

IMPLEMENTING THE CEFTA 2006 AGREEMENT: Reaping the benefits of trade and investment integration in South East Europe



APPROACH

The conclusions contained in this brochure are the result of close collaborative process involving the OECD Investment Compact, the governments of the eight signatories economies to the CEFTA 2006 – **Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, the Republic of Moldova, Montenegro, Serbia** and **UNMIK/Kosovo**¹ – the CEFTA bodies and the CEFTA Secretariat, as well as the private sector and civil society. This process spanned three years and included analyses – both quantitative and qualitative – of intra-regional trade and investment flows, reviews of institutions, policies and legislation, and policy dialogue with stakeholders through working groups and roundtables.

¹ Throughout the brochure, “UNMIK-Kosovo” refers to “the United Nations Interim Administration Mission in Kosovo on behalf of Kosovo in accordance with United Nations Security Council Resolution 1244.”

In 2007, the Western Balkan economies and the Republic of Moldova ratified the new Central European Free Trade Agreement (CEFTA) 2006. Emerging from a network of more than 30 bilateral free trade agreements, it created a unified trade market of nearly 30 million consumers. The Agreement provided for the immediate liberalisation of trade in industrial products and the gradual liberalisation of trade in agricultural products and services.

In addition to implementing traditional trade-related liberalisations such as tariff reductions and elimination of non-tariff barriers, CEFTA 2006 obliges the adhering Parties to undertake certain commitments: to co-ordinate their investment policies, progressively open their government procurement markets and effectively protect intellectual property rights. As such, CEFTA 2006 constitutes a truly modern and ambitious free trade agreement.

In co-operation with the CEFTA Secretariat, the European Commission and the Government of Hungary, since 2007 the OECD Investment Compact for South East Europe (OECD-IC) has provided support to the CEFTA Committees in monitoring the implementation of investment-related provisions and the elimination of non-tariff barriers.

This brochure contains the main conclusions from this work conducted with the CEFTA signatory Parties on issues including:

- NATIONAL TREATMENT RESTRICTIONS AND BILATERAL TREATIES
- INTELLECTUAL PROPERTY RIGHTS
- TRADE INTEGRATION, INDUSTRY CONCENTRATION AND FDI INFLOWS
- NON-TARIFF BARRIERS
- PUBLIC PROCUREMENT

It highlights key achievements, major challenges and offers recommendations to governments on ways to improve policy implementation so that the economies of the Western Balkans are able to seize all of the opportunities for investment, growth and development that the CEFTA 2006 treaty offers.

National Treatment Restrictions and Review of Bilateral Investment Treaties

The report on *National Treatment Restrictions and Review of Bilateral Investment Treaties in the CEFTA 2006 Signatory Parties* reviews two important aspects of the investment-related clauses of the agreement, specifically restrictions to national treatment and the consistency of bilateral investment treaties (BITs) signed among the CEFTA parties.

ACHIEVEMENTS

The principle of national treatment provides that governments treat those investments controlled by foreigners no less favourably than similar investments controlled by domestic investors. The report confirms that to date, CEFTA Parties have indeed taken significant steps to modify or eliminate restrictions to national treatment in their primary or secondary legislation covering foreign investment and certain sector-specific laws.

It also notes that the majority of CEFTA Parties have stopped using horizontal screening procedures for foreign investment. In most cases, a foreign-controlled enterprise is simply required to notify its entry in the host economy by registering with local commercial courts (e.g. Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro and Serbia). **The study finds that the CEFTA Parties are maintaining reforms designed to strengthen the principle of national treatment.**

In terms of the network of bilateral investment treaties (BITs) signed amongst the CEFTA 2006 Parties, the study confirms that they are broadly consistent in terms of the treatment and protection they provide to investors and their investments. The majority of these BITs use similar definitions and terms and provide comparable standards of treatment including most favoured nation (MFN) treatment at the post-establishment phase of investment; compensation against expropriation; rights to transfer capital and returns; and dispute settlement mechanisms at the state-to-state and investor-to-state level.

