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Foreword

The Baltic Regional Programme was approved by the OECD Council on 12 March 1998 and became fully operational in the final quarter of 1998. This annual report presents the Programme as it has unfolded over the first year of its operation, October 1998 - September 1999.

The aim of the OECD's Baltic Regional Programme are *(i)* to support the efforts of the Baltic countries in the completion of their transition to market economies, *(ii)* to promote their stable integration into the global economy and *(iii)* to encourage their use of the "best practices" the OECD has developed.

Having operated for one year under the co-ordination of the OECD's centre for Co-operation with Non-Members (CCNM), the Programme is starting to deliver tangible outputs. We have undertaken policy reviews in a number of areas, including a comprehensive regional economic assessment. Policy reviews have also been, or are being, undertaken in the fields of competition, foreign direct investment, education, as well as insurance and pension reform. These reviews will be the basis for the elaboration of medium-term objectives for the programme, which will serve as a yardstick to gauge its implementation. Other high-profile activities have included the establishment of the Baltic Forum for Entrepreneurship and Enterprise Development and a Ministerial conference on agricultural policy. New work on corporate governance, capital markets, taxation and statistics has been initiated. Constant attention is being given to public management. The Baltic Programme has also made a new opening to the north-western regions of the Russian Federation at a recent symposium in Saint Petersburg.

The Programme owes much to the active support from our Member countries, in particular the Nordic Member countries and Poland, which are its chief financial sponsors. We have built mechanisms into the Programme to ensure its transparency and our accountability. We have set up a communication structure with the governments of the Baltic countries, which have each created a national co-ordinating body. We also undertake regular programme review and preparation missions to the Baltic and Nordic countries, organise annual evaluation meetings in Paris, attended by the Baltic countries and our Members, and we will continue to publish annual reports on the programme implementation. The Baltic countries have very actively developed their co-operation with the OECD and have repeatedly confirmed their support for the Programme, including at the highest political levels. Baltic country officials are deeply involved in the design, development and implementation of the various activities.

This report is published on the responsibility of the Secretary-General of the OECD. It does not necessarily represent the opinion of the governments of OECD Members or any other countries.

ERIC BURGEAT

Director

OECD Centre for Co-operation with Non-Members

I. Introduction[1]

Origins of the Baltic Regional Programme

The launching, in October 1998, of the Baltic Regional Programme significantly strengthened the OECD's co-operation with the Baltic countries. The programme was developed in response to a joint declaration by the Governments of Lithuania, Estonia and Latvia, dated 22 October 1996. This declaration contained a statement of the States' intention to become members of the OECD (although they refrained from applying formally for such membership) and asked the OECD Council to examine the possibility of setting up a Special Regional Programme for the Baltic States.

When the governments presented their joint declaration, the OECD's co-operation with the Baltic countries had been an element of the general work programme of the Organisation's Centre for Co-operation with Economies in Transition (CCET), which was partly funded by the CCET's budget and partly by voluntary contributions.

A number of the activities took place in the context of an informal *Baltic Rim Economic Forum (BREF)*, initiated at a meeting in Helsinki in June 1995[2]. The BREF comprised a series of activities in the fields of enterprise reform, foreign investment, competition and accounting. Some Russian regions (Kaliningrad *oblast*, the Republic of Karelia and the City of Saint Petersburg) participated in the erstwhile BREF seminars.

Furthermore, a three-year programme aimed at building an effective framework of tax legislation and administration was launched in 1996. The OECD also published a *Review of agricultural policies* for each of the three Baltic countries in 1996[3]. An *Investment guide for Estonia* was published in 1996, followed by similar publications for Latvia and Lithuania in 1998[4]. Finally, work was done on environmental policies in the Baltic countries, with a focus on the development of national environmental financing strategies.

OECD's dialogue with emerging market economies

The OECD assists its 29 Member countries in achieving high sustainable economic growth by providing multilateral surveillance as well as a forum for discussion and peer review of macroeconomic and structural policies. Given the increasing economic interdependence between Members and non-Members, the Organisation has developed its co-operation with non-Member economies, not least with those in Central and Eastern Europe. It has created platforms for policy dialogue with various groups of non-OECD Members, including country programmes for Russia, China and Brazil, regional programmes in Asia and South America and, since 1998, it has run a regional programme with the Baltic countries.

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1 An earlier version of the text of this Introduction was published in *Baltinfo*, the official newsletter of the Council of the Baltic Sea States (CBSS), April 1999.

2 The proceedings of this meeting were published as*: Regional integration and transition economies -- The case of the Baltic Rim*, OECD Publications, 1996.

3 *Review of agricultural policies, Estonia*, OECD Publications, 1996; *Review of agricultural policies, Latvia*, OECD Publications, 1996; *Review of agricultural policies, Lithuania*, OECD Publications, 1996. See also the Internet at: http://www.oecd.org/agr/policy/ag-det/index.htm.

4 *Investment guide for Estonia*, OECD Publications, 1996; *Investment guide for Latvia*, OECD Publications, 1998; *Investment guide for Lithuania*, OECD Publications, 1998. See also the Internet, at: http://www.oecd.org/daf/cmis/cmispubs.htm#transition.

The Baltic region

The Baltic/Nordic region includes seven OECD Member countries[5], *i.e.* almost one quarter of the OECD's membership. The OECD Members' support for the Baltic Regional Programme owes much to the perception that the region has strong growth potential, as evidenced by the growing confidence of foreign investors in this region.

Another factor to the credit of the Baltic countries is that they have a proven willingness to play by the "rules of the game" in the field of investment. There has been a strong drive for integration into the European Union, which presupposes an adoption of the EU's *acquis communautaire* (*i.e.* the prevailing EU regulation). Estonia and Latvia have acceded to the World Trade Organisation; negotiations on WTO accession with Lithuania are well advanced. The three Baltic non-Members participated in the Negotiating Group for the Multilateral Agreement on Investment. If these negotiations had been concluded successfully, the countries would have had relatively few reservations with respect to the obligations under the Agreement. Currently, they are observers in the discussions on issues relating to international investment conducted in the OECD's Committee on International Investment and Multinational Enterprises[6]. The countries' interest in adherence to the *OECD Convention on combating bribery of foreign public officials in international business transactions*[7], is also a sign of their determination to play by internationally agreed standards.

The Baltic Regional Programme

The Baltic Regional Programme is the main vehicle for OECD's co-operation with Lithuania, Latvia and Estonia; for certain activities, such as competition policy and the development of entrepreneurship, it also includes certain contiguous regions of the Russian Federation, in particular Kaliningrad, Karelia and Saint Petersburg. The programme has been formulated to meet three fundamental objectives: *(i)* to assist in the completion of the transition to market economies, *(ii)* to promote the stable integration of the Baltic region into the global economy, and *(iii)* to encourage the use of best practices of OECD in developing policies and strategies in the Baltic region, in order to promote long-term sustainable economic growth and political stability.

The 1999 work programme contains a balanced set of activities, designed in close consultation with the Baltic authorities. The 1999 "flagship" activity is a *regional economic assessment*, which will provide greater insight into the economic issues confronting the Baltic region. The assessment will be published in early 2000. This, and other activities, several of them high-profile ones, are discussed extensively in chapter II.

The North-western regions of the Russian Federation were given special attention in a symposium on enterprise development and foreign investment strategies in these regions, held in September 1999 in Saint Petersburg. The OECD's activities in these regions may be expanded as of 2000.

Political commitment

The Baltic governments' commitment to co-operate with the OECD in a regional programme was expressed in their joint declaration of 22 October 1996. This commitment has been reaffirmed and elaborated in strategy papers, adopted by each of the governments at Ministerial level and presented at the

5 Denmark, Finland, Germany, Iceland, Norway, Poland and Sweden.

6 At present, eight non-OECD Member observers participate in these discussions; the others are Argentina, Brazil, Chile, the Slovak republic and Hong Kong, China.

7 See the Internet at: http://www.oecd.org/daf/nocorruption/instruments.htm.

first annual evaluation meeting of the Baltic Regional Programme, on 23 April 1999. These papers will soon be available on the Internet, at http://www.oecd.org/sge/ccnm/about/baltic.htm.

