

# **Barriers to Trade in Services in the CEFTA Region**

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## ABBREVIATION AND ACRONYMS

BiH	Bosnia and Herzegovina
CEEC	Central and Eastern European Countries
CEFTA	Central European Free Trade Agreement
DSL	Digital subscriber line
EC	European Commission
EU	European Union
GATS	General Agreement on Trade in Services
GDP	Gross domestic product
GVA	Gross value added
IP	Intellectual property
IRI	Investment Reform Index
ICT	Information and communication technology
LPI	Logistics Performance Index
SEE	Southeast Europe
OECD	Organization for Economic Co-operation and Development
TRIMS	Trade-related investment measures
WTO	World Trade Organization

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# Barriers to Trade in Services in the CEFTA Region

## 1. INTRODUCTION

1. In the past decade the economic performance of the Central European Free Trade Agreement (CEFTA) countries<sup>1</sup> was solid, especially just before the global economic crisis, which hit most CEFTA countries hard. Expansion of trade had contributed to economic growth in most CEFTA countries even though trade, measured by the share of the export of goods and services in total output, was lower than in many of the states that joined the European Union (EU) in 2004 and 2007 (New Member States). The post-crisis agenda in the CEFTA region has focused on how to make exports a greater component of sustained growth. Although that would rely primarily on exports of goods, services could also make a significant contribution, particularly through the indirect effect of facilitating exchange of goods.

2. After the armed conflicts of the 1990s, later in that decade economies in Southeast Europe (SEE) began to reintegrate their trade, signing 32 bilateral free trade agreements.<sup>2</sup> In 2006, these bilateral agreements were replaced by a regional agreement, CEFTA. The agreement, which entered into force in 2007, liberalized all trade in industrial goods and most trade in agricultural goods. CEFTA Article 1 sets out the objective: to “*expand trade in goods and services and foster investment by means of fair, clear, stable and predictable rules.*” Moreover, article 27 refers to trade in services and states that “*the Parties will gradually develop and broaden their co-operation with the aim of achieving a progressive liberalization and mutual opening of their services markets, in the context of European integration, taking into account the relevant provisions of the General Agreement on Trade in Services (GATS) and commitments entered into under GATS by Parties being members of the World Trade Organization.*” Although the agreement did not contain specific provisions on sectoral liberalization of trade in services, article 29 allowed for negotiations to be launched with the aim of achieving high liberalization of trade in services<sup>3</sup>. In addition, it committed signatories to deepen market integration in the medium term with provisions on matters related to trade in services, such as electronic commerce, intellectual property (IP) rights, public procurement, and investment.

3. Liberalization of services among the CEFTA countries intensified prior to the CEFTA Agreement, in the context of various regional sectoral initiatives. Under the auspices of the European Union, in 2006, the SEE countries, which include all CEFTA countries except Moldova, joined the

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<sup>1</sup> The CEFTA countries are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Kosovo, Moldova, Montenegro, Romania and Serbia. In the case of Kosovo, the CEFTA agreement was signed by the United Nations Mission in Kosovo. Following the ratification, Kosovo proclaimed independence in February 2009.

<sup>2</sup> The original CEFTA was signed in December 1992 by Czechoslovakia, Hungary and Poland. In 2006, the countries of SEE including Bulgaria, Romania and Moldova signed the Agreement on amendment and accession to CEFTA. In 2007 CEFTA entered into force for all signatories except Bulgaria and Romania, which left CEFTA when they joined the EU on January 1, 2007.

<sup>3</sup> Article 29: The Joint Committee shall review on an annual basis the results of the co-operation referred to in Article 27 and, if appropriate, recommend, following its rules of procedure, the launching of negotiations with the aim to achieve progressively a high level of liberalization in accordance with Article V of GATS. The commitments undertaken further to such negotiations shall be set out in schedules forming an integral part of this Agreement.

European Common Aviation Area and established a unified Energy Community in SEE in line with EU energy legislation. Then, in 2008, the Council of the European Union decided to open negotiation of a Transport Community Treaty between the European Union and SEE countries, with the objective to initially promote cooperation in this area among the SEE countries. Then, the Stabilization and Association Agreement that these countries concluded with the EU as part of the EU accession process, contained requirements on aligned domestic legislation with that of the EU in several sectors (e.g. telecommunications and banking), which implied opening of the domestic markets to foreign service providers.

4. Reaping the benefits of a larger market often requires deep regional integration that goes beyond trade in goods. Recent studies provide evidence of the positive effects on economic growth, direct and indirect, of trade in services. Mishra et al. (2011) demonstrate how the exports of services, and their sophistication, promote growth. Arnold et al. (2007, 2010) confirm the link between services policy and the productivity of manufacturing firms that rely on services as inputs; they demonstrate, for the Czech Republic and India, how deregulating service sectors increased the productivity of manufacturing firms. Integrating goods and services markets would enable the small CEFTA economies to become part of not only regional but also global supply chains and production networks, which in turn would lower costs to consumers and make these economies more attractive to foreign investment. Moreover, since regional integration is a prerequisite for joining the EU, opening the regional services market would prepare CEFTA economies for functioning within the EU single market.

5. This paper describes the economic importance of the service sector in CEFTA countries and current barriers to trade in services between CEFTA countries. It looks at four sectors: construction, land transport, legal services, and information and communication technology (ICT) services. The intent is to stimulate dialogue on trade in services between decision-makers in CEFTA countries.<sup>4</sup>

6. In CEFTA economies, export of services accounts for about 10 percent of GDP in noncoastal countries and much more in coastal countries, where foreign currency earnings from tourism are the dominant form of service exports. Though CEFTA countries have opened their markets considerably, mostly because they are pursuing accession to the EU and the World Trade Organization (WTO), there are still obstacles to trade in services. Some, such as the movement of professional workers, are general; others are sector-specific.

7. In what follows, the next section illustrates the importance of the services sectors in CEFTA economies and analyzes trends in services trade and in intraregional trade for countries that have such data available. The third section describes general barriers to trade in services, and specific barriers for the four sectors specified. The analysis reviews the legal and institutional framework for trade in services and features assessments by regional companies that export such services. The final section summarizes the findings.

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<sup>4</sup> This analysis does not cover Moldova because its trade in services with the rest of the CEFTA region is marginal, for both historical and geographic reasons. Also, since Moldova is not considered to be aspiring to accession to the EU, the need to transpose EU legislation and prepare for becoming part of a much larger open market is minimal.

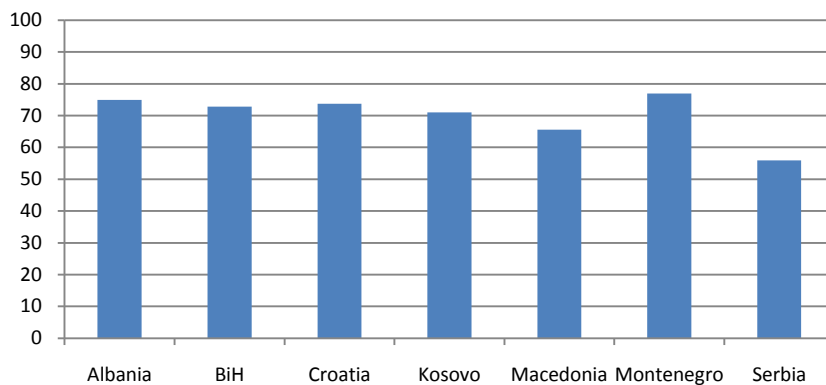
## 2. SERVICES AND TRADE IN CEFTA COUNTRIES

### The Share of Services in the Economy

8. Services account for the largest share of the economy in all CEFTA countries, and the share is increasing. On average, they account for more than two-thirds of gross value added (GVA) in the region. The shares of services in the economies of Albania, Bosnia and Herzegovina (BiH), Croatia, Kosovo, and Montenegro range from 71 to 77 percent of GVA. The only country where services represent less than 60 percent of GVA is Serbia, though the share there has been rising continuously for the past decade. In most countries, the service sectors have been growing above the average economic growth rate. Exceptions are Albania, Kosovo, and Montenegro, where the share of services, though high, has been flat. In this respect CEFTA countries are thus close to where they are ranked in terms of GDP per capita—somewhere between middle- and high-income countries. The share of services in GDP<sup>5</sup> in middle-income countries averages about 53 percent and in high-income countries about 73 percent (World Bank 2010c).

9. “Nontradable”<sup>6</sup> services dominate the economies of CEFTA countries, in most of which wholesale and retail trade and real estate are the largest service sectors.<sup>7</sup> Wholesale and retail trade on average contributes about 15 percent to GVA, real estate and other business services almost 12 percent, and construction about 8 percent (though above 10 percent in Albania and Kosovo). Coverage of professional services is in general weak; all these services are lumped together under “other.”

**Figure 1. Average Share of Service Sectors in CEFTA Economies**



*Source:* National statistics offices.

*Note:* Kosovo data are available only for 2005–2007.

<sup>5</sup> The link between GVA and GDP can be defined as follows: GDP (at current market prices) equals GVA (at current basic prices) plus taxes on products less product subsidies.

<sup>6</sup> *Nontradable* here refers to services that require local presence. Of course, such services could be “traded” through mode 3 (for discussion of the modes, see Box 1).

<sup>7</sup> Sectoral data on value added are not necessarily comparable because there are different reporting standards and classifications of sectors.



10. Which sectors are important varies by country. For Albania, the two most important are trade (including hotels and restaurants) and construction, which together accounted for 37.5 percent of GVA for 2007–2009 (see Table 2). Over the same period, for Bosnia, trade and real estate are most important, accounting for about 25 percent of GVA; in Croatia two most important sectors are financial services (including real estate) and trade accounted for about 35 percent of GVA. FYR Macedonia has a lesser concentration, with the two most important sectors, trade and transport, accounting for less than 25 percent of GVA. In Montenegro, trade and transport are most important, contributing about 27 percent of GVA (though real estate follows by less than 1 percentage point). These two sectors contributed to about 27 percent of the total GVA. In Serbia two most important sectors – real estate and trade accounted for 31.7 percent of GVA. Finally, for Kosovo, for 2005–2007 (for which data are available) the two most important sectors were real estate (including business and professional services) and trade accounted for about 26.6 percent of the GVA.

**Table 1. Shares in the National Economy of the Top Four Sectors by Country**

	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>Albania</b>			
Trade (incl. hotels and restaurants)	22.2	22.1	22.2
Construction	15.5	15.6	14.8
Transport	5.7	5.6	5.6
Post and telecommunications	4.5	4.5	4.6
<b>Bosnia</b>			
Wholesale and retail trade	15.6	16.4	15.7
Real estate and business services	11.2	10.2	10.8
Transport	8.7	8.3	8.3
Construction	6.1	6.7	6.4
<b>Croatia</b>			
Financial and real estate	22.9	22.9	24.4
Wholesale and retail trade	12.7	12.2	10.9
Transport	9.1	8.6	8.3
Construction	7.7	8.3	8.0
<b>FYR Macedonia</b>			
Wholesale and retail trade	15.1	14.1	15.0
Transport	9.3	9.3	9.0
Construction	6.6	5.7	5.9
Real estate and business services	4.1	4.9	4.9
<b>Montenegro</b>			
Wholesale and retail trade	16.8	15.4	14.4
Transport	11.2	11.7	11.5
Real estate and business services	12.0	10.2	10.1
Construction	7.3	7.7	6.5
<b>Serbia</b>			
Real estate	18.2	18.5	19.0
Wholesale and retail trade	12.7	13.4	13.1
Transport	8.9	8.9	10.1
Construction	5.2	5.6	5.2
<b>Kosovo</b>			
	<b>2005</b>	<b>2006</b>	<b>2007</b>
Real estate and business services	14.8	14.9	14.9
Wholesale and retail trade	11.8	11.9	11.4
Construction	9.7	10.4	12.0
Transport	4.8	5.3	4.3

*Source:* National statistics offices.