REMAINING CHALLENGES AND WAY FORWARD

International best practice suggests that investment treaties or free trade agreements with investment chapters which define the terms “investor” and “investment” provide governments with greater clarity regarding their treaty obligations. In the current text of the CEFTA Agreement, these terms are undefined. **The CEFTA Parties might consider undertaking a detailed review of the agreement to find ways of clarifying the intended meaning of terms such as “investment” and “investor”.**

MOST PROMINENT TYPES OF RESTRICTIONS TO NATIONAL TREATMENT AMONG CEFTA PARTIES:

- 49% foreign ownership limitation in industries and sectors related to arms manufacturing, trading, and production (e.g., Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and UNMIK-Kosovo);
- Foreign ownership of agricultural land (nearly all CEFTA Parties);
- Restrictions on the purchase of real estate in sensitive areas such as border zones, national parks, and historical areas (all CEFTA Parties);
- Restrictions on maritime transport services (e.g., Albania, Croatia, Montenegro, and Serbia) air transport (e.g., Bosnia and Herzegovina, Croatia, and Serbia) and fishing (e.g., Albania, Croatia, and Montenegro).

Intellectual Property Rights in the CEFTA 2006 Signatory Parties

The paper *Intellectual Property Rights and the CEFTA 2006* reviews the legal and regulatory frameworks in place that protect intellectual property rights in the CEFTA Parties.

ACHIEVEMENTS

The report confirms that the CEFTA Parties have made considerable progress in revising their intellectual property (IP) laws to be consistent with EU legislation and rules adopted by the World Trade Organization (WTO).

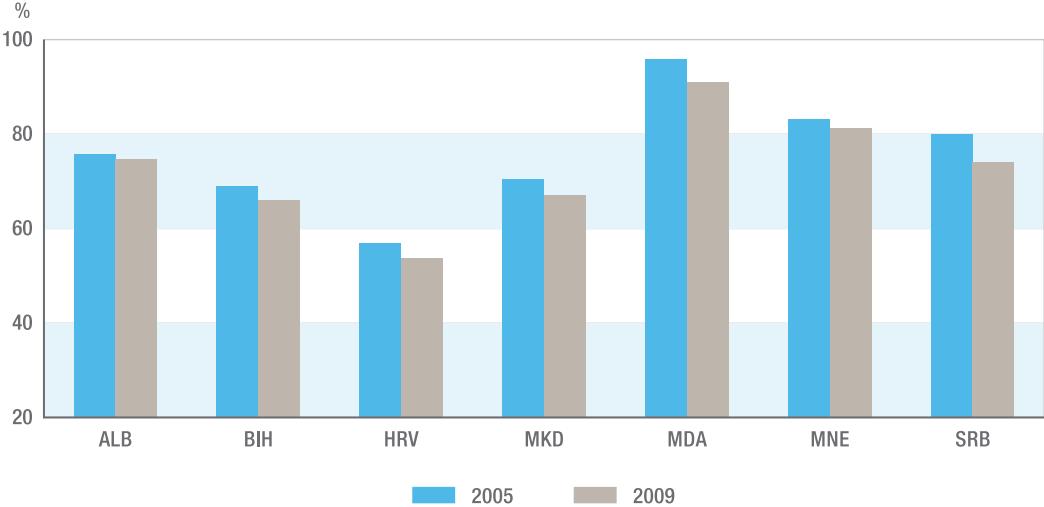
Croatia, for example, has ratified all 25 intellectual property conventions and agreements noted in Annex 7 of the CEFTA agreement. With the exception of UNMIK/Kosovo, the remaining CEFTA Parties have ratified a vast majority of those same conventions.

REMAINING CHALLENGES AND WAY FORWARD

The challenge for CEFTA Parties remains properly enforcing IP laws. Infringement of trademarks, copyrights and related rights is still common, and infringing goods remain easily accessible. None of the CEFTA Parties have formed special IP courts, therefore the competence for resolving IP rights infringement lies within general or commercial courts which tend to be already overburdened. In UNMIK/Kosovo court practice regarding IP rights is practically non-existent. International donor assistance will be necessary in the near term to provide capacity building support for institutional structures in the CEFTA Parties charged with protecting and enforcing IP laws.