II. The operational activities

During the first operational year of the Baltic Regional Programme (October 1998 - September 1999), a broad range of activities were initiated, designed in close consultation with the authorities of the Baltic countries. The most comprehensive activity was the preparation of the regional economic assessment, which was to be completed by the end of 1999. Other high-profile activities included the conference in Tallinn which served as opening event for the Programme, a conference at Ministerial level on Baltic agro-food policies, the establishment of the Baltic Forum for Entrepreneurship and Enterprise Development (FEED), policy reviews in the fields of competition, foreign direct investment and education. New work on capital markets, insurance and pension reform, on taxation policy and on statistics was initiated. A new opening was made to the north-western regions of the Russian Federation at a symposium in Saint Petersburg.

1. TALLINN CONFERENCE

The conference on *Economic development in the Baltic region: The path ahead* was held in Tallinn on 20-21 October 1998. Opened by Prime Minister Mart Siimann of Estonia and attended by the Foreign Affairs Ministers of Estonia, Latvia and Lithuania, the event served (unofficially) as the opening event of the Baltic Regional Programme.

Mr Kumiharu Shigehara, Deputy Secretary-General of the OECD, delivered a keynote address in which he made the following points on the relevance of the OECD's work with emerging market economies, like the Baltic States, and the importance of a policy dialogue between them and OECD Member countries.

> "The first obvious point that I would make is that *sustainable high economic growth of the OECD area itself* is a positive contribution to the global economy into which emerging and transition economies are increasingly integrated. This is because the OECD area still has a dominant position in the world economy, accounting for over 60 per cent of world output. In this respect, the OECD's macroeconomic and structural policy recommendations to its Member countries for achieving and maintaining non-inflationary high growth are relevant to the objective of facilitating economic development in the rest of the world as well.
>
> Related to this, my second point concerns the role of the OECD in *enhancing the multilateral system of free trade and capital flows, while ensuring social stability*. In a growing number of OECD Member countries, there are signs of a backlash against globalisation, which is perceived as one of the major causes of persistent unemployment, in particular for unskilled workers, widening wage inequality and de-industrialisation in OECD Member countries. In this environment, the OECD has a particularly important role in assisting its Member countries in their efforts to maximise the long run benefits of globalisation and to minimise the short run costs by promoting a wide range of domestic and social policy reforms, as I have just discussed. The OECD's work to encourage fuller, more active participation of OECD Member countries in the globalisation process will benefit both OECD and non-OECD economies. In this context, the OECD presented a general report on the benefits of free trade and investment to the OECD Ministerial meeting of April 1998. At the request of OECD Ministers, the OECD is now preparing a report, which I am directing, on the links between trade and investment and development, and the role that the OECD can play in promoting policy coherence required both in the OECD and non-OECD areas for the development of non-OECD economies.
>
> My third point is that the economic performance of OECD Member countries is increasingly *influenced by developments in non-OECD economies* whose weight in the global economy is steadily increasing. OECD Member countries have greatly benefited from the dynamic economic

performance of emerging economies in East Asia over recent decades, and more recently by emerging economies in Latin America and the transition economies. The counterpart is that OECD Member countries cannot remain immune from adverse developments in the non-OECD world, such as the widespread international ramifications of the financial crisis which originated in South East Asia a year and a half ago. It is thus important for the OECD and its Member countries to assist non-OECD economies in their private sector capacity-building and strengthening public governance, and at the same time to learn from the experiences of non-OECD economies.

My fourth point is that *OECD Member countries' experiences, both successes and failures, can provide useful lessons* also for emerging and transition economies, which are increasingly adopting the fundamental values that bind OECD Member countries together, namely pluralistic democracy, respect for human rights and the market economy. With these values being increasingly shared the world over, a growing list of non-OECD economies have a common policy agenda with OECD Member countries. In the course of my discussion today on policy challenges facing OECD Member countries, you may have found a lot of current and prospective policy issues shared by emerging and transition economies.

It is in the light of these considerations that over the past decade, the OECD has been developing a process of *policy dialogue* with a wide range of non-member economies. These include: dynamic economies from Asia, some of which have undergone 'managed development' with a strong hand of government; emerging economies from Latin America, many of which struggled for a long time against macroeconomic instability; lesser developed countries, notably from Africa, which are still endeavouring to create the domestic capacity for development; and of course transition economies, which have undertaken the brave challenge of transforming their economies from centrally-planned systems to market economies.

The OECD does *not offer a single model*, but rather a framework for countries to develop their own institutions and approaches. The OECD's co-operative activities open up a wealth of experience and expertise from OECD Member countries, and the OECD Secretariat, in developing the institutions and policies for a well-functioning market economy and social stability. These activities are based on policy dialogue with experts from OECD Member countries and also other international organisations, and involves sharing experiences, using 'sounding boards' for policy proposals and undergoing peer reviews."

2. REGIONAL ECONOMIC ASSESSMENT

The first year's "flagship" activity of the Baltic Regional Programme is a regional economic assessment of the three Baltic countries, which will be published under the title *The Baltic states; A regional economic assessment* (OECD Publications, 2000).

Overview of macroeconomic developments

As with most transition countries, all three Baltic countries suffered a deep output fall at the onset of transition. Management of the reform process has subsequently affected the dynamics of a recovery in which external trade was the most important factor. The peaks of GDP growth in 1997-98 for Estonia, 1996-98 for Latvia and 1996-97 in Lithuania were all driven by exports, although the trade balance has made a negative contribution to GDP growth in most years. The countries are all small open economies with a high share of trade in GDP. Hence, they naturally import a wide range of goods, but export growth has tended not to keep pace with import growth, leading to large trade gaps. In 1998, the current account position of all three countries deteriorated significantly.

The Russian crisis of mid-1998 provoked a slowdown of growth. GDP growth in Estonia decreased to 4 per cent from a peak of 10.6 per cent in 1997. In Latvia, growth slowed down to 3.6 from 8.6 per cent, while Lithuania seemed the least affected with 5.1 per cent growth in 1998 compared with 7.3 per cent in 1997. The crisis also prompted a fall in exports, and industrial production in the Baltics has been declining steadily compared with early 1998, especially in Estonia and Latvia. By mid-1999, still there were no signs that industrial output was recovering from the shock. Given results in the first quarter of 1999 and Russia's post-crisis developments, the estimates for 1999 point to a further fall in growth rates, due also to the sluggish performance of the EU, and Germany in particular.

The fiscal position was also affected by the Russian crisis. The deficit in Lithuania reached 9 per cent of GDP during the second half of 1998, though the deficit for the year was about 5 per cent of GDP; a similar deficit is expected for 1999. The Estonian deficit during the second half of 1998 rose to 2.8 per cent of GDP, though the deficit for the year as a whole was a modest 0.3 per cent of GDP. A supplementary budget is expected to restrict the 1999 deficit to 3.5 per cent of GDP. The Latvian deficit in 1998 was a creditable 0.8 per cent of GDP, and a supplementary budget is expected to contain the 1999 deficit at 4 per cent of GDP. In contrast, inflation in the Baltic countries remains subdued, at or below 4 per cent in each case. This reflects the success that fixed exchange rates and currency board arrangements have had in promoting macroeconomic stabilisation.

Structure and objectives of the regional economic assessment

The Baltic regional economic assessment is a first in two ways: it is the OECD's first combined macroeconomic and structural survey of the Baltic countries, and it is the first joint survey of three countries. The Study covers both macroeconomic and structural policies in the areas of banking, labour and social policy, trade and foreign direct investment (FDI), enterprise reform and agriculture in Estonia, Latvia and Lithuania. While not providing country-specific policy recommendations, this comparative study aims to highlight the links between macroeconomic stabilisation policies and ongoing structural adjustment, as well as requisites for sustainable growth in the Baltic region.

The draft texts of the regional assessment have been prepared for discussion at a seminar on 8 November 1999 in Paris. The seminar will be open to delegates to the OECD's Economic Development Review Committee, including the European Commission, and representatives of other international organisations, such as the World Bank and the International Monetary Fund. As is the case with similar OECD studies, the seminar is an opportunity to support a policy dialogue with non-Members in the areas of macroeconomic policies and key structural reforms focussing on the best way to co-ordinate different types of policies, notably in terms of macro-structural links. This dialogue is expected to have an impact in terms of shaping policies in non-Members in the light of the accumulated experience of OECD countries. Preceding the seminar, there has been an active and fruitful interaction between the OECD Secretariat and the Baltic countries, which started with a first mission to establish contacts and collect basic information about the countries from 20-29 September 1998. The assessment has been an interdisciplinary project, based on contributions from several OECD directorates and background papers by a number of external specialists on specific topics.