## Trends in Services Trade

11. International trade in services has been expanding continuously as technologies advance and domestic markets open up. New information technologies, in both developed and developing countries have changed the processes for producing services and created new types of services. Some services can now be unbundled and produced at different locations; others have become a “final export” for direct consumption—previously, services were an input of trade in goods (Mishra et al. 2011). As a result, the production cycle has become segmented, which in turn has led to expansion of services trade in terms of both the types being traded and their geographical reach, through off-shoring. There has also been a global trend toward liberalizing service sectors, often beyond what countries had committed to in the General Agreement on Trade in Services.<sup>8</sup> Liberalization has also been done in the context of bilateral and regional free trade agreements whose coverage addresses various aspects of services trade.

12. Trade in services has been growing at 15 percent a year since 1980, bringing global services trade to an average of 12 percent of GDP for low-, middle-, and high-income countries (Cattaneo et al. 2010). For example, in 1986 only 6 percent of services value added in the world’s economy was exported, but as more services became tradable, by 2008 this share had risen above 10 percent (Mishra et al. 2011). Today, half of global foreign direct investment is going to services sectors.

### **Box 1. Modes of Supply and Examples of Services**

The scope of activities that comprise services is defined in the General Agreement on Trade in Services (GATS) of the World Trade Organization. In contrast to traded goods, services are often intangible, invisible, or perishable, and usually require simultaneous production and consumption. The GATS takes a wide view of trade in services, which is defined to include four modes of supply based on where the service supplier is present. Table B1.1 presents the four modes of supply and for each mode gives sector examples.

**Table 2. Modes of Cross-Border Supply of Services.**

<b>Presence of Supplier</b>	<b>Other Criteria</b>	<b>Mode</b>	<b>Examples of Sector Relevance</b>
<i>Service supplier is not present in the territory of the member</i>	Service supplied in the territory of one member from the territory of another	Cross-border supply [Mode 1]	Accounting, engineering, health, ICT, and legal services
	Service supplied to a consumer of member <i>outside</i> his or her territory, in the territory of another member	Consumption abroad [Mode 2]	Tourism and health and legal services
<i>Service supplier is present in the territory of member</i>	Service supplied in the territory of one member through the presence of the commercial supplier from another	Commercial presence [Mode 3]	Accounting, construction, distribution, engineering, environmental, health, ICT, and legal services
	Service supplied <i>in</i> the territory of member by supplier from another member who is present as a natural person	Movement of natural persons [Mode 4]	Accounting, construction, engineering, environmental, health, ICT, and legal services

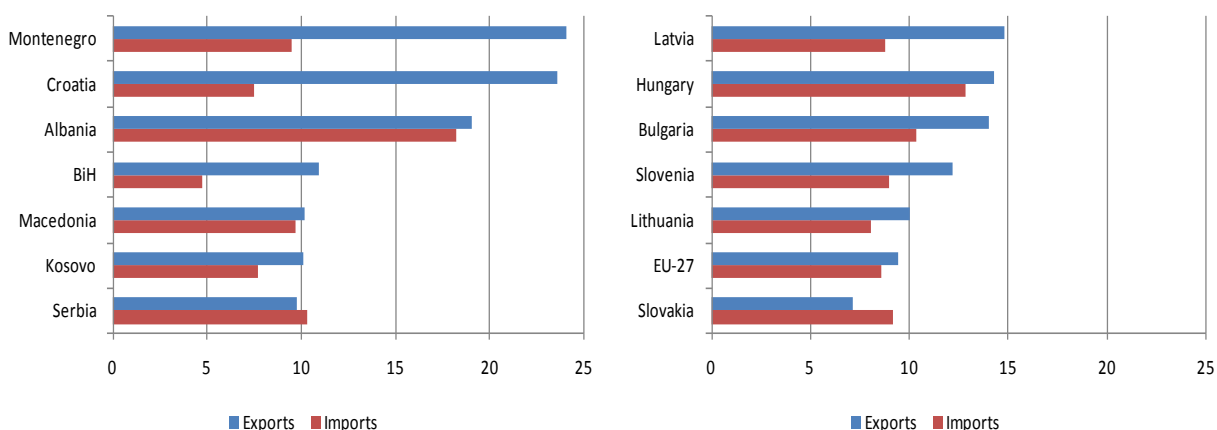
*Source:* Cattaneo et al. 2010.

<sup>8</sup> The General Agreement on Trade in Services (GATS) is a WTO treaty that entered into force in January 1995.

## Significance of CEFTA Trade in Services

13. As elsewhere, trade in services has been gaining in importance in the CEFTA region, where service exports brought in, on average, EUR 16 billion a year for 2007–09 and accounted for some 10 percent of GDP in the noncoastal countries, 19 percent in Albania, and over 23 percent in Croatia and Montenegro, which both have significant tourism receipts (about 70 percent of total service exports). The average ratio of **services** imports to GDP is about 10 percent, with Albania (18 percent) at the extreme high end and BiH (5 percent) the extreme low end (see Figure 2). Thus services trade is relatively well-developed in the CEFTA region: the EU’s exports and imports as a share of GDP are just below 10 percent, which is similar to CEFTA’s (excluding tourism receipts). In some EU-10 countries, however, service exports have reached close to 15 percent of GDP, which is higher than not only CEFTA but also the world average.<sup>9</sup>

**Figure 2. Services Trade in CEFTA and the EU, 2007–09 average (Percent of GDP)**

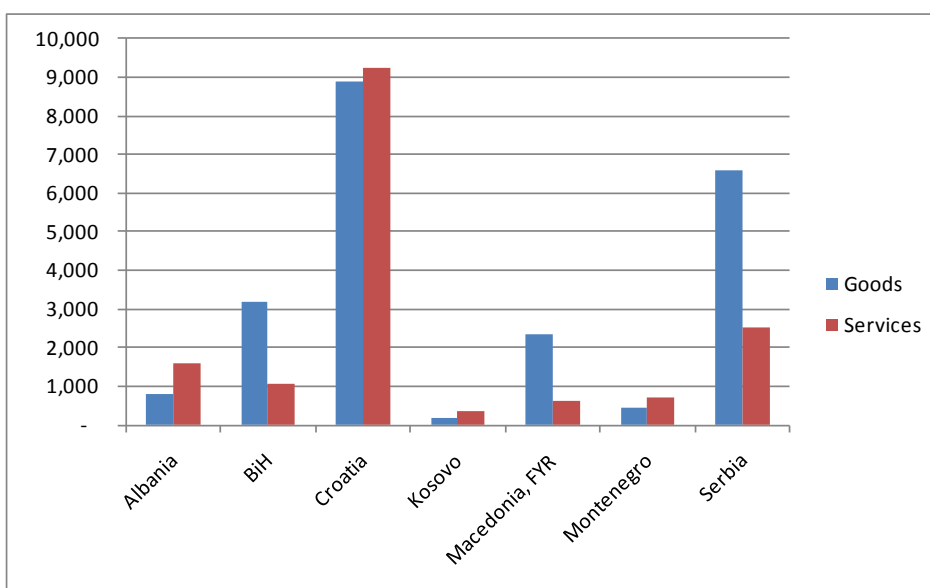


*Source:* National authorities (central banks) and Eurostat.

14. In most countries growth in services exports has surpassed growth in goods exports. In the past decade in Croatia, for example, while goods exports have not even doubled, services exports have almost quadrupled (led mostly by tourism). Up to the global economic crisis growth in services exports was outpacing growth in goods exports in most CEFTA countries (see Table 3). In 2008, only in BiH and Kosovo did goods exports rise faster than exports of services. The global crisis proved that export of services was much the more resilient: the decline in services exports from 2008 to 2009 was much lower than in goods exports, and two countries even managed to maintain growth in service exports.

<sup>9</sup> The quality and comparability of CEFTA national accounts statistics region are sometimes questionable because of the quantity of informal activity; all discussions based on GDP shares need to be viewed with caution.

**Figure 3. Exports of Goods and Services, 2007–09 Average (EUR ) Million**



Source: National authorities (central banks) and IMF.

**Table 3. Change in Exports of Goods and Services (Percent)**

	2008		2009	
	Goods	Services	Goods	Services
Albania	16.7	19.3	-18.1	1.8
BiH	13.9	6.0	-17.1	-10.9
Croatia	6.8	10.7	-21.5	-16.2
Kosovo	22.7	5.7	-25.2	21.8
Macedonia, FYR	8.9	15.6	-28.7	-10.2
Montenegro	-9.4	11.5	-36.6	-9.3
Serbia	15.5	19.0	-19.8	-8.8

Source: National authorities (central banks) and IMF.

### The Structure of CEFTA's Services Exports

15. The structure of trade in services varies across the region. The main distinction has to do with the role of tourism (see Table 4).

16. *Travel* (tourism receipts) is the major source of inflows for countries on the Adriatic coast, accounting for about 70 percent of total service exports for Albania, Croatia, and Montenegro, and 50 percent for BiH. The share in land-locked FYR Macedonia and Serbia was 25 percent. The region received EUR 9.6 billion in tourism receipts in 2009, two-thirds of which went to Croatia.

17. *Transport* is the most important traded service after tourism: CEFTA receipts have averaged about EUR 2.2 billion a year in recent years. Inflows from transport services represent 31 percent of nontourism service exports in Serbia and 44 percent in Croatia, reflecting both the competitiveness of their transport companies and their importance as transit countries. Only in Kosovo are exports of transport services less important; there transit is negligible, given the political problems that Kosovo’s transport companies face (e.g., non recognition of license plates by some neighbors and EU countries) and the closed border to the north.

18. *Communication* services are the third largest export category; together with computer and information services, they brought the region about EUR 850 million a year for 2007–09. *Construction* followed with some EUR 500 million a year. The general category of “miscellaneous professional, business and trade-related services” (legal, consulting, architectural, accounting and other services) accounted for over EUR 1.3 billion annually, but subsector data are not available to assess which areas were most important. The volume of trade in *financial* and *insurance* services has been relatively small, less than EUR 200 million in exports annually.

