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MINISTRIA E TREGETISË DHE INDUSTRISË

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Impact Analysis of Trade in Services Liberalization with CEFTA Countries

Sectors: Transport and Finance

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List of Abbreviations

BoP	Balance of Payment
CBK	Central Bank of Kosovo
CEFTA	Central European Free Trade Agreement
ECLO	European Commission Liaison Office
EU	European Union
FDI	Foreign Direct Investment
KAA	Kosovo Architects Association
KBRA	Kosovo Business Registration Agency
KBA	Kosovo Bar Association
MTI	Ministry of Trade and Industry
MPA	Ministry of Public Administration
MEST	Ministry of Education Science and Technology
SCAAK	Society of Certified Accountants and Auditors of Kosovo
STIKK	Society of Information and Communication Technology of Kosovo
TD	Trade Department
TAT	Technical Assistance Team
TPWG	Trade Policy Working Group
TIS	Trade in Services
WTO	World Trade Organization
ITIS	International Trade in Services

Introduction

Transport infrastructure in time has undergone major changes. Continuous improvements in automobile construction lay, the task of creating new demands for further development by leaps and fastest ways of building technology and conversely, technical and technological achievements in road construction, further established the premise for the development of the automotive industry. Characteristic of these factors results in the field of transport, rapid movement of the output which is the main element as vehicle speed and road as well as the increasing trend of carrier capacity (tonnage) thereof.

To achieve these characteristics the main role plays treatment of motorways, where the wording of the track in space, we view the plan and altimetry and the unity between them, is the basic element that provides movement as comfortable uniform speeds.

Road infrastructure is the determining factor of incentives for the development of Kosovo's economy and, in the circumstances of the new geostrategic and geopolitical created in the Balkan region and beyond, it is an essential element of economic, scientific, cultural, of free movement of people, and services; cooperation tends to become wider and deeper every day, since time to offer these commodities is highly crucial.

Circumstances created in the Western Balkans after the independence of Kosovo is quite clear that the integration of Balkan and into EU, the first phase of which is the Stability Pact, conditions also the integration of road network of our country in infrastructures of Pan-European transport, as adequate regarding its network of Trans-European community. The final stabilization of peace in the Balkans, coexistence in diversity, free movement of goods, services, capital and ideas seeks to shorten the maximum time of contact between the user manufacturers.

Kosovo is located in the center of Southeast Europe and claimed to have been historically important crossroads of the Balkan Peninsula. Its geographical position enables substantial connection with neighboring countries in the region.

Building corridors VI and VII and their connections with the Albanian ports and Pan European corridors VIII and X, enable better connections not only with neighboring countries but also through the port of Durres. Vlora and Shengjin enable direct links with Europe and world, so a part of international traffic from Eastern Europe could be diverted to Kosovo in harbors along the Adriatic coast, and from the Adriatic to the Black Sea.

The role of transport and infrastructure in regional cooperation in the Western Balkans is considered to be an important factor in the overall economic, social and environmental development of the Western Balkan region.

Development of the Regional Transport Network in Southeastern Europe (Core Network) represents an excellent opportunity for the Western Balkan countries joining their interests and pursue economically and socially advantageous as well as harmless to the environment, from which benefits the region as a whole.

1.1 Economic Impact on Development

In terms of economic development, the implementation of regional infrastructure projects have a positive impact on regional economies, contributes to the opening of their markets to new business initiatives, and makes more efficient trade exchanges between countries in the region.

The development of the Regional Transport Network in particular helps the governments of the Western Balkan countries tackle high unemployment initiatives, thereby increasing the overall economic development of the region. The best opportunities of work and a higher mobility at work also contribute to social development. The Regional Transport Network also helps to improve cross-border cooperation and people to people contacts. Since transport has a significant impact on the environment, European Union (EU) has a direct interest in the Western Balkans since the region lies at the heart of Europe. All Western Balkan countries are candidates or potential candidates for EU membership, this definition includes also Kosovo. To achieve this goal, they must meet all the criteria and conditions required for membership.

Regional cooperation is one of the preconditions for their successful integration into the European Union and is therefore also an essential component of the Stabilization and Association Process (SAP). For this reason, the EU is keen to support the development of regional projects, including the Core Regional Transport Network, which plays a crucial role.