The study provides policy insights consistent with desirable achievements in a broad range of reform areas, with a particular emphasis on the interdependence of policies. It will also make a key contribution to the formulation of medium-term objectives for the Baltic Regional Programme.

3. POLICY REVIEWS

3.1 COMPETITION POLICY

In the second half of 1998 and the first half of 1999 the OECD conducted a comprehensive review of competition policy in the three Baltic states, in which written reports on competition policy in each of countries were presented. It included a two-day high-level dialogue addressing issues identified in the reports, and a three-day training based on the reports, both held from 24-28 May 1999 in Riga.

The country reports, together with a synthesis, are to be published under the title *Competition law and policies in the Baltic countries* (OECD Publications, 1999).

Competition policy in the Baltic countries

Competition policy has evolved in parallel fashion in the three Baltic countries. Latvia first enacted a competition law in 1991, followed by Lithuania in 1992 and Estonia in 1993. All three enacted new laws in 1998 and 1999. The three competition laws are roughly comparable. The Latvian and Lithuanian laws include merger control, which Estonia is expected to institute within the next few years. Each of the new laws approximates the substantive provisions of EC competition law.

The Latvian and Lithuanian laws vest enforcement authority in five-member, semi-independent commissions, while the Estonian competition authority is an executive body, headed by one person appointed by the government. The three agencies are roughly the same size, each having 35-50 employees, but are still in a state of flux due to the recent enactment of new laws.

The three competition agencies have been actively enforcing their competition laws, both old and new, in the past few years. They each handle from 30 to 70 matters – cases, investigations, inquiries – each year, the numbers depending partly on how such matters are classified and counted. The most common cases involve abuse of a dominant position, often by natural monopolies, restraints by government bodies, and unfair competition. The agencies have dedicated officials, but turnover has been a problem and available resources are not always adequate for the task. They have to overcome formidable challenges, including that of garnering enhanced respect and independence within the government, which will permit greater freedom to enforce the competition law free from political influence.

The review process

The review was based on extensive discussions, examination of available reports and case decisions. Data on the structure and activities of the agencies were obtained by means of a questionnaire. In-depth interviews of agency management and enforcement officials were held, as well as discussions with officials in other relevant government agencies, the private sector and officials from the competition authorities of Germany and Sweden, who already advise the Baltic competition authorities.

The country reports discussed the history of competition policy in the relevant country, the applicable laws and regulations, the structure of the competition agency, and up to 15 different aspects of competition policy. They covered both substantive and institutional aspects of competition enforcement, such as actions against specific types of anti-competitive conduct, investigative techniques, effective sanctioning, competition advocacy, independence of the competition agency within government, development of a “competition culture” within the country, and budget and resource issues. Each section of the reports contained specific comments and recommendations.

Although the reports applied only to the Baltic states, the events were also attended by (and they benefited from) officials from the contiguous territorial offices of the Russian Antimonopoly Ministry (and one representative of the Ministry’s central office).

Recommendations in the review

The three country reports contain specific recommendations, which are summarised below. Some of the recommendations are specific to one country, while others are common to all three.

Substantive enforcement

- Abuse of dominance – agencies should perfect methodologies for defining relevant markets and identifying dominance; in so doing they should concentrate on "structural" remedies, such as eliminating artificial barriers to entry in order to permit new competition, rather than "behavioural" remedies that attempt to control or regulate dominant firms.
- Restrictive agreements – give more attention to cartels; avoid burdensome notification requirements.
- Mergers – avoid burdensome notification requirements; develop greater sophistication in merger analysis, including a better understanding of how competition from abroad affects domestic markets.
- Investigative techniques – use voluntary means where possible, but develop more effective techniques acquiring and reviewing information, including acquisition of documentary materials.
- Enforcement and sanctioning powers – continue to focus on the means of framing effective remedial orders that are easily enforced; impose increasingly large fines for cartel conduct; punish violations of agency orders and wilful destruction or withholding of evidence.

Institutional aspects

- Competition advocacy (presenting the case for competition in other executive and legislative contexts within government) – increase this activity, which is especially important in transition countries.
- Developing a competition culture – aggressively promote the understanding of and support for the agency's mission by various means: publish agency decisions, issue enforcement guidelines, develop press relations, make speeches, and sponsor seminars or conferences.
- Resources – work continually to upgrade the level of expertise of the enforcement staff; seek enhanced budgets (but recognise that there will always be budget shortages), improve the efficiency by identifying priorities, streamlining procedures and developing means of achieving compliance other than formal enforcement proceedings.

Assessment

Throughout the review process, the Baltic competition agencies expressed considerable interest in the review and enthusiasm for follow-up work. More than in 1999, the agencies themselves will play a major role in selecting the structure and content of future activities. They have in fact provided numerous suggestions for follow-up activities in 2000 and beyond; planning missions to each country would take place in mid-October 1999.

Whereas the 1999 review covered a very broad range of issues, narrower topics will be discussed in future programmes. This may make it possible to integrate the relevant Russian regional offices more fully into the activities. Moreover, for future events to include an increasing amount of real policy dialogue, it is important that there be participation by an increasing number (and increasingly high level) of representatives from the competition agencies of Member countries in the region.

3.2 FOREIGN DIRECT INVESTMENT POLICY

Assisting the Baltic States in developing a policy framework for foreign direct investment (FDI), responsive to the challenges of a transition economy, has been a major element of the OECD's work programme in the Baltic region. Between 1996 and 1998, the OECD published *Investment Guides* for Estonia, Latvia and Lithuania, respectively (see chapter I). Recent efforts have focused on assessing the overall results of this pioneer work and exploring ways of meeting the challenges of an increasingly competitive world for FDI.

Currently, the Baltic countries participate in the discussions on international investment in the OECD's Committee on International Investment and Multinational Enterprises. In December 1999, this Committee will be considering the possibilities of widening the geographical application of the OECD's Declaration on International Investment and Multinational Enterprises[8].

The first year's activities on FDI under the Baltic Regional Programme specifically consist of *(i)* the preparation of an FDI policy review for each of the three Baltic states, *(ii)* the organisation of a conference on *FDI policy and private sector development* to be held in Tallinn on 17 November 1999[9], and *(iii)* the publication of the conference proceedings and the Baltic country studies on FDI policy in the series *OECD Reviews on foreign direct investment*[10].

Future work will increasingly build upon the interdisciplinary character of the Organisation, notably in the areas of tax policy, competition policy and environment policies. The most likely follow-up to the Conference is a seminar on *Foreign direct investment and tax competition*, to be held in Vilnius in the first half of 2000.

Main findings of the review

Foreign direct investment has played a crucial role in the transition of the three Baltic countries to a market economy. FDI has provided a growing inflow of capital, new technologies, management and organisational skills, and extensive linkages with OECD Member countries. This has stimulated exports, industrial upgrading and economic growth. The growing presence of investors from Nordic and other OECD countries, and the increased complementarities in investment and trade patterns have been major ingredients in this transformation process.

As a result, the transition process has made a very considerable headway. The share of manufacturing and, for that matter, that of the entire private sector in economic activity, has strongly increased. Price liberalisation is almost completed, direct subsidies have been largely removed and more competitive market conditions have been established. The legal and regulatory framework for domestic and foreign investors has been extensively reformed and liberalised. Environmental and quality standards are improving, together with institutional and economic conditions, driven by the prospect of membership in the European Union.

The recent crisis in Russia has also confirmed the importance of foreign direct investment for these economies, not only to finance external imbalances, but also to create dynamism in the private sector, which is hampered by the collapse of trade with Russia and tightened credit conditions. However, in order

8 The *Declaration on international investment and multinational enterprises*, issued by the governments of OECD Member countries in 1976 and last revised in 1991, constitutes a policy commitment to improve the investment climate, encourage the positive contribution multinational enterprises can make to economic and social progress and minimise and resolve difficulties which may arise from their operations. With the OECD Member countries, the European Communities, Argentina, Brazil and Chile have adhered to the Declaration. The Declaration consists of four elements, including the *Guidelines for multinational enterprises*, which constitute a set of voluntary rules of conduct, a *National treatment instrument*, and rules on conflicting requirements and on investment incentives and disincentives. See the Internet at http://www.oecd.org/daf/cmis/codes/declarat.htm.