**Table 4. Structure of Service Exports, 2007–09 Average (EUR , Million)**

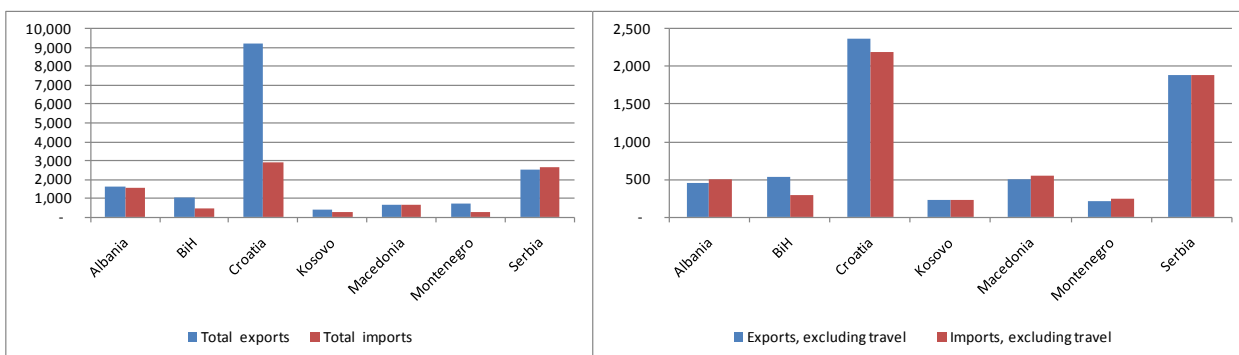
	Albania	BiH	Croatia	Kosovo	Macedonia	Montenegro	Serbia
<b>Total service exports</b>	<b>1,607</b>	<b>1,063</b>	<b>9,214</b>	<b>376</b>	<b>656</b>	<b>701</b>	<b>2,515</b>
Travel	1,158	525	6,864	145	156	483	629
Communications services	81	95	204	54	58	29	88
Construction services	15	155	93	8	38	42	184
Insurance services	4	8	22	13	6	2	18
Financial services	27	2	37	3	3	4	22
Computer and information services	7	n/a	102	2	30	3	86
Merchandising and other trade-related services	n/a	n/a	97	n/a	25	9	59
Misc. professional and technical services	n/a	n/a	636	n/a	105	28	528
Personal, cultural, and recreational services	28	n/a	68	1	13	10	105
Government services, not included elsewhere.	34	3	0	98	13	0	16
Other services	108	64	48	22	6	2	212

*Source:* National authorities (central banks).

*Note:* Data for FYR Macedonia are for 2008–09.

19. Overall, the CEFTA region is a large net exporter of services, but once tourism is taken out trade seems to be balanced. Total services exports (EUR 16.1 billion) were almost double imports (EUR 8.7 billion) for 2007–09. Tourism inflows are responsible for the surplus. Once tourism receipts and outflows are excluded, services exports (EUR 6.2 billion) were only slightly higher than imports (EUR 5.9 billion). BiH is the only CEFTA country with significant net exports due primarily to exports of construction services. Croatia’s exports are slightly higher than imports; Kosovo and Serbia have balanced trade; and the rest are by a small margin net importers.

**Figure 4. Net Trade in Services by Country, 2007–09 Average (EUR Million)**



Source: National authorities (central banks).

### Intra-CEFTA Trade in Services

20. Trade in services within CEFTA is difficult to assess because of data limitations. Statistics on service exports and imports by country are available only for Croatia, Montenegro, and Serbia, and then only with limitations. For instance, Croatia does not collect data on tourism receipts by country of origin, even though tourism is its most important source of export revenues, and Serbia’s service trade statistics by country of origin are less disaggregated than overall service trade statistics (data are not available for ICT, insurance, government services, etc.). The other CEFTA members do not collect data on their own services trade.

21. The data available suggest that services exports within the region have been significant: Croatia’s service exports to the region averaged EUR 286 million a year between 2007 and 2009, and Serbia’s were EUR 261 million, plus EUR 36 million in tourism receipts. Montenegro’s exports were expectedly more modest, at EUR 58 million a year, though, in addition, Montenegro has considerable tourism receipts from the CEFTA countries (estimated at about EUR 270 million a year).

22. In relative terms, though, intraregional trade in services seems to be less than trade in goods. The share of trade in goods is significantly greater for Serbia and Croatia and to a lesser extent Montenegro (see Table 5).

**Table 5. Share of Exports within CEFTA in Total Exports, 2008 (Percent)**

	Goods	Services
Croatia	23.0	12.9
Montenegro	34.0	26.6
Serbia	33.1	13.9

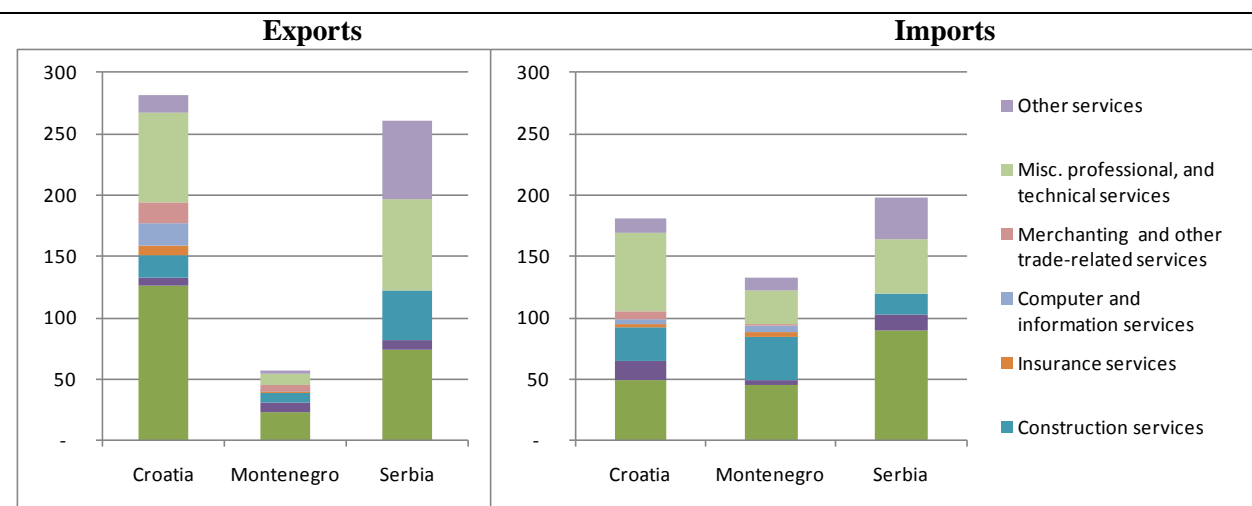
Source: Handjiski et al. (2010) and national authorities.

23. *Transport* is the most traded service, accounting for over 40 percent of trade within the region for Croatia and Montenegro and 28 percent for Serbia. This is to be expected given both sizable merchandise trade in the region and the large amounts of goods in transit to European and other markets that in crossing the two countries pay fees to road and rail providers. Montenegro’s statistics by mode of transport show maritime transport gaining importance, given the growth in the Port of Bar, which serves other CEFTA countries, over road and rail. Data by mode of transport are not available for Croatia and Serbia.

24. *Construction* is the second most important services sector, accounting for 15 percent in Serbia, 12 percent in Montenegro, and 6 percent in Croatia. In Serbia exports of construction services rose from EUR 29 million in 2007 to EUR 53 million in 2009. Construction is also important for FYR Macedonian companies, although precise data are not available.

25. *Miscellaneous business, professional, and technical services* account for over 25 percent of total intraregional exports for Croatia and Serbia and 15 percent for Montenegro. For Croatia, the only country that collects trade data by subsector, architectural and engineering services are the largest sub segment (EUR 35 million in annual exports), followed by legal, consulting and accounting services (EUR 24 million), and advertising and market research (EUR 10 million). For *computer and information services*, Croatia recorded EUR 18 million of annual exports, compared to less than EUR 1 million for Montenegro; Serbia does not have regional trade data for this sector.

**Figure 5. Trade in Services Within the CEFTA Region, 2007–09 Average, (EUR , Millions)**



Source: National authorities (central banks).

Note: Tourism receipts not included.

26. On the import side, the same sectors dominate intraregional trade: Transport has the largest share (27–45 percent), followed by construction (9–26 percent), and miscellaneous services (21–35 percent). Montenegro’s statistics by mode reveal that air transport is most important (almost half of all transport imports) followed by road. Of Croatia’s imports of miscellaneous services from CEFTA, 60 percent was advertising and market research and another 25 percent architectural and engineering services.

27. Overall, within CEFTA Croatia and Serbia are net exporters of nontourism services and Montenegro is a net importer. Croatia is a large net exporter of transport and ICT services and a net importer of construction services. Serbia, on the other hand, records a surplus in construction services trade and in miscellaneous professional services but is a net importer of transport services. Finally, Montenegro’s intraregional trade balance shows a deficit across all service sectors except communication and trade-related services.

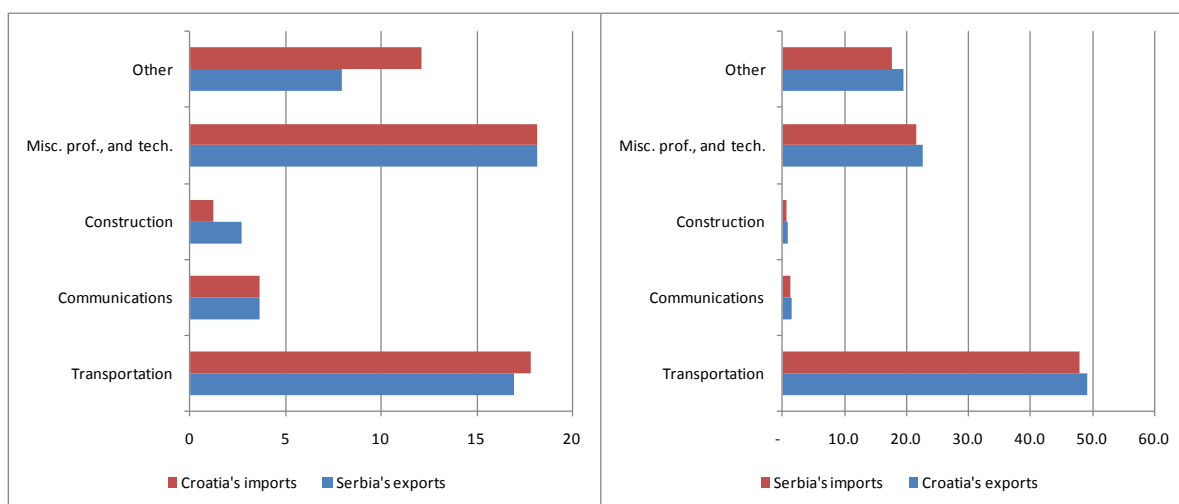


## Box 2. Quality of CEFTA Service Trade Statistics

In most countries statistics on trade in services are scarce and imprecise, in part because services are non tangible, which can make them difficult to capture. This is particularly true of the CEFTA countries. Handjiski et al. (2010, pp. 18–21) have pointed out the concerns about the quality of merchandise trade statistics, noting considerable gaps in mirror statistics between several country pairs.