Regarding development of infrastructure on services in order to improve the access of goods for and from CEFTA, it is necessary to imply that several key service sectors play a crucial role. Developed infrastructural services include: transport infrastructure (roads, airports, seaports and railways) and the services provided by the transport and logistics sector, telecommunications networks and services provided over such networks. These sectors are involved in physical infrastructure that is crucial in moving goods from exporting to importing countries (ex: Kosovo to Macedonia) and vice versa. Poor transport infrastructure or inefficient transport services are reflected in higher direct transport costs and longer time of delivery. An improvement in Kosovo's infrastructure can make a big difference to the costs of trading.

Efficient Cost of transport services can also be a major factor determining a country's comparative advantage and competitiveness. For instance, an economy with relatively low air fares has a competitive edge in supplying perishable goods such as fruits or vegetables. While for producers of bulk non-perishable goods the availability of reliable, efficient and low-cost port services can be the key factor in their logistics and distribution chain. By reducing the costs of shipping dramatically, small and medium sized firms that would otherwise be marginal may be able to expand their export activities. Financial services on the other hand support trading of goods by offering innovative crediting services with lower interest rates and less burocracy.

An inefficient and costly service infrastructure is comparable to a tax on production and exports. Exporters and producers of both goods and services need access to world-class services if they are to compete effectively. If not, agricultural producers in Kosovo will suffer due to poor transportation and storage facilities. Companies will face multiple delays and obstacles to doing business due to sub-standard communication networks. Manufacturers will also not be price competitive if they have to pay higher shipping rates due to flag discrimination and cargo preference policies, and have no access to cheap finance due to protected financial systems.

1.2 METHODOLOGY

For the purpose of this IA Paper the following key steps were undertaken in order to cover the most important issues and use best practices for as much as possible.

- Review of the existing documentation and best practices for a similar Impact Assessment exercise in view of trade in services negotiations at bilateral and multilateral level;
- Direct consultations with key stakeholders – ministries and associations;
- A residential workshop to review the initially established position based on consultations and feedback received;
- A review of the CEFTA negotiation sessions by filling the appropriate gaps and modify the respective offers for each sub-sector/category;
- Review internally by the MTI/TD staff for additional input and comments as appropriate;
- Internal close consultations by the TD Head and Officers
- Sector/sub-sector data analysis form the TIS Database and CBK published BoP format, including comparison with other regional countries to review the impact of service liberalization in these sectors;
- Thorough review of the other papers and best practices of liberalization and negotiations

2.0 Services Sectors & Balance of Payment

In Kosovo, services account for a high share of GDP, owing in large part to donor presence in the country. An overall estimate of Services contributing towards GDP is around 73% representing 9% percentage point increase from 2004 when GDP contribution was 64%.

Services are the key component of Kosovo's private sector. The banking sector is estimated to be among the sectors with the best performance in Kosovo's economy. It is generally stable, deposits and credits to the private sector have been growing, despite the global financial crisis.

Trade in Services in Kosovo in 2014 resulted in total with 1.2 billion euro. From this amount total export was 767 million euro, while total import 431 million euro. This shows a positive trade balance of 336 million euro totally in exports. Comparing to year 2013, where trade in services resulted with 952 million euro, year 2014 showed a significant increase of 26% on international trade in services. The main sectors that contributed toward positive trade balance are: travelling (tourism) with 379 million euro, followed by communication services with 20 million euro, where both sectors mainly is attributed to Kosovar Diaspora; government services 14 million euro, contribution from international presence of EULEX, KFOR, diplomatic missions and other international institutions and NGO's; other business services with 8.2 million euro; construction services 4.4 million euro with the inclusion of road construction and architectural services. (Source: CBK).

A negative trend of trade in services (in terms of import of services) appeared to show one of the main sectors: transportation with -73 million euro, while financial and insurance services with -16.5 million euro.

Having a positive trade balance of services resulted in reducing high deficit of trade in goods from -2,180 billion euro into -1,412 billion euro.

While, in 2015 trade in services in total was around 1,211 billion euro. Total exports were estimated at 777 million euro, while imports 435 million euro. The main sectors that showed positive trends are: travelling (tourism) with 545 million euro; followed by other business services with 61 million euro; ICT services 55 million euro; government services 35 million euro, contribution from international presence of EULEX, KFOR, diplomatic missions and other international institutions and NGO's; Transport services 33 million euro and lastly construction services with 14 million euro. (Source: CBK).

