoption of regulatory norms, including the introduction of high regulatory standards and the establishment of new regulatory institutions. In some cases, this process of regulatory harmonisation can result in the overregulation of service sectors, and become a barrier to market entry, in particular for small and medium sized companies, and thus limiting the choice of consumers. To reduce these risks the countries should pursue sound regulatory practices, in particular promote regulatory transparency and avoid unnecessary trade restrictiveness of new regulatory measures.

5. The new Member States acceded to the EU at a time when the latter is still engaged in the process of creating the internal market in services. Although the Single Market program has officially been implemented by 1992, the European Commission itself admitted recently that the provision of services is still distorted by a variety of barriers that exist in the Member States and that “the Internal Market for services is far from being a reality.”¹ Most of these barriers are of a regulatory nature. According to the

Commission’s report, “some barriers are due to burdensome or non-transparent regulation or practices; most are just due to the wide divergence of national rules.” This indicates that the Commission will continue to focus its attention on the removal of regulatory differences. The proposed directive on services in the internal market indicates a positive trend towards liberalisation of trade in services in the EU.

6. The objective of this study is to analyze the above mentioned changes in the service sectors and trade in services in EU acceding countries, in particular the Baltic States. Taking into account the GATS four modes of supply, the study focuses on the experiences of the Baltic States in some selected sectors such as transport, banking, tourism, telecommunications and other services. It is worth noting that the liberalization of services trade follows a different approach in the cases of GATS and the EU. Therefore, although the structure of the study adopts roughly the classification of services based on the GATS four modes of supply, the impact of EU accession and related issues are discussed by focusing on the effects of adopting *acquis communautaire*, in particular removal of border barriers and adoption of harmonised regulatory norms, which have had significantly larger impact on the development of services in the Baltic States compared to the adoption of more limited GATS commitments.

7. The study first provides an overview of the situation of services and their trade in the Baltic States, and then reviews the development in different service sectors with a view to identifying the nature of the impact of EU accession on providers of services and their consumers. It concludes with some observations on the impact of EU accession on the service sectors in the Baltic States, the main challenges and the interests of these new Members in the continued development of the Internal Market in services and the EU’s external policy.

1. **General assessment of the service sector in the Baltic States**

8. All three Baltic States have a similar economic structure with a dominant share of services: services currently contribute 72% to Estonia’s GDP, 77% to Latvia’s, and 69% to Lithuania’s. In terms of employment shares, 69% of Estonia’s labour force are engaged in services activities; and in Latvia and Lithuania, these shares are 65 and 61 per cent, respectively. These figures indicate that services are a relatively efficient activity in these countries, especially in comparison with the agricultural sector in Latvia and Lithuania, where its share in GDP amounts to 5% and 8.0%, but the shares in employment are 15% and 18%, respectively.

9. The prevalence of services activities in the economies of the Baltic States is influenced by their geographical location and the absence of important natural resources. However, it is only during the process of economic transition to market economy that the share of services in value added increased to its current levels, surpassing the average share of services in the world economy (which has been around 60%) and reached levels that characterise OECD economies.

10. The composition of services activities is rather similar in all three Baltic States with wholesale and retail trade, transport, real estate and communications making up the largest share (Table 1).

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2  Ibid., p. 13.
Table 1. Share of selected services in GDP in 2002, %

<table>
<thead>
<tr>
<th>Service</th>
<th>Estonia</th>
<th>Latvia</th>
<th>Lithuania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale and retail trade</td>
<td>13.8</td>
<td>19.9</td>
<td>18.0</td>
</tr>
<tr>
<td>Transport, storage &amp; communication</td>
<td>15.5</td>
<td>15.2</td>
<td>13.7</td>
</tr>
<tr>
<td>Real estate, renting and business activities</td>
<td>11.2</td>
<td>11.1</td>
<td>8.1</td>
</tr>
<tr>
<td>Construction</td>
<td>6.7</td>
<td>6.1</td>
<td>6.5</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>1.6</td>
<td>1.2</td>
<td>1.6</td>
</tr>
<tr>
<td>Financial intermediation</td>
<td>4.6</td>
<td>4.6</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Source: National Statistical Offices

11. The relative contribution of different services to total value-added in services has changed modestly with the share of transport and construction fluctuating from one year to another, and real estate and renting services increasing. Financial intermediation has been increasing in Estonia and Latvia. The share of trade has increased sharply during the first years following the re-establishment of the independence and is now rather stable. Some other services, like telecommunications, information technologies and tourism, are not separated in the statistical accounting and therefore are difficult to disentangle; however, other indicators such as the growth in market share indicate that these sectors have been expanding fast in recent years (see the analysis of service sectors below).

2. Baltic States' trade in services

12. The data on Baltic States trade in services show an increase in the turnover of foreign trade in services over the last five years, in particular during the last couple of years. This trend is in line with international trade in goods. However, the main difference is the positive balance of trade in services in all the three Baltic States (Table 2). Estonia has been leading in terms of turnover of services provided abroad.

Table 2. Trade in services, USD mn

<table>
<thead>
<tr>
<th>Country</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estonia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit</td>
<td>1,488.9</td>
<td>1,497.7</td>
<td>1,649.1</td>
<td>1,711.7</td>
<td>2,233.1</td>
</tr>
<tr>
<td>Debit</td>
<td>-925.0</td>
<td>-935.5</td>
<td>-1,068.7</td>
<td>-1,125.5</td>
<td>-1,382.5</td>
</tr>
<tr>
<td>Balance</td>
<td>563.9</td>
<td>562.2</td>
<td>580.4</td>
<td>586.3</td>
<td>850.5</td>
</tr>
<tr>
<td>Latvia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit</td>
<td>1,024.5</td>
<td>1,172.6</td>
<td>1,181.6</td>
<td>1,243.8</td>
<td>1,514.5</td>
</tr>
<tr>
<td>Debit</td>
<td>-688.5</td>
<td>-696.0</td>
<td>-672.4</td>
<td>-706.5</td>
<td>-938.0</td>
</tr>
<tr>
<td>Balance</td>
<td>335.9</td>
<td>476.6</td>
<td>509.2</td>
<td>537.3</td>
<td>576.5</td>
</tr>
<tr>
<td>Lithuania</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit</td>
<td>1,091.6</td>
<td>1,058.8</td>
<td>1,156.8</td>
<td>1,478.7</td>
<td>1,878.0</td>
</tr>
<tr>
<td>Debit</td>
<td>-786.2</td>
<td>-678.7</td>
<td>-700.3</td>
<td>-935.3</td>
<td>-1,263.7</td>
</tr>
<tr>
<td>Balance</td>
<td>305.4</td>
<td>380.1</td>
<td>456.5</td>
<td>543.4</td>
<td>614.3</td>
</tr>
</tbody>
</table>

Source: Central Banks of Estonia, Latvia and Lithuania

13. It should also be noted that the relative proportion between international trade in goods and in services is similar in Estonia and Latvia (value of exports of goods exceeding those of services about two times) while in the case of Lithuania the gap is significantly larger (exports of goods in 2003 exceeding sales of services about four times).

14. Transport is the most significant service sector in all the three Baltic States accounting for close to half of their international trade in services. Port activities dominate other transport services traded by Estonia and Latvia, while in Lithuania road transport accounts for around half of transport services sold abroad. Travel services (tourism) are another important item in all three Baltic States, in particular in Estonia. Construction services have been the most dynamic service sector in Latvia recording annual
growth rates of 9% during the period 1995-2001 with exports of construction services (mainly to the CIS) growing by 200% during the same period\(^4\).

3. **Major services sectors and the impact of EU accession**

3.1 **Cross-border trade in services and consumption abroad**

3.1.1. *Transport*

15. Transportation of goods is a significant economic activity and the most important service provided to foreign consumers in all three countries. It involves multimodal transport: rail - sea port or road – sea port, or road haulage as well as storage, logistics and other related services.

