

# POTENTIALS FOR THE LIBERALISATION OF TRADE IN SERVICES AMONG CEFTA 2006 PARTIES

Identifying Opportunities, Gains and Foundations for the Launching of  
Negotiations

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## Abbreviations

BiH	Bosnia and Herzegovina
BPTO	Business process and technology outsourcing
CEFTA 2006	Central European Free Trade Agreement 2006
CRS	Computer reservation systems
EBRD	European Bank for Reconstruction and Development
EU	European Union
FDI	Foreign Direct Investment
FYROM	Former Yugoslav Republic of Macedonia
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
ICT	Information and Communication Technologies
IMF	International Monetary Fund
IT	Information Technology
MFN	Most-favoured-nation
MRA	Mutual Recognition Agreement
NT	National treatment
OECD	Organization for Economic Cooperation and Development
RAMs	Recently Acceded Members
SMP	Significant Market Power
TPRM	Trade Policy Review Mechanism
UN	United Nations
UNMIK	United Nations Interim Administration Mission in Kosovo (UNMIK) on behalf of Kosovo in accordance with United Nations Security Council Resolution 1244/99
WB	World Bank
WTO	World Trade Organisation

## Summary

Since the Central European Free Trade Agreement 2006 (CEFTA 2006) entered into force for all Parties on 22 November 2007, it provided a legal framework for liberalising and expanding trade in goods and services among CEFTA Parties. Though industrial and agricultural trade has reached a high level of liberalisation, the **growing share and importance of services** in CEFTA Party economies (CEFTA simple average services exports to the world represent 36.10% of total exports, while services imports have a share of 15.29%) has boosted the efforts to start the process of services sector liberalisation which is also in compliance with Article 27 of the CEFTA 2006 Agreement. The ambition to initiate negotiations on the liberalisation of trade in services has been announced under the Serbian chairmanship and was included in the CEFTA Chairmanship Programme for 2010.

The purpose of the study is to examine the state of play in services in the intra-regional trade of CEFTA Parties and identify some of the key obstacles in that trade, with a focus on the possibilities to overcome them through a negotiated resolution of mutual interests and removal of any future challenges, based on GATS principles.

The study, which is by no means comprehensive, nor complete, nor highly detailed, highlights some of the key issues in connection with possible liberalisation efforts, that are both horizontal and sectoral in nature and suggests possible approaches. It examines the current state of liberalisation based on available documents, information and evidence, on the basis of schedules of commitments of CEFTA Parties that are members of the WTO and latest services offers of those Parties that are in the process of negotiating their accession to the WTO and have agreed to make these documents available.

A number of additional documents and independent sources have been examined, not only from a strictly liberalisation point of view, but by taking into account other challenges that inhibit the growth of services industries in the national markets and exports within the region. Instrumental in this respect have also been the meetings with stakeholders in capitals. The study indicates and substantiates that there is **a case for GATS Article V negotiations** within the CEFTA Parties, not only because of commitments in the CEFTA 2006 Agreement to examine the possibilities for such negotiations and to launch them, but as a logical step for the **advancement of regional economic integration**, for a process of modernisation of the services industries, and for taking advantage of the opportunities that present themselves in seeking symmetry and synergy, based on economic needs.

Other compelling reasons besides the expansion of the services trade is the fact that a completely liberal goods trade does not automatically translate into the expansion

of the services trade, although the need for supporting services may dramatically increase.

The most **obvious reasons for negotiations in services** are the frequently quoted legal certainty and market anticipation by the services operators, prevention of arbitrary intervention by authorities, removing the remaining limitations and restrictions in some sectors and the relaxation of administrative procedures. In other words, the liberalisation process covers in which authorities of the CEFTA Parties need to act.

The more compelling reasons are the benefits themselves for the very large number of **small and medium sized companies** that need new market access opportunities in the CEFTA Parties, and to allow the procurement of more competitive imported services, to create foundations for knowledge and experience sharing, business networking and clustering. The larger **services companies in the CEFTA region to be able to compete more efficiently in the European and global markets**, need to create regional business alliances, wherever feasible.

With the large number of services sectors and even larger number of subsectors and activities, which can even be subdivided even further, under the influence of market specialisation processes and dynamic developments in the services industries, it is inevitably necessary to **focus on some of the key sectors**, and suggest sectors that should be treated as a priority in the potential negotiations. It is a matter of course that the individual CEFTA Parties have different views of these priorities, however, in consultations in capitals it was almost an unanimous view that transport is the most important sector, followed by insurance and the information-communications sector as the most propulsive one. Both in transport and in the area of insurance regional initiatives already exist and considerable work has already been done, although in the area of transport the focus is on infrastructure. Possible sectoral preferences could be the following (not necessarily in that order): (i) **transport** services; (ii) **professional** services; (iii) **telecommunications**; (iv) **distribution** services; (v) **financial** services (other than banking, with an emphasis on insurance); (vi) **construction** services; (vii) **energy** services; (viii) **environmental** services; (ix) **ICT**-related services; (x) **educational** services (higher, secondary, adult education); (xi) **medical** services (private). These sectors were discussed with principal stakeholders in most of the CEFTA Parties, including the preferred approaches and options of potential negotiations on trade in services.

Less restrictive educational policies and the creation of better training opportunities, based on modern educational standards and up-to-date vocational requirements and capacity building in trade policy-making and in more specialised and professional services, can be achieved through negotiated outcomes and coordinated policies at the regional level.

The governments should **consequently increase their focus on services**, aiming to create an **integrated regional services market**, in priority sectors at first, by gradually, introducing more liberal and procompetitive trade principles in all modes of supply.

The study covers a number of issues which should assist the CEFTA Parties in developing a negotiations platform. It highlights some of the key challenges and possible approaches to negotiating a successful outcome. Some of the key questions that would need to be discussed and decided is the legal form of a CEFTA services agreement, whether a framework agreement, and of course, the organisation and management of the negotiations process. The study offers some views and suggestions and recommendations, especially regarding the available options for negotiations, having in mind the specific circumstances of the CEFTA region. The study suggests, among other suggestions, that a statement of “Basic Principles” be adopted as a legally non-binding document setting an agreed foundation for the negotiations on trade in services.



# INTRODUCTION

Historically, there has been an absence of a services culture in the CEFTA Parties (and much wider) and poor development of the services sector (in terms of growth, range of services, quality and efficiency of services and market structure). It also resulted in a modest role of services since industry ranked top in all economic policy considerations. As a consequence most services were considered “unproductive labour” and their contribution to the efficient functioning of the economy was neglected. Even to this date, trade policies and strategies, in particular regarding services, remain a weak point of the CEFTA Parties, especially in creating regional strategies as an answer to competition from other regions.

Since the introduction of market-oriented reforms in the CEFTA Parties at the beginning of the nineties and their continuation at the beginning of the new century, considerable changes have occurred, affecting all sectors of the economy. Government export planning still mostly sets targets in the goods trade, without focusing on the activities of services exporters with the exception of sectors that contribute substantially to the national balance-of-payments, such as tourism and travel. The awareness of government agencies and economic chambers and their associations of the direct contribution of services to domestic production, export and employment, to foreign exchange earnings, and regarding other benefits, is improving. Particular services sectors were subjected to considerable transformation in the past decade on the basis of reformed legislation, in the wake of the overall transition processes. Reformed legislation and regulatory reform was supported by market-opening measures which benefited foreign direct investment and service suppliers from abroad in key economic sectors. GATS commitments were made in the process of accession to the WTO by four out of eight CEFTA Parties, while other three are in the process of negotiating their schedules of services commitments. The CEFTA Parties have benefited from their relations with the European Union through the stabilisation and association (integration) processes, and through interim agreements, which aim to progressively establish a free-trade area between the European Union and the Western Balkans area. Where trade is concerned, they focus on liberalising trade in goods. In the area of services some Parties have undertaken autonomous liberalisation measures to improve their economic development prospects. Market-opening measures put strong pressure on the adjustment of the services sector, domestically. Large shifts took place in favour of value-added services increasing employment in the services sector and in favour of foreign direct investment growth (FDI) in services in crucial sectors of the economy. Foreign ownership and activities of foreign affiliates became dominant in key, so called infrastructural sectors, such as financial services and telecommunications. These brought into the services markets of the CEFTA Parties new technological developments and innovation, segmentation and specialization. The share of services

in the total value-added began to increase dramatically as well as in overall employment in a matter of a few years. As indicated, the most evident shift in services-related dynamism is a strong presence in all CEFTA Parties of foreign affiliates in key sectors, primarily in banking and telecommunications.

The conclusion of the CEFTA 2006 as a single free trade agreement brought a new opportunity for the Parties to further strengthen their regional economic links, links with the rest of Europe and the world, with a commitment to extend their mutual supporting obligations from the goods trade to services. Regionally and internationally, the services trade is not only an important but an absolutely necessary complement to the goods trade. Producers and exporters cannot be competitive without access to efficient banking, insurance, accountancy, telecommunications and transport systems. An efficient services economy is a prerequisite for development and growth and for the capitalisation of economic strength and advantages. It is strongly linked to investment in infrastructure and to government services. A regional free-trade area in goods must necessarily progress into a region-wide services market.

Regulatory activity and reform of the CEFTA Parties in the area of services is a logical process for the foreseeable future. Some CEFTA Parties are taking into account the EU 2006 Directive on Services in the internal market and are considering a legal foundation for the adoption of some of the horizontal principles. However, in spite of the recognition of the importance of services as a generator of revenues and employment, foreign exchange earnings, et cetera, and the fact that they have become the topic of internal economic policy discussions, there are few national strategies for services development as a whole in the CEFTA region, with sectoral exceptions such as tourism and energy, transport. In the area of energy, although there are national strategies for the development of this sector, all measures are devoted to the production of energy, and in the area of transport, planning is devoted to transport infrastructure, rather than the development of services and competition. Some CEFTA Parties, however, have national programmes of legislative and especially regulatory review, which include services, and especially those regulatory aspects which are outdated and more onerous to both domestic and foreign services suppliers. Such programmes have been initiated in Croatia, Macedonia FYR, Moldova and Serbia.

There is a very broad spectrum of services which are generally categorized as “other commercially traded services”, which is also used for statistical purposes, which include a wide variety of economic activities that support other services and manufacturing activities which depend heavily on competitive services inputs. In policy terms these are mostly overlooked as perfectly tradable, exportable, under appropriate market conditions. In spite of a growing number of professional services providers, most of them are domestic market oriented for reasons of their economic power and obstacles in the services trade, especially on the side of export market access.

The facts and nature of the services trade are that domestic and international markets increasingly demand new and innovative services in a self-perpetuating process.

Services are based on initiative and trust, creativity to gain a market advantage. In times of economic crises services have always been the social shock absorber that provided a degree of social stability and employment. This is most evident in the existence of a substantial grey economy, for example. Technological development allows services activities to be subdivided into segments and more specialised marketable activities. A liberalisation process can allow the exploitation of the enormous potentials, for example, for cross-border trade. In this study, the services classification issue is avoided, although, it is evident that it is an important issue in the process of negotiating and agreeing services concessions, especially if sectors are segmented into subsectors and specific activities. In some case, it would necessary to agree on the definition of some of the activities to ensure equal understanding.

The structure of the study is composed of 7 Chapters that are further subdivided into sections and where appropriate sub-sections. The Chapters cover topics such as the current levels of liberalisation of services within the CEFTA Parties, statistical challenge, regulatory challenge, characteristics of the CEFTA Parties' services markets, approaches to regional liberalisation of services trade, the case of the ICT sector. Each chapter provides a description of the current status in all CEFTA Parties and also possible solutions, recommendations to the subsequent initiation of the liberalisation process in trade in services. The services sector is analysed from the point of view of GATS commitments, existing legislation and policy in specific sectors, available statistical data and share of trade in services, regional and European perspective of trade in services.

The analysis is limited in scope to several sectors serving as examples to make a point on the existing obstacles in the services trade and possible approaches and targets in negotiations. An in-depth analysis would require an examination of the whole regulatory hierarchy of each CEFTA Party and other trade related conditions, which, ultimately the Parties may need to do themselves. The intention of the study is to assist the Parties to determine the necessary preparations for a more analytical approach to the services negotiations and for the conduct of appropriate preparations.

# 1 CURRENT LEVELS OF LIBERALISATION OF SERVICES WITHIN THE CEFTA PARTIES

## 1.1 GATS and WTO Membership

The General Agreement on Trade in Services (GATS) entered into force in 1995 and is the largest agreement that covers all existing services that are divided into 12 sectors. The most important obligations that Members have to comply with under the GATS Agreement are the market access, national treatment and the most-favoured-nation (MFN) principle.

When a country accedes to the WTO it has to undertake commitments in services sector that are materialized in a schedule of specific commitments that covers horizontal and specific commitments, as well as a list of MFN exemptions.

This chapter will provide an overview of the WTO schedules of commitments and services offers of 6 CEFTA Parties, namely Albania, Croatia, Macedonia FYR, Moldova, Montenegro and Serbia. Bosnia and Herzegovina has refused to provide the national services offer due to the fact that it was considered confidential information that could not be made public and was felt that it could potentially jeopardise the current WTO accession negotiations. UNMIK Kosovo does not have a GATS services offer due to unfulfilled preconditions for potential membership in the WTO.

Therefore, for the six CEFTA Parties the analysis will focus on the horizontal and specific commitments, MFN exemptions. It will show the breadth and depth of commitments, provide a summary view in the region, as well as comparing the commitments among CEFTA Parties and other WTO Members. Market access and national treatment obligations will be examined, as well as the coverage of the 4 modes of supply:

- Cross-border supply;
- Consumption abroad;
- Commercial presence;
- Presence of natural persons.

Four of the six CEFTA Parties have negotiated and joined the WTO after 1995, when the GATS agreement was already in force. Out of the CEFTA Parties, only Albania, Croatia, Macedonia FYR and Moldova are WTO Members and Members of the RAMs group (“recently acceded members”), while the others are still at different stages of the accession process, with the exception of UNMIK/Kosovo. It is to be mentioned here that the accession

process and negotiations of most CEFTA Parties were tougher and more intensive, when the newcomers were under pressure to liberalise and open their markets much more than the founding members of the WTO. This is reflected in the level of commitments both in goods and services area.

The analysis will cover the available WTO schedules of Albania, Croatia, FYROM and Moldova, and the services offers of Montenegro and Serbia.

## 1.2 Horizontal Commitments

Horizontal commitments refer to horizontal limitations applying across all sectors contained in the relevant schedule. On a horizontal level Croatia, FYROM, Moldova and Serbia have covered all sectors included in the schedule, while Albania and Montenegro have limited to several sectors such as real estate, temporary entry and stay of foreign natural persons, legal entities etc. All the parties have included in their commitments limitations related to commercial presence (mode 3) and movement of natural persons (mode 4). Limitations related to mode 3 cover such aspects as registration of the foreign company on the territory of the country, exclusive rights and limited number of operators on the market, access to real estate and treatment of foreign legal entities.

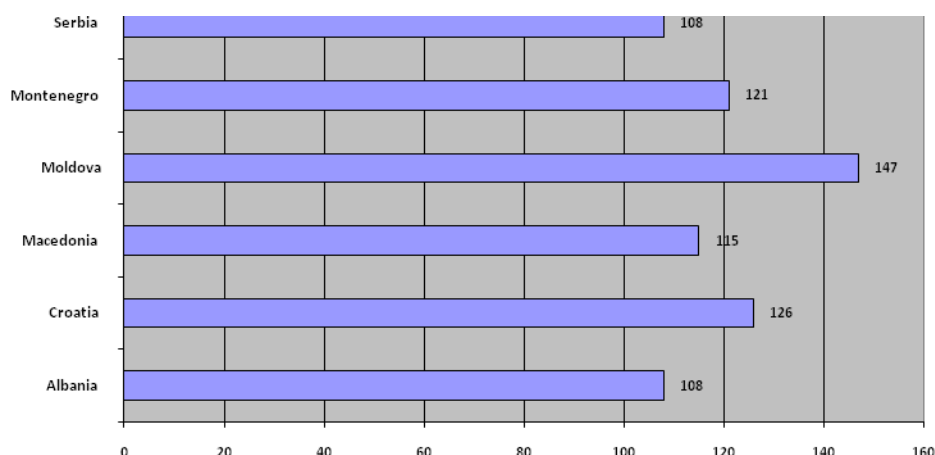
Land has also been regarded as a sensitive issue that cannot be owned by foreigners, especially agricultural land.

A major importance is given to mode 4 where parties have no commitments with the exception of some specific groups of highly skilled labour force that are allowed to enter on a temporary basis. These categories include intra-corporate transferees, business visitors, specialists with high level qualifications, contractual service suppliers. Mode 4 is generally very restrictive across all schedules, where the highest levels of commitments that can be found are undertaken by Moldova and Albania on national treatment obligation.