Comparing year 2014 and 2015 we can see that we have a slight increase in total trade in services of 11 million euro, while total exports have increased by 10 million euro.

2.1 CEFTA Negotiations

Trade in Services negotiations were organized by having six negotiating rounds and were meant to conclude within 18 months period from the first negotiating session. The end date for concluding negotiations is March 2016.

Twelve sectors have been subject to liberalization with the following tentative schedule:

- 1st and 2nd round – business and professional services
- 3rd – tourism, environmental and recreational (minus audiovisual) services
- 4th - communication and construction services
- 5th – distribution, education and health services
- 6th – finance, transport and audiovisual services

First round of negotiations (business and professional services) was held on November 6, 2014 in Skopje, Macedonia. Representatives from Albania, Bosnia and Herzegovina, Macedonia, Moldova, Montenegro, Serbia and Kosovo attended the meeting.

Second round of negotiations chaired by Moldova was held on February 26, 2015 in Brussels and business and professional services were negotiated as planned for initial two rounds.

Third round of negotiations were held on 29-30 June 2015 in Moldova.

Fourth round of negotiations were held on 17-18 September and fifth round of negotiations were also held in Moldova in November 23rd 2015, while the last round of negotiations which includes (finance, transport and audiovisual services) shall be held in Montenegro by March 2016.

For building a strategy in regard of service negotiation, the first step to be done is to perform the so called 'Mapping' of Services in Kosovo. In order to have that done it is important to identify the capacity able to cope with services. This will entail setting up the proper channel of communication with key stake holders, and conducting a trade related regulatory audit. Conducting a service negotiation, that is to acquire a voice in debates on existing legal structure and also collaterally to pursue offensive interests vs. defensive ones, where analyzing of requests from trade partners will be performed. With this enacted, will be able to formulate our own requests and offers, and also be able to participate in collective requests and offers.

Moreover, Implementing of negotiated outcomes, that is, addressing regulatory capacities and weaknesses and identifying implementation bottlenecks will be required. And finally it will have to supply competitive services that comply with international standards, with constraints on the ability to take advantage of the outcome of trade negotiations, including aid for trade in services.

Transport

3.1 Road Transport

In general rules to entry the market in most of the CEFTA members states are complex and in principle do not discriminate against foreign companies that want to operate. Entry in this sector is usually regulated by laws and regulations of the sector by the executive bodies which determine the technical, safety and financial requirements. In most countries, the responsibility lies with the relevant ministry (the Ministry of Transport / Infrastructure in Kosovo, the Ministry of Infrastructure in Serbia). Road freight traffic is strictly regulated and the regulatory and licensing measures in member countries of CEFTA will not change significantly in the EU. Standards defining national institutions and professional associations covering rules for the provision of services, minimum safety requirements for vehicles and trailers, trucks and technical standards for minimum qualifications and work efforts for truck drivers.

Cross-border service in this region is only regulated through bilateral agreements and which practically means the implementation of practices that exist across Europe. Most member states have signed the CEFTA agreement between them to determine the number of traffic licenses to be issued. Issuance of licenses depends on:

- Type of traffic: bilateral, transit, universal or third countries;

- Type of vehicle: technology standards and Euro emissions (or emissions) 1-5;

- Duration: permanent or temporary;

- Type of goods (hazardous materials or when the load exceeds the maximum weight to national borders) regular or special.

Given that CEFTA member states, by adhering to a very protectionist policy, set quotas on licenses for freight traffic on the basis of reciprocity, the liberalization level largely depends on bilateral relations. The agreements reached recently can serve as an example for other member countries of CEFTA. For example, Serbia has liberalized bilateral and transit traffic with Bosnia, Macedonia and Montenegro. Similarly, Albania and Macedonia recently reached an agreement for a significant liberalization.