16. The sea ports and the carriers of the Baltic States are competing for cargo among each other as well as with their neighbours in the Baltic Sea Region – Russia and Finland in the North, Poland and Kaliningrad area in the South (Table 3). There are substantial investments made into the ports, terminals, transport infrastructure as well as into stevedoring companies. Estonia is planning to build a new oil terminal for Russian oil export\(^5\).

![Diagram 1. Cargo loaded in ports, mn t](image)

*Source: Statistics Lithuania. Economic and Social Development in Lithuania, 2004/1

*Table 3. Ports of the Eastern part of the Baltic Sea. Cargo loaded, mn t*

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2000, without oil and oil products</th>
<th>2003 I Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primorsk</td>
<td>-</td>
<td>-</td>
<td>3.4</td>
</tr>
<tr>
<td>St. Petersburg</td>
<td>32.0</td>
<td>24.5</td>
<td>7.0</td>
</tr>
<tr>
<td>Talin</td>
<td>29.0</td>
<td>11.7</td>
<td>8.7</td>
</tr>
<tr>
<td>Riga</td>
<td>13.0</td>
<td>10.5</td>
<td>21.7 (*)</td>
</tr>
<tr>
<td>Ventspils</td>
<td>35.0</td>
<td>8.0</td>
<td>27.3 (*)</td>
</tr>
<tr>
<td>Liepaja</td>
<td>3.0</td>
<td>2.8</td>
<td>4.9 (*)</td>
</tr>
<tr>
<td>Butinge</td>
<td>3.5</td>
<td>0</td>
<td>2.7</td>
</tr>
<tr>
<td>Klaipeda</td>
<td>19.0</td>
<td>14.3</td>
<td>5.5</td>
</tr>
<tr>
<td>Kaliningrad</td>
<td>4.0</td>
<td>3.5</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

*Source: Statistics Lithuania\(^6\), Lithuanian Free Market Institute\(^7\)

*Note: (*) data for the whole year 2003.*

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\(^5\) Business News (Verslo žinios, 2004.06.17).

\(^6\) Lietuvos ekonomikos apzvalga 2003/1, 2003

\(^7\) Kroviniu krovimo ir transportavimo per Klaipedos uosta veiklos pokyčiu Lietuvali integruojantis i Europos Sajunga studija, 2001
17. Transportation of goods via the sea ports is dependent on the volume of exports, first of all Russian exports (oil, metal), Russia’s railway tariff policy, and – in some cases – weather conditions in winter. These three factors are all exogenous to the Baltic States economies. Important endogenous factors include the domestic transportation of goods to the port, in particular the quality of road and railway infrastructure, as well as the costs of customs procedures on the borders.

18. Before acceding to the EU, permits to transport goods between European countries constituted the most important obstacle for the development of the Baltic States’ road transport services. These permits have been distributed on the basis of bilateral, plurilateral or international agreements. After the Baltic States joined the EU, permissions to perform carrier services to the other member states have been abolished provided the company has the Commission’s permission. The Commission permission allows unrestricted provision of road carrier services inside the EU territory. This is especially important for the Lithuanian road haulage firms which were affected by the previous system in their operations in the EU and also in their transit through Poland. However, given the agreement on a transition period for the implementation of unrestricted cabotage services in the EU (for a maximum duration of five years), the freedom of providing road haulages services by the Baltic States will continue to be restricted during this period.

19. The removal of customs control on EU internal borders is another significant advantage of EU membership. There are still checks of persons on internal borders which will continue until these countries join the Schengen area (planned for about 2007), but these checks are now performed differently and do not impose such delays and costs for companies as before. However, permits and customs procedures remain a hindering factor with respect to the Eastern direction of the transit – Russia, Belarus, Ukraine, Kazakhstan and others. Customs procedures are being improved on all borders with the introduction of information technologies and preparations for joining the Schengen area.

20. Road transport infrastructure in Latvia and Estonia, though not perceived as the essential physical obstacle, needs to be improved in order to increase transportation speed and safety. A large portion of EU funds (including pre-accession programs such as PHARE and ISPA) is being spent on road transport projects in all the Baltic States, the most significant project being the motorway Via Baltica connecting Warsaw to Tallinn. After the accession to the EU, the improvement of the transport infrastructure is to be financed from the EU Cohesion fund and European Regional Development Fund. The transport infrastructure projects will be the priority for financing projects from these funds. For example, Lithuanian authorities expect that during 2004–2006 Lithuanian transport sector will receive about 32% of all EU structural support foreseen for the country, i.e. EUR 435 million (of which EUR 290 million will be allocated from the Cohesion Fund and EUR 145 million from the Regional Development Fund). Although the financing of infrastructure in Estonia and Latvia is more limited, its development by using EU funds is also one of the priorities in these countries.

21. The road haulage companies are private entities that have been for some time competing in the local and international markets. Lithuanian transport firms are particularly competitive, having established an important presence in the European road haulage market several years before gaining EU membership.

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8 Russia uses railway tariffs to promote Russian ports. The Baltic countries have complained to the EU regarding too high railway transportation tariffs applied by Russia. (Business News, 2004.06.17)
9 Transit freight from Russia through Estonia constitutes approximately 85% of the freight turnover of Estonian Railway.
10 According to Business News (Verslo žinios, 2004.06.07), after abolishing customs procedures to the EU countries, Lithuanian trucks travel 10-30% faster.
Their biggest challenge is to maintain competitiveness in the context of increasing labour costs due to the pressure to raise wages coming from the Single market and to adjust to stricter regulatory standards.

22. The functioning of the rail transport system is closely connected to ports. Local cargo transported by rail make up less than 6% of the entire freight transport in Latvia and Estonia, around 13% in Lithuania (32% of rail transit in Lithuania go via Klaipeda port and 66% – to Kaliningrad area).\(^\text{12}\) Crude oil and oil products, black metals, wood, coal, fertilisers, building materials, grain, food products are the main types of goods transported. All transit activity is vulnerable to the functioning of railways as a biggest share of cargo and for some goods 100% is transported to the ports by rail. Anticipating further increase in cargo flows between Russia and Asia on the one hand and the EU on the other, the Baltic States’ railways are participating in the joint project involving Russia, Kazakhstan, Uzbekistan, Latvia, Lithuania and Estonia with the objective to extend container transport business linking the Baltic countries’ and Kaliningrad ports with the Northern Provinces of China.

23. There are other ambitious plans for new infrastructural projects as well: European track project in Lithuania which aims at extending the European standard track to link Lithuanian – Polish border with the second biggest Lithuanian city Kaunas, and the Rail Baltica project which is expected to link all three Baltic States and Poland with modern high speed train. Bearing in mind rather moderate cargo flows in the North-South direction and extremely high costs of these projects, they can be considered only as a means of stronger integration of the Baltic region into the EU with the consequent positive effects to tourism, but not as commercially feasible projects.\(^\text{13}\)

24. Though there is a significant role for the governmental institutions in negotiating the tariffs (Russian tariff policy remains a big problem for the Baltic States), both transportation price and capacity can be improved with the introduction of competition between private operators into the railway sector. Railway companies in all three Baltic States compete for cargo between each other. Liberalisation of the railway market would allow less distorted competition to be introduced on the national markets.

25. Passenger rail transport, first of all international, has been decreasing since 1990 in all three countries. It made 4% to 5% of all passenger transport turnover in Estonia and 2% in Latvia and Lithuania in 2003. This trend is an outcome of the restrictions on competition, lack of investments into the infrastructure, rolling stock and the services. Consequently, transport is slow and non-attractive for passengers. State monopoly and price control of public transport prevent competition and investments.