9 Back-to-back with a workshop on FDI statistics (see section 7).

10 See the Internet, at: http://www.oecd.org/daf/cmis/cmispubs.htm#transition.

to complete the transition successfully and encourage the inflow of long-term capital, the Baltic States still need to address a number of challenges:

- The progress achieved in privatisation diminishes its role as a generator of FDI, while liberal investment frameworks have become increasingly commonplace and may therefore in themselves have become less effective in giving countries a competitive edge in attracting FDI.
- The Baltic countries still suffer from inconsistencies in the legal framework for investment and uncertainty in the interpretation and enforcement of regulatory regimes. Problems can arise in the tax system, in customs clearances and in immigration procedures and often after the establishment of an enterprise.
- Legal recourse procedures for commercial disputes are not yet adequate.
- The same is true for access to investment and development financing at all stages of the business cycle.

The integration into the EU, and the consequent adoption of the *acquis communautaire*, will make the Baltic States more attractive by compelling them to harmonise their laws and regulations with those of the EU. Apart from the EU enlargement, the co-operation among the Baltic States in the field of attracting FDI also requires special attention.

3.3 EDUCATION POLICY

Each of the Baltic countries has to confront specific challenges in the field of education. The Baltic Regional Programme includes a review of education policy which will address these challenges in individual country sections.

The Latvian segment of the review was financed a grant from EC-Phare, and those of Estonia and Lithuania by Poland and the Nordic countries via the CCNM Baltic Programme. The examining team includes the Chairman of the OECD's Education Committee, former ministers, experts and officials of the World Bank and European Training Foundation. Two-week site visits were organised for each country.

The review is to result in recommendations for the individual Baltic countries on education goals, access and opportunity for all; curriculum and assessment; teachers and teacher training; reforming vocational and technical education within a changing economy; management, finance and the role of government. Recommendations will also be formulated on other issues that cover the entire region: large urban areas and declining rural populations, large minority populations and important economic disparities between regions.

These disparities raise concern about *social polarisation*, and the risk that some vulnerable populations will not be served. Poverty is a serious and growing problem, linked to unemployment, social isolation and marginalisation, and affecting access and equity not only for school-age children but also for out-of-school youth, adults and communities in general. The Ministry of Welfare in Latvia ranks poverty as Latvia's main social problem, one that results in "a rapid polarisation of communities" along economic, social and cultural lines.[11] The effects of poverty on family life, child health and social participation are also felt in the region's schools, in particular in areas hardest hit by economic crisis.

Language issue. Although much public attention is focussed on the use of the national language in classroom instruction, the examining team was under the impression that this is more a political than an educational issue. Most schools, teachers and students, are coping quite adequately with the national languages, although there are some practical problems related to textbooks, materials and subject-related teacher re-training. Little evidence was found, at school level, that 'the language issue' is creating tensions among children and teachers.

11 Ministry of Welfare, *Social Report 1998*, p. 11.

Declining birth rate and the future of small (often rural) schools. This is a complex policy issue. Latvia's school-age population, for example, is shrinking rapidly: between 1990 and 1996, the number of children born annually fell by 54 per cent. School enrolments have begun to show the effects, and first-year enrolments will continue to decline for the foreseeable future. It is not yet clear that an appropriate policy response to this decline is being developed, but, with fewer children arriving at the school door, it will become even harder for the education sector to justify maintaining small schools and very low (by international standards) pupil/teacher ratios. School systems will have to find ways to increase class sizes and reduce the cost (not least heating costs) of unnecessary classroom space. Multi-graded classes, merging of small schools, raising pupil/teacher ratios and a significant reduction in the teaching force may need to be considered.

Standards and quality. Impressive strides have been made in curriculum reform and in setting national frameworks for standards and assessment. However, because the responsibility for education has been largely devolved to municipalities, ministries have no national mechanisms for quality control in primary and secondary education. Nor is there (as yet) a system for evaluating teacher quality: teachers are so badly paid that they do not take kindly to the idea of having their work evaluated. But if schools are to maintain and raise learner achievement, some form of systematic teacher appraisal -- whether or not linked to salary -- will need to be introduced.

The draft report, including a chapter on regional issues, will be discussed at a special meeting of the Education Committee to be hosted by the Finnish authorities on 26-27 June 2000 in Helsinki.

4. OTHER HIGH-PROFILE ACTIVITIES

4.1 POLICY ANALYSIS OF THE AGRO-FOOD SECTOR

The overarching goal of developing a competitive agro-food industry is of high priority in the Baltic countries. Nevertheless, the three Baltic countries have taken quite different approaches to achieving this goal. For example, while Estonia has maintained a completely open trade regime with no border tariffs or internal support, Latvia and Lithuania have retained quite high border tariffs, as well as a range of *ad hoc* support measures. Much progress has been achieved in macroeconomic stabilisation, structural and policy reforms in all sectors, including the agro-food sector. More specifically, privatisation of the agro-food sector is almost completed in the region, and rationalisation and restructuring is on-going in many sub-sectors. The low level of investment in agriculture continues to entail a lack of technological innovation, thus hampering productivity growth and improvements in farm incomes across the region.

Meeting at ministerial level on Baltic agro-food policies, Riga, Latvia, 26-27 November 1998

Just as the OECD Ministers of Agriculture met in 1998 to take stock of agricultural policy developments in OECD Member countries and to look at the challenges ahead, so too Baltic Ministers and a number of their OECD counterparts met in Riga a few months later. They set two objectives for their discussions: first, to assess how far they had come in agricultural policy reform, privatisation and restructuring of the agro-food sector; and second, to identify appropriate medium-term policies and policy instruments to facilitate the development of a competitive agro-food sector.

The statements and reports presented at the conference, as well as the contributions from the Ministerial panels and discussants, have been summarised and published in the proceedings report[12].

The report highlights the areas where policies are tending to converge in the three countries, as well as the emerging challenges facing the Baltic food industry in the medium term. One of the key challenges

12 *Baltic agro-food policies; Proceedings of the OECD meeting at Ministerial level*, OECD Publications, 1999.

continues to be to foster their integration into global markets, while recognising the economic and social role of agriculture in the region. In this context, the Baltic countries are giving top priority to their accession to the World Trade Organisation and adherence to the economic disciplines of the European Union. The most pressing medium-term objective is to harmonise national legislation with that of the EU. However, the Baltic countries have to overcome an enormous challenge in developing administrative and institutional capacities to implement the various elements of the *acquis communautaire* and to gain access to EU policies and funding. Agricultural policies and prices have tended to converge across the region, driven not only by the implementation of the *acquis* but also by the deepening of trade relations under the Baltic Free-Trade Agreement (BAFTA).

Participants in the conference included Ministers of Agriculture of Estonia, Latvia, Lithuania and Sweden as well as high-level officials from Denmark, Ireland, Norway and Poland. The meeting was opened by Mr V. Kristopans, Prime Minister of Latvia and Ms J. Shelton, Deputy Secretary-General of the OECD. Mrs M. Winberg, the Swedish Minister of Agriculture, and Mr J. Woroniecki, Ambassador and Poland's Permanent Representative to the OECD, presided over the conference. The foundations for this event had been laid at an expert-level seminar held in Parnu, Estonia in September 1997[13].

The Forum on Agricultural Policies in Non-Member Countries

The Forum on Agricultural Policies in Non-Member Countries brings together experts from the OECD Members and 18 non-Member economies. The Forum entertains a policy dialogue aimed at analysing and monitoring agricultural policy, markets and trade developments and at evaluating progress towards agricultural policies that are market-based and oriented towards integration into the global economy. The Forum's proceedings result in the annual publication *Agricultural policies in emerging and transition economies*; the July 1999 issue was the seventh in this series. a new companion volume, entitled *Agriculture at a glance in emerging and transition economies* provides brief policy highlights and statistics by country. It contains separate chapters on agricultural policy, trade and market developments in (among others) Estonia, Latvia and Lithuania in 1998 and the first part of 1999.

Agricultural policy experts from Estonia, Latvia and Lithuania participated in the biannual meetings of the Forum, which were held in October 1998 and April 1999. For the October 1998 meeting, the Baltic representatives provided background papers on the following issues:

- Impacts of the Russian and Asian crises on agricultural trade and the agricultural financial situation;
- Policy reform and labour market adjustment;
- Agricultural land reform and farmland markets.