3.2 Railways Transport

Railway transport has lost its relevance in all CEFTA member states during the last two and a half decades both in terms of passenger and freight transport. A recent study of the World Bank on the railways in Eastern Europe and Turkey (World Bank 2011) states that on average rail systems in member countries of CEFTA have only half the traffic intensity and a third of EU productivity, with none of the member countries of CEFTA being singled with better performance. The situation is particularly urgent in Macedonia, Serbia, Montenegro, Bosnia and Albania. Croatia and Kosovo are somewhat more productive, but not enough compared to the level achieved in the EU. Excessive numbers of employees is the most significant features in all countries, except Croatia, where it is only slightly lower. The cause of the second most important is the bad performance of low traffic thickness which is less than one third of the EU average in all member countries of CEFTA, with the exception of Croatia again.

Railroads in the region are also at risk because of aging infrastructure due to lack of investment for almost 25 years. Because of this, the speed limits are set for safety reasons in many parts of the rail network. Electrification of the railway is not finished and goes from non-existent in Albania and Kosovo at a maximum 76% in Bosnia (Montenegro 68%, Croatia 36%, Macedonia 33% and 31% in Serbia).

The biggest obstacle to trade in railway services is de facto and de jure in some cases, a ban on market access for foreign railway companies. Although laws in all member countries of CEFTA, with the exception of Kosovo, allow private and foreign companies to provide rail services, a wide range of legal and technical barriers prevent this practice. For example, Albania has not yet formed a committee to safety rules which will have the power to issue licenses to private carriers. Similarly, Serbia does not have an independent regulatory body for the railway traffic and a traffic safety agency to draft a law on railways. In addition, Serbia and Montenegro apply the principle of reciprocity with countries where their railway public companies want to work in their territory. On the other hand, Croatia and Macedonia have liberalized the sector somewhat, because they share the infrastructure of traffic services and create conditions for private service providers and foreign.

Regulation and licensing of operators in this sector is transparent to all CEFTA region. Licenses usually are given for a period of five years, with the exception of Albania and Kosovo, where they are unlimited. There are adequate legal mechanisms in place for appeals against decisions of regulatory authorities.

4.0 Strategy and Government Policies

Despite the experience gained through dozen of years in trade in services, there are still quite complex topics in trade diplomacy. The complexity arises from a number of factors, including (1) the intangible nature of service sector activity and the corresponding difficulty of measuring and assessing the sector's contribution to production and exchange and the economic consequences of alternative policy choices (2) the considerable diversity of activities in the sector, (3) the challenge of the factor mobility (capital and labor) in service transactions, and (4) the ubiquity (and diversity) of the market failures affecting service transactions and, because of the failures, the intensity of regulatory activity.

In the last two years Ministry of Trade and Industry has established the Coordination body on Services to coordinate and facilitate issue and policies related to service process in Kosovo. The representatives of this Coordination Group are from Legal Departments of the various Ministries. So far, the Coordination Group held four meetings. The objective of this body is to: 1) Identify the legislation or parts of legislation that regulates the field of services; 2) Detection and elimination of conflicts; 3) Removal or elimination of barriers faced by natural and legal entities; 4) Providing information and assistance related to services; and 5) Identification of the supervisory authorities.

Sub-working group on services within the Trade Department / MTI held several meetings and this body consists of different Ministries, business community and civil society.

Given the regulatory intensity of many service activities and the range of sectors involved, proper coordination across various government agencies is critical. Promoting an effective process of intra-governmental coordination is likely to generate positive policy-making externalities. In order to have this functional the following is required:

***Creation of a range of government position adequate for tracking service development* –** Having in mind that service negotiations are information intensive, coordination to the development of negotiating positions is essential. This based on a thorough assessment of national priorities and to ensuring that negotiators are well informed of all the factors influencing the domestic service market.

Avoidance of duplication in domestic stakeholder and intra-governmental consultations - Given the multitude of subsectors and measures involved in the service trade, it is important to establish a balance between the engagement of intra-governmental partners on issues of mutual concern and avoiding loading key departments and agencies with too much information or too many requests for input. The establishment of regular lines of communication among individuals may play a significant role in permitting issues to be addressed quickly without creating unnecessary processes. If a particular government entity has to consult with the firms under its direct mandate, the consultation should be coordinated with the trade ministry so that the consultation covers any service-related issues, thereby avoiding the need to resurvey the firms about the trade in services.