However, the limited data available on service trade by country and sector do show that recording of service trade seems to be adequate. Mirror statistics for Croatia and Serbia (Figure B2.1) show almost a complete match for most sectors. The only significant exception is that less than 50 percent of Serbia’s construction exports are captured in Croatia’s import statistics.

**Figure 6. Mirror Gap Trade Statistics for Croatia and Serbia, 2009 (EUR Million)**



Source: National authorities (central banks).

### 3. BARRIERS TO TRADE IN SERVICES BY SECTOR<sup>10</sup>

#### General Market Access and Barriers

28. Over the past decade CEFTA countries have made great progress in opening both goods and services markets to foreign competition and investment, a result partly of GATS commitments made during WTO negotiations and partly of pursuing EU membership. All potential candidates for EU membership sign Stabilization and Association Agreements with the EU that include liberalization of services sectors. Moreover, as part of the EU accession process CEFTA countries have signed regional

<sup>10</sup> The assessment of the legal framework related to trade in services among CEFTA countries relied on the background information and data provided by local counsel that were engaged by the World Bank Group for this project during the last quarter of 2010. While the World Bank Group believes the information provided by local counsel to be current and accurate, it cannot guarantee that the information is error-free, and makes no claims, guarantees or assurances as to the accuracy of that background information.

treaties aimed at opening and integrating markets in several sectors within the region and the EU, among them treaties related to aviation and energy. A regional treaty is also being negotiated for railway transport.

29. The next section reviews progress in liberalization and the barriers to trade in services that remain, and the following sections look at specific barriers in four sectors. The assessments are done in terms of aspects identified by Cattaneo et al. (2010): market access, commercial presence and ownership, performance requirements, transparency and protection of rights, and movement of natural persons.

30. In terms of *market access*, for most services (except, e.g., for some transport and legal services), no CEFTA country has legal restrictions on foreign firms establishing a commercial presence, and once established, foreign-owned firms are subject to the same nondiscriminatory rules as domestic firms. The OECD Investment Reform Index (IRI) 2010 confirms that CEFTA countries have made considerable progress in adopting the principle of national treatment and have not added any restrictions in the last four years. It also notes that SEE economies do not use trans-sectoral screening for foreign investment. In this context, the CEFTA agreement does not contain provisions on aspects of the quality of the regulatory processes (which can sometimes affect market access), though there is a provision (article 31) that commits parties to “create and maintain stable, favorable and transparent conditions for investors of the other Parties” and to “grant the necessary permits and administrative authorizations in connection with investments”.

31. Concerning *commercial presence and ownership*, foreign-owned local firms seem to be free to determine their ownership structure (up to 100 percent foreign ownership allowed) and whether they will joint venture with local or other foreign-owned firms. Also, the state has generally pulled out of most service sectors as an owner or monopoly rights holder (with some differences among the CEFTA countries), so foreign-owned firms compete with domestic under the same market rules. The one form of restriction that is common across the region is a 49 percent limitation on foreign ownership in areas related to arms manufacturing, trade, and production.

32. *Performance requirements*, such as local content requirements, have mostly been removed (OECD 2010). WTO members in the region must adhere to the Agreement on Trade Related Investment Measures (TRIMS). BiH, Montenegro, and Serbia are in the process of acceding to the WTO and have made commitments not to apply performance requirements inconsistent with TRIMS. Though not in the WTO accession process, Kosovo also does not impose requirements prohibited by TRIMS.

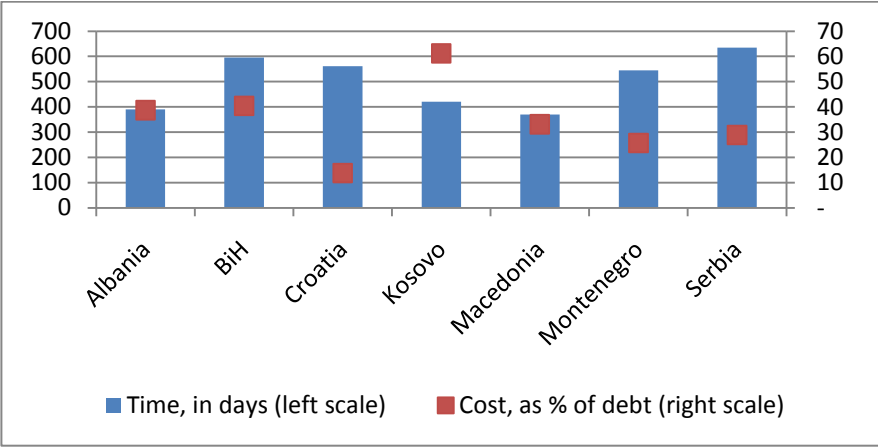
33. Limitations like citizenship requirements for managers, board members, and employees have also generally been removed. Foreign-owned firms are free to use their original names and logos (with some minimal additional requirements, e.g., when the alphabet is different) and can fully repatriate their profits. Last but not least, once locally established, foreign firms may join professional bodies and industry associations.

34. Legal systems in CEFTA members have also advanced significantly in terms of *transparency and protection of the rights of foreign-owned firms*. All CEFTA countries publish laws and implementing regulations in official gazettes and on the websites of the agencies responsible. The high degree of

transparency is confirmed by the IRI (OECD 2010). When dealing with the state, foreign-owned firms follow the same procedures for legal and institutional recourse as domestic firms. For example, foreign-owned firms may appeal administrative decisions through several levels.

35. However, in many CEFTA countries court procedures for enforcing contracts can be very lengthy and costly and discourage foreign firms from providing services. Interviews with construction firms revealed a reluctance to getting involved with private parties because of possible problems with collecting payment. If firms do end up in court, it typically takes more than a year to enforce a contract (World Bank 2011); up to 60 percent of the contract value may be lost in the process.

**Figure 7. Time and Cost of Enforcing a Contract**



Source: World Bank 2011.

36. One aspect of the legal system that matters to foreign firms is the possibility of arbitrating commercial disputes. Modern laws and institutions provide flexible choices for commercial dispute resolution. All CEFTA countries have introduced some sort of alternative dispute resolution,<sup>11</sup> though their use and effectiveness varies greatly by country. Serbian courts are fairly efficient at enforcing arbitration awards, taking only 6 weeks for a domestic award and 11 weeks for a foreign award. In Montenegro, on the other hand, enforcement takes 45 weeks.

<sup>11</sup> All CEFTA countries except Kosovo are party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958), and all except Montenegro have ratified the Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States (1965).

**Table 6. Arbitrating Commercial Disputes**

	<b>Strength of laws index</b>	<b>Ease of arbitration index</b>	<b>Extent of judicial assistance index</b>	<b>Time to enforce domestic award (weeks)</b>	<b>Time to enforce foreign award (weeks)</b>
Serbia	95	71	90	6	11
BiH	73	57	76	n/a	13
Albania	84	41	69	14	15
Macedonia, FYR	93	75	70	15	34
Montenegro	64	60	47	45	45
Croatia	93	71	53	26	48
Kosovo	75	64	28	n/a	n/a

*Source:* Investment Across Borders 2010.

*Note:* The **strength of laws index** (0–100) analyzes both legal frameworks for alternative dispute resolution and adherence to the main international conventions related to international arbitration. The **ease of arbitration process index** assesses whether disputing parties face restrictions or other obstacles in seeking to resolve their dispute; the **extent of judicial assistance index** measures interaction between domestic courts and arbitral tribunals, including the willingness of courts to assist during the arbitration process and how effectively they enforce arbitration awards.

37. Also, competition policy and enforcement of its legal provisions are important in expanding trade in services. The CEFTA countries have adopted competition laws in compliance with EU rules and most of them have established independent competition authorities (Kathuria, 2008), though progress in implementation of these laws varies across countries. As a matter of fact, the poor enforcement track-record in terms of cases investigated and volumes of fines collected indicates that capacity building for competition is still needed. Kathuria (2008) recommends that “given the small size of these countries, it might be useful to contemplate the establishment of multiregulators or certain regional-level regulatory structures”. The CEFTA agreement does not contain any provisions along those lines but it does oblige the signatory parties (in articles 19 and 20) to apply the principles of the competition rules applicable in the EU<sup>12</sup>. Indeed in the case of the EU, competition provisions and their enforcement have been very important in expanding intra-EU trade in services.

38. *Movement of natural persons* (supply mode 4; see Box 1) is the most restricted mode of supply. None of the CEFTA countries offer “freedom of employment”; citizens of CEFTA members, like those of other countries, need to obtain authorization before beginning to work. Procedures for doing this tend to be cumbersome and lengthy. Unfortunately, no data on how long this process takes are available, but anecdotal evidence shows that foreign companies face major challenges to obtain work authorizations for their foreign workers. According to an interview with one law firm, even managers of large foreign companies sometimes need to wait for a year to obtain a work authorization. Moreover, countries often

<sup>12</sup> Article 81 of the Treaty of the European Communities (Official Journal of the European Union C 321 E/74) states “all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market”.

have quotas on foreign workers, and decisions about whether employing a foreign worker is economically justified are often arbitrary.

39. Some CEFTA countries also do not give temporary-entry privileges to foreign workers to execute a short-term service contract (e.g., construction workers coming in for several weeks or months). This is of particular relevance to trade in services. Kosovo has the most liberal approach: several types of foreign workers are fully exempt from the work authorization process. Albania, FYR Macedonia, and Montenegro have special categories for temporary work permits that, among other things, do not impose a residency requirement. BiH, Croatia, and Serbia—the largest CEFTA economies—do not offer temporary-work privileges, and obtaining a work authorization is tedious even for short-term engagements in the country.

**Table 7. Work Authorizations in CEFTA Countries**

	Type of work authorizations	Quotas on foreign labor	Economic needs test	Temporary transfers	Residency requirement for short-term stay
<b>Albania</b>	Several types of work authorizations: work permit for employees, seasonal workers, inter-company transfer employees, students, cross-borderwork, family members, students and vocational training	No	No	Yes	No
<b>Bosnia</b>	Work permit (for business owners) or operating license (for employees, including managers)	Yes	Yes	No	Yes
<b>Croatia</b>	Work permit (for business owners) or operating license (for employees, including managers)	Yes	Yes	No	Yes
<b>Kosovo</b>	Work permit, but several categories exempted from obtaining work authorization: executive directors, intra-company transfer employees, people involved in cross-border transport, academic staff, etc.	No	Yes	Yes	No
<b>Macedonia, FYR</b>	Personal work permit, license for employment, or work permit (for seasonal work, cross-border service provision, vocational training, and contractual services)	Yes	No	Yes	No
<b>Montenegro</b>	Personal work permit, license for employment, or work permit (for seasonal work, cross-border service provision, vocational training, and contractual services)	Yes	No	Yes	No
<b>Serbia</b>	Standard work permit, no sub-categories	No	No	No	Yes

Source: Authors.

40. A second aspect of the movement of natural persons is *recognition of professional skills and diplomas*. Even if, for example, it were possible to work in Montenegro with limited or no work authorization formalities, Croatian citizens would not be able to take up employment in a number of service sectors (such as health, construction, and legal) unless Montenegro recognized their diplomas. Though not relevant for services like ICT services and tourism, recognition of skills is highly relevant for construction, health, and some other services. The challenges related to skill recognition are discussed in the sectoral analysis.