The financial crisis which erupted in August 1998 in Russia, has had a major dislocation on trade, especially for agricultural products. The collapse of the agricultural product markets in the countries of the former Soviet Union has depressed prices across the region and this has caused severe problems for farmers and the processing sector.

Employment in the agricultural sector is high relative to agriculture's share of GDP, especially in Lithuania, implying that productivity in the sector is relatively low. While some outflow of labour has taken place, especially in Estonia and Latvia, further adjustment will be inevitable if a more efficient and competitive agro-food sector is to be developed.

On the issue of land reform, most of the agricultural land has been privatised in the region, but further restructuring and consolidation is ongoing and viable farm structures are emerging. While the legislation

13 *Agricultural policies in the Baltic countries: Proceedings of the Parnu seminar*, OECD Publications, 1998.

for a land market has been established in all Baltic countries, a functioning land market does not yet operate in any of the countries.

In the April 1999 meeting of the Forum, the policy experts provided an update on domestic support, structural, and trade policy changes during 1998 and the first part of 1999. In preparation for their accession to the EU, all three countries are making great efforts to design and implement policies similar to those of the EU's Common Agricultural Policy, including the introduction of direct payments and rural development policies. Furthermore, Latvia and Estonia have completed their negotiations on accession to the World Trade Organisation and have become members, while Lithuania's negotiations are at an advanced stage. Implementation of the commitments under the Uruguay Round Agreement on agriculture has proven to be very challenging to the Baltic countries, and domestic support policies and export subsidies continue to cause difficulties, especially for Lithuania.

Monitoring of agricultural policies in Estonia, Latvia and Lithuania, including the updating of the producer and consumer support estimates

In the publication *Agriculture at a glance in emerging and transition economies*, producer and consumer support estimates (PSEs/CSEs) are calculated for 1998 and the new estimates are discussed. PSEs are indicators of the value of gross transfers from consumers and taxpayers to agricultural producers, arising from policy measures which support agriculture. CSEs indicate the value of gross transfers to consumers of agricultural commodities arising from policy measures which support agriculture.

In the assessment of the Baltic countries, four important findings were identified:

- Depressed demand in international markets for agricultural commodities, exacerbated by the Russian crisis, has resulted in a dramatic fall in farm incomes and has created major problems for the food processing industry. Moreover, a surge in food imports, much of which had been displaced from the Russian market, has resulted in further market turbulence in the region.
- The policy response across the region, as in many other central European countries, has been to introduce and/or increase financial support to farmers. In general, this has taken the form of direct payments, and to a lesser extent a tightening in border measures.
- Also in response to the market difficulties in 1998, Estonia, Latvia and Lithuania are making great strides to diversify their export markets for agricultural products; away from Russia and the other Newly Independent States and towards Western Europe and other OECD countries, including the Middle East.
- Implementation of the BAFTA had slowed and frictions amongst its members increased in 1998 and 1999. However, this development is seen as only a temporary setback; deepening of trade relations under the BAFTA remains a high priority in all three Baltic countries.

Baltic regional economic assessment: agriculture

The OECD's Agriculture Directorate contributed to the Baltic Regional Economic Assessment by preparing a chapter on recent policy developments in the agro-food sector. The chapter on agriculture focuses on the spill-over effects of the Russian crisis on trade in agricultural and food products between the Baltic region and Russia. In the latter part of 1998 and the first half of 1999, agricultural exports to Russia from Estonia, Latvia and Lithuania collapsed, which resulted in severe financial problems in many food-processing enterprises, especially for milk and meat processing industries. Moreover, prices on the domestic market were further depressed by a surge in imports of meat and meat products from other European countries. On the other hand, the crisis is likely to speed up the pace of restructuring in the food processing industry and to lead to a more efficient and competitive sector in the longer run.

In addition, the paper also identifies several medium-term policy objectives which need to be addressed in the development of a sustainable agro-food sector. Of high priority is the completion of land reform and the creation of transparent, efficient and functioning input and output markets. An essential element in this process is to ensure that bankruptcy laws are properly enforced. Moreover, there is a need to improve efficiency in agriculture, as well as to implement policies which will address the outflow of labour from the sector.

While domestic support to agriculture is currently low compared to the OECD average, there is growing pressure to increase budgetary and market support to the sector. The policy response to such demands should be effectively targeted to overcome the structural weaknesses in the sector and should not create new economic distortions and inefficiencies that could impede further restructuring of the sector. The low level of price transmission remains a serious impediment to efficiency in the agro-food sector. Further deepening of co-operation under the BAFTA is likely to speed up the restructuring in the food processing sector, and may lead to the emergence of several pan-Baltic food processing companies in the long run.

4.2 CORPORATE GOVERNANCE

The OECD Principles

Corporate governance has risen in prominence on the international agenda, sparked in particular by the recent financial crises in Russia and Asia. Indeed, these crises have made clear how poor corporate governance can harm company performance, national economies and ultimately global financial stability. Corporate governance has also become an increasingly important consideration in international investment decisions. Establishing credible corporate governance arrangements will help countries and companies to attract long-term, “patient” capital. Many countries are now reviewing their corporate governance frameworks to provide for transparent decision making processes and to stipulate the rights of shareholders (not least minority shareholders) and other stakeholders.

The OECD has developed *Principles of corporate governance*[14] in response to requests by the G-7 and G-22. Member and selected non-member governments, key international organisations and a number of private sector and non-governmental organisations contributed to this first inter-governmental attempt to develop international standards on corporate governance. The OECD’s 29 Member countries endorsed the Principles in May 1999.

The Principles are general in nature. They give a broad, “global vision” of what constitutes good corporate governance and need to be combined with a “local focus”. In order to make them operational, they must take into account the specificity of the national system, the legal and cultural traditions, and the markets in which a company operates. This approach allows national officials and the private sector flexibility to adapt the Principles to their local context.

Corporate governance in the Baltic countries

In the Baltic countries too, corporate governance has recently become a topical issue, in particular after the Russian financial crisis, which created a new business and financial environment at a time of significant enterprise restructuring. Indeed, the reforms these countries are undertaking call for adequate corporate governance structures. In many countries in economic transition, weak corporate governance has been blamed for the delay in post-privatisation restructuring. While privatisation succeeded in transferring ownership of enterprises from public to private hands, ambiguous property rights often resulted in the concentration of ownership in the hands of insiders and later in non-transparent ownership structures. Even in enterprises that allowed outsiders to buy shares, the rights of the new minority shareholders were

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14 *OECD Principles of corporate governance*, OECD Publications, 1999. The Principles are presented on the Internet at: http://www.oecd.org/daf/governance/principles.htm.

not always protected. In many cases, this did not produce effective incentives for improving corporate governance. The lack of sufficiently developed institutions and market mechanisms, such as a strong banking system and financial markets that would monitor enterprise performance, combined with insufficient competition in product and capital markets, has hindered post-privatisation enterprise restructuring.

Hence, there is growing awareness that one of the most important conditions for investors to regain confidence in their host country's companies is the improvement of corporate governance mechanisms. In addition to a credible and enforceable regulatory framework, transparency and the emergence of independent and active shareholders will be critical.

To improve the expertise of the relevant institutions and encourage co-operation between the public and private sector, it was decided to organise a policy forum for government officials, academic experts, business representatives and international organisations under the Baltic Regional Programme. Using the Principles as a the main point of reference in structuring the dialogue, the seminar on *Corporate governance in the Baltics*, to be held on 21-22 October 1999 in Vilnius, has four objectives:

- To present trends in international governance to economic decision-makers from the Baltic countries in order to create a better understanding of the fundamental role of corporate governance;
- To review the situation in the Baltic countries and consider possible policy measures to improve corporate governance, using the *OECD Principles of corporate governance* as a benchmark;
- To encourage foreign investors to expose their concerns as regards corporate practices to a group of high-level officials, regulators, judges and corporate and financial leaders from the Baltic countries; and
- To provide OECD Member country representatives with an insight into corporate governance in the Baltic countries.

This meeting could be the beginning of a process that would continue to broaden and deepen future dialogue on corporate governance, help raise and maintain momentum for reforms and ensure high-quality advice for policy makers involved in these reforms. Whatever form this co-operation may take, strengthening the corporate governance framework in countries around the world is now recognised as a key element in laying a strong foundation for economic growth and for a more stable international economic system.