## 1.3 Sectoral Coverage

An important feature of CEFTA Parties is their high level of scheduled service sub-sectors. Compared to a WTO Member that has on average included no more than one-third of the 160-odd sub-sectors, a CEFTA Party has more than two-thirds out of the total sub-sectors (see chart 1). The fact that CEFTA Parties have committed more sectors than other developed WTO Members can be explained to be due to a variety of factors, including the special context of the accession process, costs of non-membership, limited capacity to negotiate efficiently and lack of very well defined priorities on a national level due to serious institutional limitations. As a rule, the CEFTA Parties that have negotiated their membership in the WTO, and those that are in the process of accession, didn't or do not base their negotiating positions on an analytical and impact assessment approach. Also in the case of the CEFTA Parties who are WTO members, the services industry has progressed and new legislation has been introduced and therefore the services schedules may not reflect the actual state of liberalisation. The Trade Policy Review for Croatia of February 2010 specifically states that the actual services regime in practice is more liberal than its GATS schedule.

**Chart 1. Number of scheduled sub-sectors by country**



Source: WTO GATS schedules of commitments and services offers of CEFTA Parties

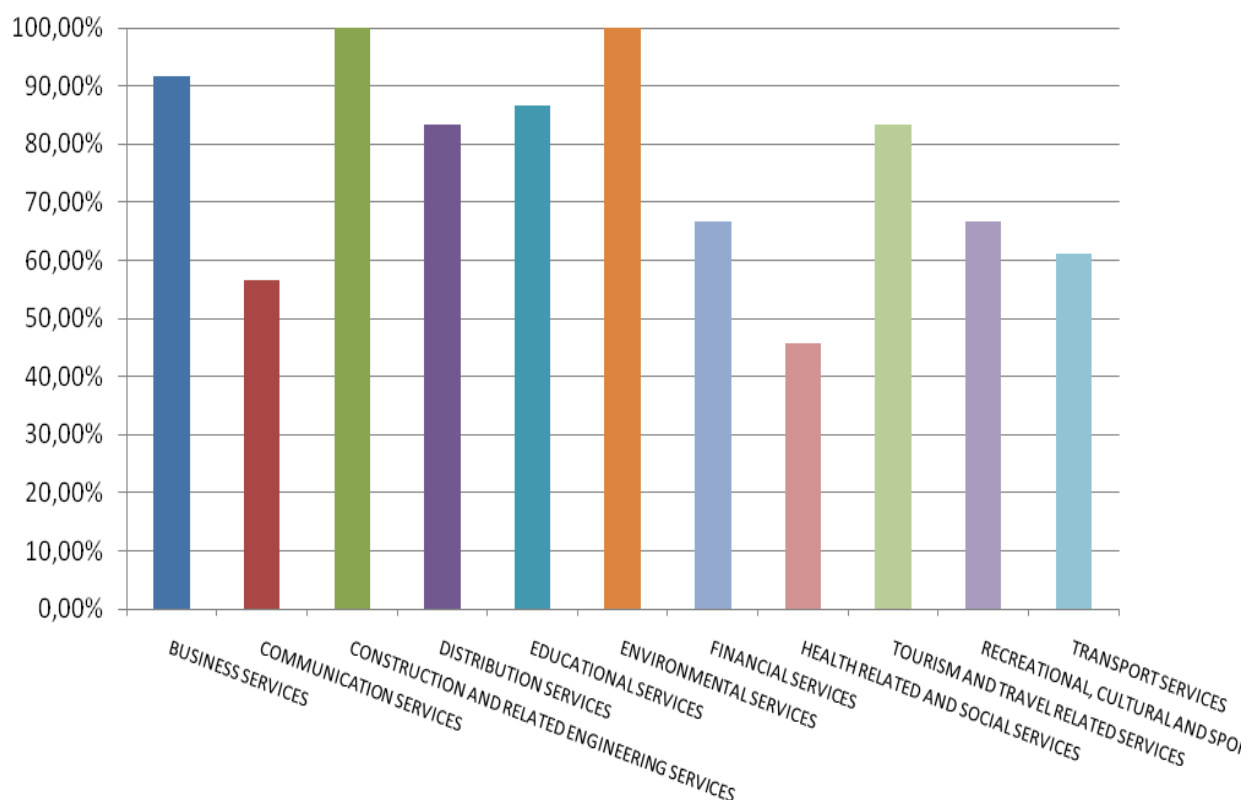
Sector specific commitments of the CEFTA Parties show a similar pattern as the overall commitments undertaken by those WTO Members that have acceded after 1995, covering all 11 sectors of the sectoral list and the respective sub-sectors. The highest level of coverage refer to construction and related engineering services, environmental services and business services. These are followed by distribution, educational and tourism and travel related services. While the tourism sector is commonly included in the schedules of other WTO Members due to the fact that tourism has been traditionally open to foreign investment (mode 3) and lack of restrictions for consumption abroad (mode 2) represented an important factor in attracting more tourists, distribution and educational services are an outstanding feature of the CEFTA Parties concerned compared to the majority of WTO Members that have not included these sectors in their schedules.

Financial services have a full coverage in the CEFTA Parties schedules and offers, as there are many foreign-owned as well as privatized banks. Transport services are also covered by all CEFTA Parties, while such sectors as maritime transport and internal waterways transport are absent in some schedules of commitments, but this can be explained by the specific geographical land-locked position of a Party.

Health related and social services have the lowest coverage among CEFTA Parties concerned due to the sensitivity of these domains that also reflects the national interests in ensuring proper regulation, as well as an apprehension towards allowing private commercial presence in the sectors.

The Chart 2 below shows the proportion of sectoral commitments by the CEFTA Parties in percentages of sectoral coverage.

**Chart 2. Proportion of sectoral commitments by CEFTA Parties (% of sectoral coverage)**



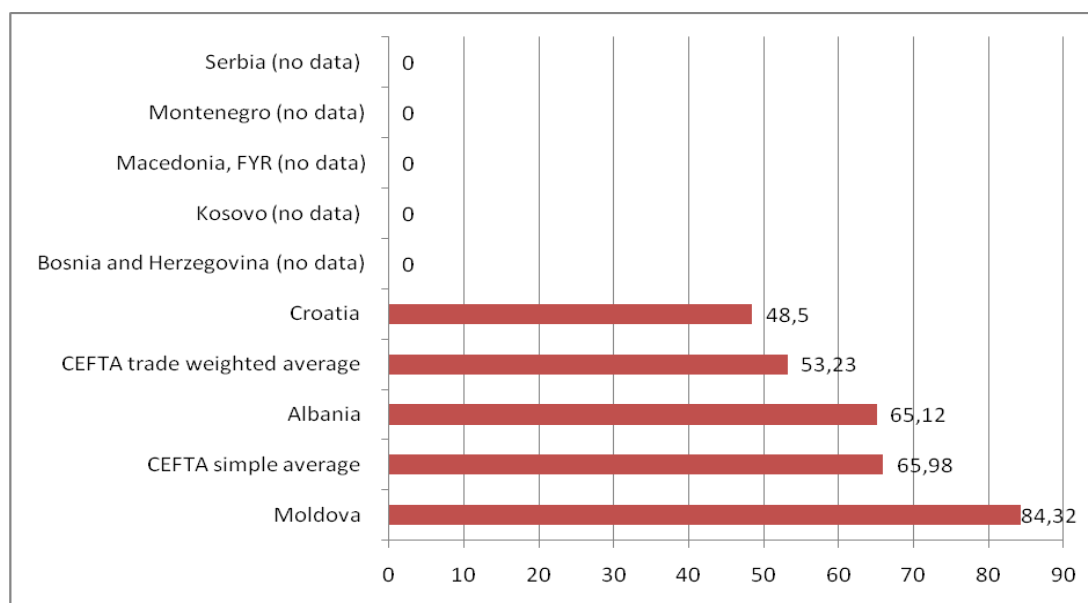
Source: WTO GATS schedules of commitments and services offers of CEFTA Parties

According to the GATS commitments index<sup>1</sup> elaborated by the World Bank, the level of GATS commitments can be measured not only by sectoral coverage, but also by the level of treatment bound for each committed sector. The index rather shows the level of access that Members were willing to guarantee.

As is shown in the chart 3, out of the analysed CEFTA Parties, Moldova is placed in this ranking on the first place, being more liberal and having a larger share of commitments. Moldova is followed by Albania, while on third place is situated Croatia. On average CEFTA would have an index of 65.98.

<sup>1</sup> GATS commitments index - all service sectors (12) - This indicator measures the extent of GATS commitments for all 155 services sub-sectors as classified by the GATS and in the four modes of the GATS (0-100, most liberal).

**Chart 3. GATS commitments restrictiveness index - CEFTA Parties (all sectors -2006-2009)**



Source: World Trade Indicators 2009/2010, World Bank

## 1.4 Market Access – Depth of Commitments Across Modes

According to Article XVI of GATS, WTO Members have the right to designate the sectors in the schedules of commitments where they assume obligations in the four modes of supply. Parties may indicate limitations to the commitments so that it would offer the right to apply measures that are inconsistent with full market access or national treatment provisions.

There are six types of market access restrictions that must not be maintained in the absence of limitations: (a) the number of service suppliers; (b) the value of service transactions or assets; (c) the number of operations or quantity of output; (d) the number of natural persons supplying a service; (e) the type of legal entity or joint venture; (f) the participation of foreign capital.

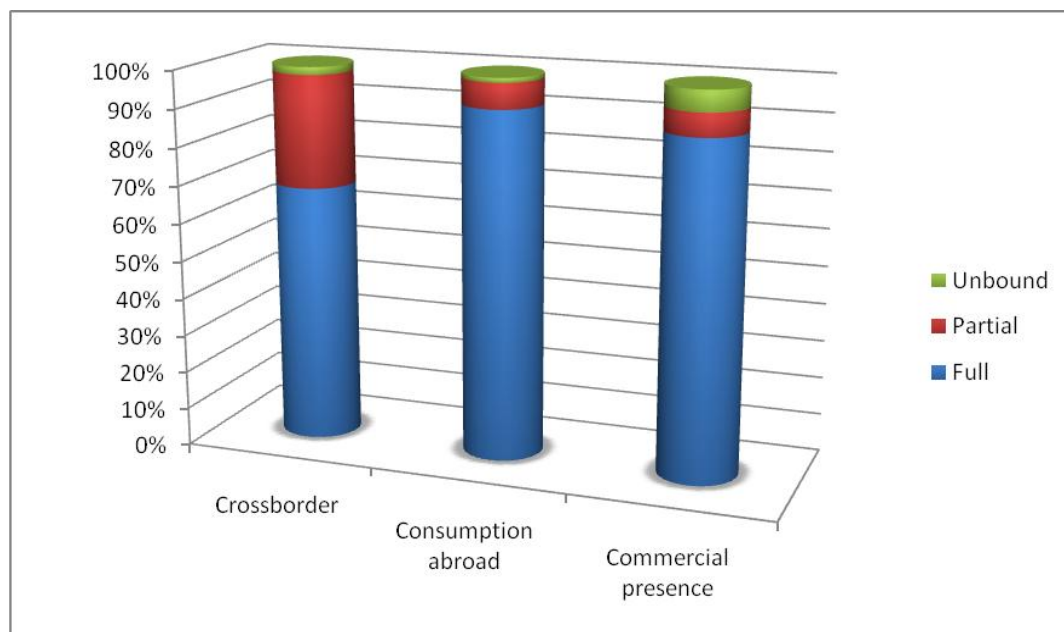
For the purposes of this study there were identified 3 categories of commitments in order to show the depth of commitments across modes of supply. These categories are the following: full commitments (where there are no sectoral specific limitations, entries as „none”), no commitments (indicated in schedules as „unbound”) and partial commitments where some limitations have been provided.

The level of commitments in mode 1 to 3 differs from that of mode 4 and these 2 groups can be characterized by different approaches. Commitments in modes 1-3 have a tendency to open and liberalise fully, while some limitations are included due to several reasons that a Party may consider important to preserve national interests. Regarding mode 4, it is to be noted that the situation is different when on a horizontal level very limited commitments are taken and are mostly related to movement of specialised personnel, well-qualified and that are not available in the said Party. The period of stay of such professionals is also limited in time, with some possibility of extending it. The commitments in mode 4 also depend upon commercial presence of a specific business.



Chart 4 shows the average depth of commitments of the 6 CEFTA Parties in market access for the 3 modes of supply, covering all sub-sectors in the schedules due to the high level of coverage and liberalization across the lists.

**Chart 4. Level of commitments in market access (CEFTA Parties)**



Source: WTO GATS schedules of commitments and services offers of CEFTA Parties

The highest level of liberalization is observed in mode 2 (consumption abroad), where the full bindings are at a level of 92%. This reflects a general trend for all WTO Members, especially the Baltic states. No limitations in mode 2 may be explained by the fact that states cannot control their nationals abroad and that there are no mechanisms to monitor their activity. Additionally, this opens up new opportunities for nationals from other WTO Members to use services abroad that would bring higher revenues to the host country. Thus, the opening of mode 2 would lead to mutual benefits, but that does not mean that there is a preference for mode 2 commitments.

The second highest ranked in terms of liberalisation is mode 3 (commercial presence) with a share of approximately 88%. This is above the world average which is roughly 70% of all services supplied. Mode 3 again is an important tool for opening the market and attracting foreign investments. This argument is considered to be valid for smaller and less-known markets, such as the case may be for CEFTA Parties. The governments would prioritize and promote favorable conditions for FDIs, attracting foreign investors and international companies. Additionally, there are many bilateral investment agreements that refer to mutually protecting investments and non-discrimination. The existing limitations for mode 3 in the schedules relate to conditions on registration of companies, foreign equity ceilings, exclusive rights to provide a service. There are few sectors where such limitations apply such as financial services and telecommunications. In such sensitive sectors as health, education, environment, the Parties are not fully open for private sector access and maintain some specific requirements.

Mode 1 (cross border supply) is the one with the most limitations that account to

approximately 29.74%. A higher number of partial commitments and non-bindings in this mode reflect the specific features of some sectors, such as health services, education, environmental services etc. Also, in cross border supply there are no expressly stated rules on the obligations of trade partners; there are fewer mechanisms to intervene for regulatory purposes or other strategic policy reasons. More limitations in mode 1 are supposed to stimulate trade under mode 3 which is perceived as a means to attract more foreign investments and expertise, which does not mean that more investment wouldn't follow a more open mode 1 trade, once a client base develops.

Nevertheless, it is to be mentioned that the importance of mode 1 is considerably growing worldwide, especially with the development of new communication technologies. The potential for cross border trade is acknowledged and new offers have been put on the table in the Doha Round. Even such sectors as education or health that traditionally have not been regarded under mode 1, now become more and more realistic with the use of e-medicine and e-education.

## 1.5 National Treatment – Depth of Commitments

Article XVII of GATS stipulates that Members should not discriminate among national and foreign suppliers thus modifying the rules of competition. Members may list the relevant limitations they wish to keep that are not consistent with national treatment principle, though Article XVII does not contain the types of restrictions that can be applied as compared to the market access provisions.

Compared to the market access limitations specified in the schedules of the CEFTA Parties concerned, the national treatment limitations column has very few entries, the liberalisation reaching a very high share of more than 90%. This trend can be seen throughout the 3 modes of supply.

On the sectoral level a common pattern for CEFTA Parties are the limitations that refer to nationality and residency requirements for foreign companies, some qualification requirements and experience. These are very frequent in other WTO Members schedules as well.

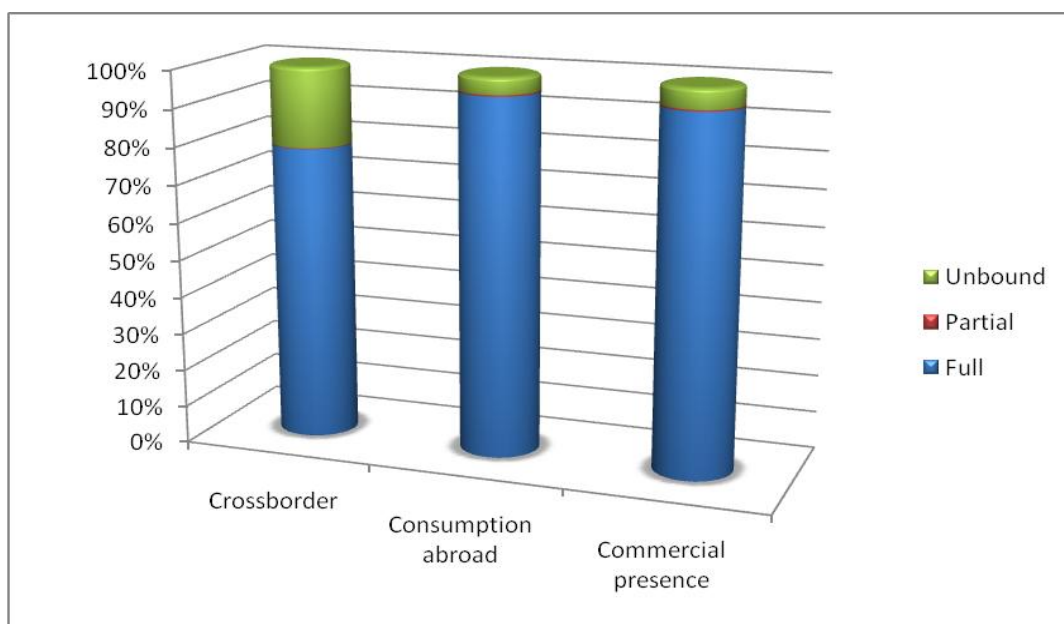
National treatment limitations are normally included in the horizontal commitments that have an impact on the whole schedule. On this level the Parties concerned indicated limitations related to ownership of land, especially agricultural land, access to subsidies, acquisition of real estate. Land-related restrictions seem to be a predominant factor in all schedules, which shows more control over agricultural land and state ownership. Generally, there is a tendency to rely much more on horizontal limitations than on sectoral ones which has an impact on transparency.