26. Estonian railway transport is an exceptional case. Estonian Railway Company “Eesti Raudtee” was privatised in 2001 and became the first vertically integrated private railroad in Europe. 66% of the company’s shares were bought by Baltic Rail Service – American, British and Estonian investors. The owners are investing to modernise the infrastructure, rolling stock and management with the objective of providing customers with flexible services (for example, just-in-time services).\(^\text{14}\) There were five railway operators in Estonia in 2003: three of them private and two of them without their own network. Every owner of the railway infrastructure is obliged to give 20% of its free capacity to other operators.

27. Restructuring of railway in order to open the market for competing operators is under way in Latvia. The restructuring of the Latvian State Railway company started in 2002. In the period of 1999–2001 three


\(^{13}\) Cost of the Rail Baltica is estimated at about EUR 3 billion. This project is competing for the EU support as a regional project, connecting the periphery of the EU with the centre.

\(^{14}\) Esti Raudtee, www.evr.ee, 2004.05
new cargo carriers have entered the market. The Public Utilities Commission is in charge of setting the public railway infrastructure fee and providing methodology for calculation of passenger transport prices. In the process restructuring, the state railway company acts as a freight operator and manager of the use of railway infrastructure, using separate management and accounting for these activities. The latest amendments of the “Law on Railways” practically opened the railway market for competing operators. Currently, two private freight operators are working within the public use railway network; by the end of 2004 they represented approximately 10% of total freight turnover.

28. In Lithuania, the actual railway restructuring has not been started yet. According to the Strategy of the railway sector reform for 2003-2006, the reform will be implemented in five stages, starting from separation of the accounts in Lithuanian Railway Company for cargo, passenger and infrastructure services and finishing with the liberalisation of the market. The latter is being postponed without a fixed future date.

29. The main advantage of the Baltic States transport service providers is their market are a relatively stable flow of goods in the East–West direction which is expected to grow in the future, and business contacts (including language and familiarity with business culture) in Russia, Ukraine, Kazakhstan and the other former Soviet countries. However, port infrastructure is of rather good quality and road infrastructure needs to be improved in Estonia and Latvia. Technical parameters of the railway infrastructure, first of all the track gauge and signalling equipment, constitute advantage at the Eastern borders and the disadvantage in connecting with the European standard railway at the Polish border (the latter disadvantage is avoided when goods are transported via the port). The fleet of Lithuanian road transport companies working in international routes is up-to-date and their market shares in the EU are expanding. Traditions of transport business are strong, the know-how is present and the wage levels remain so far competitive.

30. The major shortcomings of the Baltic countries transport are related first of all to the lack of investment in certain infrastructures. Railway transport has a worn out infrastructure and the rolling stock and generally outdated management (less in Estonia). Without the introduction of competition into the sector it is hardly possible to attract needed investments as well as to expect efficient services. Customs procedures on the external EU borders should be further improved. High cargo flow dependency on one country could be perceived as the risk as well.

The impact of EU accession

31. The main benefits of the EU membership for the transport sector of the Baltic States are mostly related to the abolishing of barriers to the provision of services between the EU Member States (for example, quotas for permits to provide carrier services). This provides new opportunities for the competitive road carrier companies, in particular Lithuanian firms, to expand further their market share in the EU. The opportunities for the cabotage services in some important markets like Germany will remain restricted for the period of maximum five years (which itself is a sign of perceived threat from the competitors in Lithuania and other new Member States). However, after this transition period is over, opportunities for cabotage services will also provide an incentive to expand transport services in other Member States. The EU has also been one of the key factors behind the liberalisation of railway transport, although the progress of reform differed depending on the country (Estonia being the most advanced in the railway reform).

32. Accession into the EU might also contribute to the increase of transit from Russia and other third countries via the Baltic States to the EU (through railways and sea or roads). However, the complexity and costs of border formalities will be an important factor in addition to the development of transport infrastructure in Russia, Finland and other competing transit routes. EU funding with a significant share being allocated for the improvement of quality of transport infrastructure and services should contribute to the increase of transit flows and transport services in general.
33. The main adjustment costs related to EU accession are mostly linked to the need to adjust to new regulatory norms. The costs of adjustment to the norms of financial standing, recording equipment and tachographs were behind the requests of Lithuanian and Latvia negotiators during the accession negotiations. The impact of these regulatory norms is mostly concentrated on domestic carriers, in particular small companies with old vehicles which have to invest to comply with the new requirements. Companies which have been providing international transport services had to be able to meet these regulatory standards before the accession in order to operate in the EU. In the future, the largest costs might be caused by stricter environmental norms and changing taxation for the infrastructure.

3.1.2. Tourism

34. The Baltic States can not be regarded as tourism countries presently, although tourism is the second largest service exported by these countries. However, the potential exists and the ambitions associated with the development of tourism services are quite high. Tourism is a priority in the Single Programming Documents of the three Baltic States and considered as an opportunity for the development of the countries. The use of the Structural funds to improve physical and information infrastructure for tourism, education of staff, and promotion of rural tourism as an alternative economic activity in agricultural areas is foreseen in the Single Programming Documents of all Baltic countries. Lithuania was the first country from the Baltic States to become a member of the World Tourism Organisation in 2003.

Diagram 2. Foreign visitors, thous.

35. The largest share of foreign visitors comes from the neighbouring countries: 74% of foreign tourists in Estonia in 2003 came from Finland, Russia and Latvia (from Finland alone – 53%); 72% of foreign visitors in Latvia came from Estonia (33%), Lithuania (32%) and Russia (7%); in Lithuania - 77%, respectively from Latvia (29%), Russia (24%), Belarus (14%) and Poland (10%).

36. Although all three countries attract mostly tourists from the neighbouring countries, the purpose of travel as well as the purchasing power of the visitors differs significantly (e.g. Finish tourists in Estonia compared to visitors from Belarus and Kaliningrad area in Lithuania) and thus influence accordingly receiving country’s economy in general and tourism sector in particular. In 2003, Estonia, having lower flows of foreign tourists than Lithuania, earned EUR 782 million (40% of total service export) from inbound tourism while Lithuania’s earnings were limited to EUR 493 million (30% of total service export)

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For example, there were 2.8 hotel beds for 1000 inhabitants in Lithuania in 2001 while the EU average was 25.

Estonia estimated tourism sector to create 8.2% of the country’s GDP in 2000. In Latvia, the share of tourism services exported equalled 2.2% in 2003, but the sector has been growing.

37. As indicated in Figure 2, the trends of tourism are rather different in the Baltic States: in Latvia and Estonia a number of visitors have been increasing in recent years, while in Lithuania the trend was negative. According to the Lithuanian Tourism department, the decline of visitors in Lithuania in 2002–2003 was caused by several new factors, which have changed motivations of Russian and Belarusian visitors: (1) visa regime for the residents of Kaliningrad region to enter Lithuania, (2) an additional local fee for crossing Lithuanian-Belarus border, (3) a duty in Russia for the used imported cars (this is confirmed by the export statistics of used cars), (4) mandatory vehicle insurance in Lithuania (2003). Due to the long-lasting effects of the mentioned factors, the Department forecasts a further decline of the number of visitors from Russia and Belarus to Lithuania in 2004. Most of these changes are linked to the accession into the EU and strengthening of the external border control.

38. While the number of tourists from the CIS is decreasing with the accession of the Baltic States into the EU, the flows of tourists from the EU countries is growing. This trend is likely to get stronger as for most West Europeans the new Member States are still relatively unknown destinations. The simplification of the border procedures should also contribute to the increase in the number of tourists from other Member States. Although it is too early to generalise, the flows of people during the first several months of EU membership seem to confirm an increase of tourism from the neighbouring member states. For example, the number of Polish tourists visiting Lithuania has tripled during the first months after the enlargement compared to the pre-accession period (although the seasonal factor could be important as well since most important destinations included Vilnius and the sea resort of Palanga).