4.3 BALTIC FORUM FOR ENTREPRENEURSHIP AND ENTERPRISE DEVELOPMENT

The Baltic Forum for Entrepreneurship and Enterprise Development (Baltic FEED)[15] was launched at the first meeting of the Forum, in Helsinki in November 1998. Its objectives are to strengthen the enterprise policy framework and to promote better conditions for entrepreneurship in Estonia, Latvia, Lithuania and the Russian regions of Kaliningrad and Saint Petersburg. Achievement of these objectives will contribute to job creation and economic integration and growth and underpin the development of civil and democratic societies in the Baltic region.

The context of the work of the Baltic FEED needs to be viewed in perspective. Macroeconomic disciplines alone are not enough to drive market economy development and growth of the private sector in transition economies. Experience has shown that there needs to be accompanying and in-depth structural policy reform. Entrepreneurs are 'agents of change' and play a fundamental role in the transition process from a centrally planned to a market economy.

[15] For more information on the FEED, see the Internet at http://www.oecd.org/daf/psd/feed/index.htm.

There is widespread agreement that the business environment and conditions for small and medium-sized business -- although varying significantly across the Baltic region and notwithstanding progress achieved to date -- are less than optimal. They need to be improved and the policy and institutional framework for promoting entrepreneurship and private sector development needs to be substantially developed. OECD research and experience has shown that entrepreneurship needs three broad dimensions working together: *(i)* conducive framework conditions, *(ii)* well-designed government support policies and programmes, *(iii)* supportive social and cultural attitudes to entrepreneurs. The Baltic FEED, with strong participation and support from the OECD Nordic Member countries, the European Union and the European Bank for Reconstruction and Development, was designed to provide a horizontal and multi-theme approach on a continuing basis to address these issues.

The Baltic FEED is implemented by sharing OECD and intra-regional experience and stimulating exchanges of views on what constitutes ‘best practice’ in entrepreneurship and enterprise policy development. Using interactive dialogue based on research papers and case studies from the region, senior Baltic policy makers, working with expert representatives of OECD Member countries and international organisations, have developed policy guidelines and recommendations tailored to the specific conditions and needs of the region. The broad representative nature of the FEED meetings, and the unique opportunity to share multi-theme experiences in a forum that replicates OECD Member country meeting practices, have been welcomed by the Baltic FEED delegates. Two working party meetings of the Baltic FEED were held in Helsinki, in November 1998 and in Jönköping, Sweden, in March/April 1999.

Six topics, under the broad headings of *(i)* the institutional framework and *(ii)* the support services and financial instruments for entrepreneurship, were addressed at the FEED meetings in 1998 and 1999. The following notes contain summaries of the discussion on key issues in these topics.

Institutional framework for entrepreneurship

Institutionalisation of SME policy and SME representation

Expectations for the small and medium-sized (SME) business sector in the Baltic region are high and there has been measurable progress in stimulating new enterprises. They are the main source of new jobs. At the same time, the policy framework and institutional structures were deemed to be deficient in many areas and the contribution of the private sector in the development of policy and identification of obstacles to entrepreneurship can be improved. The policy guidelines developed at the FEED meetings propose specific actions that can assist policy makers in establishing policies and objectives for the sector, in assigning clear institutional responsibilities, in improving communication with the private sector and in monitoring and measuring the impact of policy measures.

Rule of law and regulation, informal economy

A picture of bureaucratic and excessive laws and regulations that impede entrepreneurship in the Baltic region was drawn at FEED meetings. The overriding importance of removing constraints and obstacles to business formation and enterprise development was seen as a high-priority issue for policy makers. Detailed recommendations for the improvement of the legal and regulatory environment were made, along with longer-term measures to improve the public attitude towards entrepreneurs. The importance of developing constructive policies to address the informal sector, understanding better what is happening in various segments of the informal economy, and ensuring continuing programmes to deal with corruption were broad themes that were considered and on which policy guidelines were drafted.

Tax policy for small business

Surveys in the region have highlighted heavy tax burdens, frequent changes in policies and institutions relating to taxation and discouraging attitudes to entrepreneurs as serious obstacles to the development of small business in the region. The need to bring simplification, clarity and stability to tax systems was strongly endorsed at FEED meetings. Measures to build tax policies on the basis of partnership with the private sector, to simplify rules and improve compliance, to facilitate the consultation process on new tax codes, to examine and evaluate any tax incentives planned, and to equip tax administrators to deal better with entrepreneurs were elaborated in the draft guidelines.

Support services and financial instruments for entrepreneurship

Financial instruments for start-ups and small business

The lack of finance is one of the core difficulties that entrepreneurs in the region have to cope with. Only a very limited number of small businesses can manage to obtain funding from the banks and in many areas, the financial services sector itself needs considerable reform and improvement. FEED policy guidelines and recommendations concentrated mainly on steps that will help to strengthen the financial service sector and provide non-traditional credit schemes where funding gaps persist. Various practical measures that will begin the process of improving access to finance, and that will spread funding to regional as well as urban locations, were proposed.

Advisory services for new and small businesses

Advisory services that provide fundamental know-how on running businesses in a market economy were seen as a crucial component of small business policy, particularly in the transition phase of the Baltic states and regions. The focus of FEED dialogue here was on the role of governments in intervening, on the need to encourage the private sector in providing such services and on the best ways to use donor funds and the private sector in establishing relevant and sustainable advisory services. The types of services to be provided and delivery methodologies were considered and policy guidelines and recommendations were developed on the basis of the extensive practical experience of both Baltic countries and OECD Members.

Regional and local enterprise promotion

Regional and local enterprise development has received higher priority on the policy agenda in Baltic countries in recent years, due to the important spatial differences in economic development, as well as the need to adapt policy instruments to local conditions. Significant disparities in development and gaps in national and regional policies have been identified. As with other subjects considered at the meetings, new policy directions and approaches in the context of the pre-accession phase of the Baltic states to the European Union were considered and specific recommendations made. These encompass, for example, better articulation of regional development strategies, more capacity building at local level and specific recommendations on the use of business incubators, special zones, *et cetera.*

At the annual meeting of the FEED (Riga, 28-30 September 1999), the draft policy guidelines and recommendations, developed by the working parties were adopted by the Baltic FEED delegates, subject to final amendments proposed and review by the OECD. The ‘best practice’ guidelines will be presented to governments and policy makers in the Baltic region and disseminated widely when finalised and published (the targeted publishing date is before the end of 1999). The FEED will continue its work in 2000 and beyond, and will monitor the use and implementation of the policy guidelines and consider new and relevant topics for discussion in the rapidly changing environment in the region.

4.4 SYMPOSIUM WITH NORTH-WESTERN RUSSIAN REGIONS

The symposium on *Enterprise development and foreign direct investment strategies in the Baltic Rim* was the first OECD-sponsored event which addressed the north-western Russian regions specifically. It was organised in co-operation with the Council of Baltic Sea States, the Centre for International Co-operation and the City of Saint Petersburg. Among the participants were representatives from nine Russian regions[16], the Russian Federal Government, the Baltic countries, OECD Members, international organisations and the private sector.

The participants at this meeting observed that foreign investment in the Russian region had lagged considerably behind that in other transition economies around the Baltic Sea and that the creation of new small and medium-sized enterprises (SMEs) had stagnated. They were told that Russian investment promoting agencies need greater understanding as to what investors want. Paying attention to investors' needs, also when drafting regulations, is important: it will improve the insight of policy makers into how a law will work in the real world, once it has been promulgated.

Potentially, the Baltic region offers a promising market of 80-100 million consumers. At the OECD's Baltic programme seminars, the point is often stressed that foreign investors tend to see the region as one entity, which should therefore not be promoted as a patchwork of small regions and countries. In response to such recommendations, co-operation has indeed been established among the Baltic and Nordic foreign investment agencies.

Most obstacles for foreign direct investment are of a regulatory nature and relate to inadequacies in legal protection for contracts because of inadequate bankruptcy and property laws, a lack adequate financial supervision and foreign currency regulations, opaqueness in the division of authority between local and federal authorities, and a fear of corruption and crime. The main problem is not in the text of the laws, but in their implementation. Russian FDI legislation leaves considerable discretion to law enforcers, which will make implementation unpredictable. Moreover, the law pays little attention to interests of SMEs.