The sectors that are most targeted in national treatment limitations are financial and professional services, to some extent educational, transport and environmental services are also touched upon.

Generally, it is claimed that horizontal limitations related to restrictions for land ownership or access to subsidies may be less trade-restrictive than the sector-specific measures. There

are alternatives to renting or leasing land (that could be for as long as 99 years) instead of purchasing it, thus reducing the economic disadvantages related to it. The most relevant sectors that are subsidized are education, health and social services, which are mainly public sector domains. Thus these limitations do not seem to create important obstacles to trade in services, by themselves.

**Chart 5. Level of commitments –national treatment (CEFTA Parties)**



Source: WTO GATS schedules of commitments and services offers of CEFTA Parties

## 1.6 MFN Exemptions

While analyzing the List of Article II (MFN) Exemptions of all the six Parties (table 1), common features and similarities with the majority of WTO Members may be observed. CEFTA Parties have included in their schedules 3 sectors that can be found in the lists of recently acceded parties, specifically the Baltic States. These refer to road transport services, audiovisual services and sale and marketing of air transport services (CRS) (except Croatia). Road transport limitations result from existing or potential bilateral/regional/international agreements that regulate this area and relate to specific conditions and characteristics of the transport services. In audiovisual services more favourable access was granted to EU members in view of preserving European culture and further prospects of the EU integration processes. Air transport services exemptions refer to the fact that parties sign bilateral air transport agreements that incorporate the reciprocity principle, due to the fact that there is insufficient development of multilaterally agreed rules for the operation of CRS.

The fourth common sector that can be found in the MFN exemptions of Croatia, FYROM, Montenegro and Serbia is real estate. Property may be acquired under the reciprocity requirement specified in relevant national laws. It is to be mentioned that though Croatia has indicated it as a temporary exemption, other Parties maintain it for an indefinite period.

Legal services are covered by the lists of 3 Parties (Macedonia FYR, Montenegro, and Serbia) by claiming a reciprocity basis, while Montenegro and Serbia have included in their

draft list of MFN exemptions all sectors that relate to movement of natural persons favouring EU countries and countries in the region.

**Table 1. Number of MFN exemptions by country**

	<i>Albania</i>	<i>Croatia</i>	<i>FYROM</i>	<i>Moldova</i>	<i>Montenegro</i>	<i>Serbia</i>
Audiovisual services						
Road transport services						
Sale and marketing of air transport services						
Real estate						
Legal services						
Educational services						
Internal waterways transport						
Rail transport services						
All sectors						
<b>Total – no. of sectors with MFN exemptions</b>	<b>3</b>	<b>3</b>	<b>6</b>	<b>3</b>	<b>6</b>	<b>8</b>

Source: WTO GATS schedules of commitments and services offers of CEFTA Parties

## 2 THE STATISTICAL CHALLENGE

Regarding the needs of a variety of users of up-to-date statistical information regarding services, for analytical purposes, be it the international institutions as well as academics, and governmental institutions, it is widely recognised that there is a problem of reliability and availability of sufficiently complete data on the services trade, especially, at bilateral or regional levels. The deficiencies in the basic data collection are well known. There are many economic activities which are not directly observed through the standard statistical surveys. Major services sectors such as tourism, transport, financial services (pertaining to banks and insurance companies) may be well covered on the basis of specific methodology. The methodology, for example, of tourism statistics is being constantly upgraded and improved and methodology is being harmonized through international seminars and within the World Tourism Organisation. Central banks, as is the case in the CEFTA Parties, follow the IMF methodology and Manual on Statistics of International Trade in Services, a joint publication of six international agencies. The IMF approach is based on balance-of-payments statistics, the source of data compiled by the national banks are commercial banks that are reporting on financial transactions of companies related to services. In the system of national accounts the main sources for the GDP calculation are the financial statements compiled by the national banks. This is the prime source providing coverage for defining the active status of enterprises. This source can be unreliable due to failure to submit financial statements or due to inaccuracies.

Inevitably, not all aspects of the services trade are covered. For example, from a GATS mode of supply aspect the coverage of services is not factored in any statistical survey that would in any way correspond to the GATS context. The largest group of services by type, generally referred to as “other commercially traded services”, is shown in aggregate, by value of exports and imports in relation to the world. Statistical focus may be on trade with the European Union and other large markets. Some independent surveys show, for example, the largest services companies by annual turnover in South East Europe, that indigenous. There are approximately 15 companies or groups in the CEFTA 2006 region that have the potential to become greater regional and international players, i.e. to become multinational companies and investors. The strength of the companies is mostly in distribution services, financial services, and business services.

National bureaus of statistics normally show aggregated levels of trade of goods and services. Analytical approaches to the services are rare pertaining to the CEFTA region, or, they are not up-to-date. If there are any, these are analyses of independent institutions that analyse specific sectors (such as the OECD and the WTO). Statistical information is included in the TPRM documents (for Albania and Croatia), to a certain extent.

Important segments of the services trade within the CEFTA region remain either underreported or unreported. The existence of the so called “missing economic activities” suggests that the GDP figures published by national statistics offices exclude large parts of the economy. This particularly applies to services. It is difficult to account for certain types

of activity, which cannot be observed and measured directly by official statisticians. There is no unified methodology or approach to measuring the grey economy in services, which, according to general agreement is widespread in South-East Europe. In the area of catering and tourism, construction, there are unreported capacities and unreported income and so called “black” employment. Estimates of the share in the GDP are from 10% to almost 37%. By some estimates, in one of the CEFTA Parties more than 70% of construction activities are not reported, including construction work abroad, to the tax authorities. There is also the problem of underreporting and inaccurate reporting by legal entities. Highest incidence is in construction, retail and wholesale trade, hotels and restaurants, real-estate renting and business activities, transport and storage. On the transactions level between firms, important services may be not visible, since they can be hidden within contracts and are not specifically invoiced, which means that the commercial banks, which are the source of information on payments for services, may not detect that any services have been traded. Statistics also do not cover important segments of the services trade that influence the balance-of-payments, such as the localized cross-border trade, transactions of domestic companies with large foreign affiliates (which in fact is a mode 1, mode 2 and mode 3 situation). Most available figures on international trade in services apply to modes 1 and modes 2 (as they are based on international payments), mode 4 is captured by rough proxies, such as compensation of employees (by foreign companies) and workers' remittances from abroad. Services firms also earn (de facto) foreign exchange by supplying local foreign banks and companies, from business persons temporarily in the market, local representative offices, international organizations and representatives.

It is a fact, that the services trade within the CEFTA region is not recorded properly on a bilateral basis, since no special attention is devoted to it by relevant institutions and therefore, when estimates are made, the trade is underestimated (and often seen as less important at least by volume). Nevertheless, the development of accurate national statistics within appropriate frameworks (on a bilateral basis) on the services trade, based on modes of supply, would better serve the purposes of regional economic integration and help identify opportunities and would enable to measure the impacts of trade liberalisation and services outputs. This will remain a challenge, when it is considered that information technology, coupled with telecommunications, have made virtually all services tradable through one mode of supply or another. Where there are a large number of small enterprises in the economy, the unreported economic units could run into the thousands, employing a large number of undeclared employees, especially if they function in a system of unofficial relationships which correspond to unincorporated enterprises.

The situation of statistical coverage of the services economies of the CEFTA Parties and analyses has been discussed to a limited extent during the visits of the respective capitals. Officials are aware that there is a lack of information that would equip them for the purposes of negotiations on trade in services. The information obtained is the following:

### Albania

There was a separate meeting with the Bank of Albania, as well as the (private) Chamber of Commerce and also the non-banking financial services regulator.

The Bank of Albania provided written material, a statement, on the external sector developments in the Albanian economy, up to the second quarter of 2009, which contained an explanation of the methodology used to measure foreign payments transactions. The paper shows a services account balance and a trend. Albania has a slight surplus in travel services which are the predominant services sector with a share of 75% on the revenue side

and 71% on the expenditure side. This indicates poorly developed services in other sectors and very limited diversification. The rate of growth of travel services is approximately 20% per annum.

The methodology used for the compilation of balance-of-payments statistics is the IMF methodology, published in detail in official publications of the Bank of Albania.

The Chamber of Commerce was unable to provide any useful information. The financial services regulator provided statistics on financial services (mainly insurance), which show that 97% falls to compulsory insurance. Albanian insurance companies export their services to neighboring areas.

### Bosnia and Herzegovina

The central statistical office does not cover the services trade as such. It depends on inputs from the two entities. The Chamber of Economy could only provide specific information on tourism which is the only service sector that is centrally regulated. A table that was provided shows the overall balance in the services trade in net value terms and services payments and revenues for construction and unspecified "other services". The table shows a positive growth in services exports since 1999.

### Croatia

The experts were referred to the data contained in the Trade Policy Review of Croatia of February 2010.

The Chamber of Commerce and Industry (privatised) was unable to provide any specific information on the services trade.

### Macedonia FYR

During a special meeting at the National Bank of Macedonia a methodology paper was provided as well as useful oral information.

Statistics for the balance-of-payments are prepared in accordance with the methodology of the International Monetary Fund (IMF), i.e. on the basis of the Balance of Payments Manual, 5<sup>th</sup> edition.

The main source of information are the commercial banks that provide reports on international payment operations (ITRS) and monthly reports on other receipts and payments of non-residents. There is also a single administrative document for foreign trade. The main data categories are all forms of transportation, construction, and all "other services". The specialised services chamber (a private association of mostly consulting companies) does not analyze the services trade nor collect information, with the exceptions of exports of consulting services by its members.

### Moldova

Information was provided on the basis of a questionnaire by the Bank of Moldova, in a table showing services sectors and current account balances for a period of five years in millions of US dollars. The information covers transport, tourism, communications services, construction services, and "other" services.

There is no specific explanation on the methodology. The data shows a surplus in transport and communications services and an overall deficit of roughly 15%. The latest table for the period 2009-2010 period shows a more detailed presentation of credit and debit for selected services (including construction, financial services, computer and information services, royalties, license fees, other business services). The information is useful in order to determine the main exporting services sectors.

#### Montenegro

A system of data collection and output measurement is developed for the tourism sector and overseas shipping.

#### Serbia

A meeting with the representative of the Bank of Serbia provided information on the system of data collection on the basis of international payments transactions and reporting by commercial banks, which are the only source of information. Due to strict currency controls, any international payment is possible only through bank channels as well as receipts. On that basis, it is possible to determine the payments transactions and receipts from other CEFTA Parties. Services are coded. However, there is a possibility that not all services trade is covered or that banks do not specifically pay attention to accurate reporting on the services trade if that is hidden within other business transactions. There is no reporting by companies as there is no legal obligation, other than financial reports. Foreign accounts are not allowed, unless specifically authorised, for example for overseas construction projects.

Recent methodological changes in Serbia have revealed a deficit in the services trade.

Other statistical methods are being developed by the Office of Statistics in cooperation with the Chamber of Commerce of Serbia.

#### UNMIK/Kosovo

No specific information was made available relevant to statistical coverage of services and trade.



### 3 THE REGULATORY CHALLENGE

The regulation of core services activities sector by sector differ considerably from one CEFTA Party to another. The individual Parties have different approaches to the regulation of specific sectors, different requirements, which is of course normal. Regarding the specific requirements from the modes of supply point of view, some of the Parties are more restrictive than others. Some Parties are, in specific instances, significantly more liberal. This requires careful study and comparative analysis, sector by sector and at the subsectoral level or even lower. In such a way it is possible to identify the specific barriers to trade in services, protectionist measures, where they exist.

The existing analyses of regulatory systems of the Parties are few, not up-to-date, and are usually limited to a few chosen sectors. The differences in regulatory approaches and in the levels of restrictiveness can be exploited for the purposes of negotiations by taking the best practices of a Party as a basis for liberalization of a particular sector by other Parties.

According to one of the used World Bank's Governance Indicators<sup>2</sup> – Regulatory Quality that captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development, most of CEFTA Parties are situated among the countries that are ranked at a medium level of regulatory quality. The highest percentile was attributed to Croatia (66.7), followed by Macedonia FYR (58.5), while the lowest rank goes to Serbia (47.3) (see the chart).<sup>3</sup>

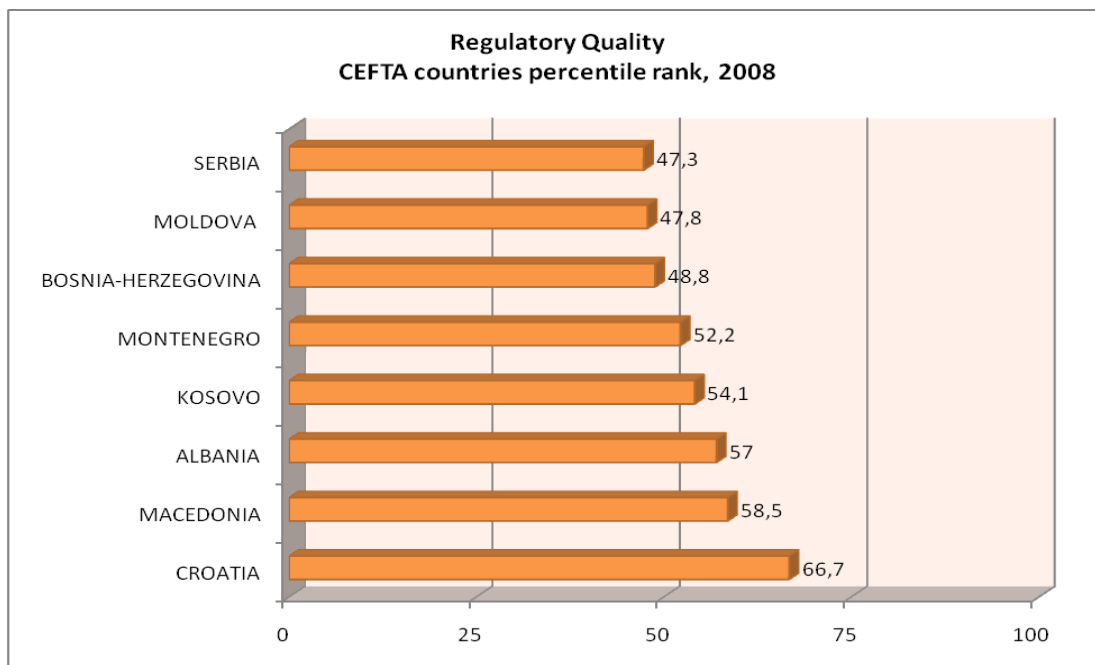
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<sup>2</sup> Worldwide Governance Indicators include six governance dimensions: i) Voice & Accountability, ii) Political Stability and Lack of Violence/Terrorism, iii) Government Effectiveness, iv) Regulatory Quality, v) Rule of Law, and vi) Control of Corruption.

<sup>3</sup> Concept measured – Regulatory Quality. Representative Sources: Export Regulations; Import Regulations; Other Regulation burdens; Restrictions on ownership of Business by Non-Residents; Restrictions on ownership of equity by Non-Residents; Unfair competitive practices; Price controls; Discriminatory tariffs; Excessive protections; Stock Exchange/Capital Markets Foreign Investment; Administrative regulations are burdensome; Tax system is distortionary; Import barriers as obstacle to growth; Competition in local market is limited; Anti monopoly policy is lax and ineffective; Environmental regulations hurt competitiveness; Complexity of tax System; Easy to start company; Foreign investment; Banking / finance; Wage/Prices; Administrative business start-up formalities; Administered prices and market prices; Competition: productive sector: ease of market entry for new firms; Competition between businesses: competition regulation arrangements; Investment Profile. Tax Effectiveness: How efficient the country's tax collection system is; Legislation: An assessment of whether the necessary business laws are in place.

Non-representative Sources: Trade policy; Competitive environment; Labor Market Policies; Trade Policy and Forex Regime; Enabling Environment for Private Sector Development; How problematic are labor regulations for the growth of your business; How problematic are tax regulations for the growth of your business; How problematic are custom and trade regulations for the growth of your business; Competition Price Stability; Competitive environment; Trade policy; Price liberalization; Trade & foreign exchange system; Competition policy; Enabling conditions for rural financial services development; Investment climate for rural businesses; Access to agricultural input and produce markets; Access to capital markets (foreign and domestic) is easily available; Ease of Doing Business; Banking regulation does not hinder competitiveness; Competition legislation in your country does not prevent unfair competition; Customs' authorities do not facilitate the efficient transit of

Compared to other countries in the region such as Slovenia, Czech Republic, Slovakia, Baltic States, CEFTA Parties still require further improvements in their regulatory area, Estonia having a rank of 91.8 and the highest level among these countries.