## *Moving toward the EU*

41. Since all CEFTA countries aspire to join the EU, trade in services will ultimately need to be liberalized to the level of the EU common market. Further integration of CEFTA services markets would have a positive economic impact, direct and indirect, and would help member countries prepare for joining the EU. Currently their legal systems contain restrictions on foreign entry which are incompatible with EU legislation.

42. Opening up services markets for intra-EU competition has been a long-standing objective and challenge for the European Commission (EC). EU policy makers have long been aware that their economies do not benefit fully from otherwise very developed service sectors because they are fragmented. The Directive on Services in the Internal Market adopted in December 2006 by the European Council and Parliament, which entered into force before 2010, states that “elimination of barriers to the development of service activities between Member States is essential in order to strengthen the integration of the peoples of Europe and to promote balanced and sustainable economic and social progress.”

43. The Services Directive requires EU states to simplify procedures and remove barriers to cross-border service provision. The cornerstone is the “country of origin” principle, which means that a company offering its services in another EU country would operate according to the regulations of its home country. It also requires EU Member States to abolish discriminatory requirements, such as those related to nationality or residence; “economic needs” tests (requiring businesses to prove demand for their services); or requirements for a minimum number of employees.

44. Service providers benefit from simplified procedures and formalities when establishing a business in another EU country or supplying services across borders to another Member State, since it is no longer necessary to set up an establishment there. However, Member States must set up “points of single contact” through which service providers can obtain information and deal electronically with all administrative formalities—physical presence is not required. Consumers of services, both individuals and businesses, benefit from a wider selection of suppliers, improved standards for services delivery, and better consumer protection.

45. The Services Directive, however, excludes a number of sectors: (a) financial services, (b) electronic communications services, (c) most transport services, (e) health care, (f) temporary work agencies, (g) private security services, (h) audiovisual services, (i) gambling, (j) certain social services provided by the state, and (k) services provided by notaries and bailiffs, though some of these, such as the first two, are covered by other EC legislation.

### **Sectoral Barriers to Trade in Services**

46. The following sections describe market-entry barriers in four sectors found to be of relevance for CEFTA countries: transport, construction, ICT, and legal services. The sectors were selected for one or more of the following reasons: (a) size and trade potential, (b) sector priorities for liberalization announced by CEFTA countries, and (c) significant current barriers to entry.

47. The sections will assess regulatory differences between countries for each sector, focusing on the barriers to cross-border provision. The analysis of barriers covers the following aspects: (a) market access, including cross-border supply; (b) foreign ownership and commercial presence; and (c) regulation and licensing.

### **Construction**

48. Trade in construction services is of great relevance for many CEFTA countries because of booming real estate and infrastructure investments and a long tradition of exporting construction services. Over the last decade investment in transport, energy, and other infrastructure and in real estate has grown faster than average economic growth in the region.<sup>13</sup> The countries with the largest investment programs are often importers of construction services, but several CEFTA countries have traditionally been exporters; FYR Macedonian and Serbian companies can be found among the top 225 international construction contractors (Cattaneo et al. 2010). Some of these companies have in recent years achieved remarkable growth. For example, FYR Macedonia's exports of construction services increased sevenfold in only three years, peaking in 2005, and BiH's exports more than tripled between 2002 and 2007. Construction trade relationships among these countries are not new: several large regional construction companies were established in the former Yugoslavia and operated across national borders, as they are again doing.

49. The benefits of cross-border provision of construction services are multiple. In countries with large investment programs, foreign presence can fill a domestic capacity gap. When complex projects are being designed and built, established foreign firms bring in new know-how and technologies, which are adapted and adopted by domestic firms. Large foreign firms sometimes also offer a more innovative and deeper selection of financial resources. Finally, competition puts pressure on domestic contractors to be more productive while offering the potential for partnering with foreign companies both domestically and abroad.

50. Construction services are provided mostly through commercial presence (mode 3),<sup>14</sup> as when, for example, a Serbian company establishes a subsidiary in Montenegro to provide services locally; and temporary movement of personnel (mode 4), as when an FYR Macedonian company takes workers to BiH to build a factory or a road. Related services, such as architecture and engineering,<sup>15</sup> are often provided through mode 4 (e.g., a Croatian architect goes to Serbia to design a project) or mode 1 (a Croatian architect in Zagreb designs a project and sends it to the Serbian client).

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<sup>13</sup> Globally, construction services are dominated by the transportation, building, and oil sectors, each accounting for about a quarter of the total market.

<sup>14</sup> See Box 1 describing the four modes of trade in services.

<sup>15</sup> According to the WTO, "construction services" comprise general construction work, installation and assembly work, and building completion and finishing work, while architectural and engineering services are classified under "miscellaneous professional services."

51. Despite well-developed regional trade links, construction firms face a number of barriers to entry into CEFTA markets with respect to both market access and presence, though these vary by country (Table 9) at the end of this section summarizes the barriers in this sector). Only BiH allows for *cross-border provision* of construction services; at the same time, it also used to be the only CEFTA country that required investment approval from the Ministry of Foreign Trade and Economic Relations for foreign companies, but that was abolished by a 2010 law. All other CEFTA countries require foreign companies to establish a local presence, and most set limitations on the type of presence, requiring that a local company be established—branch or representative offices may not provide construction services. In some CEFTA countries, starting a business by a foreign company is fairly fast (7 days in Albania, 8 in FYR Macedonia), but the process is torturously bureaucratic in BiH and Kosovo, taking more than 80 days (World Bank 2010c). In all other countries starting a foreign business does not require much additional time and effort; the only burden relative to local investors is that foreign investors need to authenticate the documents of the parent company abroad.

52. Once the foreign company has established a local presence that local company needs to obtain the relevant licenses to provide construction services. The only exception is BiH, which allows foreign companies to provide construction services and requires only that they be appropriately licensed in their home country and meet BiH requirements for number of staff and competencies of key employees. The licensing process differs from country to country: in FYR Macedonia and Montenegro, foreign companies can ask to have licenses from their home country recognized; in all other CEFTA countries foreign firms go through the same procedure as domestic firms. However, how easy this is differs by country. Recognition in FYR Macedonia, for example, is done by the Chamber of Authorized Architects and Engineers, which has to confirm that the license of the foreign firm corresponds to Macedonian legal requirements.

53. Requirements and types of licenses vary considerably. In BiH, for example, the licensing requirements specify the number of qualified employees and possession of appropriate equipment (depending on the type of license). In FYR Macedonia, a construction company needs between 2 employees (for the lowest license type) and 30 (for the highest), as well as licensed professional staff (engineers). Croatia's requirements are much stricter: a construction company needs 300 employees, of which 10 are licensed professionals, to qualify for the highest license type, which allows it to perform public construction work with a value of EUR 7 million or more. In Albania and Kosovo, on the other hand, to perform construction services a company needs only a certified technical director. The procedure for licensing a construction company is fairly streamlined throughout the region: it typically takes no more than two months and licenses are effective for four to seven years.

54. One requirement for obtaining a construction license concerns the qualifications of key personnel (for example, an employee with an architectural and engineering design license, or licensed building and supervisory engineers). If the foreign company wishes to bring professional workers from its home country to the local subsidiary, their professional qualifications will not be accepted; they must certify their diplomas or apply in the recipient country for the same licenses they hold at home. Again, the complexity of the process varies: Kosovo, for instance, recognizes foreign licenses while in Croatia a Serbian engineer will have to have the Serbian diploma attested and then secure a license from the Croatian Chamber of Architects and Engineers.



55. Foreign companies need to obtain work authorizations (see Table 7) for foreign employees they plan to bring in. The limitations in each CEFTA country on temporary movement of workers for all sectors can be a particularly serious impediment for construction, which is labor-intensive and often requires high short-term circulation of professional staff (architects, welders, builders, crane operators, etc.). It may also involve transfer of a large number of low-skill construction workers for short periods (e.g., 1–3 months). Obtaining work authorizations in both cases can be so lengthy and tedious that they cause delays and increase costs. FYR Macedonia is the only country that has a distinct work permit with streamlined procedures for temporary and seasonal workers. In Albania, even though the legislation does not provide for a similar work permit, the contractor for a large highway project (Bechtel-Enka) was able to reach agreement with the government to facilitate issuance of work permits for foreign workers.

56. Labor mobility is a highly sensitive political issue, but several countries have moved to recognize qualifications. Albania and FYR Macedonia have agreed to mutual recognition. For construction work BiH accepts diplomas obtained before 1993 in the former Yugoslavia and foreign licenses. In FYR Macedonia, the Chamber of Authorized Architects and Engineers verifies foreign licenses. Serbia also accepts diplomas from former Yugoslavia and recognizes construction work licenses based on reciprocity.

#### *Domestic Regulation and Cross-border Provision*

57. Barriers to greater trade in construction services are not limited to entry and establishing local presence. Domestic nondiscriminatory regulations that apply to all companies can have disproportionately higher impact on foreign-owned companies. Typically, construction is highly regulated, and differences in regulation make it more costly for firms to enter foreign markets. For example, in the CEFTA region there can be large variations in technical standards and regulations. In some countries, standards are enforced by ministries of physical and spatial planning; in others firms also have to deal with local authorities. Technical standards and building codes in some countries, like Croatia, are aligned with EU standards, but in others are less harmonized with EU or other international standards (although all CEFTA countries are now reinforcing and harmonizing their design and construction standards for roads). As a result, construction companies have to learn and apply different technical standards in each country. Converging to common European standards would reduce transaction costs and ease the entry of local companies into foreign markets.

58. Dealing with construction permits may also disproportionately affect foreign construction firms. In all CEFTA countries procedures for obtaining construction permits are cumbersome. *Doing Business 2011* shows that even the best performer in this area, Croatia, ranks only 132<sup>nd</sup> on a global scale. When licensing requirements are complex, factors beyond the legal requirements determine the outcome of the process and its speed. Where personal relationships with public officials could ease the process, foreign firms are clearly disadvantaged.