SMEs are important as investors, not only in their own right, but also because they are often part of larger clusters of enterprises. The reason for this is that, increasingly, companies rely on outsourcing of activities that are not their core business and hence need to create networks of subcontractors. Foreign investment promoters and SME agencies need to pay attention to this and be aware of the emergence of such business clusters. Major foreign investors may need smaller local suppliers and subcontractors, or large local enterprises may need foreign subcontractors.

Like larger enterprises, SMEs will look for fair and equitable taxation, adequate property regulation etc. However, there are two specific points that require particular attention if SMEs are to be attracted as investors: their access to finance and to information and consultation with the authorities. A system providing adequate credit guarantees can be a useful instrument for facilitating SME financing. It is also important that there is an adequate mechanism for the settlement of disputes and that SMEs have a proper channel of communications with the authorities.

There are a large number of regional initiatives and co-operative agreements aimed at promoting trade and investments, such as those to harmonise certification requirements, or to promote jointly the Baltic region as a venue for foreign investment.

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16 Archangelsk, Kaliningrad, Karelia, Komi Republic, Leningrad *oblast*, Murmansk, Novgorod, Pskov, Saint Petersburg.

The north-western regions of Russia participate in both the Baltic and the Russian Forum for Entrepreneurship and Enterprise Development. Furthermore, as part of the activities of the Anti-Corruption Network for Transition Economies, the OECD is establishing an Integrity Steering Group for the Russian Federation. The Steering Group will bring representatives of non-governmental institutions (such as business associations and non-governmental organisations) together to devise and co-ordinate anti-corruption activities for the benefit of private sector development.

Finally, the OECD used the occasion offered by this symposium to propose the establishment of a permanent structure for its co-operation with north-western Russia in the form of a working group. This working group should be product-oriented; its products could include an investment profile for the region, a set of best practices in investment promotion and the development of private/public partnerships.

5. TAXATION TRAINING AND POLICY DIALOGUE

The regional tax programme for the three Baltic countries was already in place when the Baltic Regional Programme was initiated. Launched in December 1995 as a joint effort of the OECD and Nordic countries, the first programme module ran for three years. It was designed to help the Baltic countries move towards self-sufficiency in developing and implementing tax rules as well as training their tax officials.

The first stage of the programme (1996-1998)

The first stage of the Baltic tax programme consisted of three main elements:

Seminars on specialised tax topics

While considerable progress was made in tax reform in the Baltic countries, especially Estonia, during the years 1991-1995, tax laws remained incomplete, staff in the Ministries of Finance and tax administrations were relatively inexperienced and more sophisticated aspects of tax systems, particularly international tax norms and standards, were often unknown. The OECD organised a series of seminars dealing with areas where the Organisation has particular expertise to share: international tax avoidance and evasion; taxation of pensions and pension funds and taxation of financial institutions.

Experience-sharing workshops

Traditionally, the three Baltic countries have co-operated extensively in many aspects of tax policy and administration. To facilitate this co-operation, the OECD organised a series of workshops that provided for experience-sharing between Baltic tax officials and experts from OECD member countries. The workshops were focusing on common solutions to tax issues such as the taxation or real property, auditing of bank and insurance companies and combating corruption in tax administration.

Establishment of national tax training programmes

The Baltic countries recognise that a well-trained workforce is key to an effective tax system. The OECD assisted the countries in developing national training programmes. Specifically, the OECD improved the quality of their training material, developed course material for a number of essential training courses for tax administration (such as principles of tax administration and corporate and personal income tax) and improved the delivery of training by offering Train-the-Trainers courses.

Comprehensive evaluations of the programme by participants demonstrated a high level of satisfaction with the results achieved. The initial process of establishing national training plans and programmes has been completed successfully. All three tax administrations have been restructured and tax laws are much more sophisticated than they were a few years ago. As a result of this programme, the Baltic countries now look to the OECD and its member countries for guidance and support when considering changes in their tax systems, policies, laws and administrative practices. Indeed, the fact that OECD member countries have reached consensus on a particular tax issue can often determine the outcome of a debate on proposed tax policy and other changes.

The Baltic regional programme in 1999

The Baltic countries recognise that the expansion of cross-border transactions and the rise in offshore tax-free zones call for an intensified co-operation in establishing and implementing tax policy. They are confronted with the international problem of harmful tax competition, *i.e.* the practice that tax regimes are tailored to erode the tax base of other countries. This can occur when tax regimes attract investment or savings originating elsewhere and when they facilitate the avoidance of other countries' taxes. Harmful tax competition puts pressure on the Baltic countries to turn themselves into tax havens by abolishing their tax on business income.

To help the Baltic countries meet these new challenges and resist the pressure to become tax havens, the strategic direction of the Baltic programme was changed. Beginning in 1999, four specialised workshops in tax policy were offered in areas of priority for the Baltic countries, notably harmful tax competition, tax incentives, tax treaties, exchange of information, property tax and improved anti-avoidance legislation.

Reflecting close co-operation and trust between the Baltic countries and the OECD, the former have taken the lead in organising and managing the workshops. For each workshop, the countries choose the topics, prepare papers on each topic and rotate the responsibility for hosting the seminars. The workshops last five days; with 5-6 tax policy participants from each Baltic country and 3-4 experts from OECD member countries, mainly Nordic countries. Following the final workshop in 1999, a cross-section of papers will selected for publication by the OECD as part of its ongoing tax policy review series.

Benefits from the programme

The current Baltic programme provides benefits for the Baltic countries and the OECD alike. For the Baltic countries, the programme allows them access to OECD expertise in setting the tax rules of the game in important areas such as tax treaties, exchange of information and harmful tax competition. For the OECD and Baltic countries, the programme has facilitated the development of a joint approach to challenges of globalisation and international tax evasion. Their policy dialogue offers the Baltic countries the opportunity to examine a variety of approaches to solve specific tax problems and determine whether the best practices in the particular area can be adapted to the laws and experience of their country.

A number of important accomplishments have been achieved during the first two workshops held in 1999. As a result of the workshop on *Corporate and personal income tax* (Vilnius, 1-5 March 1999), significant weaknesses in the design of the current loss transfer rules and tax incentives were identified in all three countries. The policy and practical problems associated with Lithuania's proposal to eliminate corporate income tax were also examined in depth. These conclusions are now being utilised by Estonia as it considers the benefits and costs of eliminating its tax on business income. Deficiencies in pension reforms in Baltic countries, as compared with recent reforms in Hungary and Poland, were also identified and analysed.

The second seminar, on *International tax issues of treaty policy and exchange of information* (Tallinn, 7-11 June 1999) generated equally valuable outcomes. The tax treaties concluded by the Baltic countries are based on the *OECD Model tax convention*[17]. OECD experts briefed the Baltic countries on the latest

[17] *Model tax convention on income and capital, June 1998, condensed version*, OECD Publications, 1998. The Model Convention is available on the Internet at http://www.oecd.org/daf/fa/first_en.htm.

developments and issues related to the Model and received their input into resolving the issues. The workshop also provided better insight in the benefits offered by the joint Council of Europe/OECD *Convention on mutual assistance in tax matters*[18] and the merits of joining the convention. The information helped to convince the Latvian government to sign the agreement, and to formulate a proposal by Estonian and Lithuanian tax administrations to their governments recommending the agreement. The workshop also provided the opportunity to discuss practical ways to improve exchange of information through the presentation of the checklist in the *OECD Manual on the implementation of exchange of information* and to present the work of the OECD in this field and in particular in assistance in tax collection.

Future directions of the programme

Two seminars were to be held in the final quarter of 1999 (on *Tax policy and administration,* 4-8 October 1999, Riga, and *Property taxation*, 18-22 October 1999, Budapest). All three Baltic countries have started to introduce property taxation based on market values. Estonia has implemented a market-value based tax on land and is moving towards taxation of buildings. Latvia and Lithuania have prepared draft laws and are working on the improvement of valuation process. The Riga workshop was to highlight areas where the OECD has specific experience and developed guidelines and workshop material, including the taxation of unincorporated businesses, taxation of related parties and the taxation of investment funds.

At the request of the Baltic countries, the OECD will offer four more tax policy workshops in 2000 aimed at associating these countries more closely with the work of the OECD's Committee on Fiscal Affairs. Specifically, the workshops will highlight issues in tax competition, anti-avoidance rules and OECD model transfer pricing rules. In addition, the OECD will organise a Baltic seminar on *Foreign direct investment and taxation* in the second quarter of 2000.