Note: Percentile ranks indicate the percentage of countries worldwide that rate below the selected country. Higher values thus indicate better governance ratings.

Source: Kaufmann D., A. Kraay, and M. Mastruzzi 2009: Governance Matters VIII: Governance Indicators for 1996-2008

There are several problems that exist, one of them is multilayered regulation, i.e. the same services are regulated by different levels of authority, for example, at the national level, by sub-central levels of government, by local communities, by professional bodies and associations, as will be subsequently demonstrated. The other problem is sector-specific stacked (multilayered) requirements, such as double procedures, and accreditation and licensing, plus registration, beyond any practical need. The third problem is that specific measures are intended to protect the local market, including at local government levels.

There are cases where procedures are more burdensome than necessary and extreme cases where an applicant finds it very difficult to meet the requirements. There are exclusionary measures. In the procurement area, there are often long lists of requirements for foreign bidders to meet. There are sector specific limitations on specific modes of supply, including mode 3. There are such requirements for foreign providers, firms and individuals, to establish binding or non-binding associations in the local market and/or relations with domestic services suppliers in order to alleviate some of the more onerous market access

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goods; Financial institutions' transparency is not widely developed in your country; Easy to start company; Foreign investors are free to acquire control in domestic companies; Price controls affect pricing of products in most industries; Public sector contracts are sufficiently open to foreign bidders; Real corporate taxes are non distortionary; Real personal taxes are non distortionary; the legal framework is detrimental to your country's competitiveness; Protectionism in your country negatively affects the conduct of business in your country; Labor regulations hinder business activities; Subsidies impair economic development.

requirements. Cross-border supply, in some cases is prohibited, for lack of regulatory and supervisory capacity. In fact, in some CEFTA Parties, for their services companies that mainly supply to the local market *internal obstacles* to trade in services are more crucial than the external obstacles. That is an important aspect even for services companies that export, because they still do most of their business domestically. This is the case for a majority of small service companies.

There are specific cases (especially in the area of professional services) where the lack of mutual recognition of qualifications, i.e. where reciprocity has not been established but is required, is a direct market barrier for foreign service suppliers. Applied are also economic needs tests and labour market tests. In extreme cases, a perception that there is no need for new entrants in the market is a non-regulatory barrier. Under the circumstances of a more liberal market in services there are two issues that arise and need to be addressed. One of them is efficient consumer protection and the other is unethical practices, especially in the area of IT generated services. These are existing reasons for caution in the area of liberalisation. In one particular case a CEFTA Party believes that mutual recognition agreements are not necessary. It believes that its own domestic system of verification of professional qualifications is sufficient (although it takes at least three month for the process to be finished and the final decision is arbitrary).

Some of the CEFTA Parties have embarked upon national programmes to review their regulations (Croatia, Macedonia FYR, Moldova, Serbia) in order to reduce their numbers and update them in accordance with current economic needs and align them with European standards. This poses a challenge because the regulations are numerous and have been accumulating due to a tendency to over regulate. The problem is also in duplication by the local communities and between sectors and sometimes regulations are contradictory. According to an independent source there are approximately 14000 implementing regulations in Croatia.

It can be said with some certainty that regulations, especially of a technical nature, can be equally onerous for foreign services suppliers as well as domestic services suppliers. Dealing with regulators in a market, by companies or individual service providers, requires resources. The degree of hardship for new entrants determines the dynamism and attractiveness of a particular sectoral market and above all, the ability of smaller companies and individual service suppliers, with limited resources, to enter the market and build-up a client base.

Limitations equally affect the higher skilled end of the market as well as the lower skilled end. For foreign operators, new entrants and those that wish to take over incumbent operations, all modes of supply are relevant, and especially mode 4. In practical terms, the strict application of mode 4 restrictions affects foreign investment and causes interferences in the fulfillment of contracts.

However, apart from complaints from companies that information regarding regulations and about changes is not readily available, it is generally accepted that the regulatory regimes, in practice, are in fact more lenient. For example the TPR for Croatia indicates that its services regime is more liberal than its scheduled commitments in the WTO. The other extreme is the lack of regulations which may constitute a barrier. For example, a foreign operator may not be able to obtain a license for a specialised environmental service due to the lack of appropriate regulation or legal basis, although the service is well accepted as such.

For any comprehensive assessment of full requirements in any sector, and especially at sub-

sector or activity levels, there is a need for full transparency at all levels, including professional associations. The current regulations, as a rule, do not take into account the progress and practices that have been influenced by the IT revolution and the availability of open communication networks. This allows cross-border trade that can circumvent some of the requirements for market entry. Regulators, therefore, prefer mode 3 for better control of activities.

It is also necessary to take on board the fact that certain measures not only increase the cost of doing business but affect competitiveness in the local in an export market; calculations of economic effects of restrictions and limitations are difficult and rare. However, in some sectors, such as distribution, it is an accepted fact that regulations have a cost creating effect. Apart from the economic effects of regulatory measures there are also technical requirements and administrative procedures, which can equally affect the supply of a service and its competitiveness.

At the regional level, significant progress could be made in the area of rationalisation and improvements, up-dating of services regulations, across all jurisdictions and levels in order to raise the quality of services.

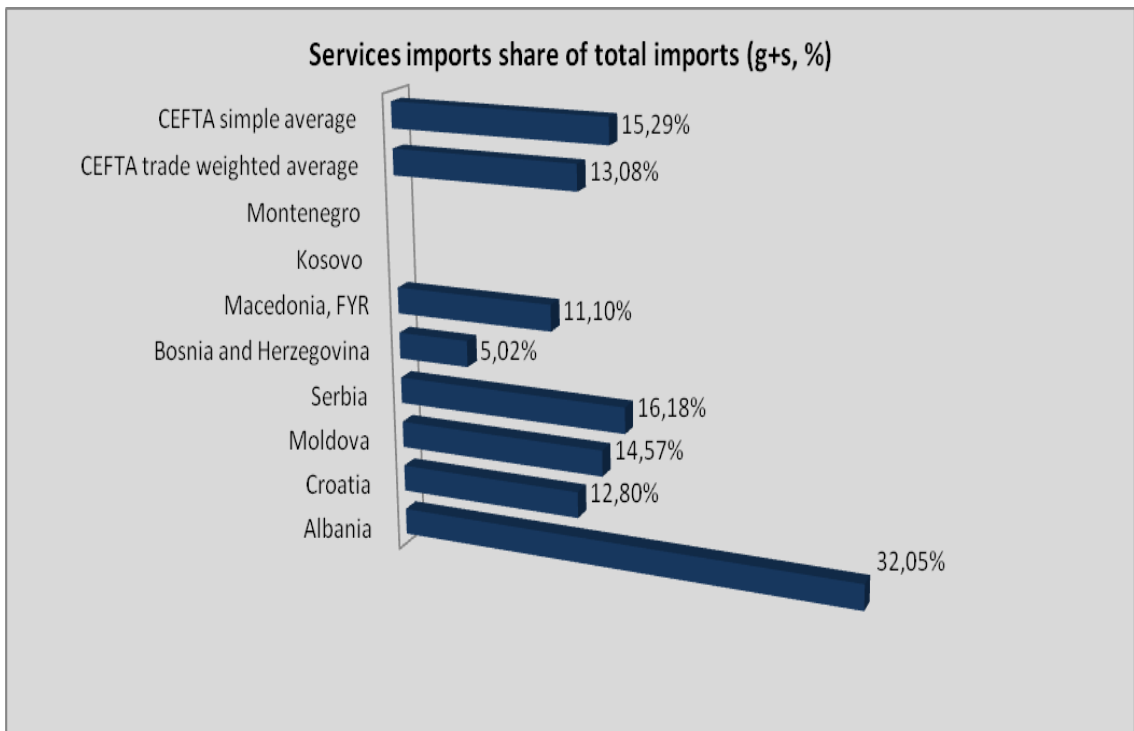
## 4 CHARACTERISTICS OF THE CEFTA PARTIES' SERVICES MARKETS

The CEFTA Parties constitute an area populated by nearly 29 million inhabitants, in an area that is heterogeneous in many respects. The Parties vary from small (of less than 700 000 inhabitants) to a medium size of 7.5 million inhabitants. The levels of economic development are different. The differences are in GDP on a per capita basis, rates of unemployment, trade balances, the structure of the economy, and effectively, in the nature of the domestic services market and international activities in the services trade. The CEFTA Parties belong in the lower middle or lower income category of economies, Croatia having the highest per capita income of € 10 600 in 2008 and Moldova having the lowest minimum salary in Europe.

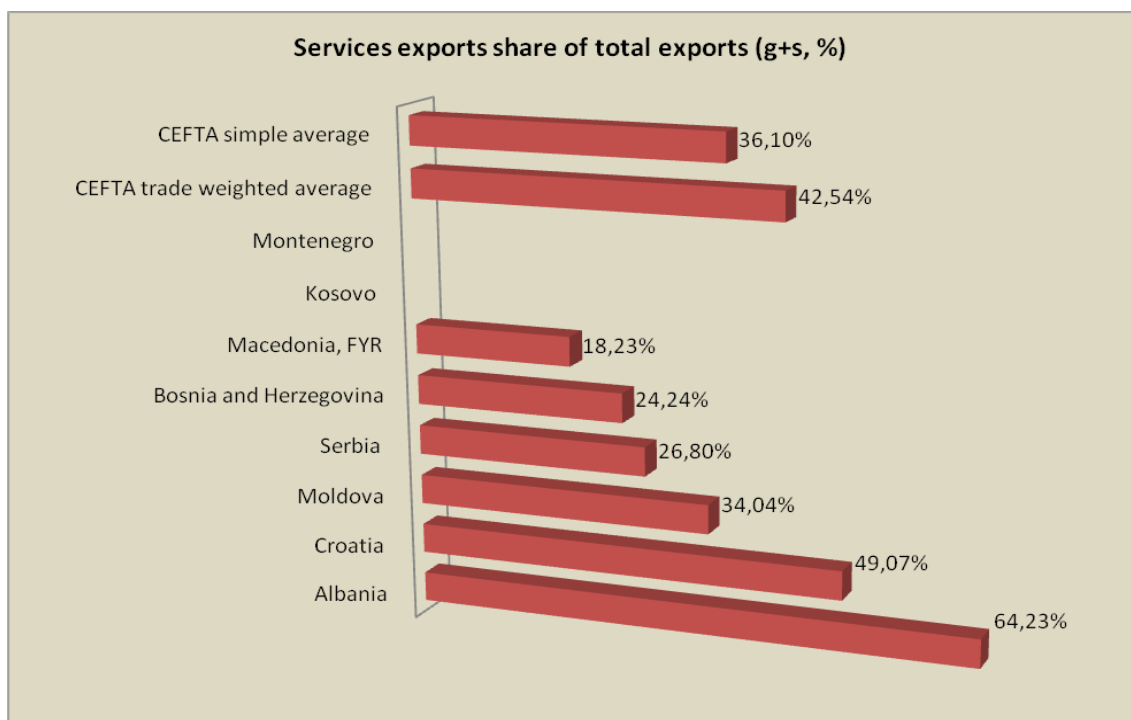
In global terms, each of the Parties world share in exports and imports of services is insignificant (in each case less than 0.05%). Jointly their global share is well below 2%. For example, Croatia's share in total world exports of services (in 2008) was 0.40% and in imports 0.13%, while Serbia's shares were 0.11% and 0.12%, respectively (source: WTO Trade Profiles).

The shares of the services trade, as it relates to overall foreign trade of the individual Parties are, of course, different and have fluctuated in the period between 2000 and 2008. Albania started at 23.7% in 2000 and its share grew to 39.5% in 2008, which is the highest percentage share of services in the total trade, compared to other CEFTA Parties. This is due to the fact, that Albania still has a large agricultural and weak manufacturing sector. Bosnia and Herzegovina's share of the services trade in its overall foreign trade was 13% in 2000 and dropped to 12.4% in 2008. For Croatia the percentages are 27.0% (2000) and 28.4% (2008). For Serbia the shares in 2008 was 16.5%, FYROM's share in 2000 was 16.2% and in 2008 it was 21.2%. World's relative average shares of services and goods trade are 20% for services and 80% for the goods trade.

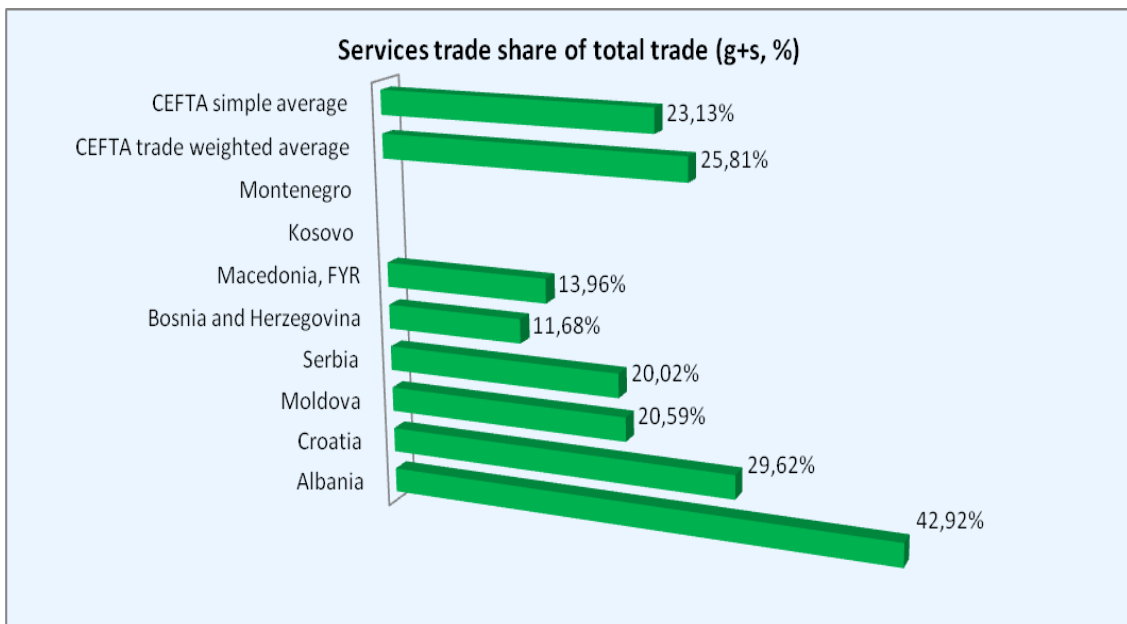
As per the World Bank data, the charts below show the importance of services trade for CEFTA Parties in their total trade of goods and services within the period of 2006 -2009 (average for these years) and the emerging leaders, as well as potential services exporters in the region. Overall, all the parties show a positive trade balance in services trade, thus providing a more meaningful stimulus for enhancement of regional trade in services. As a CEFTA simple average services exports represent 36.10% of total exports for 2006-2009, while services imports have a share of 15.29% for the same period. In the region, services have had a slow but steady growth in exports and the share in total trade has been increasing.



Source: World Trade Indicators 2009/2010, World Bank



Source: World Trade Indicators 2009/2010, World Bank

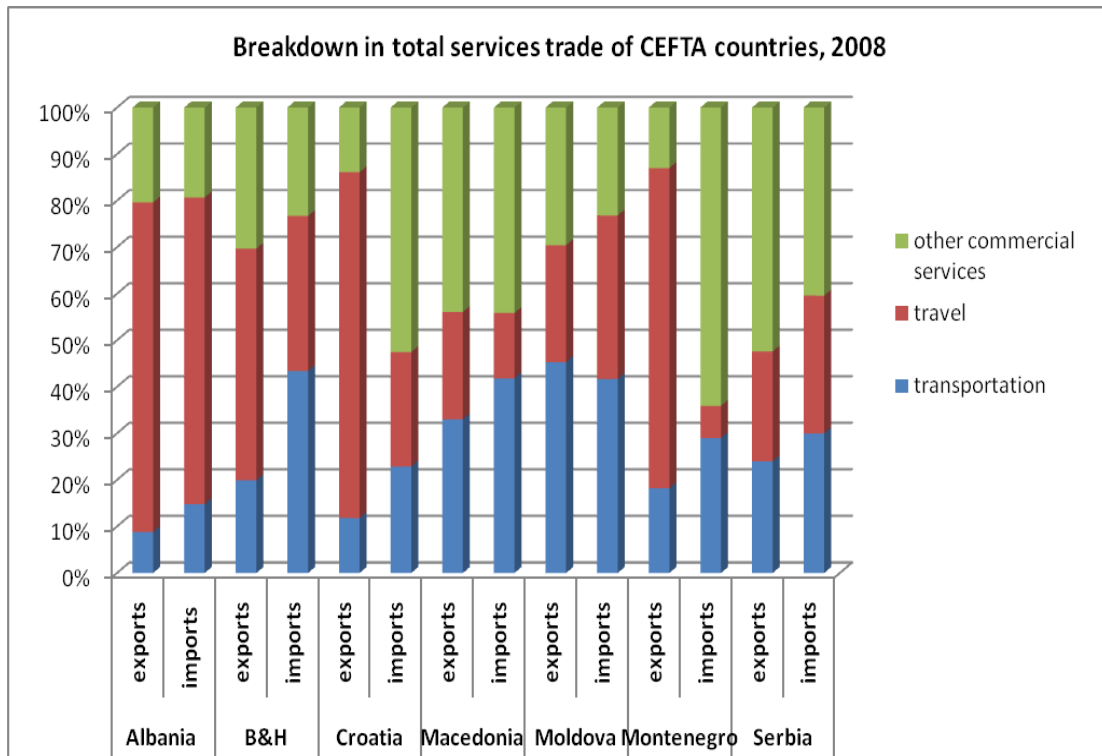


Source: World Trade Indicators 2009/2010, World Bank

In the case of Albania over 70% of the services trade accounts for exports of travel services and 65.9% of imports of travel services; transportation accounts for (only) 8.8% of services exports and 14.8% of imports; all other commercial services accounted for 20.4% on the export side and 19.3% on the import side (all data for 2008). Similar breakdowns for the other economies are shown in the chart below.