The maintenance of contributions to ongoing impact assessments of service trade liberalization - the data used in impact analyses are the responsibility of the national statistics agency. However, the task is challenging, and the alternative information sources may be useful. First, service trade agreements address the issue of the flow of services, while data collection is typically focused on populations of service industries. Second, also service trade agreements entail the four modes of service supply, which requires quite extended knowledge on actual setting of these modes. Third, a particular service may also be exported by goods manufacturers and firms in related service industries, meaning that simply by surveying a particular service industry may therefore not always offer an accurate picture of export activity.

Services sold to foreigners must be distinguished from domestic service transactions that are embedded in exported goods and, so, are not service exports. It is helpful to alert the various parts of government that participate in data collection to the relevant issues and data requirements in proper assessment.

Service sectors vary from the level of regulation. Some are highly regulated as a consequence of policy objectives; others may be less regulated again as a repercussion of the same policy objectives. Examples are sectors such as consumer protection, universal access to health care and education services, protection of environment, and financial services (maintenance of financial stability). Here, should be considered also additional sectors of economic importance. In the same time ensuring competition or equitable and universal access to a service, reducing income and regional disparities is unavoidable. Accordingly, both the GATS and preferential service agreements recognize the right of countries to regulate and introduce new regulations on the supply of services so as to meet national policy objectives.

Trade liberalization in services may intersect with domestic regulation. Information on the potential economic, trade, and investment costs may assist governments in finding most efficient regulatory tools for achieving desired policy objectives. Here to consider the reasonableness, objectivity, and transparency of the regulation; whether the regulation is proportional to the objective being pursued; whether the regulation is linked to or rooted in international standards

***Creation of an information database on measures affecting the trade in services* -** A key substantive obligation flowing from most trade agreements covering services is to provide trading partners with accurate information on the domestic regulatory environment affecting the trade in services. Meeting this transparency obligation can be assisted through the creation and maintenance of a central inventory or focal point and a database of the various regulatory measures.

5.0 Financial Sector

In 2014, the value of total assets of the Kosovo financial system amounted to 4.5 billion euro, marking an annual increase of 7.4 percent (10.5 percent in 2013). During 2014, the growth of financial system assets was mainly attributed to the growth of pension fund and commercial banks assets. The insurance sector, despite the expansion of its activity, had little contribution to the growth of total financial system assets. While the financial assets of microfinance sector and financial auxiliaries had almost neutral contribution to the growth of total assets.

In 2014, the structure of financial system assets remains dominated by the banking sector assets followed by pension funds. Regarding the number of institutions, during 2014, to the financial market of the country was added a branch of a foreign bank (which has been granted the preliminary license), a microfinance institution established by foreign capital, as well as an insurance company with foreign capital (which has been granted the preliminary license). Also, during 2014, the number of financial intermediaries increased to 42. (CBK, 2014)

Table. 1.1

Description	2011	2012	2013	2014
Commercial Banks	8	9	9	10
Insurance Companies	13	13	13	14
Pension Funds	2	2	2	2
Financial Auxiliaries	34	38	39	42
Microfinance Institutions	20	17	17	18

(Source: CBK, 2015)

Financial services are vital to the efficient functioning of modern industrial economies. They offer mediation between lenders and borrowers, to allow firms to diversify and manage risk; they share capital in the whole economy, and provide much of the necessary technical services for domestic and international trade to operate. In countries with weak economies, the development of a strong financial sector is now recognized as one of the key components of sustainable development.

Since international trade in goods and services take a more important role in global economy, international financial services providers are increasingly important as facilitators of transactions in the primary economy. Integration of financial institutions across borders in this case with

CEFTA member countries serves to allocate capital more efficiently between national markets, stimulating real economic development.

The financial services industry is a major sector of the economy and increasing developing and developed economy. In industrialized countries, the financial services account for between 3.5% and 13.5% of value added in GDP and an average of about 5% of the workforce. In some developing countries, financial services account for more than 5% of GDP (Gillespie, 2000).

Benefits of financial liberalization

With the growth of trade in financial services, benefits customers and strengthens the sector as a whole. Market access by foreign firms show some indication of increased competitive pressure, banks experience marginal narrowing net interest, and many of them show lower return on their assets as their monopoly profits are competitive. In almost all cases, the entry of foreign competition is related to the technological modernization of the country's banks, and with increasing sophistication of prudential regulatory systems.