**Table 8. Ease of Obtaining Construction Permits**

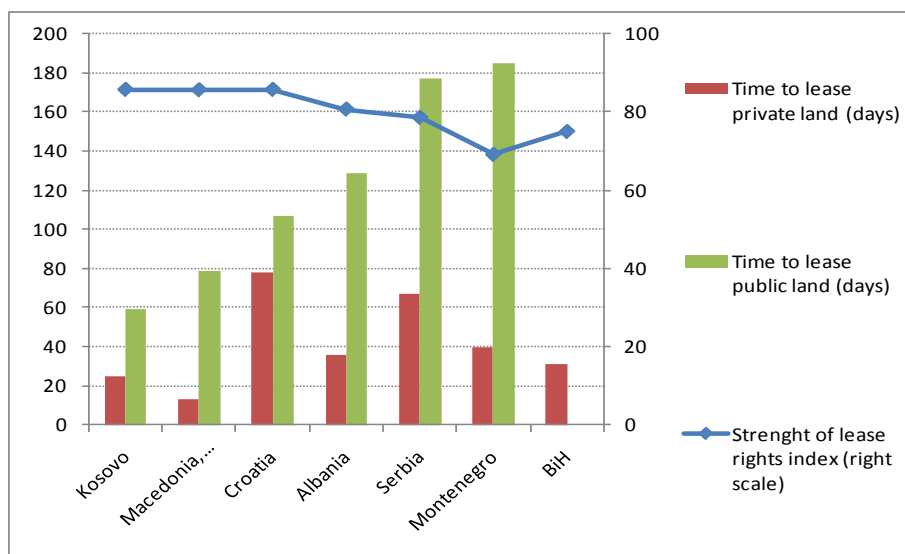
	Procedures (number)	Time (days)	Cost (% of income per capita)	<b>DB 2011 global rank</b>
Croatia	13	315	851	<b>132</b>
Macedonia, FYR	21	146	1,601	<b>136</b>
BiH	16	255	578	<b>139</b>
Montenegro	19	230	1,215	<b>161</b>
Albania	24	331	381	<b>170</b>
Kosovo	21	320	857	<b>172</b>
Serbia	20	279	1,821	<b>176</b>

Source: World Bank, *Doing Business 2011*.

59. Restrictions on ownership of land and other real estate may apply to all sectors but have more impact on construction companies—a relevant factor when foreign real estate developers are interested in investing. All CEFTA countries allow foreign and foreign-owned firms to own developed real estate, but ownership of nonagricultural land is more restricted. BiH, Croatia, FYR Macedonia, and Kosovo accept the reciprocity principle. Albania, Montenegro, and Serbia in principle do not restrict land ownership by foreigners, though there may be additional requirements.

60. Leasing is another option for acquiring land that may can promote or impede foreign investment, depending on how easy the process is. *Investment Across Borders* (World Bank 2010c) shows that acquiring land through leasing can be very simple and quick or very lengthy, depending on the country and the type of land. For example, it takes only 13 days to lease land from a private owner in FYR Macedonia but almost 80 days in Croatia. Leasing from the government, as might be expected, takes longer but varies from less than 60 days in Kosovo to over 180 days in Montenegro.

**Figure 8. Ease of Leasing Land**



*Note:* The lease rights index is based on (a) the ability of foreign-owned companies to lease land, (b) whether leasing procedures are the same for foreign and domestic companies, (c) whether there is a statutory maximum duration of leases, (d) whether there is a statutory maximum on how much land a foreign-owned company may lease, and (e) the ability of foreign-owned companies to renew, transfer, sublease, subdivide, or mortgage leased land.

*Source:* IAB 2010.

61. Finally, the largest client for construction services, in particular cross-border services, is the public sector. According to Cattaneo et al. (2010), public procurement accounts for half of construction activity in many developing countries, for such activities as civil engineering projects (roads, railways, airports, dams, and ports), utility infrastructure (water, sanitation, electricity), and housing. The CEFTA countries have opened up procurement for construction projects by providing a level playing field for domestic and foreign firms. However, anecdotal evidence suggests that domestic firms are sometimes favored, though some feel that foreign firms are being favored. Many CEFTA public infrastructure projects are financed by international institutions, whose procurement standards often prohibit discrimination between domestic and foreign suppliers.<sup>16</sup>

#### *The View of Private Construction Firms*

62. In addition to analysis of the laws, several firms in the region were interviewed to get first-hand knowledge of the barriers they face. As noted, several CEFTA countries have construction industries with established regional and international presence that date from the former Yugoslavia. Companies interviewed stated that though the regional market continues to be important, many bid only on public investments because enforcing contracts (collecting payment) against private firms is so risky. However, foreign construction firms may also have financial problems in dealing with the state (e.g., getting VAT refunds).

<sup>16</sup> World Bank procurement guidelines allow a slight preference for local qualified companies, at the client's request.

63. Construction companies typically set up local firms or branches when entering the regional market, a fairly low-cost process. Difficulties are mostly related to the transfer of employees from the home country to another CEFTA country. Sometimes getting engineers and other key staff licensed can be costly and time consuming. Then, firms face limitations on bringing construction workers from their home country. Apart from the work authorization procedure, companies stated they sometimes face additional hurdles, such as needing to terminate employment of workers in the parent company in order to employ them in the foreign subsidiary and then having to do the reverse at the end of the project.

64. Because construction firms typically apply for public tenders, firms interviewed perceived protection of domestic industry to be their most difficult hurdle. They claimed that strict enforcement of the legal requirements is one tool used to protect domestic industry: countries that are strict in enforcing their own standards can make it difficult for foreign firms to operate. However, differences in technical standards and regulations are not perceived to be a major barrier. Information on standards and regulations is transparent and available, so even when standards are different, foreign companies know from the start what the requirements are.

**Table 9. Summary Table of Regulatory Approaches To Construction in CEFTA Countries**

	<b>Is cross-border service provision allowed?</b>	<b>Limitations on local presence?</b>	<b>Is license from host country applicable?</b>	<b>Duration of license</b>	<b>Is certification of diplomas required?</b>
<b>Albania</b>	No	No	No, companies have to obtain license locally	n/a	Yes (Agreement on mutual recognition with Macedonia)
<b>BiH (FBiH)</b>	Yes	No	Yes, foreign companies may provide services in FBiH provided that they have construction license in the home country and the meet FBiH's requirements on staff and competencies	4 years	Yes, except diplomas granted in Socialist Federal Republic of Yugoslavia (SFRY) until 1992
<b>BiH (RS)</b>	Yes	No	No	4 years	Yes, except diplomas granted in SFRY (until 1992) and diplomas from Serbia
<b>Croatia</b>	Yes to firms from WTO member countries; reciprocity principle applied to non-WTO members	Yes, has to be local company (branch)	No	n/a	Yes, diploma has to be recognized in Croatia and license obtained based on the recognized diploma.
<b>Kosovo</b>	No	Yes, has to be local company (branch)	No	5 years	Yes
<b>Macedonia, FYR</b>	No	Yes, has to be local company (branch)	No	7 years	Yes (Agreement on mutual recognition with Albania)
<b>Montenegro</b>	No	Yes, has to be local company (branch)	Yes, but foreign-owned company can request its license from host country to be recognized	5 years	Yes
<b>Serbia</b>	No	Yes, has to be local company (branch)	No	n/a	Yes, except diplomas granted in SFRY (until 1992)

## Transport

65. Good functioning transport is crucial for trade in goods and ultimately economic growth. Lower transport costs and reliable and timely transport make products more competitive, thus promoting exports. Moreover, the transport sector is often a major employer and could be an important source of export revenues for this group of countries, given the volume of freight transiting through their territories.

66. Land transport comprises rail and road, freight and passenger. This section focuses on freight transport, particularly for-hire freight services.

67. Land transport volumes are expected to continue to increase throughout the CEFTA region as economies recover from the economic crisis which led to a huge, but temporary, decline in goods exports. Until the crisis began in 2009, land freight transport was increasing in all CEFTA countries except FYR Macedonia. Historical data on transport volumes<sup>17</sup> show the potential for growth (see Table 10). Land freight transport in 2008 for the entire region was only 34 percent higher than in 1990<sup>18</sup>; in fact, in BiH and Serbia volumes were below 1990 levels.

**Table 10. Total Land Freight Transport (Ton-Km, Billions)**

	1970	1990	2000	2007	2008	2009
Albania	1.0	1.8	2.2	3.7	4.2	n/a
Bosnia	4.2	7.1	0.4	1.9	2.1	1.8
Croatia	7.0	9.4	2.9	14.1	14.3	12.0
Macedonia, FYR	1.4	3.0	1.3	6.7	4.7	4.5
Serbia	9.6	15.8	7.3	13.6	13.8	n/a

*Source:* International Transport Forum, national statistics offices.

68. The structure of land transportation has changed over time. Today the dominant mode of land transport is roads, which account for about three-fourths of total CEFTA freight transport (see Table 11); in the early 1990s, the share of road transport was just above 50 percent. The current share is close to that of Western European countries and is significantly higher than in EU New Member States (Table 11, memo items). Among CEFTA countries, road transportation has the highest share in Albania and FYR Macedonia.

<sup>17</sup> Measured in ton-kilometers.

<sup>18</sup> In the EU the increase was close to 80 percent.

**Table 11. Share of Road Transportation in Total Land Freight Transport (Percent)**

	1970	1990	2000	2007	2008	2009	Average 2007–09
Albania	80.0	66.7	100.0	97.3	97.6	n/a	97.5
Bosnia	19.0	43.7	75.0	63.2	57.1	61.1	60.5
Croatia	18.6	30.9	37.1	72.9	75.9	77.0	75.3
Macedonia, FYR	57.1	73.3	61.5	88.1	85.1	88.9	87.4
Serbia	36.5	54.4	65.2	59.6	62.5	n/a	61.1
<i>Memo items</i>							
CEFTA average	42.2	53.8	67.8	76.2	75.6	75.7	
CEEC average <sup>19</sup>	26.1 <sup>a</sup>	30.5	52.7	61.5 <sup>b</sup>	n/a	n/a	
Western Europe average	66.5 <sup>a</sup>	70.8	76.8	78.5 <sup>b</sup>	n/a	n/a	

Source: ITF, national statistics offices.

Notes: <sup>a</sup> Data for 1980; <sup>b</sup> data for 2005.

69. The World Bank's Logistics Performance Index (LPI), which measures six aspects of the logistics environment including transport services, helps to identify areas where improvements are most needed. The LPI is based on a worldwide survey of freight forwarders and express carriers and on quantitative data on the performance of the logistics chain. In all aspects CEFTA countries lag behind high-income countries. The biggest difference is in the quality of infrastructure and the ease of arranging international shipments. Overall, the highest ranked CEFTA country is FYR Macedonia (73<sup>rd</sup>); the lowest is Montenegro (121<sup>st</sup>).

**Table 12. Logistics Performance Indicator**

Country	LPI rank	LPI score	Sub dimension scores					
			Customs	Infrastructure	International shipments	Logistics competence	Tracking and tracing	Timeliness
FYROM	73	<b>2.8</b>	2.6	2.6	2.8	2.8	2.8	3.1
Croatia	74	<b>2.8</b>	2.6	2.4	3.0	2.5	2.8	3.2
Serbia	83	<b>2.7</b>	2.2	2.3	3.4	2.6	2.7	2.8
BiH	87	<b>2.7</b>	2.3	2.2	3.1	2.3	2.7	3.2
Albania	119	<b>2.5</b>	2.1	2.1	2.6	2.4	2.4	3.0
Montenegro	121	<b>2.4</b>	2.2	2.5	2.5	2.3	2.4	2.7
<i>Memo items</i>								
CEFTA		<b>2.6</b>	2.3	2.3	2.9	2.5	2.6	3.0
High-income		<b>3.6</b>	3.4	3.6	3.3	3.5	3.7	4.0

Source: World Bank 2010a.

<sup>19</sup> CEEC countries, according to ITF, are Albania, Bosnia, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, FYR Macedonia, Poland, Romania, Serbia, Slovakia, and Slovenia.

70. Because laws related to cross-border provision of road and railway freight transport services differ, assessments of the barriers to trade are discussed separately next. The focus of the assessment is on market access, commercial presence, and regulatory measures and licensing.