39. In 2003, most visitors (over 80%) arrive in Latvia and Lithuania via the roads, in Estonia 65% – via the sea (mostly from or via Finland). Air mode tourism makes up around 5% in Lithuania and in Estonia, 7% in Latvia. By rail arrive only 1% of tourists to Estonia, 6% to Latvia and over 12% to Lithuania.

40. The absence of the convenient rail connection in the eastern part of the Baltic Sea is the major infrastructural shortage restricting the development of tourism in the Baltic States. However, as mentioned in the section on transport services, this is an expensive and hardly commercially viable project.

41. Due mainly to the small size of countries and their periphery location, the air transport suffers from a shortage of direct flights and a rather weak competition. However, with the opening of the market and the entry of the low cost airlines competition is increasing and it has recently resulted in the fall of prices that are important for the residents of the Baltic States.

42. The share of the sea transport in tourism is negligible in Lithuania (in Latvia 7% of tourists come by the sea). This is very much influenced by the fact that popular sea routes are much longer to Lithuania in comparison with Estonia and Latvia and that Lithuanian capital city is not at the sea.

43. Supply of sufficient accommodation facilities in the country is another important condition for tourism. The Baltic States experience a boom of new high quality hotel constructions, to a certain extent

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influenced by the expectations of an increase of tourists from the other EU Member States. However, there are still not enough of the budget-type accommodation facilities both in cities and countryside, especially in Lithuania.

The impact of EU accession

44. Tourism is a rather new and fast growing industry in the Baltic States which has still a large unused potential in terms of demand as well as supply. To develop it faster will require further foreign investments, both in financial capital and know-how. Integration into the EU has been anticipated as a big push for this industry by opening the new markets and bringing new investors. The main benefits of EU accession are still too early to be evaluated. But there is sufficient basis to expect the increase of demand for tourism services provided to other Member States’ nationals. Simplification of cross-border procedures and the eventual accession of the Baltic States to the Schengen area will contribute to the growth of travel and tourism. This should provide a stronger push for the development of related services and the increase in the quality of services.

45. There might be some negative effects of EU accession for the tourist flows into the Baltic States from the neighbouring third countries such Russia and Belarus. The introduction of visas for Kaliningrad region residents, new transit regime of Russian citizens via Lithuania, strengthening of external EU border controls are likely to act as new barriers for the tourist flows from these neighbouring countries which have been until recently major sources of tourists. However, further developments in this area will also depend on the EU policies toward neighbouring markets, in particular visa and trade regimes.

3.2. Commercial presence and FDI in services

46. Most of FDI inflows into the Baltic States have been directly linked with the process of privatisation. It was during the privatisation of the large state-owned infrastructure companies such as telecommunications, transport and energy as well as financial institutions that major foreign investments have been made. Most of the services in these sectors are currently provided by foreign owned private companies.

47. Estonia has been a leader among the three countries in terms of the volumes of FDI inflows. Early opening of privatisation opportunities for foreign investors and general liberalisation of economic transactions have been among the most important factors in attracting significant FDI inflows, in particular during the first half of 1990s. Estonian investors (mostly having business connections to Nordic countries) also started outward investments exceeding significantly those of Latvia and Lithuania.

<table>
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<tbody>
<tr>
<td>Estonia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inward</td>
<td>60</td>
<td>581</td>
<td>305</td>
<td>387</td>
<td>542</td>
<td>307</td>
</tr>
<tr>
<td>Outward</td>
<td>1</td>
<td>6</td>
<td>83</td>
<td>63</td>
<td>200</td>
<td>122</td>
</tr>
<tr>
<td>Latvia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inward</td>
<td>43</td>
<td>357</td>
<td>347</td>
<td>413</td>
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</tr>
<tr>
<td>Outward</td>
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<td>54</td>
<td>17</td>
<td>12</td>
<td>19</td>
<td>4</td>
</tr>
<tr>
<td>Lithuania</td>
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<td></td>
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</tr>
<tr>
<td>Inward</td>
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<td>926</td>
<td>486</td>
<td>379</td>
<td>446</td>
<td>732</td>
</tr>
<tr>
<td>Outward</td>
<td>-</td>
<td>4</td>
<td>9</td>
<td>4</td>
<td>7</td>
<td>18</td>
</tr>
</tbody>
</table>

Source: UNCTAD, World Investment Report 2003

48. According to the UNCTAD, the inward FDI performance index during the period of 1999–2001 was highest in the case of Estonia (2.211) which was ranked 21 among all the world countries analysed. Latvia and Lithuania have been significantly lower ranking 51 (1.210) and 60 (1.098) respectively.
49. Although the comparative difference of FDI inflows has decreased in recent years, cumulative inward investments are still significantly higher in Estonia compared to Latvia and Lithuania, in particular on per capita basis.

<table>
<thead>
<tr>
<th>Table 5. FDI in the Baltic States, beginning of 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estonia</td>
</tr>
<tr>
<td>--------------</td>
</tr>
<tr>
<td>Cumulative FDI, mn. Euro</td>
</tr>
<tr>
<td>Per capita FDI, Euro</td>
</tr>
</tbody>
</table>

*Source: Lithuanian Department of Statistics, 2004*

50. Most of FDI inflows went into financial intermediation and manufacturing. For example, in Lithuania in the beginning of 2004 manufacturing industries accounted for almost one third of FDI stock (31.1%), trade accounted for 17.9%, followed by transport and communications (17.1%) and financial intermediation (13.3%). The relative share of FDI in other two countries has been slightly different with financial intermediation leading in terms of FDI stock in Estonia. Financial sector and telecommunications absorb about half of FDI made in Estonia.

51. The origin and the flows of FDI into the Baltic States reflect the general tendencies of economic integration into the EU’s common market. Most FDI into the Baltic countries originates from the Nordic markets, with Germany and the US also being important sources of capital.

<table>
<thead>
<tr>
<th>Table 6. Major Countries Investors, end of 2002, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lithuania</td>
</tr>
<tr>
<td>Denmark – 17.2</td>
</tr>
<tr>
<td>Sweden – 15.3</td>
</tr>
<tr>
<td>Estonia – 11.7</td>
</tr>
<tr>
<td>Germany – 9.6</td>
</tr>
<tr>
<td>US – 8.7</td>
</tr>
</tbody>
</table>

*Source: Lithuania, Latvia and Estonia – Key Indicators 2000-2002*

52. Particularly significant presence of neighbouring Nordic countries FDI in Estonia was often used by foreign investors as a springboard for moving into the other Baltic States. This process was facilitated by the establishment of the Baltic Free Trade Area which reached a depth of integration surpassing most of the free trade areas created in the world. In addition to removing customs duties to trade in industrial products (in 1993), the Baltic States liberalised trade in agricultural products (in 1996) and abolished major non-tariff barriers (1997). The growth of trade in goods has been paralleled by the growth of FDI and intra-regional trade in services and expansion of business. This process explains the increased presence of Estonian FDI in Lithuania and Latvia, while the spread of Lithuania retail services into Latvia has been another recent phenomenon of business integration.

53. Creation of the Baltic Free Trade Area stopping short of the customs union contributed to increasing market integration and growth of competitive service sectors. The Baltic States’ market, though much more limited in its size, provided first significant opportunities for local service sectors to take advantage of a larger market share and to compete before joining the EU. Although the presence of FDI has been important in strengthening market position and expanding into the other Baltic countries, in some sectors such as retail, transport or construction, domestic companies have been successfully expanding their activities into the other European markets.