In view of EU membership, CEFTA Parties still have to make significant strides in IP protection and enforcement, including the full implementation of EU regulations and standards. Governments will also have to undertake effective communication campaigns to change public perception so that citizens come to see that intellectual property deserves to be protected as much as physical property does.

ESTIMATED PERSONAL COMPUTER SOFTWARE PIRACY RATES



Note: Data for UNMIK/Kosovo not available.

Source: Seventh Annual BSA-IDC Global Software 09 Piracy Study.

ALB: Albania
BIH: Bosnia and Herzegovina
HRV: Croatia
MKD: The former Yugoslav Republic of Macedonia
MDA: The Republic of Moldova
MNE: Montenegro
SRB: Serbia

Trade Integration, Industry Concentration and FDI Inflows: The Experience in Central and South Eastern Europe

Over the past twenty years, the economies of Central and South East Europe (CEE and SEE) have undergone fundamental reforms – the opening of new markets, major policy reforms, deeper intra- and inter-regional economic integration and institutional improvements – which have significantly altered the landscape of economic activity and foreign investment in the region. *Trade Integration, Industry Concentration and FDI Inflow: the Experience in South East Europe* investigates how this growth has impacted the geographical location of economic activity in the region as well as foreign direct investment (FDI) flows.

ACHIEVEMENTS

The report looks at whether CEE countries have experienced more economic dispersion -- thereby reducing industry concentration in certain geographic areas -- due to increased regional and European Union integration. It concludes that this has indeed been the case (see graph p.9), and **that regional and EU integration has resulted in a more equal cross-country distribution of economic activity.**

The study also shows that industries which have been most successful in overcoming concentration during the period 2001-2005 -- a period of accelerated market integration -- were those with the lowest trade costs. **This suggests that governments which have enacted measures to lower trade costs have been more successful in overcoming industry concentration.**

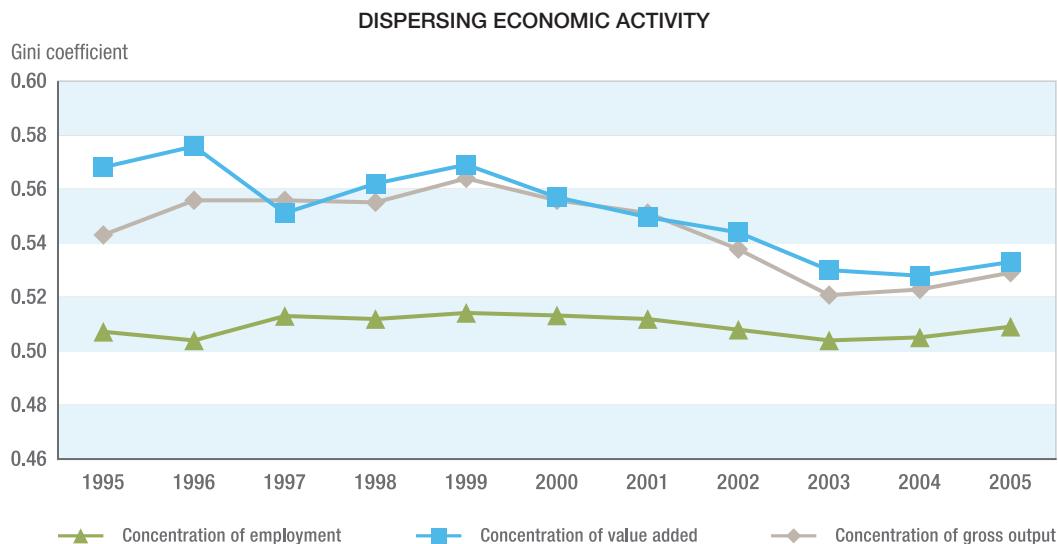
As regards whether increased regional and European Union integration has impacted FDI in CEE and SEE, the study concluded that FDI is both market and efficiency seeking. The greater the market potential of a particular country, the higher FDI tends to be. In addition, a higher ratio of labour productivity to hourly labour costs (i.e. lower unit cost) makes a country attractive for FDI. **Evidence shows that the largest economies in the region have attracted the greatest FDI inflows, while FDI in manufacturing was directed mainly to sectors where SEE countries already had revealed comparative advantages.**