Among the dominant, and in some cases most prominent sectors (Albania, Croatia, Montenegro) are travel (i.e. agency services and tourism, catering), and transportation. The trade in “other commercial services” is prominent in the case of Montenegro, Croatia, Macedonia FYR and Serbia. Tourism and travel are probably the most significant contributors to the balance-of-payments in at least three cases. It could be argued that the international trade in services of the CEFTA Parties is either poorly diversified or because it is not broken-down to the level of most important subsectors, which could show the actual diversification of the services trade, such an interpretation may not be fully justified.

A break-down of “other commercial services” would reveal important sectors and subsectors, among them infrastructural services, that are important for the whole economy, such as telecommunications, financial services, and a host of business services, construction, etc. Construction as an export service may be statistically marginal, the same case may apply to logistics, but they are crucial in the shaping of the overall economic performance, a component of the production and distribution chain. For example, logistics, contribute a heavy burden for the landlocked CEFTA Parties, such as Macedonia FYR, Moldova, UNMIK/Kosovo and Serbia.



Source: Trade Profiles 2009, WTO

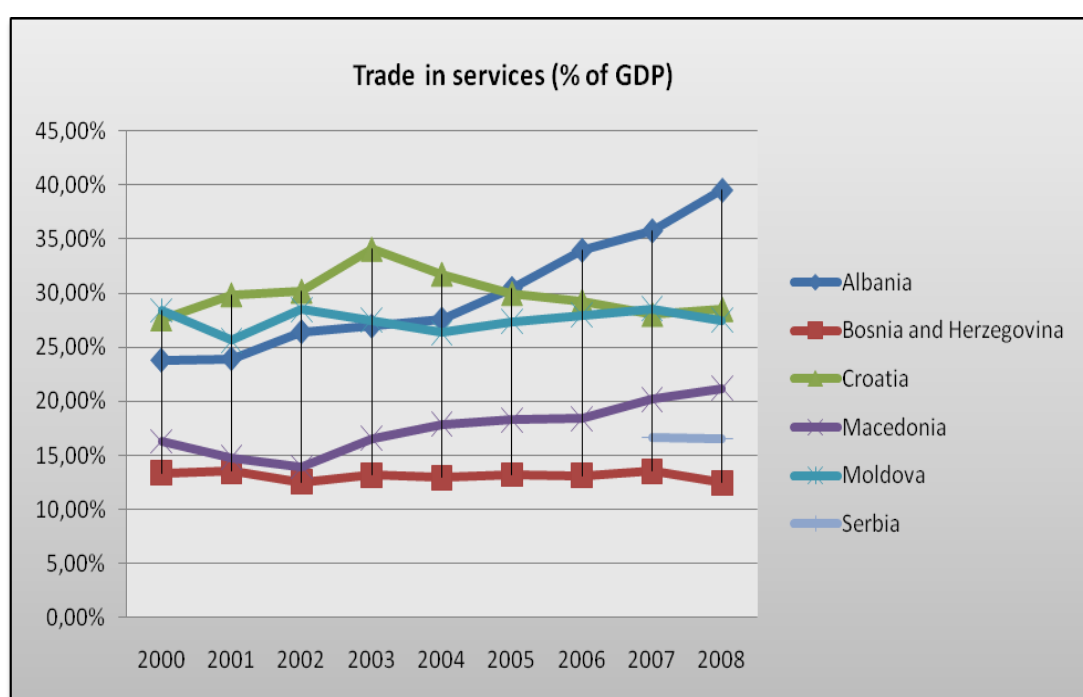
The growth rates of the services sector in the CEFTA Parties have, in the last decade, been strongly influenced by foreign direct investment, either by Greenfield investment, acquisitions and takeovers. The following sectors have received the most of the foreign direct investment, by rank:

- Banking
- Telecommunications and IT services
- Trade and distribution
- Insurance
- Construction
- Business services
- Real estate
- Tourism and catering, travel.

The banking and telecommunications sectors (especially in the mobile communications subsector) in the CEFTA region are either entirely or almost entirely foreign owned, or have dominant shares of foreign capital. In Serbia there are 21 foreign-owned bank subsidiaries, and in Croatia there are 16; the banking sector is almost entirely foreign-owned. The five largest banks have assets of over 90%. The level of foreign investment in banking in Moldova, for example is 77.8%. It is similar in the other CEFTA Parties. To a large extent the same situation applies to the insurance sector. Foreign multinational companies are present in the CEFTA Parties' markets through franchises. Domestic companies have become a part of an international business network. The structure of the domestic insurance markets are such that compulsory insurance services dominate, while other types of insurance are poorly developed (one of the reasons is a lack of demand). Some of the indigenous banks, which are, as a rule, under-capitalised do not have international market experience or the knowledge to participate in the international money markets (the case of Albania).



The shares of services in the GDP have increased very rapidly in a few years. Until the year 2000 some of the CEFTA Parties have had a very low start in the development of services domestically and in their ability to penetrate foreign markets. Albania's share of trade in services in the GDP was 23.79% in 2000 and it increased to 39.5% in 2008, to 38% employment and 60% of all revenues. Macedonia's FYR share of trade in services in GDP in 2000 represented 16.3%, while in 2008 it has increased to 21.23%. At the same time, Moldova's share has slightly decreased in 2008 by 1% (27.48%) as compared to 2000 (28.42%). Serbia and Montenegro's (jointly) had a 38% share in 2006. In most cases, the CEFTA Parties have surpassed their industrial sectors (in Albania's case that relates to the agricultural sector which employs 47% of its workforce) as the leading sector of the economy. The share of employment in services is rising steadily, with a slower pace in Macedonia FYR.



Source: World Trade Indicators 2009/2010, World Bank

Foreign operators played and still play an important role in modernising the financial services and other sectors of the CEFTA Parties, but they have also created a concentration of this modernising influence to a small number of sectors. Foreign bank subsidiaries have brought significant expertise, for example, in loan risk management and assessment and methods of operation distanced from political influence. Telecommunications operators have brought up-to-date digital and mobile services technologies and opened many avenues to new and sophisticated, value-added types of services. Foreign suppliers have placed competitive disciplines on domestic firms and brought about an evolution in regulatory policy, market efficiency and openness. The fact that the cost of labour in services is well below that of some neighbouring and EU member countries, may have been an important attraction to the CEFTA markets, certainly for the location or relocation of certain services centres.

In the majority of services sectors and especially subsectors, as a rule, there are no large domestic private service providers, other than utilities and public service providers, and/or monopolies or service providers with exclusive rights. In some important sectors, the CEFTA Party economies are devoid of service providers of any consequence, such as is the case of environmental services which are gaining in importance in other economies, where the private sector is active. The concept of other services is also lacking, such as services incidental to manufacturing, which as part of a package, provide greater competitiveness to a manufacturer.

There are few domestic services companies in the region, other than the above exceptions, that employ more than 50 people (in Serbia, for example, 39% of registered companies employ less than 50 people). Those that employ over 200 employees are very rare. The regional average for a private services company is between 15 and 20 employees. These averages are much lower in professional services, where a single employee and operator is the standard. In addition, the average small company is domestically oriented rather than export oriented. In Albania, for example, there is a growing number of accountants, lawyers, human resource consultants, who are mainly focused on the domestic market. Albania imports consulting services of all kinds. Montenegro imports most of the engineering services and know-how. There is a regional anomaly of a large number of sole proprietorships which are registered for tax purposes.

Fragmented services markets, insufficient regional cooperation, foreign competition are factors that influence the ability of services companies to compete efficiently and to access export markets. As a rule they are hampered by regulatory requirements or the need to invest, lack of financing. Other factors play a part, such as the need to apply higher professional and international standards, lack of skilled and experienced labour in certain types of services. The “brain-drain”, the exodus of young, educated and talented professionals, in favour of better paying markets with better opportunities for advancement, is still an issue of concern in the region and it affects all of the CEFTA Party economies. Certain services exports, at international levels, such as business and professional services, are associated with higher levels of economic development.

Most CEFTA Parties are not yet in a position to be large scale services exporters, with the exception of Croatia in the area of tourism, which contributes to a services trade surplus of 5.8 billion Euros and to Croatia's position as the 25th services exporter in the world. But export potentials do exist and can be developed. Outdated services sectors require modernization and the introduction of more sophisticated business methods, supported by better regulation and synergetic regional cooperation. A more open regional services market could provide a more supportive trade environment. The recent case of the joint rail company (alliance) of Croatia, Serbia and Slovenia, called “Cargo 10”, was established out of simple economic need, to service the Xth transport corridor, dictated by the loss of the rail freight business to the IVth transport corridor, which, even though it is 900 kilometers longer, is more competitive. This initiative has drawn international attention and interests from other countries, including Greece and Italy.

There are other companies that have the potential to become regional and international players in the area of distribution and business services. Serbia ranks third in South East

Europe regarding the number of large companies (measured by business turnover), among them are state-owned companies and monopolies. Croatia ranks fourth to fifth. On the other side of the spectrum are some small and propulsive companies that are internationally active and have large multinational clients and cover a niche market. These however suffer from another constraint, the lack of a sufficient number of highly skilled and experienced labour.

The skills gap that exists in the region is resulting from a conservative education system and out-dated programmes, curricula, which do not respond to market needs. Vocational training is mainly devoted to personal services. Education and training emerges as a key policy issue, together with public-private sector cooperation. The availability of quality personnel emerges as a problem when positions need to be filled with highly-skilled professionals. The need for engineers in some of the Parties has dictated a more pragmatic position towards the import of qualified labour and the recognition of their qualifications. There is a lack of experienced project managers, of specialists such as application developers, multimedia designers, and others. Firms that are small cannot afford on-the-job training and rely on the state to supply the personnel they need, through its education system. This kind of situation is resulting in the increase of running costs, loss of service quality, loss of business opportunity. Most university graduates have no knowledge or experience with modern business processes. Besides, in foreign markets, including in the CEFTA region, companies meet with restrictive business practices and non-transparent administrative procedures or regulatory requirements. They encounter some not easily detected barriers to trade.

Businesses, either domestic or foreign-owned, complain that the business environment is inhibited by difficulties in obtaining licenses, corruption and an inefficient public administration. Most of the CEFTA Parties have introduced some form of a “single window” approach in order to eliminate some of the red tape and reduce time and the number of procedures for the registration of a business activity. Albania introduced a single office for business registration and acquirement of licenses.

To underscore the above, the regional services market is not integrated, and the services markets of the individual CEFTA Party are under-developed; they are below their economic potential and insufficiently supported in the development of a greater potential from policy makers and authorities. There is incompatibility of the markets, lack of policy focus and support, there are legal differences, market protection in certain sectors, and other factors that prevent the development of an integrated regional services market. CEFTA Parties have certain specific sectoral development strategies, but no national strategies for the overall augmentation of their services economy.

The rationale calling for services liberalisation in the region is not different, in principle, from the rationale that has driven the liberalisation of trade in goods. The competitiveness and efficiency of an economy also depends on the capabilities of its services industry to innovate and upgrade, reduce costs. The small and mediums sized companies must be able to develop niche markets and exploit them beyond national borders.

The regional dimension of services liberalisation within the CEFTA Parties would be a logical and necessary complement to the already existing integration in terms of trade in goods and in view of other important linkages, to reduce the different trade in services

regimes and increase their economic compatibility. In fact, the CEFTA Parties need to recognise the need for economic pragmatism and increasing their general competitiveness that can contribute to economic progress and the rise in living standards.

Each CEFTA Party has some specific feature or features in the area of services that makes their services regimes distinctive. On a sectoral basis there are differences in policy approaches. Banking could be regarded as an exception. There are similarities, such as the one-stop-shop approach to the establishment of enterprises and licensing. Albania has a national centre for business, Moldova a chamber of licensing, and Montenegro and FYROM have easy and quick processes for registering a company. In Serbia that may also be the case provided that all documentary requirements are met.

Most services regimes of the CEFTA Parties are governed, however, by licensing and approvals. There are also other horizontal requirements contained in company laws, such as mandatory registration and incorporation in a prescribed form in order to perform economic activities in the territory, which could seem as restrictive, especially for smaller services operators.

Another common feature is the conspicuous absence of mutual recognition agreements and transparent procedures for the recognition of qualifications or the requirement of specific qualifications related to specific activities. This could be regarded as a barrier. All CEFTA Parties have unbound mode 4 commitments and apply measures for strict implementation of labour policies, especially pertaining to technical and support personnel (which could be essential for an investor or contractor).

Among the CEFTA Parties, Albania stands out in terms of reforms, driven by the desire to be more closely integrated into the European Union. It is also outstanding in the degree of regulatory transparency. On the other hand it has capital movement controls. It also mandates the establishment of professional organisations that regulate and set qualification requirements for a number of professional services.

Differences between the regulatory regimes among the CEFTA Parties can be illustrated on the example of accounting services which are not unimportant in the plethora of professional services. In some Parties the accountancy sector is regulated while in others it is not. There are many other differences in the treatment of services activities, for example in the area of insurance (branching and cross-border supply), in modes of supply in exclusions and sensitivities. A detailed comparative analysis would be necessary to cover the many examples of differences and facets of the services trade of the CEFTA Parties.

Bosnia and Herzegovina is a special case regarding its internal services market, which is not integrated. The only centrally administered sector is tourism. All other services are in the competence of the two entities that have regulatory distinctions. Sectors, such as education, media services, audio-visual services, are considered sensitive.

The distinction in Macedonia FYR is the existence of a private services chamber and an IT chamber. On the other hand it requests reciprocity in construction services, legal and real-

estate services. Especially, in construction, such a request reduces the market access opportunities for domestic operators seeking jobs abroad.

Serbia's distinction is a very large number of registered small companies (different sources provide different figures), of which only one third is active, that have a low export orientation.

In the detailed differences is the foundation for relaxation and harmonisation of the services regimes, especially, if the most liberal approach (non regulation or more liberal regulation) is taken as the common denominator. In negotiations, the comparison of sectoral regimes and specific requirements will be the main task of the experts to help fulfill the mandate for regional services trade liberalisation.

## 5 APPROACHES TO THE REGIONAL LIBERALISATION OF SERVICES TRADE WITHIN THE CEFTA

### 5.1 Horizontal Issues Underpinning and Intra-regional Agreement on Services – Supporting Obligations

#### 5.1.1 Rationale

There is a high coincidence and influence of various services with multiplicative effects on other sectors. The services trade follows a domestic-regional-global pattern and vice-versa in such a way that domestic export services capacities can take advantage of the most competitive inputs available, by importing services. The multiplicative effect of a service sector, for example in the maritime transport sector is the following: maritime transport services extend to ship-repair, maintenance, supply of parts and components, distribution, logistics, professional services, communications, banking, trade, insurance, and other incidental services. The global services trade dictates the need for regionally-based companies to link-up, increase export capacity and competitiveness, and thereby increase their credibility in the global market.

The rationale for maintaining certain limitations in the bilateral trade or restrictive practices loses its practical value and becomes (has become) a redundant obstacle. The purpose of a regional services agreement is to confer more favourable treatment to regional trading partners on a non-MFN basis.

The rising salience of cross-border trade and possibilities of remotely supplied services, in line with market demand, highlights the need for greater regulatory convergence on a regional basis and therefore dealing with the horizontal issues and supporting policies, that underpin any services regime in any given market, and function as a barrier to trade, the elimination or reduction of these could strengthen the supply side of each CEFTA Party.

A review and acceptance of sector-specific commitments cannot be complete without a review of the horizontal limitations on national treatment and market access by the different modes of supply. Measures that affect all services sectors are based on domestic regulation (and not necessarily scheduled as an exception or limitation and is not visible) and there are trade policy positions and interpretations (that are not necessarily transparent, especially at local levels of authority). Within the region there are differences in the implementation of the same or similar measures.

The ultimate goal should be as free a flow of services within the region as possible secured by irreversible commitments, beginning with full transparency of existing measures, for example, through an exchange of lists of economic activities in the area of services that are subject to special legal requirements (extended to local authorities with policy-making prerogatives and implementation-related discretionary powers). This should include professional organizations that have public functions and can influence market access conditions, or are mandated by law to set national standards.