54. It should be noted that the dominance of Nordic investors in the Baltic States, notably in Estonia, contributed to the development of information and communication technologies (ICT) which are highly developed in Sweden and Finland, the two main investor countries in Estonia. The establishment of
subsidiaries of Nordic companies and the investments into the banking sector which is active in implementing technologies contributed to ICT penetration growth. Similar transfer of technologies and know-how has been taking place with Nordic investments into telecommunications sector. FDI has played a major role in the period of restructuring of telecommunication services – restructuring of state owned fixed telephone network operators and establishment of mobile telecommunication services.

The impact of EU accession

55. With the process of privatisation coming to its completion, the attraction of FDI becomes an increasingly challenging economic policy issue. For example, during 2003 FDI in Lithuania increased only by 3.9%, the lowest growth since 1997. It has been expected that membership in the EU should facilitate attraction of FDI and establishment of foreign company subsidiaries taking advantage of the expansion of EU Single market, reduced country risk and more familiar regulatory framework. However, the positive push for FDI inflows due to the EU accession has probably occurred before the actual accession.

56. Therefore the future FDI inflows will depend to a large degree on domestic economic policies – taxation level and tax administration, labour regulations and others. Although many of the US investors operating in Germany and other old Member States indicate their preferences to invest in the new Members, most new Members will be competing to be chosen as locations for the future investments. While the accession into the EU is likely to facilitate the presence of small and medium size businesses from neighbouring Member States and the development of cross-border services, the attraction of green-field investments will be one of the most important economic policy challenges for the Baltic States.

3.2.1. Banking

57. There are six commercial banks in Estonia, 22 in Latvia and ten in Lithuania. A number of foreign credit institutions operate in the Baltic States via branches or representative offices and this number has further increased after the accession into the EU. Immediately after the accession a number of banks operating in other Member States announced their intentions to take advantage of the freedom to provide financial services in the Baltic States. Several months later, six brokerage companies and two banks from other Member States contacted the Lithuanian Securities commission with the intention to provide investment services in Lithuania without establishing their subsidiaries. Although it is still too early to generalise, these intentions signal the potential for the increase of the presence of financial institutions in Lithuania from other Member States and a further increase in competition. In Latvia, most major banks are already EU owned, but it is possible that some among the remaining small locally owned banks will be taken over by other EU banks.

58. Financial service sector is the leading sector in terms of the presence of FDI. Banking sector in the Baltic States can be characterised by a high concentration of foreign (mostly Scandinavian) capital and private ownership, modern management and innovative services. Foreigners own over 86% of the total stock of shares of banks in Estonia, up to 57% in Latvia and 89% in Lithuania.21 There are no state owned banks in Estonia and Lithuania. In Latvia, the state owns 6% of the banks’ total share capital – it is a sole owner of Latvias Hipoteku un zemes banka.

59. Estonian banking market is dominated by the two banks Hansapank and Eesti Uhispank, which take around 84% of the total market share. Three banks – Vilniaus bankas, Hansabankas and Nord/LB –
account for 72.8% of the Lithuanian banking market. The participation of banks in other financial intermediaries, such as leasing companies and pensions funds, is quite high.

60. Estonian bank Hansabank Group currently present in Latvia and Lithuania is one of the best examples of taking advantage of the Baltic market with free movement across the borders. The bank has also opened Hansa Leasing Russia in 2002. Estonian Uhisbank and Lithuanian Vilniaus bankas belong to the same SEB group. The earlier integration of the Baltic States markets (mostly trade in goods) and the process of accession into the EU with eventual participation in the Internal Market contributed to the presence of foreign investors in the financial sector of the Baltic States, often linked by ownership.

61. The assets and credit portfolios as well as the profits of banks are growing and crediting conditions are being constantly improved. However, in comparison with the old EU member states, crediting activities in the Baltic countries remain still modest: according to the Bank Austria Creditanstalt, loans made 90% of GDP in EU15 in 2003, while in Estonia – 36%, in Latvia – 49%, and in Lithuania – 21%. 22

62. Interest rates on loans and deposits are low: in April 2004, average interest rates for loans in national currencies were 5.89% in Estonia, 6.32% in Lithuania, 7.21% for enterprises and 9.03% for households in Latvia. 23 The significant reduction of interest rates in recent years paralleled and preceded the process of EU accession, most probably reflecting expectations of a more stable macroeconomic environment and increase in competition. However, as the Vilniaus bankas forecasts, the interests for loans and leasing will go up in future, mostly due to the external factors such as interest rate policy of the European Central Bank. 24

63. Due to prevailing foreign ownership and increased credit ratings, borrowing from international sources has become much cheaper. Thus, despite slower pace of growth of deposits compared to the growth of loans there is no shortage of available funds in the banks. However, according to Vilniaus bankas analysts, the issue of the crediting means supply can be brought to attention if domestic savings do not increase in future. Currently, as interest rates remain low and competition increases, banks earn their profits mainly by expanding loan base, introducing new services and decreasing administrative costs through the improvements in management.

64. A strong growth of housing loans and leasing as well as leasing of other consumer goods (cars, furniture, etc.) has been another clear tendency over the past years. In 2003, housing credits made up almost 15% of the total loan portfolio in Lithuania, while in 2001 - only 8.6 (forecast for 2005 – around 25%). Sharp growth of the housing loans started first in Estonia and in 1–2 year period became widespread in Latvia and Lithuania as well. According to the forecasts of Vilniaus bankas, volumes of housing crediting will further increase in the coming 2-3 years. Financing of commercial real estate is also growing. It is a very strong factor in stimulating construction, real estate business and trade.

65. Monetary systems of Estonia and Lithuania are operating under the currency board regime with fixed exchange rate and secured convertibility of the national currencies against the Euro. Latvian lats was pegged to the basket of SDR currencies till the end of 2004. 25 Currency board regime has been crucial in reducing high inflation during the early years of transition reforms and continues to be one of the major factors contributing to low interest rates. Estonia and Lithuania presently fulfil all Maastricht criterions for entering the EMU. These two countries together with Slovenia on 27 June 2004, were admitted to the

22 Business news Verslo Zinios, 2004.05.11.
23 National Central banks of the Baltic States.
25 In January 2005 Latvia pegged the Lats to the Euro at 1 EUR = 0.702804 LVL.
ERMII and could join the euro area by late 2006 – early 2007. There are no restrictions on capital flows to and from the Baltic States.

3.2.2. Telecommunications

66. Telecommunications has been an extremely dynamic sector in the Baltic States during the recent years. It almost reaches the levels of saturation in certain services (mobile telephony, first of all) therefore the pace of growth is about to slow down. In 2003, in Estonia, Latvia and Lithuania fixed telephone services penetration reached 38%, 29% and 25%, mobile service – 68%, 40% and 55%, internet penetration – 35%, 17% and 18% respectively. The number of fixed telephone users has declined in Latvia and Lithuania in past three years due to competition in voice services with the mobile telephony. However, internet penetration is still low and this is a major field for the future growth. Launching of the new generation mobile services (3G) is foreseen in the near future: licenses for the UMTS services are already issued in Estonia (three) and Latvia (two).

Diagram 3. Mobile subscribers per 100 population

Diagram 4. Internet users per 100 population

Source: eEurope+, 2003

67. Companies of the Baltic States and Poland participate in a project of the network connection. Spare capacity of the optic fibre network, which via Poland is connected to the networks of the EU countries, is used for high speed data transmission services. Recently, the telecom companies started expanding their services to neighbouring countries. For example, in 2002, Lattelekom began providing telecommunications services in Lithuania and Estonia, operating in the Internet wholesale sector and providing data transmission services to the companies having subsidiaries in all Baltic States.