The report confirms the positive correlation between trade openness and rising levels of FDI. It notes that the combination of CEFTA implementation - with the resulting lowering of trade barriers it has brought amongst members –and reforms aimed at improving the investment climate would lead to greater FDI inflows. This implies that **CEFTA implementation, greater trade openness and investment climate reforms mutually reinforce each other to bring the highest levels of FDI to the region.**

REMAINING CHALLENGES AND WAY FORWARD

The study underlines that in order to maximize benefits arising from trade liberalisation at regional and European level, the CEFTA Parties need to work simultaneously on implementing the CEFTA agreement, the EU Association and Stabilisation Agreements and on improving the investment climate through economic reforms and institutional development, such as upgrading skills, implementing regulatory reforms and strengthening the role of competition authorities. Focusing on trade liberalisation alone, without connecting it with investment climate reforms, will not lead to higher FDI inflows in tradable sectors. The CEFTA Parties should thus intensify their actions in reducing barriers both to intra-regional trade, focusing on the removal of NTBs, and to intra-regional and extra-regional FDI flows.

Going forward, the OECD Investment Compact will undertake further work to extend the analysis conducted within *Trade Integration, Industry Concentration and FDI Inflow: the Experience in South East Europe*. **Specifically, a more disaggregated analysis will be conducted to determine in greater detail the dynamics of economic concentration and the location of FDI within specific SEE economies.**



Overcoming Non-Tariff Barriers in CEFTA

The project on non-tariff barriers (NTB), supported by the Government of Hungary, aims to assist CEFTA signatories in deriving the full benefits of the implementation of CEFTA through the reduction of non-tariff barriers. It aims to identify, classify and prioritise those NTBs that affect main trade flows among the Parties and neighbouring EU Member States. It also provides the CEFTA bodies with an action plan to eliminate those barriers.

ACHIEVEMENTS

The CEFTA agreement has generated an increase in intra-regional trade which is increasing, although trade flows continue to be strongly oriented towards the EU. The majority of intra-regional merchandise exports concentrate on low value added industrial supplies and consumer goods, and a similar pattern can be observed for exports to the EU. Increases in intra-regional trade as a consequence of the CEFTA agreement could spur the production of value-added goods, through the creation of vertically integrated value chains. Therefore, it can be expected that the CEFTA will lead to an increase in both intra-regional and intra-industry trade.

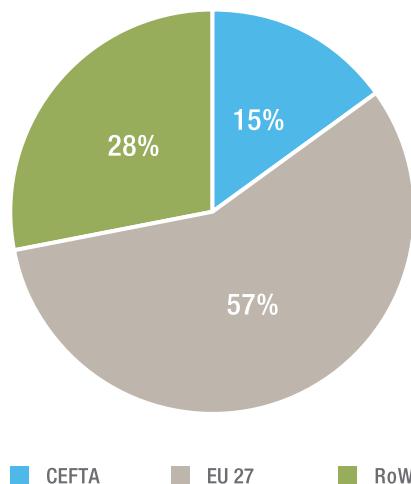
REMAINING CHALLENGES AND WAY FORWARD

Compliance with technical regulations and standards and sanitary and phytosanitary (SPS) measures appears to be the key constraint to further expanding trade with the EU, which is already the largest trading partner of the region. Not only does non-compliance with EU standards prevent growth of trade volumes, it also undercuts the Western Balkans' potential to deepen trade relations by becoming a part of more sophisticated value chains.