It is interesting how competition benefits materialize rapidly, as in the industrial market as well as in development: foreign entry effects are felt even when foreign firms do not have a large market share. Moreover, multilateral agreements to liberalize the market enable firms a guarantee of long-term political stability, reducing the risk caused in foreign direct investment. Foreign direct investment (investment of a foreign firm in controlling interest of an internal company or create an entity totally new) is especially important in developing countries, as competition directly from foreign firms is a strong boost to follow the "technical development best practices" (Gillespie, 2000).

Numerous studies on the impact of services liberalization have found that:

- Welfare gains flowing from a 50% cut in services protection can be five times larger than those from non-services trade liberalization.

- The total global gain from liberalizing all post-Uruguay Round trade restrictions on services is US$130 billion, which is more the US $80 billion estimated for liberalizing goods trade.

- A 33% reduction of access barriers in service sectors may lead to a rise in global welfare of about US$413 billion. Although developed countries are the main beneficiaries in this study, with some US$330 billion, the gains to be expected by developing countries are still very significant. Again, services liberalization has been found to yield larger gains than trade liberalization in agriculture and manufacturing.

- A 40% cut in protection of business and construction services would translate into a US$22 billion increase in income. The corresponding estimates for the trade and transport sectors are US$332 billion. With few exceptions, all developed and developing countries are expected to benefit.
- Gains from liberalizing financial services and insurance services have been estimated at US$24 billion. In both sectors, the major contribution comes from removing restrictions that discriminate against foreign firms.

5.1 Challenges of liberalization

Opening services markets lead to long term gains but it is neither adjustment nor risk free in the short term. Moving towards a more competitive environment may take time and may impose significant burdens as the adjustment takes place. While costs go down overall, in sectors that previously enjoyed heavy protection, a period of adjustment may see the prices of some individual products become temporarily more expensive as markets adjust. There may also be labor market adjustments as the economy reorganizes and resources are reallocated. Badly designed reforms may unnecessarily complicate the adjustment process, or even more seriously, may undermine the viability and credibility of the new environment.

The pace, content and sequencing of liberalization strategy is thus key to avoiding unnecessary frictions and ensuring the efficiency and viability of more open, market-oriented service regimes. The GATS offers a number of ways to help governments ensure proper sequencing of reforms and to take adequate regulatory safeguards.

The GATS is remarkably flexible as it allows governments to a very great extent to determine how much to commit and what level of obligation to assume. (Stuart et al, 2005)

- Governments are not obliged to make commitments on the whole universe of service sectors all at once. Governments retain the full flexibility to specify the sectors on which they will take commitments. There is no minimum requirement as to the number of sectors to be covered.
- Even when commitments are made on particular service sectors, the GATS allows governments to exercise a great deal of control over the operation of foreign suppliers in the domestic market. These take the form of limitations to market access and national treatment. In other words, governments specify the level of market access and the degree of national treatment they are prepared to guarantee.
- Commitments may be limited to one or more of the four recognized "modes of supply" through which services are traded. They may also withdraw and renegotiate commitments.
- In addition to scheduling limitations, time-frames for implementation can also be specified. Commitments taken in the GATS do not need to be implemented with immediate effect, but can be phased in over pre-defined periods. Such phase-in commitments played a particularly prominent role in the extended negotiations on basic telecommunications. Governments in countries that were still in the process of regulatory reform and institution building used this opportunity to signal their intent to reform and to mobilize the domestic and international business community.
- In financial services, governments are given very wide latitude to take prudential measures, such as those for the protection of investors, depositors and insurance policy holders, and to ensure the integrity and stability of the financial system. The Annex on Financial Services also excludes from the agreement services provided when a government is exercising its authority over the financial system, for example central banks' services.

6.0 Conclusion

In a market of 24 million inhabitants (CEFTA members) having access to provide trade in services is therefore highly significant as the total amount of exports are estimated to be €2.43 billion. Although Kosovo market is still fragile and less experienced in many sectors, liberalizing trade in services mainly (transport and financial services) it will enable its service suppliers and skilled labor to move freely to a greater market and increase their export revenues and shift this negative balance of trade. However, in order to achieve maximum results Kosovo government institutions should pay more attention and invest heavily in human resource management and capacity building. Currently, quality education on specific sectors (engineering, IT, accounting & finance and auditing) is lacking to produce quality human resources in order to compete in the region, and it is necessary to review higher education curriculum and produce skilled human resources.

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