68. In all three countries, the sector is dominated by the Scandinavian ownership with TeliaSonera being the major shareholder in “Lietuvos telekomas”, in the biggest Lithuanian and Latvian mobile operators “Omnitel” and “Latvijas Mobilais Telefons” as well as having 49% of the shares in “Lattelekom” and

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26 eEurope+ 2003, Progress Report, 2004
“Eesti telekom”. Swedish company Tele2 owns mobile operators Tele2 in all three Baltic countries. Possibility of mergers of the Baltic States telecoms or mobile companies of the same owner is discussed for some time already, but no concrete decisions are publicly known.

69. Due mainly to their privatisation, telecommunications received one of the largest (after financial intermediation) proportions of the FDI in the Baltic States. Digitalisation of the fixed networks reached 76%, 82% and 88% in Estonia, Latvia and Lithuania respectively in 2002. Average salaries in this sector are also among the highest in all three countries. Monopoly rights of the telecoms were abolished in January of 2001 in Estonia and in January 2003 in Latvia and Lithuania.

70. Bearing in mind that the telecommunications sector is modernised both in technological and management sense, its regulatory framework, though changed several times recently in order to be aligned with the EU directives, should remain intact this year. Competition is very intense in this sector, and companies are introducing new services (e.g. data communication). Therefore, there should be no significant changes in the near future in this service market.

71. The major risks for the telecommunications sector in the Baltic States originate from the regulatory framework and its implementation. The EU telecommunications policy is framed by extensive and intensive regulations, which aim at creating conditions for efficient competition and are based on the decisions of national regulatory agencies empowered with strong rights to intervene into business of the operators having significant market power (SMPs). Bearing in mind top-down regulatory traditions and low institutional capacities in the Baltic States, significant powers granted to the regulatory agencies in these countries could lead them to intervene extensively into these sectoral activities. This would mean the slowdown of the innovations, growth and investment, both into infrastructure and services, and lesser satisfaction of the consumers’ demands.

The impact of EU accession

72. The main benefits of EU accession on the telecommunications sector have been felt before the actual accession. The accession process, especially the monitoring of the European Commission and its recommendations in regular annual Progress Reports, created a pressure on Latvia and Lithuania to liberalise their provision of fixed networks and to end the monopoly granted during the privatisation process. Although the prospective EU membership can not be seen as the main factor in the decision of the Nordic companies to invest in this sector in the Baltic States, the overall process of integration has facilitated the flows of investments and other business links between the different members of the Single market. The presence of FDI has been the most important feature of the development of telecommunications sector. Although the growth of services has so far been limited mostly to the national markets, recent trends show the tendency to expand telecommunication services to the neighbouring markets.

73. The most important risks in the development of telecommunications sector could emerge in relation with the implementation of the regulatory policies. The regulatory regime of the telecommunications sector and its supervision has been influenced significantly by the process of regulatory harmonisation with the EU norms. For example, the European Commission linked the process of accession negotiations with Lithuania with the strengthening of the regulatory agency. The Commission also insisted that acceding

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28 Original privatisation agreement of the Lattelecom provided monopoly right till 2013. In order to comply with the EU legislation, Latvia had to renegotiate the agreement. A settlement between the Latvian government and TeliaSonera was reached in March 2004.
countries first implement the old package of telecom directives, although the new package with somewhat more liberal provisions has been already drafted and coming into force in the EU. This resulted in the extremely fast-changing regulatory environment in the acceding countries. In the future, the regulatory policies will to a large degree depend on the discretion of national regulatory agencies. However, for the development and internationalisation of telecommunications services the technological progress has an equally significant impact as the regulatory environment.

3.2.3. Retail trade

74. Trade sector takes the biggest share of services in the Baltic States – close to 20% in Latvia and Lithuania and 14% in Estonia. It is also among the fastest growing service exports. The share of trade in economic activity increased very rapidly after centrally-planned economy was started to be demolished. Sharp growth of the retail trade services reflected unsatisfied consumption demand of the population. Later, these services have continued to increase at a slower pace – determined by the income growth and reinforced by spreading consumption credits. Despite the fast growth, shopping area per capita in the Baltic countries is still considerably lower than in the EU15 (e.g. in Lithuania where there is half of the EU15 average) therefore further active expansion of the sector is anticipated.

![Diagram 5. Dynamics of the retail trade turnover, percent](image)

Source: National Statistical Offices

75. In Lithuania, retail trade market is dominated by the local supermarket chain VP Market. VP Market is the largest retailer in the Baltic States, operating 186 shops in Lithuania, 82 in Latvia and 3 in Estonia. VP Market takes over 22% of Lithuanian and Latvian retail trade markets. The company is planning to open 30 new shops in Estonia in 2004-2005. Second largest retailer in Lithuania is Belgian capital company Iki, operating 124 shops in the country and having 10% of the market. The third – Rimi – is held by ICA Baltic which has 33 shops and over 5% market share in Lithuania. ICA Baltic operates Rimi Latvia with 36 shops and 15% of the Latvian market (second largest in Latvia) and Rimi Estonia with 6 shops.

76. VP Market and VP Group is an interesting phenomenon in Lithuanian and Baltic economies. It is known for the fast growth and innovative solutions. VP Market is the biggest company in the country in

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29 For example, the law on telecommunications, implementing the “old directive package” came in force in January 2003, while the law on electronic communication, implementing “the new package”, is in force from May, 2004.

30 Verslo Zinios (Business News), 2004.06.17

31 www.vpmarket.lt, 2004.06

32 Verslo Zinios, 2004.06.17 In Latvia, VP market takes an important part in retail sales in non-specialized stores with food, beverages or tobacco predominating (NACE/ISIC activity class 52.11), but its share in the whole retail trade activities is significantly smaller.

33 www.rimi.lt, 2004.06
terms of people employed and the second biggest company in terms of sales. Established in 1992 the company grew very fast – its turnover made around 260 million Litas in 1996 and 4 000 million Litas turnover is expected for 2004. VP Market belongs to VP Group that is engaged in various activities including telecommunications, electricity distribution, construction and etc. As noted above, the company makes good use of the Baltic area by also expanding sales markets for Lithuanian diary and other food producers who use VP Market retail chain to enter Latvian and Estonian markets.

The impact of EU accession

77. The EU does not regulate retail trade, which remains in the competence of the Member States. Despite regularly emerging political initiatives to impose restrictions on working hours, locations of the supermarkets and other regulatory norms in some Baltic countries, retail trade regime in these countries remains comparably liberal and this has been one of the factors which account for the very low inflation (sometimes deflation) during recent years in the Baltic countries. This is also one of the factors facilitating successful and dynamic development of the sector. Membership in the EU could strengthen the arguments of those who argue for more regulation by imitating regulatory models in other Member States.

78. On the other hand, the common market provides retailers with the wider variety of goods. Bearing in mind the fact that retail market in the Baltic States is still not saturated, entry of the European market chains can be expected. This would create an additional competitive pressure on the existing players. At the same time, the Baltic States’ retail chains are about to enter other neighbouring markets – not only in other EU Member States such as Poland, but also in Ukraine and Russia.

79. However, neither the availability of new producers and suppliers, nor a bigger competition is likely to decrease general consumer price level. General price level in the Baltic States is much lower than in the EU, while the free movement of labour (although implementing gradually) pushes salaries up, and higher regulatory standards (hygiene, veterinary, product quality, etc. norms) require substantial investments. New products and services for consumers are expected as well as bigger flexibility for retailers in dealing with the suppliers.