While most CEFTA Parties have, or are in the process of, adopting the relevant EU acquis -- thus moving toward alignment with EU norms in terms of procedures and regulations -- **multi-speed adoption of these standards may result in the creation of additional technical barriers to trade among CEFTA members.**

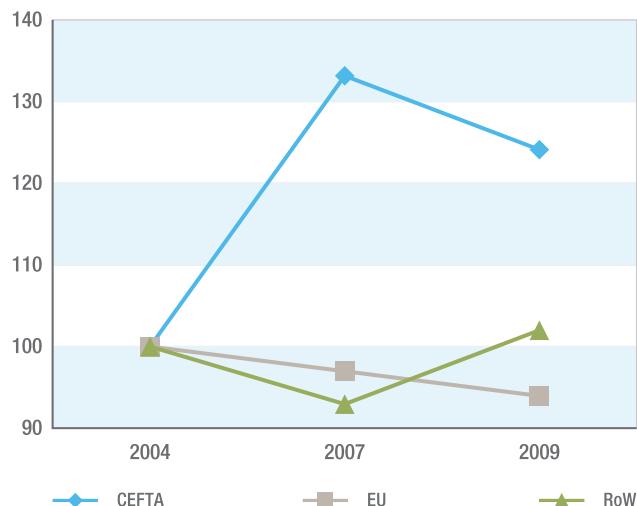
EU remains the dominant trade partner...

REGIONAL TOTAL GOODS TRADE, 2009



... but the share of CEFTA intra-regional trade is increasing

CHANGE IN COMPOSITION OF INTRA-REGIONAL TRADE, 2004-2009 (2004 = 100)



Ineffective implementation remains another key challenge. A lack of administrative capacity and fragmented institutional responsibility, the slow pace of legislative change, and inadequate or outdated equipment hinder the application of regulations and standards. Companies consistently report difficulties with changing requirements regarding packaging, traceability and labelling.

There is also a lack of technical knowledge on the part of representatives of business groups such as Chambers of Commerce (as well as some officials) in identifying different types of NTBs.

The OECD Investment Compact has submitted to the CEFTA Parties a number of recommendations for actions to be taken going forward to reduce and eliminate NTBs in terms of improving the structure and functioning of the CEFTA bodies, increasing information exchanges between the CEFTA bodies and with the private sector, and following progress through a monitoring system that has been developed based on the OECD-IC's Investment Reform Index.

Round Table on Public Procurement

Public procurement accounts for a considerable share of total internal demand in the CEFTA 2006 area. The CEFTA 2006 Parties are now going through a process of bringing their public procurement legislative and regulatory framework, as well as public procurement practices, in line with those of the European Union and have asked for the support of the OECD Investment Compact in this process.

ACHIEVEMENTS

In November 2009, the OECD Investment Compact and the Government of Slovenia jointly organised a Round Table on Public Procurement in Ljubljana to examine the progress made by the Parties in aligning their public procurement legislation and procedures with that of the EU and the CEFTA 2006.

The workshop noted that **considerable progress has been made by all CEFTA Parties in harmonising their public procurement legislation and procedures with the EU and the CEFTA 2006. Moreover, appropriate institutions have been established in all Parties and are operational.** CEFTA Parties are now in the process of harmonising their public procurement legislation and procedures with that of the EU as part of their EU accession process and in some cases (e.g. the Republic of Moldova) World Trade Organisation (WTO) requirements. In addition, the eight Parties have committed themselves to ensuring that procurement takes place in a transparent and reasonable matter, treats all supplies of the other Parties equally and is based on the principle of open and effective competition. The Parties have also agreed that the goods, services and suppliers of the other Parties are granted a treatment no less favourable than that accorded to domestic goods, services and suppliers.

REMAINING CHALLENGES AND WAY FORWARD

Despite progress, certain Parties have progressed further than others in harmonising their legislation and procedures. For example, Bosnia and Herzegovina faces particular challenges due to its complex political situation.

Although they are in place in all CEFTA Parties, the **institutions that have been created to oversee this harmonisation process all face constraints in terms of staffing and financial resources.** This has been exacerbated by the financial crisis, which has led to an even further decrease in budgets and lowered the scope and scale of procurement offers.