### *Road Transport*

71. *Market access* rules for road transportation in all CEFTA countries, though cumbersome, generally do not discriminate against foreign-owned companies. Entry is typically regulated by sectoral laws and regulations of implementing bodies that establish technical, safety, and financial requirements. In most countries responsibility lies with the Ministry of Transport (Ministry of Public Works and Transport in Albania, Ministry of Infrastructure in Serbia).

72. Cross-border provision of services is regulated exclusively by bilateral agreements. Most CEFTA countries have concluded agreements with each other that determine how many transportation licenses will be granted. The licenses granted depend on

- (1) types of transport: bilateral, transit, universal, or for third countries;
- (2) types of vehicles: EURO 1–4 technological and emission standards;
- (3) duration: permanent or temporary;
- (4) type of goods: regular or special (hazardous goods, or when cargo exceeds national maximum weight limits).

73. Because most CEFTA countries, pursuing a rather protectionist policy, determine road freight license quotas based on reciprocity, the degree of liberalization depends primarily on bilateral relations. Several agreements provide for considerable liberalization and could be used as examples for other CEFTA countries. For instance, Serbia has significantly liberalized both bilateral and transit transport with BiH, FYR Macedonia, and Montenegro. Similarly, Albania and FYR Macedonia recently agreed on substantial liberalization.

74. Concerning *commercial presence*, there are no restrictions on the type of company, ownership structure, or other aspects of commercial presence (see general assessment on commercial presence in section 2).

75. Road freight transport is heavily regulated, and the *regulatory measures and licenses* in CEFTA countries are not much different than in the EU. Standards as defined by national authorities or by professional associations include rules for providing services, minimum safety requirements for vehicles and trailers, technical standards for truck engines, and qualifications and maximum work load for truck drivers.

76. In most CEFTA countries licenses for domestic road transportation are issued for a period of five years. Serbia is the only CEFTA country that does not require licenses. In FYR Macedonia licenses have no time limit, and BiH defines the validity of the license based on the age of the vehicle. In all countries licenses are not transferable, and selling one is considered to be a legal offense.



77. Licenses for international transport are always issued annually, and in most CEFTA countries obtaining one can be costly and time-consuming. For instance, in Serbia the licensing process has 12 steps, including submitting documentary proof of business establishment, structure and qualifications of employees, vehicle capacity and quality, financial assets (bank guarantee), previous traffic violations, and previous licenses.

### *Rail Transport*

78. Rail transport has been declining for the last two decades in all CEFTA countries. A recent World Bank study of rail in SEE and Turkey (World Bank 2011) finds that railway systems in CEFTA have just half the traffic density and a third of the productivity of those in the EU; no CEFTA country performs well. The situation is particularly urgent in FYR Macedonia, Serbia, Montenegro, BiH, and Albania. Croatia and Kosovo are slightly more productive, though still low compared to EU levels. Overstaffing is the most striking feature in every country except Croatia. The second most important reason for poor performance is low traffic density, which is less than a third of the EU average in all CEFTA countries except Croatia.

79. Rail in the region is also hampered by deteriorated infrastructure due to lack of investment for close to 20 years. As a result, there are speed restrictions for safety reasons on numerous sections of the rail network. Electrification ranges from nonexistent in Albania and Kosovo to 76 percent in BiH (Montenegro has 68 percent, Croatia 36 percent, FYR Macedonia 33 percent, and Serbia 31 percent).

80. Improvements in the sector largely depend on restructuring state-owned companies. Albania, BiH, and Serbia still have vertically integrated, state-owned rail companies that manage both infrastructure and transport services. Croatia, FYR Macedonia, and Montenegro have separated infrastructure from transportation. In Kosovo, laws to separate infrastructure and transport services have been enacted but not yet implemented.

81. *Market access* of foreign rail companies is limited. Even though the law in every CEFTA country except Kosovo allows private operators, including foreign-owned, to provide rail transport, a variety of legal and technical barriers make this practically impossible except in Croatia and FYR Macedonia. For example, Albania has not yet established the Commission for Safety Regulations that is mandated to issue licenses to private operators. Similarly, Serbia does not have the independent rail transport regulator and safety agency that the Law on Railways specifies. In addition, Serbia and Montenegro apply the reciprocity principle to countries whose public rail companies seek to operate in their territory. In contrast, Croatia and FYR Macedonia have not only separated infrastructure from transport services but have also created the preconditions for private, including foreign, service provision.

82. All CEFTA countries except Kosovo formally allow foreign ownership (*commercial presence*) of up to 100 percent in the rail sector. Requirements for foreign investors and domestic private companies are the same.

83. *Regulation and licensing* of operations in this sector are transparent across the CEFTA region. Licenses are typically issued for five years, except that in Albania and Kosovo the duration is not defined. There also seem to be appropriate legal mechanisms for appealing the decisions of regulators.

### **Box 3. The Experience of the EU**

Even though European integration started right after the World War II, progress with integration of the rail transport went slowly. Therefore rail transport is currently the least integrated transport mode within the EU (World Bank, 2011). The more intensive work on better integration within this sector across European countries started in 1998 but it is still ongoing.

The first package of railway laws<sup>1</sup> (presented in 1998 and adopted in 2001) gave rail operators access to the trans-European network on a nondiscriminatory basis.

The second package (2004) accelerated liberalization of rail freight services by fully opening the rail freight market to competition as of 2007. It also created the European Railway Agency, introduced common procedures for accident investigation, and established safety authorities in each EU Member State.

The third railway package (2007) contained measures to open up the international passenger transport market by 2010 and regulate passenger rights and the certification of train crews.

<sup>1</sup> The summary of the three railway packages is based on the reports from the EC Director General, Transport.

84. Some CEFTA countries see greater regional cooperation in the railway sector as a precondition for improving its performance. In 2010 the governments of Slovenia (an EU member), Croatia, and Serbia established a joint company, Cargo 10, for selling freight transport services on Corridor 10 (i.e. the Slovenia-Croatia-Serbia-Bulgaria-Turkey route).<sup>20</sup> Cargo 10 is a one-stop-shop for providing sales services. The idea is to attract customers with harmonized pricing and allow the three transport operators to negotiate jointly with clients. Increased coordination of trains should also reduce transit times. The goal is to reduce elapsed time from Ljubljana to Istanbul by at least one-third. The railway companies of FBiH, Republika Srpska, Montenegro, and FYR Macedonia have expressed interest in joining Cargo 10.

### **Legal Services**

85. Well-functioning justice systems are critical to an enabling business environment. Over the last two decades the legal systems in CEFTA countries have undergone ambitious and difficult reforms to redesign judicial systems and reinforce administrative capacity, but because little or no attention has been paid to trade in legal services, cross-border delivery is highly restricted across the region.

86. *Market access* to and delivery of legal services are conditioned by requirements for both individual lawyers and law firms, but restrictions on cross-border provision are similar to practices in most countries worldwide. Only advisory legal services are not restricted, and law firms and individual lawyers can provide such services, including across borders, throughout CEFTA. Advisory legal services

<sup>20</sup> All three countries have equal stakes in Cargo 10, which is headquartered in Ljubljana, Slovenia. Combined, the rail companies of these three countries have 25,000 freight cars—5 percent of European potential in this sphere (World Bank 2011).

can relate to a number of areas, including land entitlements, IP rights, establishment of businesses, and taxation.

87. Foreign individual lawyers are in general strictly prohibited from offering cross-border services in CEFTA, but there are some exceptions. Albanian law envisages the possibility of foreign nationals being granted a license for legal services. However, in addition to other requirements, they must pass an examination in the Albanian language. Kosovo allows foreign lawyers who are permanent residents to provide services there. BiH, Montenegro, and Serbia in theory allow cross-border supply of services by lawyers based on reciprocity, but in practice only Montenegro and Serbia have actually signed such an agreement.

88. While advisory legal services can generally be supplied on a cross-border basis, there are some exceptions. For example, Kosovo requires providers of advisory services to register with the Ministry of Trade. In BiH cross-border advisory services are restricted to market research and promotional activities. In other countries this area of legal practice is relatively liberalized to facilitate entry of foreign investors, which typically use foreign legal firms when entering CEFTA markets, though the firms cannot represent the investor in court.

89. Foreign law firms are allowed a commercial presence in CEFTA through local establishment. There are no limitations on ownership structure, but foreign-owned law firms have to hire local lawyers because only citizens can be licensed to provide all legal services (except as noted in Albania and Kosovo).

90. Given these barriers, trade in legal services in CEFTA has so far been limited.<sup>21</sup> Nonetheless, cross-border provision is expected to increase as these economies become more integrated. Recently, affiliation and formal cooperation with local law firms has become a common way to provide cross-border services. In such cases, a law firm contracts with a law firm in another CEFTA country to represent it or work on its behalf. This can only be a second-best option for entering foreign markets because it increases the costs for users of the services. On the other hand, it brings such benefits as exchange of good practices and access to the rules for practicing in third countries. Usually such affiliation agreements or contracts are registered with the local authorities or, more usually, the bar association. BiH is the only CEFTA country that does not allow contractual relations between law firms based in different countries.

91. *Licensing procedures and requirements* are complex. Lawyers must go through academic and professional qualification, certification, and accreditation steps before they can be licensed in any CEFTA country. Bar associations or chambers of lawyers are responsible for defining the conditions for obtaining licenses, and Ministries of Justice set additional requirements.

92. Once a lawyer, as an individual provider of legal services, is granted the license to provide services in line with the requirements and standards set by the professional association in the country,

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<sup>21</sup> Also, the statistics available probably underestimate the actual amounts spent on legal services across borders, since some services are sought and delivered within multinational companies.

Licensing requires a one-time payment; membership fees for professional associations are usually paid annually.

93. Unlike most other sectors, professional associations for lawyers are a major factor in determining market entry because they not only set the licensing rules but also conduct the actual qualification examination. While the terms for providing legal services are considered transparent in all CEFTA countries, there are some concerns that regulations issued by bar associations or chambers are not always available on the Internet. Beyond licensing the new entrants, bar associations also have another important role: investigating misconduct. Ultimately, they can thus withdraw licenses.

#### **Box 4. Expansion of Cross-Border Legal Services**

Though legal services in CEFTA have long been considered nontradable, in recent years some large firms have started to expand regionally, either by establishing local companies or law firms or by cooperating with a local law office. One such company explained that a core reason for regional expansion has been client demand – foreign investors that see the region as a common market seek to establish relations with several countries.

One obvious disadvantage is that foreign lawyers cannot represent clients in court in any CEFTA country. As countries become members of the EU, they will have to grant lawyers from other EU countries some of the rights of domestic lawyers, but it will take many years before this restriction is removed throughout the region. Another drawback is the difference in the framework for offering legal services. Specifically, because legislation in several CEFTA countries lacks provisions on establishing law firms, firms from one country cannot register in other countries.