3.3. The movement of natural persons

80. The movement of natural persons – self-employment (and the right of establishment) and the movement of employees – form part of the free movement of labour and free provision of services in the EU Internal market. There are several different regimes which are associated with the movement of natural persons in the case of the EU Internal market.
Table 7. Overview of cases of labour movement and their respective regulatory regimes

<table>
<thead>
<tr>
<th></th>
<th>Workplace = residence</th>
<th>Workplace ≠ residence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Worker in home country company</td>
<td>—</td>
<td>Posted worker</td>
</tr>
<tr>
<td>Worker in company of other country</td>
<td>Migrant worker</td>
<td>Frontier worker</td>
</tr>
<tr>
<td>Self-employed</td>
<td>Establishment</td>
<td>Cross-border provision of services</td>
</tr>
<tr>
<td>Company (services sector)</td>
<td>Establishment</td>
<td>Cross-border provision of services</td>
</tr>
</tbody>
</table>

Source: European Commission (2001)

81. The removal of barriers to these freedoms, in particular to the free movement of labour, has been slower and more complicated than the establishment of the free movement of goods in the EU. The flows of labour are still relatively small in the EU if compared to the migration inside the US.

82. Although the data from different sources gives somewhat different picture regarding net migration trends in the Baltic States, there is more evidence to the negative net migration.34

83. The citizens of the EU have so far made up a relatively small share of residents in the Baltic States. According to the data of the Migration Department of Lithuania, in 2003 out of all foreign citizens permanently residing in Lithuania, only 0.53% were citizens of the EU. Out of all temporary foreign residents in Lithuania (4,833 at the end of 2003) 19.2% were citizens of the EU (an increase from 15.4% in 2002). In Estonia, according to the Citizenship and Migration Board, in October 2003, out of 100,522 citizens of other countries, only 3,120 or 3.1% were citizens of the EU.

84. Some of the studies provide a comparative picture of labour outflows from the Central and Eastern European countries into the old EU member states.

Table 8. Stock of residents from the CEECs in old EU countries

<table>
<thead>
<tr>
<th></th>
<th>Austria</th>
<th>Denmark</th>
<th>Finland</th>
<th>Germany</th>
<th>Italy</th>
<th>Luxembourg</th>
<th>Nether.</th>
<th>Sweden</th>
<th>Total EU-8</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residents by citizenship (persons)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total EU-8</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bulgaria</td>
<td>4217</td>
<td>443</td>
<td>297</td>
<td>38143</td>
<td>6758</td>
<td>193</td>
<td>na</td>
<td>805</td>
<td>50856</td>
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<tr>
<td>Czech Rep.</td>
<td>7313</td>
<td>412</td>
<td>125</td>
<td>38504</td>
<td>3468</td>
<td>173</td>
<td>na</td>
<td>471</td>
<td>50466</td>
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<tr>
<td>Estonia</td>
<td>54</td>
<td>523</td>
<td>10839</td>
<td>3880</td>
<td>205</td>
<td>131</td>
<td>na</td>
<td>1662</td>
<td>17294</td>
</tr>
<tr>
<td>Hungary</td>
<td>12729</td>
<td>457</td>
<td>654</td>
<td>55978</td>
<td>3066</td>
<td>417</td>
<td>na</td>
<td>2727</td>
<td>76028</td>
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<tr>
<td>Latvia</td>
<td>153</td>
<td>894</td>
<td>227</td>
<td>8543</td>
<td>467</td>
<td>41</td>
<td>na</td>
<td>780</td>
<td>11105</td>
</tr>
<tr>
<td>Lithuania</td>
<td>208</td>
<td>1583</td>
<td>204</td>
<td>11156</td>
<td>322</td>
<td>32</td>
<td>na</td>
<td>727</td>
<td>14232</td>
</tr>
<tr>
<td>Poland</td>
<td>21841</td>
<td>5410</td>
<td>694</td>
<td>310432</td>
<td>29282</td>
<td>885</td>
<td>na</td>
<td>15511</td>
<td>384055</td>
</tr>
<tr>
<td>Romania</td>
<td>17470</td>
<td>1258</td>
<td>489</td>
<td>88102</td>
<td>62262</td>
<td>596</td>
<td>na</td>
<td>2495</td>
<td>172672</td>
</tr>
<tr>
<td>Slovak Rep.</td>
<td>7739</td>
<td>216</td>
<td>51</td>
<td>23004</td>
<td>6</td>
<td>114</td>
<td>na</td>
<td>363</td>
<td>31493</td>
</tr>
<tr>
<td>Slovenia</td>
<td>6893</td>
<td>56</td>
<td>10</td>
<td>19395</td>
<td>1583</td>
<td>72</td>
<td>na</td>
<td>627</td>
<td>28636</td>
</tr>
<tr>
<td>CEEC-10</td>
<td>78617</td>
<td>11252</td>
<td>13590</td>
<td>597137</td>
<td>107419</td>
<td>2654</td>
<td>14417</td>
<td>26168</td>
<td>851254</td>
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<tr>
<td>CEEC-8</td>
<td>56930</td>
<td>9551</td>
<td>12804</td>
<td>470892</td>
<td>38399</td>
<td>1865</td>
<td>na</td>
<td>22868</td>
<td>613309</td>
</tr>
</tbody>
</table>


34 According to the Lithuanian Department of Migration, in 2003 the negative net migration was 6300 people (the trend present for a number of years). (See http://www.migracija.lt/md/Raida2003/r2003.htm. - site visited on 2004.07.19). Although according to the CIA World Factbook the net migrate rate as of January 2003 in the case of Lithuania was 0.14 (migrants per 1000 population), in the cases of Estonia and Latvia these numbers have been negative - respectively -0.71 and -1.19. (See http://www.indexmundi.com. – site visited on 2004.07.19).
It could be observed that geographic proximity is one of the strongest factors in the movement of people. However, the data above does not include Ireland and Great Britain which have been popular EU destinations for the Baltic States citizens, and this trend was strengthened by the fact that these two countries removed most barriers to the free movement of labour after the enlargement. Moreover, the official data should be treated with caution because of the significant flows of illegal labour migration.

The accession into the EU is likely to have important implications for the movement of natural persons due the removal of discrimination of the grounds of nationality. The popular expectation is that because of the differences in the level of income in the old and new member states the economic incentives for migration from poorer to the richer economies will further be strengthened.

Table 9. Per capita GDP of New Members in relative and absolute terms, 2003

<table>
<thead>
<tr>
<th>Country</th>
<th>Czech Rep.</th>
<th>Estonia</th>
<th>Hungary</th>
<th>Latvia</th>
<th>Lithuania</th>
<th>Poland</th>
<th>Slovakia</th>
<th>Slovenia</th>
<th>Cyprus</th>
<th>Malta</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP per head in PPS Euro</td>
<td>15 500</td>
<td>9 900</td>
<td>13 000</td>
<td>9 000</td>
<td>9 800</td>
<td>9 800</td>
<td>10 900</td>
<td>16 500</td>
<td>17 700</td>
<td>15 900</td>
</tr>
<tr>
<td>GDP per head in PPS EU = 100</td>
<td>73</td>
<td>46</td>
<td>61</td>
<td>42</td>
<td>46</td>
<td>46</td>
<td>51</td>
<td>77</td>
<td>83</td>
<td>74</td>
</tr>
</tbody>
</table>

Source: Eurostat
Note: PPS – purchasing power standards

However, increases in the flows of labour are not expected to be very significant. It has been estimated that during 2001-2002 there were about 1 million citizens from Central and Eastern European countries residing in EU-15, while the number of employees was estimated at about 400,000. Most studies forecast that the outflows from New Members are likely to make up about 2-4% of the population. The cross-border provision of services is likely to become more intense. In the case of the Baltic States, the movement from the Baltic States to the Nordic EU members is likely to intensify. Overall, the provision of services to other member states will increase with the removal of barriers to the movement of persons inside the EU. According to the Lithuanian Labour Exchange data, the most popular jobs for the migrants from new to old member states include work with information technologies, housekeeping, construction and other services (catering, etc.). However, the increase in the movement of natural persons is not expected to be sudden and very strong.