The CEFTA Parties should at the outset agree on a set principles and minimum negotiating targets regarding the horizontal issues as suggested below. In the regional context, the Parties can take a more liberal approach and accept general, across the board commitments, for example, in the area of licensing, certifications, etc. and recognize each other's institutions and authorities (especially in BiH, internally) and their procedures. For example, the certification of professionals can be agreed on an intra-regional multilateral or plurilateral level. Recognitions or acceptance of credentials could be accepted without any discrimination, by applying agreed standards and criteria.

### 5.1.2 Mutual Recognition of Qualifications on the Basis of MRAs - the State of Play

Bilateral mutual recognition agreements in the area of professional services are an area that the CEFTA Parties have not paid a great deal of attention to. That is evident from the fact that there is either an absence of such agreements, or, the few such agreements are limited to a minimum number of specific sectors and are narrowly bilateral in nature. Most CEFTA Parties have no agreements. Those that do exist are based on the strictest rules of reciprocity and are based on national procedures for the verification of credentials, which can be different and arbitrary. Some CEFTA Parties have a more liberal approach and pragmatically confer acceptance of professional credentials of credible education institutions, without the government to government agreements, purely on the basis of economic need and lack of specific highly-skilled personnel, which the domestic education system either cannot supply at all or supply in sufficient numbers, such as certain professions (e.g. forestry engineer) where there are no education programmes in place. The case in point are skilled technical personnel, especially engineers, project managers, etc. (see below the case of the ICT sector), which are not scheduled in the services schedules, but are important for the realisation of specific projects and investments (see further comments on mode 4 issues).

The question of mutual recognition can be resolved regionally on a multilateral or at least on a plurilateral basis as a horizontal issue, at least on the basis of agreed criteria in principle, and by respecting the rights of each Party to verify any credentials in a process which is not designed a measure of protection.

### 5.1.3 Exceptions to National Treatment

The Parties could conduct a joint review of the most exposed national treatment limitations and review their rationale in a regional context. The aim would be to eliminate or reduce those that have no convincing justification. This would include real-estate ownership policies, reciprocity, nationality, minimum equity requirements, special conditions in the area of licensing and approval, citizenship which can be converted into residency, etc. In other words limitations or specific requirements may have a less restrictive alternative.

#### 5.1.4 Issues Related to the Specific Modes of Supply

##### **a. Mode 1 (cross-border supply)**

Given that most services are tradable by electronic means, some of the mode 1 limitations and prohibitions seem to be redundant. The only caveat could be unresolved taxation issues. An increase of mode 1 supply in the market does open the question of a need to develop reliable consumer advisory and protection mechanisms, as well as the means to deal effectively with unethical practices.

The above may equally apply to mode 2 (consumption abroad), which some Parties do not limit at all. The dependence on mode 3 could be significantly reduced, as well as some limitations on mode 4 (temporary presence of natural persons). This could lower transaction costs for the supplier and the customer.

E-commerce is gaining in prominence and consumer acceptance, through the increased use of web-sites, which contains certain risks for the consumer, but incidence of fraud are low where consumer protection mechanisms exist.

##### Suggested minimum targets:

- No commercial presence requirement in the initial phases (in the phase of establishing a client base in the market, and subsequently);
- Extended periods of temporary stay for marketing purposes;
- To commit commercially meaningful sectors;
- Review the possibility of reducing the dependence on mode 3 (commercial presence) of specific sectors.

##### **b. Mode 2 (consumption abroad)**

This is a closely related mode of supply to mode 1. The most obvious of the services supplied is travel. Other services are distance learning, training abroad, consumption of medical, financial and many other services abroad. In some cases there are limitations, which are in fact ineffective, and confer all risks to the consumer. In a liberalized intra-regional services trade environment, any limitations or prohibitions could be dropped with an effectively increased competition in some service sub-sectors, such as life insurance, mutual funds, etc.

##### **c. Mode 3 (commercial presence)**

This mode of supply is prevalent in the global services trade (over 70% of all services trade in the world are traded through mode 3). There are many reasons for that: investment policies and incentives, barriers related to other modes of supply and the simple need to be present in the market. There are of course services that require an on-site presence, such as construction, retail, and others. Trade-policy makers prefer mode 3 and legislation, such as company and other (sectoral) laws create a mode 3 dependence by (rigidly) prescribing the legal forms of foreign-owned companies that have operations in the domestic market, or foreign participation in the domestic companies. These are also the reasons that mode 3 is the most frequently bound mode of supply. This reflects the desire of policy-makers to



attract foreign investment, import modern business methods and processes, new technologies and create employment. The tendency of policy-makers is to reduce the dependence on modes 1 and 2, which are better suited for small service providers.

Mode 3 is an advantage for large services companies, multinationals with financial strength, strong technological support and sophisticated organizational forms. It is best suited for companies that can provide a complement of services and need a broader client base, or multiple business services for selected clients.

The general legal bases for mode 3 are the companies acts, sectoral legislation, such as the banking act, insurance act, and others, but there is no general services act that would provide certain horizontal principles and rules specific to services as such, although in some of the CEFTA Parties such legislation is under preparation in the process of approximation with the EU *acquis*. Stipulations in the company act are conservative and may seem restrictive, such as the stipulation that all economic activities in a territory can be only conducted in one of the prescribed legal forms. Such stipulations may cause confusion because there is no obvious explanation how they apply to mode 1 and mode 2. Besides, the differences in legal rights and obligations of subsidiaries, branches and representative offices are not often very clear or differentiated or they are significantly curtailed. Branches, in financial services, for example, in some CEFTA Parties are simply not allowed in others not defined. But in the CEFTA Parties, activities of foreign affiliates constitute an important share in the overall trade in services, bilaterally and regionally.

The overwhelming positive point of mode 3 is legal certainty and greater responsibility of service suppliers on the basis of host country laws and regulations. But in many respects the need for commercial presence is superseded by an increasingly electronically facilitated cross-border trade. Unbundling of production and consumption, specialised producer inputs, supported by information technologies are less and less dependent on the commercial presence in the market. Small companies are more concerned with their right not to establish a local commercial presence. Franchise chains and multisite management companies rely on local firms and staff and draw income from a minimum of investment, if any at all.

#### Suggested minimum targets for mode 3:

- Review the possibilities to remove key limitations, such as types of legal entity, foreign equity limitations, citizenship and other discriminatory requirements;
- Eliminate all economic needs tests;
- Eliminate limits to the number of services suppliers;
- Reduce exclusive rights in some key sectors (such as energy distribution).

#### **d. Mode 4 (temporary presence of natural persons)**

The dynamism of global markets means a shorter reaction time to spare for problem-solving, which frequently calls for the immediate availability of service personnel. Modern corporate structures and management, company affiliations, require flexible movement of personnel, which is a crucial means of delivery for exporting countries. If significantly obstructed for labour policy reasons, even by law-enforcement agencies, the supply of a service and market access are affected and contractual obligations may be disrupted.

It is customary by the CEFTA Parties to schedule as “unbound” the movement of natural persons, except for temporary stay of specific categories of personnel, which is limited, with

prescribed functions that may or may not be performed. The term “essential personnel”, for example, is not defined which causes misconceptions on the side of policy-makers. Thereon, the stipulation “unbound, except as indicated in the horizontal section” applies to all sectors. Inflexible mode 4 policies create problems for investors or owners in tourism (the requirement to recruit local staff and incorporate every activity, limitations on the use of corporate property for tourism purposes) and in such services which are incidental to manufacturing (e.g. assembly, maintenance, and so called investment works). The use of “unbound” creates uncertainties and allows regulatory and policy intervention and arbitrariness, especially at local levels. Certain categories of services personnel (which could be “essential”) are not accounted for.

Suggested minimum targets for mode 4:

- Consider an annex on mode 4 policies;
- First and foremost abolish remaining intra-regional visa requirements;
- Improve commitments through enhanced coverage, including categories de-linked from commercial presence, such as sole proprietors, independent professionals, researchers, independent managers of facilities, etc;
- Extend the length of stay periods and eliminate residence requirement, or contract requirements unless strictly necessary, especially if there are no revenues earned;
- Eliminate any economic needs tests for temporary relocations.

Further targets:

- Harmonize and agree on common terms and definitions for categories of personnel, such generic terms as: administrators, managers, specialists, executives, senior personnel, professionals, contractual service providers, and ensure equal treatment in all CEFTA Parties;
- Eliminate labour market tests;
- Ensure swift adoption of decisions on individual or company applications, especially at the level of the local community;
- Eliminate license requirements for proven specialists.

Mode 4 is a potential area for meaningful progress in liberalisation of the services trade in the region through extended commitments in combination with other modes of supply. On a regional basis the “unbound” can be converted into “bound” on the basis of a regional multilateral MFN exemption on labour policy.

<i>HORIZONTAL LIMITATIONS – MINIMUM TARGETS</i>	
<i>MRAs in the area of professional services</i>	Multilateral or plurilateral agreements on the basis of agreed criteria, respecting the rights of each Party to verify the credentials
<i>National treatment</i>	Eliminate/reduce those that have no convincing justification, including <i>real-estate</i> ownership policies, reciprocity, nationality, minimum equity requirements, special conditions in the area of licensing and approval, and others.

<i>Mode 1</i>	No commercial presence requirement in the initial phases; Extended periods of temporary stay for marketing purposes; Commit commercially meaningful sectors; Reduce the dependence on mode 3 of specific sectors.
<i>Mode 2</i>	Exclude limitations
<i>Mode 3</i>	Review the possibilities to remove key limitations, such as types of legal entity, foreign equity limitations, citizenship etc; Eliminate all economic needs tests; Eliminate limits to the number of services suppliers; Reduce exclusive rights in some key sectors (energy distribution).
<i>Mode 4</i>	Annex on mode 4 policies; Abolish remaining intra-regional visa requirements; Enhance the coverage, incl. de-linked from commercial presence; Extend the length of stay periods and eliminate residence requirement, or contract requirements unless strictly necessary; Eliminate any economic needs tests for temporary relocations.

## 5.2 Sectoral Issues and Approaches

Note: comments in this section refer to all CEFTA Parties unless otherwise specified. In this part only certain services sectors are dealt with, which are perhaps more significant for liberalisation in the regional context, as an example of the types of barriers to a freer trade in services that exist, and indications of possible approaches to eliminate them in the course of intra-regional services liberalisation negotiations.

### 5.2.1 Essential Sectors and Possible Determination of Priority Sectors and Subsectors

The services sectors and sub-sectors that provide essential infrastructural conditions for economic development (by rank of importance) are banking; telecommunications; distribution; transport; construction. From a regional negotiations point of view, a list of sectoral priorities could be the following (although not necessarily in the order shown):

- Transport services; including maritime transport, air transport, auxiliary services, with an emphasis on road transport, for freight and passengers (possible target: elimination of MFN exemptions), and logistics;
- Professional services (and other business services): this subsector is the most restrictive and least liberalized in the region.

- Telecommunications;
- Distribution services;
- Financial services (other than banking, with an emphasis on insurance);
- Construction services;
- Energy services;
- Environmental services;
- ICT-related services;
- Educational services (higher, secondary, adult education)
- Medical services (private); other.

During the consultations in capitals three sectors emerged as the front-line sectors. These are transport, insurance and ICT services. In the case of the first two considerable work is being done in a regional context and regional initiatives already exist, although in transport they are devoted to infrastructure and connections of various routes with the main traffic arteries.

For the purposes of negotiations, the sectors above can be subdivided into subsectors, of which each has a commonly accepted list of so called core activities. It is not uncommon that specific core activities are the subject of special interest and negotiations. Regulations are, as a rule, based on activities rather than whole sectors, and different activities within a sector or subsector can be regulated differently and separately. Therefore, the Parties can choose which sector or subsectors they may wish to tackle depending on the possibilities to achieve (possibly early harvest) results.

### 5.2.2 Setting Minimum Targets

In dealing with liberalisation efforts on a sectoral basis, it may be necessary to set minimum targets, which can nevertheless be ambitious. For example, to substantially liberalise at least one mode of supply, to include new activities, to change “unbound” into “bound” and increase the degree of “bound” liberalisation across the board. Parties may provide new additional commitments in a regional context. Certainly a worthwhile target would be to review and improve mode 4 commitments in all sectors, among other ways, by including new categories of service suppliers.

### 5.2.3 Possible Sectoral Approaches

#### a) Transport Services

Recent regional initiatives in the area of rail transport could serve as an example of mutually beneficial alliances. The established “Cargo 10” company, designed to serve the Xth transport corridor, to restore lost rail freight business, to modernise the services and improve competitiveness, to reduce administrative barriers. Similar regional alliances are possible in the area of road transport, maritime transport. Transport negotiations should seek synergetic means of cooperation.

#### b) Professional Services

The four subsectors below are dealt with in some detail, from a regulatory point of view, in order to illustrate the barriers that occur in these subsectors. In all the subsectors below, the core activities are heavily regulated in the CEFTA region.

The practice of professional services suppliers are regulated by government authority in all the CEFTA Parties. Rules and regulations are enforced at the national level, subnational - regional- level, local level, and by professional organisations in the country of origin and in the local market. In most cases, there is also a separate regulator (for example for engineering services). Professional organisations adopt and enforce codes of conduct, and impose licensing, specific technical rules and standards and other requirements, which can be different from one CEFTA Party to another. Professional organisations may have an invested power to take punitive measures against unethical conduct, such as revocation of a license. In worse cases, accreditations and licenses can be subject to review based on audit reports. Government authorities, as well as professional organisations, may be involved in price/fee setting or imposing pricing guidelines.

Professional services, as whole, require effective market access measures, and, for example, domestic consumers, businesses, may wish to have access to foreign legal consultancy.

Subsectors dealt with below are one of the most regulated activities in all the CEFTA Parties. There are degrees of less and more liberal regulations; however, in all cases market access is difficult. The key subsectors are: accountancy, architectural services, engineering and legal services.

The degree of liberalisation of each of these sectors is measured by the ratio of the number of activities that are reserved by law and the number of activities that can be exercised by the profession. In the most liberal case, all the activities can be exercised by the profession, with a minimum of public functions.

#### c) Accountancy

All Parties require that domestic and foreign suppliers be accredited and/or licensed. This applies to individual providers and the firm in which they are employed. Besides the accreditation of the firm, it also needs to be registered. Most Parties request proof of professional qualifications and foreign market experience. In more restrictive cases, domestic market experience is required of a certain period, usually between three and four years. As a rule, membership in a local professional body and the professional body of the country of origin is required. Variations are both memberships and either one. Croatia has a nationality condition for certain activities. Moldova has introduced more lenient practices.

The norm is double licensing and equal requirements for both permanent and temporary market entry. Establishment in this subsector is generally not restricted for both firms and for an individual accountancy service provider. However, certain prerequisites may be imposed. The company itself must be registered and/or licensed and all professional staff also has to have licences, and must meet the prescribed professional qualifications. There are cases of several levels of registration (for example, with the court, chamber and/or a professional organisation).

All Parties, except Moldova, require local establishment of a service provider. Croatia allows entry to projects. Moldova allows subsidiaries, while other Parties do not. Sole proprietorship in the area of accountancy is not allowed in Croatia for services rendered by a foreign supplier. In some cases, access to the local market may be achieved through legally non-binding relations with local associations and/or by hiring local professionals. There are cases of nationality requirements and a minimum number of locally recruited directors and minimum quotas for certified accountants. Albania specifies the type of education and

training required (university diploma in finance and accounting).

Other types of limitations are the prohibition on association with other professions. Labour market tests are practiced in Albania and Croatia for intra-corporate transferees. Croatia requires the validation of a foreign certified accountant certificate.

Cross-border supply can be limited to management consulting and investment advice. Some Parties require professional indemnity insurance for firms and individual service providers.

Mode 4 provisions differ from one Party to another. In most Parties temporary practice is not regulated. Therefore, this option does not exist. There may be equity limitations for professionals and non-professionals regarding the ownership of firms or parts of firms.

In the area of procurement there are a number of conditions that need to be met in order to participate in the procurement processes. One such condition may be the registration on a permanent list of qualified suppliers. There are criteria for the determination of who may be considered a qualified supplier. An independent regulator may impose additional conditions.

In the area of accountancy, it is considered that application procedures in most of the Parties, for accreditation and/or licensing, are more burdensome than necessary. The measure for it is the number of documents that are required, as well as the number of procedures.

The most liberalised regime in accountancy among the CEFTA Parties and best practices could be considered as a possible minimum level of liberalisation in the other Parties, with the view of eliminating all explicitly protectionist measures.

#### d) Architectural Services

Under this heading fits a number of core activities. These are also divided into those reserved by law and into activities entirely exercised by the profession. As elsewhere in professional services the performance of architectural services is subject to accreditation and/or licensing under conditions which are different from Party to Party. An architectural firm must be registered even if not established in the local market and the firm itself must obtain appropriate accreditation and/or licensing. All professional employees must satisfy qualification requirements. A non-binding form of association with professional bodies may relax any nationality or qualification requirements; such a professional body may certify or vouch for the foreign provider.