Ensuring transparency throughout the entire public procurement system is important. **The rapid pace of legislative change in the CEFTA Parties as part of the EU accession process can lead to hidden dangers, including unintended consequences of different laws on the public procurement systems.**

The next Round Table on Public Procurement will be held in the fourth quarter of 2010. **This second Round Table will focus on monitoring the public procurement commitments taken under CEFTA and increasing the transparency and dissemination of information.**

KEY CONTACT INFORMATION:

OECD INVESTMENT COMPACT FOR SOUTH EAST EUROPE PROGRAMME:

Mr. Antonio Fanelli, Deputy Head of the OECD Private Sector Development Division
investmentcompact@oecd.org

CENTRAL EUROPEAN FREE TRADE AGREEMENT SECRETARIAT:

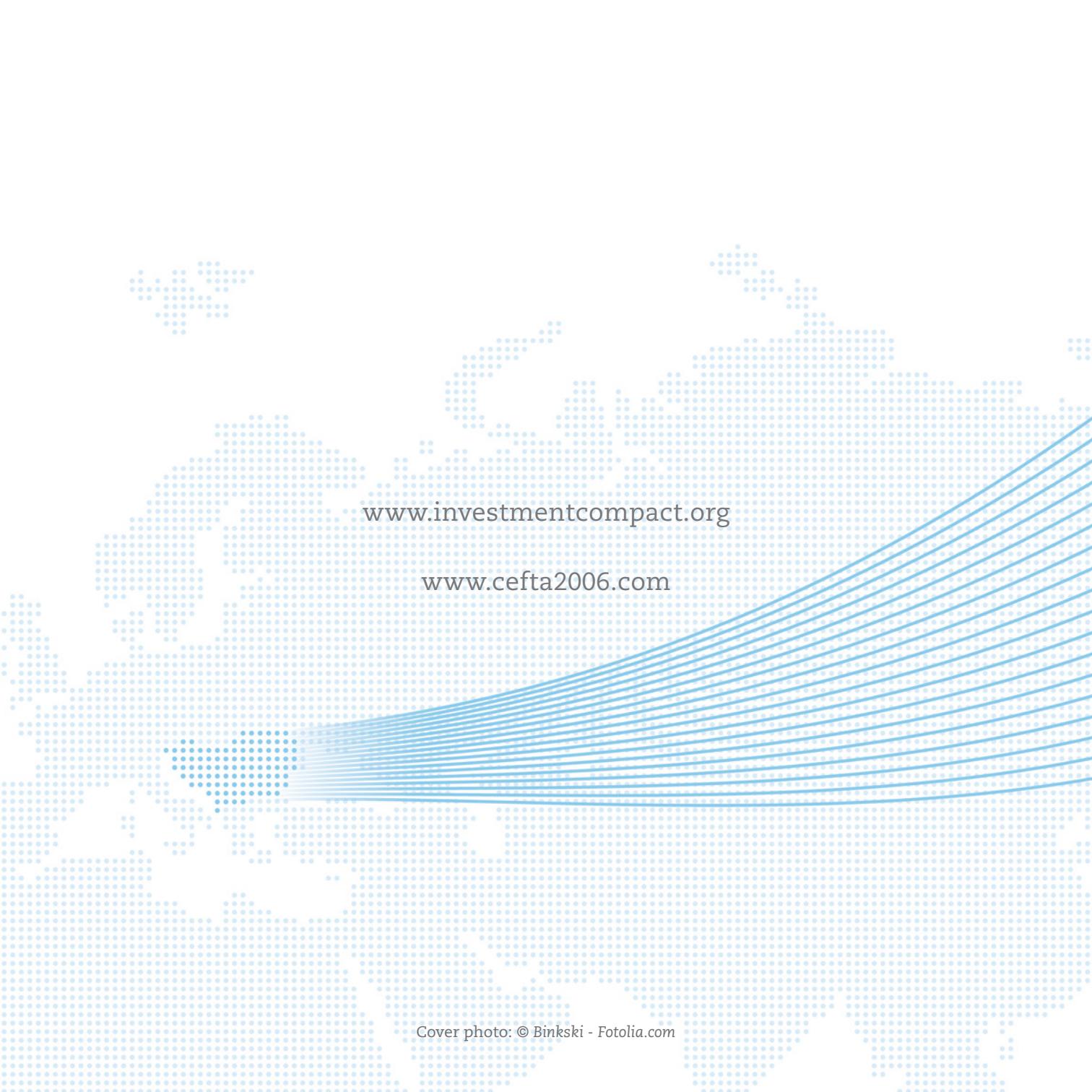
Liudmila Nistor-Mihajlova
cefta@cefta.int

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