The immediate increase of migration of natural persons in the EU after its enlargement is restricted by several factors. First, most of EU member states opted for the transition periods of up to seven years, during which the movement of labour from the New Members will be restricted by quotas. Second, some member states such as Denmark introduced additional safeguards such as the requirement to get a permission from the trade union to employ a citizen of a New Member state against the inflow of labour from the New Member states, although the conformity of these measures with the EU acquis might be questioned. Third, the self-employment and the migration of employees are restricted by the rigid national rules regulating labour market which, although not being discriminatory, complicate the entry into the labour market. Fourth, the dynamic economic development of the new Member States exceeding the growth of the euro area economies should reduce economic incentives for migration.

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Table 10. Average GDP growth rates, real annual percentage change

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estonia</td>
<td>7.3</td>
<td>6.5</td>
<td>6.0</td>
<td>4.8</td>
<td>5.4</td>
<td>5.9</td>
</tr>
<tr>
<td>Latvia</td>
<td>6.8</td>
<td>7.9</td>
<td>6.1</td>
<td>7.5</td>
<td>6.2</td>
<td>6.2</td>
</tr>
<tr>
<td>Lithuania</td>
<td>4.0</td>
<td>6.5</td>
<td>6.8</td>
<td>8.9</td>
<td>6.9</td>
<td>6.6</td>
</tr>
<tr>
<td>Acceding countries</td>
<td>4.1</td>
<td>2.5</td>
<td>2.4</td>
<td>3.6</td>
<td>4.0</td>
<td>4.2</td>
</tr>
<tr>
<td>Euro area</td>
<td>3.5</td>
<td>1.6</td>
<td>0.9</td>
<td>0.4</td>
<td>1.7</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Source: European Commission Spring 2004 forecast

89. Table 10 shows that the economic growth of new Member states has been constantly higher that the growth of the euro area since 2000 and the difference is expected to remain in the coming years. Among the new Member States, the Baltic economies showed the highest growth rates for the last several years, thereby accelerating the catch-up process which might take shorter than most analysts expected if the current growth rates are maintained. Such a fast catching-up (with an increase in demand for labour) should further reduce economic incentives for migration to richer Member States. Finally, there are other social and cultural factors typical to most economies which restrict the movement of labour in the EU (knowledge of languages and others).

90. The inflow of natural persons into the Baltic States will most likely remain limited in the future. Although in the area of mutual recognition of qualifications and the right of establishment there have not been major difficulties during the accession negotiations, the actual implementation of EU acquis in this area is complicated by the complexities of labour market regulations (and sometimes resistance of the domestic interest groups to allow new players to enter the market). These regulatory barriers, even if not discriminatory, create more difficulties for self-employed and small business than for large investors, which have been present in most service sectors since the selling of formerly state owned enterprises.

4. Conclusions

91. The service sectors have been the most dynamic sectors of the Baltic economies. Their shares in GDP are now similar to most OECD economies, although their international trade in services is still significantly lower than merchandise trade. The most important services traded by the Baltic countries include transport and tourism. Other sectors are relatively less important, though some like retail and construction services have been growing fast in recent years.

92. In terms of GATS four modes of supply, transport is the most developed and most widely exported service under Mode 1. Tourism appears to be another important service traded by the Baltic States, which dominates Mode 2 service supply. Although FDI originating from the Baltic States is still modest (with the exception of Estonia, which has been often used as a basis for business expansion to the other two Baltic States), inflows of FDI have been very significant. FDI into the telecommunications and financial sectors have been essential in upgrading the quality of services, their expansion and integration within the regional Baltic market. These services are expected to become significant export items as well. Technological progress can particularly facilitate the export of telecommunication services. Finally, movement of natural people from and even more so to the Baltic States has been limited and to a large extent being part of the shadow economy (illegal emigration from the Baltic States to the other Member States).

93. It should be noted that the Baltic States had relatively open economies in the mid-1990s, in particular as regards their trade regime, which has been in some aspects more liberalised than the EU’s. The three Baltic countries, beginning with Estonia, and later the other two Baltic countries, created a favourable environment for FDI, which has been an important factor in the development of service sectors. The experience of the Baltic States confirms the argument, that “adopting liberal trade and investment regime and a pro-competitive regulatory stance in key infrastructural service sectors – telecommunications,
finance, transport and energy – will be essential for countries to maximise benefits from the internationalisation of services markets.”

94. The overall impact of the EU accession on the development of service sectors has been positive. It is often said that service sectors expand with the development of the economy and growth of income level. The growth of the Baltic economies, first of all an outcome of transition reforms and opening of the economies, has also been due to the process of EU accession, in particular trade liberalisation and expectations of investors. Although different estimates have been made as to how much additional growth has been generated by the membership in the EU Internal market, most estimates predict additional growth of 1-2% for the Baltic States. The growth of economies and personal incomes should further contribute to the development of services in terms of both their choice and quality.

95. The most important positive impact of EU accession is linked to the participation in the Internal Market and the related opening of the economies. The process of accession associated with the removal of border and other barriers (quotas, etc.) to the provision of services has contributed (and will continue to do so) to the growth of the service sectors in the Baltic States. The expansion of the road haulage services provided by the Lithuanian carrier companies is the best illustration of this impact. The increasing presence of retail chains, financial and other service providers should intensify already intense competition in most service sectors and further improve the quality of services.

96. The adoption of EU regulatory norms has had generally a positive impact on the development of services. However, in some cases it has not allowed reducing significantly general market entry barriers, in particular for small companies. This effect has been strengthened by the current differences in economic development between rich Member States which established the current acquis and the poorer new entrants. For example, financial standing norms and other new requirements for the operations of road haulage can act as a regulatory barrier for small companies. Emphasis on regulatory activities and regulatory agencies can create regulatory failures in the Baltic States where the administrative capacities of these agencies are still relatively low and the tradition of regulatory supervision is in its infancy. It should be acknowledged, however, that in many cases it is up to national authorities to set the regulatory rules, for example in the retail sector, while in other cases the EU norms leave room for more or less restrictive national implementing norms, as it is the cases in energy regulation. Therefore, the impact of EU accession depends to a large degree on national transposition and implementation of the acquis.

97. The accession to the EU has also had an impact on services trade with third countries. Although this impact might not be as straightforward as in the case of the trade in goods, the process of harmonisation of border and customs regime can create for the new members some limitations to the provision of services. This is particularly evident in the field of tourism from Russia and other third countries. However, the long-term implications of the wider market with harmonised regulations are expected to be positive, including for FDI inflows to the new members. The effect of changes in border regimes will also depend on the future development of the EU’s external policy. The Baltic States interest is in further liberalisation of trade by using both WTO and bilateral agreements with third countries. Their geographical position (bordering the neighbours of the EU, being transit locations, etc.) implies that liberalisation of trade with third countries would bring them significant additional benefits.

98. The accession to the EU is likely to have a significant impact on the development of the infrastructure that is required for the provision and growth of some services. This is particularly the case in the field of transport, which will receive significant funds from the EU budget. Moreover, the support of the European Commission for integrating new Member States into the Internal Market could provide a welcome push for such projects as the electricity bridge connecting Lithuania via Poland with the West

37 Open Services Markes Matter, OECD Observer, October 2001, p. 3.
European grid. The development of infrastructure will be one of the main factors for the provision of related services.

99. In terms of the continued development of the Internal Market in services, the interests of the Baltic States lie in the flexible regulatory approach respecting economic and social differences in the member States, the reduction of national administrative barriers to the provision of services (although often falling outside the competence of the Union) and further liberalisation of sectors such as electricity and postal services. The recent approach of the European Commission to emphasise the conditions for competition rather than sector specific regulatory norms is also beneficial, particularly taking into account weak administrative capacities of national regulatory agencies.