94. Liberalizing trade in legal services may bring some benefits for CEFTA countries, though probably not as much as liberalizing other sectors. The most important benefits are usually lower costs for clients and greater demand for those who provide services. One potential benefit could be increased mobility for investors and businesses across the region due to easier access to legal services and the possibility of using services from lawyers from the home country in other markets; another could be resolving bottlenecks posed by capacity constraints. Skill shortages are a common problem in CEFTA countries, particularly in sophisticated fields of practice like IP rights or financial transactions, such as mergers and acquisitions.

#### **ICT Services**

95. As ICT (or information and computer<sup>22</sup>) has grown rapidly with the diffusion of infrastructure across developing as well as developed countries, so has trade in ICT services. The global market for outsourced ICT services is now about US\$250 billion (Cattaneo et al. 2010), and developing countries like India, Costa Rica, and Malaysia have become significant exporters.

96. For several reasons ICT services have great potential for helping small developing countries to move up the value ladder: First, the sector not only makes intensive use of human capital, it often does

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<sup>22</sup> This term is used in balance of payments statistics.

not require substantial capital investment, so countries with limited capital but well-developed education systems should have a comparative advantage. Second, because the diffusion of ICT infrastructure has minimized the transaction costs for trade in ICT services trade, companies can export from any location with good connectivity. Third, because ICT service provision has become global, companies can tap foreign markets without having to build production capacity at home. Finally, because software development and other ICT services consist of many small, separable tasks that can be performed by different firms, even small firms can trade globally by establishing a niche.

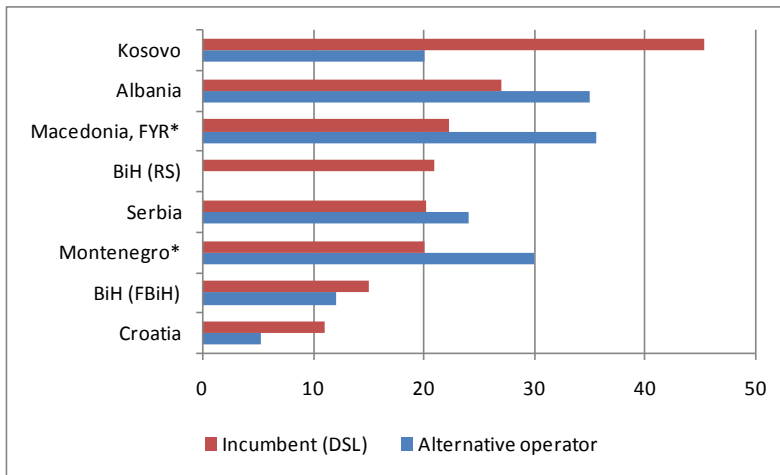
97. All CEFTA countries have made ICT services a priority in their development strategies. Most have already made considerable efforts to promote ICT investment and proliferation, and some have improved the quality and quantity of related education. For example, telecommunications have been deregulated and state-owned monopolies privatized in almost all CEFTA countries. The legislation is or is being aligned with EU legislation and allows for entry of competition. This has led to rapid mobile and Internet penetration, followed by a decline in prices (although there is much variation by country). Governments have also invested more heavily in ICT, both in hardware (computers and equipment) and software (for e-government services).

98. As a result, export-oriented ICT service firms are mushrooming throughout the region. Croatia's exports rose from about EUR 80 million in 2007 to almost EUR 120 million in 2009. In the same period, Serbia's exports went from EUR 60 million to EUR 100 million. Macedonia's exports have been averaging about EUR 30 million, some 0.5 percent of GDP. Intraregional trade also seems to have picked up, with a number of companies competing at a regional level. Croatia's statistics, for example, show that regional exports almost doubled between 2007 and 2009, reaching EUR 22 million.

99. Unlike the other sectors covered here, ICT services are fairly open to foreign competition. Most important, every CEFTA country allows them to be provided across borders, and in no country does the state have any role as a service provider. However, in Albania, even though the law allows cross-border provision, to fight tax avoidance, according to interviews with local lawyers, the tax authority tries to push firms to establish a local presence. If foreign firms wish to provide services through a local commercial presence, there are no impediments arising from licensing or certification of professional skills.

100. Two factors are particularly relevant to expanding trade in IT services: infrastructure (adequate communications and broadband; shared data centers/cloud computing) and protection of IP rights. Ability to produce and sell ICT services cross-border is determined by the capacity and cost of infrastructure; reliable, advanced, and cheap telecommunications are critical. CEFTA countries have achieved remarkable progress in building telecommunications industries. Incumbents, previously state-owned monopolies, have mostly privatized and there is competition in most services, especially in broadband Internet (which matters most for the sector). Nonetheless, the quality of services, the menu of providers, and (most important) the costs vary greatly from country to country. For example, the monthly fee for digital subscriber line (DSL) Internet in Kosovo is more than twice as high as in BiH, Serbia, and Montenegro, and three times higher than in Croatia (Cullen, 2010). On the other hand, Kosovo's alternative provider is much cheaper than those in Albania, FYR Macedonia, and Montenegro.

**Figure 9. Monthly Retail Price for 2 Mbps Broadband Internet Access 2010 (EUR )**



\* Price for 1 Mbps speed

Source: Cullen 2010.

101. *Protection of IP rights* is particularly important for ICT services; because software and some other services are intangible and can be easily replicated, developers must rely on the legal system to protect their copyrights and prevent piracy. All CEFTA countries have modern IP legislation, more or less aligned with EU standards. The laws make infringement a criminal offense subject to punishments of several years of prison. Moreover, all but Kosovo are members of the World Intellectual Property Organization.

**Box 5. Obligations to Protect IP Rights Arising from the CEFTA Agreement**

CEFTA signatories commit to providing “appropriate protection of intellectual property rights in accordance with international standards.” Article 38 of the CEFTA 2006 Agreement obliges them “to ensure adequate and effective implementation of the obligations [related to IP protection] arising from the conventions listed in Annex 7.”

Article 38 also sets a deadline for countries that are not yet members of the listed conventions, stating “Eligible Parties not yet members of the conventions listed in Annex 7 shall accede to them and undertake all necessary measures with a view to implement the obligations arising from them adequately and effectively no later than 1 May 2014.”

102. However, enforcement of the legislation ranges from very low to very high. In Kosovo, for example, the legislation has not been fully implemented: the IP office set up in the Ministry of Culture is not yet operational, so piracy is widespread and enforcement is extremely low. In Albania and BiH it is estimated that about 70 percent of software is pirated. Serbia has made real progress by creating a department specifically for IP-related crimes in the Ministry of Interior, though further work is needed to ensure that the legislation is enforced fully and effectively. Croatia has probably advanced the furthest in this area. The EC’s 2010 Progress Report states that Croatia has achieved very close alignment with the EU *acquis* in this area.

### *The View of Regional ICT Firms*

103. Some IT companies in the region already have offices in most CEFTA countries. From interviews with such companies it appears that the expansion has been driven by the potential for growth in sales of ICT solutions developed for the home market and by the similarity in business environment and culture in the region. For one company, the main concerns before entering new CEFTA markets were finding skilled employees and facing discrimination as a foreign company; however, setting up a local presence and attracting good workers did not appear to be major constraints generally.

104. Even though cross-border provision of IT services is permitted, companies choose to establish local firms to demonstrate to private clients that service will be provided continuously. Local presence is also an asset when applying for public projects because it shows a commitment to the local economy. Nevertheless, one of the main concerns when dealing with public projects has been the tendency of authorities to favor domestic providers. This is usually not explicit, although sometimes staff providing a service may be required to speak the local language. Foreign companies sometimes notice public tenders being annulled when their bids are most competitive. In such cases, the tender documents are modified to help domestic firms win.

105. IP rights are largely protected in the CEFTA region, though there have been cases where a company from one CEFTA country sees its IP rights breached by a company in another.

106. In dealing with products and services offered through global vendor partnerships (e.g. with major firms like SAP, Microsoft, or IBM), cross-border provision is most often prohibited by the vendor that owns the product, because global firms establish a local presence or partnership in most countries and segment the markets by prohibiting vendors from offering the services in other countries.

107. There is a growing interest in the public sector in using open source software to reduce the cost and time required to develop ICT solutions. A large number of local firms and small and medium enterprises are developing solutions and providing installation, training, and support services. The EC has created a web portal to promote such collaboration and in 2008 made available a software repository ([www.osor.eu](http://www.osor.eu)). ICT companies from CEFTA countries are also involved in such initiatives to expand the scope of their services.

108. ICT companies in the region would like to see CEFTA governments invest more in ICT, especially software and other services, because such investments would help build the sector in the region.

#### 4. CONCLUSIONS

109. The economic literature illustrates the positive effects on economic growth, direct and indirect, of trade in services. Services exports can bring substantial foreign receipts; imports make domestic markets more competitive and efficient which increases the productivity of manufacturing firms that rely on services.

110. The world's trade in services has been growing at 15 percent annually since 1980. CEFTA countries similarly witnessed high growth over the last decade as their service economies have grown rapidly. Service exports brought, on average, EUR 16 billion annually into CEFTA countries in recent years. Intra-CEFTA trade appears to be an important component of CEFTA services trade, though precise data are not available to confirm this.

111. The proliferation of trade in services for the CEFTA economies has come as a result of advancement of their service sectors as well as their opening many services market to foreign competition. In the context of WTO and EU accession, the CEFTA countries have taken reforms to improve market access, ease foreign ownership, and remove policies discriminating against foreign firms. Nonetheless, various policy barriers still constrain expansion of trade in services through any of the four modes of supply.

112. In terms of general barriers, movement of foreign workers/professionals is the most restricted mode of supply in CEFTA countries. Obtaining work authorizations for foreign workers is arduous, and even temporary entry of workers to provide a service is difficult. Recognition of skills and diplomas is a second obstacle that makes it difficult for foreign professionals to supply services.

113. Sectoral analysis of barriers to trade in construction, land transport, and legal and IT services identified various types of barriers. In construction, there are limitations on cross-border supply and on acceptance of foreign licenses. In land transport, heavy regulations, market protectionism, and the presence of state-owned monopolies limit the possibility for trade. Most restricted is the legal sector, where service provision is limited to country nationals. Only advisory legal services are open to foreign suppliers. In contrast, IT services are lightly regulated and trade in this sector depends largely on other factors, such as technological advancement (i.e. demand for such services) and protection of IP rights. It is important to note, in each case, that the barriers and regulations differ across countries. Hence, CEFTA countries that have more open trade in services can serve as examples on how to liberalize services trade to those with more restrictions.

114. This study does not offer policy recommendations on how to remove or minimize barriers. Nevertheless, as all these countries aspire to join the EU, adopting similar principles of integration as regards, for example, right of establishment and cross-border provision seems to be a natural path to follow. In any case, if the CEFTA countries decide to enhance trade and integration of their service sectors, the next step would be to review in detail domestic regulation of the sectors of interest. Then, regulations that are more trade- restrictive than necessary should be removed. Changing the rules may be



easy procedurally aspect, but there may well be serious objections from parties with vested interests. Finally, the authorities should seek ways to improve the competitiveness of their domestic firms which would enable them to compete in foreign markets as well. The discussions on further liberalization under CEFTA auspices should be a good opportunity to address some of the issues identified here.

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