In some cases there are restrictions on advertising, and a regulator or professional organisation may be involved in fee/price-setting. None of the Parties regulate a temporary practice, which means that they are not an option. Although most liberal in this field, Moldova requires authorisation for equity investment or establishment of an architectural firm under foreign ownership. Albania is most restrictive among the Parties. In the procurement area, a whole catalogue of conditions must be met for a foreign provider to participate in a procedure.

This sub-sector is usually over-regulated and the regulations do not reflect current practices and developments in the profession and especially the possibilities of supply by electronic means.

#### e) Engineering Services

In general this is one of the most important subsectors which cover various professional fields. In most of the Parties the core engineering activities are reserved by law and heavily regulated. In the more liberal Parties (Montenegro, Moldova) most of the activities are exercised by the profession. The underlying reason for a more liberal approach, including the recognition of qualifications, is the lack of qualified and experienced engineers in the market.

In all Parties, nominally, there is unrestricted access to engineering services, however, full accreditation and licensing is required for both, an engineering company and its professional staff. Montenegro does not require special verification of foreign qualifications. In worse cases, acquired local experience is a condition for foreign providers, for a period of several years, which is subject to a work and residence permit and economic needs tests.

Cross-border supply (mode 1) is allowed by all Parties in all of the core activities. Albania restricts foreign providers to small volume or value projects and requires equivalency tests. Mode 1 is subject to reciprocity on the basis of a bilateral agreement. There are no systems in place that allow temporary practice, which means that full requirements need to be met even for short-term projects.

Moldova is implementing best practices in engineering services and could be used as an example.

This subsector, that has significant effects on other sectors and can generate employment and economic development and growth, is over-regulated in all the Parties from the standpoint of liberalised trade in services.

#### f) Legal Services

Excluding the administration of justice, legal services cover a number of different activities, such as advisory and information services, representational services, home country and third country law, international law (different branches), certification services, investment and business law, corporate law, etc.

The still widely used classifications of legal services and core activities do not cover new developments in the area of legal services which are the result of a growth in demand of corporate clients doing business abroad, as well as legal services provided for potential investors. This includes cross-border mergers and acquisitions. More and more of these services are the result of outsourcing (mode 2), especially in matters predominantly regulated by foreign and international law.

The primary barrier in this field is the national character of law and the fact that legal training is not necessarily transferable to another national legal environment. In the CEFTA region there a number of limitations on specific activities and a common approach is a nationality requirement and membership in the national bar association for barristers. As a rule, foreign service providers cannot participate in other legal procedures, although there is no contest. There are limitations on incorporation and employment of locally licensed professional staff by foreign legal firms. There are limitations for foreign directors in terms of qualifications, but mostly partnerships with other professions are allowed. Moldova allows subsidiaries. Limitations on fees may be imposed by professional organisations.

Albania is the most restrictive of the Parties in the area of legal services. By law only nationals resident in Albania may practice any form of legal practice. No foreign wholly or

partially owned entities are allowed. In Bosnia and Herzegovina there are differences in regulations of the two entities. For example, notaries in one entity have no jurisdiction in the other entity, even though the services of a notary are very important for businesses in Bosnia and Herzegovina. Their functions are similar to a general legal office.

New entrants in the market may be severely limited; in the most extreme case, besides permanent residency, there are requalification requirements, language proficiency, and experience in the local market for at least three years. There are equity limitations in Macedonia FYR (below 50% of ownership of a firm by a foreign party). Foreign firms that are not established in the market are limited to projects which may be limited in value. Entry of new firms in Albania is de facto blocked, while in Macedonia FYR both economic needs and labour market tests are applied. An application may be rejected by the simple perception that there is no need for any new entrant in the market of foreign origins. On the other side of the extreme is Moldova's policy (the only one) to allow representative offices. Entry into the market (in Macedonia FYR) and some other Parties can be more relaxed if local professionals are hired.

There is an example of a mutual recognition agreement between Montenegro and Serbia. Lawyers of either Party may represent clients in each other's courts. There is interest in the region for similar agreements between other Parties and for an intra-regional association (of legal professionals).

The absence of appropriate mutual recognition agreements is an obstacle to the development in cross-border trade in the region.

#### g) Business Services other than Professional Services

This area covers a diverse range of subsectors, from ICT services, for example, to building cleaning services. As an input to other businesses, they employ a large segment of the workforce, and represent a large number of small and medium sized companies. The growth in value-added and employment, normally, exceeds that of manufacturing. They relate to other businesses on a business -to-business level and provide a business infrastructure to enable industry (manufacturing, agriculture, or other services sectors) to operate effectively and competitively.

The global trend is to develop outreach industries in general and it is becoming increasingly crucial for the business services to be able to "move" with their clients. Technological progress in connectivity and electronic commerce in particular, has provided new possibilities for service suppliers to "internationalise" their operations, from whatever economic environment. Cross-border provision of certain business services has become more practical and easier. This same trend is evident in the CEFTA region.

As opposed to professional services, most business services are supposed to be much less regulated and GATS commitments are normally more liberal than in many other services sectors. Market access, in general, is liberal, especially through investment (mode 3). However, commitments in some sub-sectors may impose limitations and conditions for market access and national treatment, for example in research and development, real estate. Other business services may still be highly regulated, especially, if there is a strong element of public policy interest, and the government wishes to pursue objectives, such as consumer protection and quality standards. Some sub-sectors, such as advertising, are locally monopolised, limited in terms of equity, influenced by the state control of the media, by tax policies, by bans on certain types of advertising, by linguistic requirements, etc. Industry associations may have "self-regulatory" powers, which influence the market. It is possible to



analyse specific situations of other business services, which can be very different.

For this area of services subsectors, for the CEFTA Parties, it would be necessary to examine what are the specific remaining restrictions that effect market access, in all modes of supply, and agree on specific market access improvements. In the regional context, any “unbound” commitments in services schedules or services offers should be converted into “bound” commitments.

Other possible approaches would be, for example in mode 1, to re-examine and propose less trade-restrictive measures. Residency requirements could be replaced by other possibilities, such as the appointment of a representative agent, or by introducing liability insurance, etc., where applicable.

In mode 2, there is hardly any excuse for not removing any restrictions, in mode 3, any restrictions on ownership, equity, form of establishment, can mostly be eliminated or relaxed. Residency requirement, as suggested above, can be replaced by other measures.

Mode 4, as suggested in the section of this study on horizontal issues, the CEFTA Parties could consider improvements and better facilitate the temporary movement of natural persons for the provision of specific services, especially, of contractual service providers and allow free entrepreneurship and eliminate some of the reasons for the existence of a grey economy, at least on the side of regulations.

#### h) Distribution Services

The CEFTA region, in the past decade, has seen a revolutionary development in the area of distribution services, through foreign investment, and the growth of large domestic distribution companies, which themselves invest abroad, especially in wholesale and retail. Franchising has also taken route.

This sector is a crucial link between the producers and consumers and the performance of distribution services providers strongly influences consumer welfare. This sector may be economically significant as only second to manufacturing. Foreign trade occurs primarily through commercial presence. Normally, there are no explicit restrictions to market access, except requirements that are based in specific laws, such as spatial planning (zoning), permitted size of distribution centres, and limits on types of goods that can be distributed in a certain manner. The sector normally comprises all goods, except water, energy, waste, and others, that are governed by specific regulations for reasons of health and safety. Foreign distribution service providers may be limited by restrictions for new entrants in the market, such as the possibility to acquire commercial land, by local government regulations, and by mode 4 limitations. Local governments, especially municipalities, have a tendency to raise the cost of doing business and increase the resource requirements. Other limitations may concern the issue of wholesale licenses; promotional activities, environmental regulations and policies, and some regulations require special qualifications for retailing specific goods.

Since distribution services are pervasive and because they strongly effect down-stream users, and are connected with business services (quality control, inventory maintenance, advertising, packaging, door-to-door services, etc.) it is necessary to review the possibilities for deregulation, especially at municipality levels, and review if there are any differences in requirements at different local jurisdictions, especially for smaller wholesalers and on-line retailers.

#### i) Environmental Services

There is a high growth market for environmental services, globally. This sector is comparable to the pharmaceuticals and ICT industries for economic and social impacts. Most of the demands for environmental services is met by smaller, versatile, companies. Some environmental services depend on special technological know-how and capital goods. Environmental services often cross with other services, such as research and development, engineering, construction, distribution, transport, business services, in fact, with any other service with an environmental component. In this sector new services are being developed, especially in the area of cleaner production (introduction of cleaner production methods) and such specialised services as chemical leasing, hazardous waste disposal. New developments are also influenced by the effects of climate change and the need for adaptation and mitigation measures.

The CEFTA Parties, should demonstrate their substantial interest in the development of these services and review the sector and possibly commit all modes of supply without restrictions or preconditions, with the view of an open regional market in all types of environmental services. By taking into account the specific nature of a service and how the provision of the service is organized, the CEFTA Parties should establish intra-regional direct channels for the transfer of environmental technologies, know-how, for environmental gains, and remove as many prerequisites as feasible. Special focus should be given to advisory without the need for mode 3 requirements, and, for example for the cross border supply of environmental risk analysis and environmental impact assessment services, as well as others, where domestic capacities are lacking.

Liberalisation in this sector should be motivated by the desire to achieve better results in the area of environmental protection and therefore ambitious enough to surpass the limited capacities in this sector. The CEFTA Parties should include “other types of environmental services” in order to include, for example the special services related to industry, energy, and a systematic introduction of environmentally sound technologies.

#### j) Construction and related Engineering Services

This is a fundamental economic activity in general and within the CEFTA region, which is normally governed by a sectoral law. For some Parties it is an important export service, especially the smaller economies, which need to employ their capacities outside of their borders. The CEFTA Parties may consider the need to regionally integrate this sector in order to compete internationally, which would require an unrestricted market access and national treatment in all modes of supply.

Although mode 1 is usually scheduled as “none” for lack of feasibility, certain activities however are feasible even in this mode of supply. For example: cross-border support services (project management, design, on-site investigation, etc.). In mode 2 restrictions, if any, are not justified. In mode 3 there are restrictions on the form of establishment, equity and type of legal entity. On mode 4, all the comments already made apply in this case as well.

The construction sector is subject to many regulatory requirements of a technical, safety nature, and regarding standards. Liberalisation of the sector does not need to effect these requirements, however, the maze of regulations that exist at all levels of government and procedures, should be reviewed from the stand-point of being unnecessarily burdensome and above all time consuming. In the process, some of the regulations could be streamlined

and harmonized.

### k) Energy Services

In spite of the national energy strategies and policies and long-term production and supply objectives, the energy sector, regardless of classification problems, represents a host of marketable activities which can support national objectives. The CEFTA Parties should give the energy sector greater visibility and individualise energy specific activities which could be tradable in an intra-regional context, especially since this sector is closely related to business services and crosses with other sectors. The list of activities is quite long (from exploration to production, to construction, installation, maintenance, repair, network and auxiliary services, storage, trading, brokerage, management, advisory, wholesale, retail, energy audit, energy efficiency, decommissioning, etc.). The most visible obstacles in this sector are exclusive rights by state owned companies or by de-facto monopolies. There are restrictions on legal forms (equity ownership of large distribution companies), unspecified licensing requirements, unspecified economic needs tests, and others, such as residency, etc.

Liberalisation is possible in modes 1, 2, and 3, and improvements in mode 4, by taking into account the specifics of the sector, its organisation and structure, especially in the electrical energy sector. Given the objectives of security of supply, environmental protection, public service obligations, the CEFTA Parties can and should adopt a pro-competitive framework for this sector.

In a similar vein other sectors, subsectors and services activities can be analysed and comparatively examined in order to determine the desired foundations for negotiated solutions.

Tables below indicate the depth of sectoral coverage of commitments of the CEFTA Parties in market access according to their national WTO GATS schedules of commitments and services offers. Only the first 3 modes of supply were included, as mode 4 is a separate case and overall has much less commitments. These tables could be a useful tool in identifying and prioritising sectoral approaches in negotiations among CEFTA Parties.

<b>BUSINESS SERVICES</b>	<b>Albania</b>	<b>Croatia</b>	<b>FYROM</b>	<b>Moldova</b>	<b>Montenegro</b>	<b>Serbia</b>
<b>1) None</b>	28	28	30	14	32	34
<b>1) Unbound</b>	3	7	7	1	6	2
<b>1) Partial</b>	1	4	2			
<b>2) None</b>	32	38	36	13	38	35
<b>2) Unbound</b>		1	2			
<b>2) Partial</b>			1	2		1
<b>3) None</b>	31	38	31	10	38	35
<b>3) Unbound</b>		1	7			
<b>3) Partial</b>	1		1	5		1
<b>Total no. of sub-sectors included</b>	32	39	39	47	38	36

<b>COMMUNICATION SERVICES</b>	<b>Albania</b>	<b>Croatia</b>	<b>FYROM</b>	<b>Moldova</b>	<b>Montenegro</b>	<b>Serbia</b>
1) None	16	20	16	23	8	8
1) Unbound						
1) Partial			1	1	1	
2) None	16	20	17	24	8	8
2) Unbound						
2) Partial					1	
3) None	16	20	16	21	8	7
3) Unbound						1
3) Partial			1	3	1	
<b>Total no. of sub-sectors included</b>	16	20	17	24	9	8

<b>CONSTRUCTION AND RELATED ENGINEERING SERVICES</b>	<b>Albania</b>	<b>Croatia</b>	<b>FYROM</b>	<b>Moldova</b>	<b>Montenegro</b>	<b>Serbia</b>
1) None	5	4		5		
1) Unbound						
1) Partial		1	5		5	5
2) None	5	5	5	5	5	5
2) Unbound						
2) Partial						
3) None	5	5	5	5	5	5
3) Unbound						
3) Partial						
<b>Total no. of sub-sectors included</b>	5	5	5	5	5	5

<b>DISTRIBUTION SERVICES</b>	<b>Albania</b>	<b>Croatia</b>	<b>FYROM</b>	<b>Moldova</b>	<b>Montenegro</b>	<b>Serbia</b>
1) None	4	4	4	5	4	4
1) Unbound						
1) Partial						
2) None	4	4	4	5	4	4
2) Unbound						
2) Partial						

3) None	4	4	4	5	4	4
3) Unbound						
3) Partial						
<b>Total no. of sub-sectors included</b>	4	4	4	5	4	4

<b>EDUCATIONAL SERVICES</b>	<b>Albania</b>	<b>Croatia</b>	<b>FYROM</b>	<b>Moldova</b>	<b>Montenegro</b>	<b>Serbia</b>
1) None	3	3	3	5	5	5
1) Unbound	2	1				
1) Partial						
2) None	5	4	3	5	5	5
2) Unbound						
2) Partial						
3) None	5	4	3	5	5	5
3) Unbound						
3) Partial						
<b>Total no. of sub-sectors included</b>	5	4	3	5	5	5

<b>ENVIRONMENTAL SERVICES</b>	<b>Albania</b>	<b>Croatia</b>	<b>FYROM</b>	<b>Moldova</b>	<b>Montenegro</b>	<b>Serbia</b>
1) None	5			4		
1) Unbound		7	6		7	6
1) Partial						
2) None	5	7	6	4	7	2
2) Unbound						4
2) Partial						
3) None	5	3	6	4	7	5
3) Unbound						1
3) Partial		4				
<b>Total no. of sub-sectors included</b>	5	7	6	4	7	6

<b>FINANCIAL SERVICES</b>	<b>Albania</b>	<b>Croatia</b>	<b>FYROM</b>	<b>Moldova</b>	<b>Montenegro</b>	<b>Serbia</b>
1) None	9	4	2	15	10	3

1) Unbound	8	7	16	2	5	16
1) Partial		7			2	
2) None	16	4	7	17	17	10
2) Unbound	1	2	11			8
2) Partial		12				1
3) None	16	18	10	17	10	17
3) Unbound			1			1
3) Partial	1		7		7	1
<b>Total no. of sub-sectors included</b>	17	18	18	17	17	19

<b>HEALTH RELATED AND SOCIAL SERVICES</b>	<b>Albania</b>	<b>Croatia</b>	<b>FYROM</b>	<b>Moldova</b>	<b>Montenegro</b>	<b>Serbia</b>
1) None	2			3		
1) Unbound		1	2		2	1
1) Partial						
2) None	2	1		3	2	
2) Unbound			2			
2) Partial						1
3) None	2	1		3	2	1
3) Unbound			2			
3) Partial						
<b>Total no. of sub-sectors included</b>	2	1	2	3	2	1

<b>TOURISM SERVICES</b>	<b>Albania</b>	<b>Croatia</b>	<b>FYROM</b>	<b>Moldova</b>	<b>Montenegro</b>	<b>Serbia</b>
1) None	3	3	1	4	3	3
1) Unbound		1	2			
1) Partial						
2) None	3	4	3	4	3	3
2) Unbound						
2) Partial						
3) None	3	4	2	4	3	3
3) Unbound			1			
3) Partial						
<b>Total no. of sub-sectors</b>	3	4	3	4	3	3

included

RECREATIONAL SERVICES	Albania	Croatia	FYROM	Moldova	Montenegro	Serbia
1) None	3	1	2	3	2	2
1) Unbound	2	2	1	1	1	1
1) Partial						
2) None	5	3	3	4	3	3
2) Unbound						
2) Partial						
3) None	5	3	2	4	3	2
3) Unbound			1			1
3) Partial						
<b>Total no. of sub-sectors included</b>	5	3	3	4	3	3

TRANSPORT SERVICES	Albania	Croatia	FYROM	Moldova	Montenegro	Serbia
1) None	11	8	3	19	12	7
1) Unbound	5	12	13		11	4
1) Partial						
2) None	14	20	16	19	23	11
2) Unbound	2					
2) Partial						
3) None	16	20	13	19	21	10
3) Unbound			3		2	1
3) Partial						
<b>Total no. of sub-sectors included</b>	16	20	16	19	23	11

### 5.3 Highlights of the advantages and disadvantages of negotiating options

The CEFTA 2006 does not prejudice or prescribe any negotiating option on services which are bilateral, plurilateral, multilateral, specifically sectoral or by a cluster approach. In any case, the key question will be the rules, the management of a negotiating process, correlation of the outcomes, time frames, and expected outcomes.

During consultations in capitals certain preferences were expressed and in some cases outright rejection of a specific option. Any decision must have in view the legal form of the final negotiating document or documents as the case may be. It is highly recommended that the Parties agree in advance on a set of principles and possibly adopt a non-binding

document “Basic Principles”. It would be an initial agreement on how the negotiations would be conducted (for example on the basis of GATS Article V), and an agreement on the scope and depth of negotiations.

- ***Bilateral negotiations***

This is the least attractive option. The reasons are the following:

- technically complicated process, difficult to coordinate;
- a danger of uneven results;
- danger of exclusions or lack of motivation or economic interest to negotiate with a specific Party;
- lack of the necessary skills and capacity;
- cost of conducting over fifty individual negotiations times the number of required meetings, combined with the work of experts on sectoral discussions;
- implementation-related questions;
- necessity of high level of discipline and openness.

The treatment of autonomous liberalisation of the more advanced Parties would create pressures on those Parties that are lagging behind.

On the positive side bilateral negotiations would allow a high degree of flexibility to the Parties and can decide their own negotiation dynamics. This would require a neutral manager who would record the results.

- ***Plurilateral negotiations***

This option is acceptable under certain conditions, namely, that no Party is excluded in advance. All Parties would need to be invited to participate in negotiations at whatever level and may themselves opt out of the negotiations. Therefore, negotiations would be conducted among those that accept to negotiate and accept the initial principles and rules. Plurilateral negotiations are best suited for sectoral negotiations or for a cluster approach.

- ***Multilateral negotiations***

The difference to the above option is that negotiations are conducted on the basis of a draft initial agreement and the final result is open to adoption/ratification. The agreement would enter into force if at least (for example) three Parties adopt the agreement and would be valid for them alone. Such an agreement could best deal with the horizontal issues. The individual Parties would be able to lodge exceptions or reservations which would need to be negotiated and negotiate implementation as well as transition periods and solutions. Specific sectoral agreements could be attached to a basic agreement.

- ***Sectoral and cluster negotiations***

These negotiations could be stand alone negotiations or as an integral part of a broader agreement on services, as complimentary parts. The advantage of sectoral negotiations is that they necessarily include experts who have the knowledge related to a specific sector and can possibly bring sufficiently speedy results, especially if advance contacts have been established and there is a basic understanding of what the mutual interests are.

## Conclusion

Whatever option will be chosen the legal form of an agreement would need to be agreed in advance. There are several possibilities which need to be separately examined from a legal point of view.



## 6 THE CASE OF THE INFORMATION & COMMUNICATION TECHNOLOGIES SECTOR (ICT) IN THE CEFTA REGION

The ICT industry plays an important role in encouraging economic growth and contributes to greater access to basic services such as education, healthcare, finance, while also improving the ways these services are provided to citizens. ICT broadens the reach of technologies such as high-speed Internet, mobile, broadband and computing. The parties that have a more advanced ICT sector present the highest levels of competitiveness, suggesting that having a country enabled by ICT improves the overall performance of its economy in the long run.

The CEFTA region as a whole has a rapidly growing ICT sector industry which represents 1.2% of regional GDP and is expected to grow by 9% by 2011 on the basis of 2009.

The mobile telephony is one of most developed segments in the CEFTA Parties. Mobile telephone subscriptions in 2008<sup>4</sup> had covered more than 100% of population in Croatia (132%), Macedonia, FYR (122%), Montenegro (118%). Albania (99%), Serbia (98%), Bosnia and Herzegovina(84%) and Moldova(78,1%) are approaching closely to 100%.

The broadband internet penetration in 2008<sup>5</sup> in CEFTA Parties has been lower than the average of 23% for EU countries. Croatia, Montenegro and FYROM have reached around 10% of broadband internet subscribers per 100 population, while Bosnia and Herzegovina, Serbia, Moldova - around 5%. Albania is having the lowest level of penetration (2%).

E-government has changed the way government organisations deliver services to citizens and the use of ICT to provide public-sector services, transactions, and interactions — has improved and made more efficient the interaction on both sides. According to the Government Online Service Index<sup>6</sup> (2009) that assesses the quality of government's delivery of online services, out of 133 countries Croatia is placed on the 40th rank, while FYROM has 68<sup>th</sup> rank, Montenegro – 71<sup>st</sup>, followed by Albania – 72<sup>nd</sup>. Bosnia and Herzegovina has been placed on 86<sup>th</sup> rank and Serbia – 96<sup>th</sup>.

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<sup>4</sup> International Telecommunication Union, World Telecommunication/ICT Indicators Database 2009;

<sup>5</sup> International Telecommunication Union, World Telecommunication/ICT Indicators Database 2009;

<sup>6</sup> United Nations, UN e-Government Survey 2010: Leveraging e-Government at a Time of Financial and Economic Crisis;

Related to the political and regulatory environment it is to be mentioned that a complex indicator of assessment<sup>7</sup> is used which includes six main group indicators: regulatory independence, SMP (Significant Market Power) and safeguards, market access wired, market access radio, interconnection and special access, dispute resolution and appeal. This indicator shows that Croatia and FYROM have full compliance, while on the opposite side Serbia was qualified to have low compliance.

Full Compliance	High Compliance	Medium Compliance	Low Compliance
Croatia	Albania	UNMIK Kosovo	Serbia
FYR Macedonia	Bosnia & Herzegovina	Moldova	
		Montenegro	

Source: Comparative assessment of the telecommunications sector in the transition economies, European Bank for Reconstruction and Development (EBRD), December 2008.

The CEFTA region has emerged as a strong contender in at least three segments: software development, back-office development and call centres, however, in a situation of strongly segmented and fragmented national markets. On the demand side, the rise in BPTO services, and especially information technology related services (IT services), has been fuelled by customer requirements of cost reduction, a focus on core competences and especially the need and ability to leverage external expertise.

Some companies in the CEFTA region have evolved into full BPTO services firms. Suppliers of these services have invested into attracting and training well qualified employees. The average size of a company in the BPTO sector in the CEFTA region is 13 employees per company with very few employing more than 50 employees. In the case of UNMIK Kosovo the average size is even smaller, i.e. 1 – 3 employees per company. Because of their size, these companies do not have the time nor the means to devote its energies to employee development and training in sorely needed technical skills, especially those related to information technologies. It is therefore widely believed, that education and vocational training, and therefore the supply of skilled labour in accordance with market demand is the function of the state. Up to 80% of costs in the BPTO sector services are employee related. Labour costs in the BPTO sector are rising. In order for the CEFTA region to maintain the competitive advantages and leading edge in specialised services it needs, as a whole, higher skilled levels and a sufficient supply of appropriately skilled, experienced and well trained personnel. Specialties that are based on business process experience and analytical capabilities are in high demand.

The cost of labour in services is comparatively lower (up to five times) in the region than, for example, in Hungary or Poland. In addition the proximity to the EU and other regional markets makes the CEFTA region a prime location for companies interested in outsourcing some of their operations, therefore an export development opportunity in value added and specialized services.

<sup>7</sup> The compliance score is as follows; Full Compliance means an assessment score of 90-100; High Compliance means an assessment score of 75-89; Medium Compliance means an assessment score of 50-74; Low Compliance means an assessment score of under 50. Compliance in this context should be understood as compliance with the World Trade Organisation (WTO) Reference Paper on Telecommunications Services. It specifically does not mean full compliance with EU regulatory framework(s).

Facilities have developed closer to the customers and CEFTA region companies have been able to adapt to customer requirements. There has been investment from EU companies and from multinationals, employing a larger number of local employees, in order to cover niche markets, or specific client segments (e.g. foreign banks and companies that have operations in the CEFTA region). For specific clients, call centres have developed. For software development, sector specific and individual business driven solutions have been developed, i.e. Sector-specific capabilities, offering complete solutions, not just programmes.

On a national level an ICT cluster exists in Serbia, which comprises 100 leading private ICT companies in Serbia, and representatives of research, academic and other institutions. ICT services companies need to develop close linkages with vertical industries, for example, tourism and pharmaceuticals, as a means of conceptualising and delivering advanced ICT solutions, and benefit from government incentives in the area of research and development.

The region as a whole (and some economies in particular) is suffering from three basic problems:

- a) The so called „skills gap“, and insufficient supply of skilled labour;
- b) The firms in the region are too fragmented to be able to compete effectively; and
- c) A closed and conservative education system that does not correspond to the market needs, including lack of investment.

The other problem are inflexible Mode 4 policies, especially since IT related services are labour intensive and require personnel that is not in any executive or decision-making positions. In Albania, Bosnia and Herzegovina and UNMIK Kosovo, there is low-cost, volume-driven, back-office work in data processing, payroll management, etc., while in other areas (such as Croatia and Serbia) companies are focused on high growth segments in financial services and mobile telecommunications. It is estimated that Croatia, which is the most developed CEFTA Party in the ICT sector in the region, lacked more than 5000 IT experts in 2008; it is also estimated that this shortage would grow by 25% by the end of 2010. It is also estimated that Croatia has one of the highest levels of “brain-drain” in the region and in Europe in general (29.4%).

Short-term opportunities for business process and technology outsourcing (BPTO), in “hard“ and “soft“ capabilities already exist. Language capabilities are strong across the region and it has been already practically demonstrated that multilingual call centres are a viable option. Some of the CEFTA Parties have emerged as leaders in software development (Croatia, Serbia, Macedonia FYR).

The general trend is towards developing value-added services, towards innovation in customized electronically-supported solutions. In Croatia, for example, the ICT infrastructure has reached or even surpassed the level of some EU countries, and Bosnia and Herzegovina, Macedonia FYR and Serbia have made major strides in the development of infrastructure in major cities, while peripheral areas are lagging behind.

Because of the need for technology specific skills, the lack or inadequacy of education and training programmes under the auspices of the public sector, there is an increasing demand for investment into human resources development through private sector involvement. There is an evident correlation of the ICT sector with the educational services sector in terms of policy and investment. There are no evident barriers to Modes 1, 2 (such as tele-learning and distance learning) and 3, however, specific regulations regarding curricula and

staffing constitute a de-facto barrier in this sector.

*The Foreign Direct Investment and exports in the outsourcing area are not recorded or accounted for in national statistics.* The ICT sector is considered marginal in the region. There are about 12000 companies in the region, of which 7000 are engaged in software development. Companies believe that significant policy changes are needed and governments to address the human capital development issue. There is a need for industry consolidation on a regional level.

*ICT companies need the freedom to operate beyond national borders.* CEFTA services negotiations can significantly improve intra-regional market access or/and opt for an ICT free trade area, that would enable business clusters, the harmonisation of the evaluation of the skills gap by CEFTA Parties governments, and support better-tailored educational programmes and openness to private investment. This can be done through more specified multilaterally agreed commitments.

The ICT sector is especially important for potential enhanced regional cooperation on a policy level. This should be based on specific and meaningful liberalisation efforts in the area of all modes of supply, combined with liberalized policies in related services sectors, such as educational services and research and development. This would allow better networking of ICT companies, enlarge the market, and enable transfers of know-how, experience and technologies.

The vision is to establish links among networks and technologies, regardless of national borders, links between people and organisations, skills and solutions, contents and services providers and users, based on actual projects and top knowledge. Such an approach to this sector by policy-makers and regulators would stimulate the development of new enterprises and - through multiplication effects – competitiveness on a global level.

## 7 CONCLUSIONS AND RECOMMENDATIONS

Based on the existing available information and data it can be concluded that overall the regional services market is not integrated, and the services markets of the individual CEFTA Parties are under-developed, i.e. below their economic potential. These markets have incompatibilities; there is a lack of policy focus and support; legal differences and market protection exist in certain sectors, and other factors that prevent the development of an integrated regional services market.

CEFTA Parties have certain specific sectoral development strategies, but no national strategies for the overall augmentation of the services economy and review of legislation and regulations. At the regional level, significant progress could be made in the area of rationalization and improvements, up-dating of services regulations, across all jurisdiction and levels. There is a case for harmonisation of some of the basic requirements or for their elimination.

All CEFTA Parties have specific sectoral interests in services resulting from the fact that economically they are in fact different. Regardless of the formal commitment to negotiate services, as a logical upgrade to the free trade area in goods, there are many other compelling economic reasons for such an exercise to begin in earnest. There is a long list of benefits, but there is a need in the region **to strengthen the supply-side capacities in services, to modernise them, to create a competitive difference for services firms and service suppliers.**

Certainly the basic GATS principles, the right to regulate among them, the requests that services liberalisation should be specific and cover substantially all sectors and modes of supply and that any agreement between the parties shouldn't adversely affect other parties which are no party to the agreement, should be the guiding principles.

The recommended sectoral approach in these regional negotiations should focus on the following:

- Transport services, including maritime transport, air transport, auxiliary services, with an emphasis on road transport, for freight and passengers and logistics;
- Professional services (and other business services);
- Telecommunications;
- Distribution services;
- Financial services (other than banking, with an emphasis on insurance);
- Construction services;
- Energy services;
- Environmental services;

- ICT-related services;
- Educational services (higher, secondary, adult education)
- Medical services (private).

For the purposes of negotiations, the sectors above can be subdivided into subsectors, of which each has a commonly accepted list of so called core activities.

The minimum negotiating targets regarding the horizontal issues refer to:

- **National treatment** - Eliminate/reduce those that have no convincing justification, including real-estate ownership policies, reciprocity, nationality, minimum equity requirements, special conditions in the area of licensing and approval, and others.
- **Mode 1** - No commercial presence requirement in the initial phases. Extended periods of temporary stay for marketing purposes. Commit commercially meaningful sectors. Reduce the dependence on mode 3 of specific sectors.
- **Mode 2** - Exclude limitations.
- **Mode 3** - Review the possibilities to remove key limitations, such as types of legal entity, foreign equity limitations, citizenship etc. Eliminate all economic needs tests. Eliminate limits to the number of services suppliers. Reduce exclusive rights in some key sectors (energy distribution).
- **Mode 4** - Annex on mode 4 policies. Abolish remaining intra-regional visa requirements. Enhance the coverage, incl. de-linked from commercial presence. Extend the length of stay periods and eliminate residence requirement, or contract requirements unless strictly necessary. Eliminate any economic needs tests for temporary relocations.

It seems that the **key to regional liberalisation of the services trade is in mode 4 policies** and implementation, and in the closely connected mutual respect of institutions and recognition of qualifications, and in line with economic realities the identification of existing barriers designed to limit competition.

There is no doubt that the **potential for the launching of services negotiations within the CEFTA Parties exists**, that they can be specified and directed to the key sectors and issues, as long as there are unbound services activities, exemptions and exclusions and limitations and restrictions that are applied on an MFN basis.

It would require a systematic approach, recognition that regional negotiations can be more flexible and relaxed, and a well managed approach, both within the negotiating parties, as well as in respect of the inclusion of all the relevant authorities and stakeholders. Much would depend on transparency, identification of real barriers, elimination of redundant, unnecessary regulations and relaxation of limitations and requirements.

The negotiations should start at the earliest in a systematic way.

The process would allow the development of new and modern services, innovation, and establishment of new firms and thus higher levels of employment. Undoubtedly a great potential lies in the cross-border trade.

Through consultations in the capitals of the Parties, industry associations have expressed an interest in the establishment of regional chambers (such as in the area of legal services,

transport, etc.) as fora for the exchange of information and discussion of questions of mutual concern.

Regional negotiations have an advantage in the fact that partners in the CEFTA region are closely connected and are familiar with each other and have many traits in common.

The basic recommendation would be to opt for a **multilateral and/or plurilateral approach** as best manageable. Bilateral negotiations could prove time-consuming and could result in uneven outcomes. **Sectors and especially subsectors should be approached in an integrated fashion**, due to the high interdependence and interactivity, using all available tools. The Parties should take a pro-competitive stand.

Negotiations in the area of services on a regional basis is a very complex initiative which requires leadership, very good coordination and understanding that they are mutually beneficial, that they affect people's quality of life and economic prosperity.

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