6. FINANCIAL AND CAPITAL MARKETS REFORM

6.1 INSURANCE AND PENSION REFORM

The importance of insurance and pension reform in the Baltic countries

Government officials in the Baltic countries are aware of the key role of *insurance* in affording social and economic protection and in stimulating the development of entrepreneurship and global financial markets (indeed, insurance companies are the most important institutional investors in OECD countries). However, the public lack of knowledge in the sector and a certain reluctance in the legislature *vis-à-vis* the insurance industry have delayed the pace of reform.

Although considerable progress has been made in reforming insurance systems, the Baltic countries have required assistance in filling regulatory voids in key areas such as compulsory insurance or insurance intermediation, or to provide much needed improvement in many other fields (contract law, reinsurance, supervision, accounting, *et cetera*).

As in many OECD countries, financing the retirements of an ageing population will exert considerable pressure on the Baltic public pension systems. Therefore, Baltic policy makers have initiated *pension systems reform* programmes and are moving towards greater reliance on funded pension schemes (as opposed to pay-as-you-go systems). In Latvia, the first pension funds were licensed in October 1998 and in Estonia, the first pension fund agreement was concluded in April 1999. Implementation of the new Lithuanian pension legislation is foreseen in 2000. The growing importance of funded pension schemes is now putting the spotlight on the regulatory and supervisory regimes of pension systems. Protecting the

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[18] For information on this Convention, see the *Explanatory report on the Convention on mutual assistance in tax matters*, OECD Publications, 1989. See also the Internet at http://www.oecd.org/daf/fa.

rights of retirees, ensuring the financial security of funded schemes and the identifying the proper conditions for the development of a private pension market are major issues confronting policy makers.

The Baltic Regional Programme is dealing with these issues. It provides an instrument for assessing the main obstacles to the modernisation of insurance markets and to their integration into the global market for insurance services. It offers a policy dialogue on regulatory and supervisory reform of the insurance and pension markets and technical assistance in drafting regulation and establishing adequate insurance and private pension supervisory systems. The OECD guidelines[19], analysis and policy-oriented studies serve as key points of reference in this process.

The OECD's Insurance Committee has been at the forefront of providing policy assistance on insurance to economies in transition, including the Baltic countries. Therefore, the Committee's experts know the Baltic insurance markets and the countries' achievements and needs. Besides, the Committee has developed numerous analytical studies that cover virtually every economic and regulatory aspects of insurance markets[20]. It has also compiled regulatory, supervisory and statistical data bases[21] which are of high value for the reform of insurance systems in the Baltic region.

Pension reform is an area where the Baltic countries, like many OECD countries, are engaged in a reform process. These efforts have entailed intensive research, resulting in many comparative studies. Policy dialogue and experience sharing in this field will be highly stimulating and enriching for all parties.

Implementation of the programme

Insurance reform

Missions by OECD-designated experts to the Baltic countries[22] have led the way to a review of the insurance market and its regulation, and to the provision of technical assistance at individual countries' requests. Issues covered included solvency assessment, reinsurance and financial reinsurance, investment regulation, supervision of insurance groups, insurance and reinsurance accounting, including the consolidation of accounts in insurance groups, insurance contract law, compulsory insurance, technical provisions regulation, *etc.* High-level experts, such as the heads of several OECD insurance supervisory authorities, or the heads of the insurance departments of relevant ministries, were involved in all missions.

The Baltic countries underlined that the OECD involvement was a key factor determining the success of the reform process. They have conveyed requests for further co-operation with the Insurance Committee on a wide range of issues to the OECD Secretariat after the missions. A selection of these issues was put on the agenda of a workshop on insurance reform in the Baltic countries (Vilnius, 22-23 November 1999), while many more key issues, like private health insurance, call for continued co-operation.

Issues to be dealt with at the November 1999 workshop will include investment regulation, compulsory insurance, reinsurance, distribution of insurance products, liberalisation and competition. It would also be useful if this occasion were used to raise the awareness of the Lithuanian legislature of the issue of third-party liability insurance for motor vehicles, an insurance that has been made compulsory in all Central and Eastern European countries except Russia and Lithuania.

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19 See in particular *Insurance guidelines for economies in transition*, OECD Publications, 1997.

20 See *i.a.* the Internet: http://www.oecd.org/daf/fin/netinsur.htm.

21 The latest database on the regulation and supervision of insurance will be derestricted for the workshop on insurance, to be held in Vilnius in November 1999.

22 To Estonia on 23-24 November 1998, Lithuania on 7-8 January 1999, Latvia on 8-9 July 1999.

Furthermore, this workshop will provide an opportunity for explaining and promoting the insurance guidelines developed by the Organisation and the OECD's *Recommendation on assessment of reinsurance companies*.

Pension reform

To start the work on pension reform under the Baltic Regional Programme, the reform process in the three countries will be assessed in expert missions to the Baltic countries. From preliminary contacts it appears that the programme is very timely and raises high expectations. All three countries have expressed their urgent need of assistance in the pension reform process, particularly in the development of private pension systems. Two workshops on pension reform in the Baltic countries will be held in 2000. Their agendas will cover the financial security of pension funds, the rights of beneficiaries and the practical organisation of supervision.

6.2 CAPITAL MARKET REFORM

During 1999, exploratory consultations were held with the financial authorities in the Baltic countries. These were the first steps towards the formulation and implementation of a work programme of capital market reform, which will be concentrated on two key financial policy areas:

1. Strategies and techniques concerning government securities markets and public debt management;
2. The development and strengthening of the infrastructure of capital markets.

Starting in 2000, the programme will be executed with the help of national experts and with a consultant to prepare documentation. The International Monetary Fund, the International Finance Corporation[23] and the International Organisation of Securities Commissions (IOSCO) have been invited to participate in both activities. A workshop will be organised for each of the two activities.

Government securities and debt management

Public debt as a percentage of the gross domestic product in all three Baltic countries is substantially below the EU average. Most of it is denominated in foreign currency. In particular Latvia has emphasised raising foreign currency debt, due to weakness of its domestic currency. There is an interest in finding more sophisticated borrowing instruments, developing tools for managing currency as well as other risks, and improving the planning of cash flows.

Estonia's public debt/GDP ratio is significantly below 10 per cent. However, legislation is in place to permit the government to borrow short-term to manage its liquidity. To date, no T-bills have been issued; the central bank uses certificates of deposit (CDs) for monetary management purposes. Loans in foreign currency have been taken from international financial institutions, such as the Word Bank, and some countries.

A key issue is how to reach the pool of private savings with government securities. There is resistance from the banking system, particularly from the big savings banks, which want to retain private deposits. It is desirable to find a system that could compete with the banks for the savings of the small investor.

Another issue is risk management, which figures prominently in the governments' lending and loan guarantees to enterprises. Incoming multilateral loans saddle state treasuries with considerable amounts of liquid assets, which they will need to manage awaiting their on-lending to industrial and commercial firms through commercial banks. (Treasuries do not wish to sell all or even the better part of their foreign

[23] A member of the World Bank group which provides financing for private sector projects.

exchange proceeds to the Central Bank.) This calls for modern risk hedging techniques, for which derivatives such as options and futures may be used.

Other issues the Baltic countries have suggested for a future policy dialogue are: debt recording and accounting, design of financial instruments, the use of information technology and benchmarking.

Development and strengthening of the infrastructure of capital markets.

The exploratory consultations with the Baltic countries brought up a wide array of issues for possible inclusion in the policy dialogue. The implications of financial market integration are an important point of consideration. The principles of the EU's internal market and the free movement of capital in the EU, which the Baltic countries aspire to join, raise the issue of mutual recognition of market intermediaries' licences and of securities issuers' prospectuses. Increasing integration also raises the question of co-operation and exchange of views and opinions among supervisory bodies and of possible cross-border supervision. For example, should there be one single overall regulator or a multiple of regulators in the financial sector, including securities, insurance and banking ?

Another issue is the lack of trust in the securities market as a whole among the public, which has suffered losses as part of historical events. There is a need to attract additional customers into the securities markets and to improve the markets' liquidity. There are concerns about the way in which fiduciary duties of directors on management boards should be upheld, which may call for legislation to specify the duties and responsibilities of directors in company law. There is also the question as to how the international accounting standards set by the International Accounting Standards Committee can be enforced.

Further attention would also be required to the regulation of securities issuers, *i.e.* of listed companies. The listing on a stock exchange of a privatised company entails many new responsibilities, in particular a greater accountability of managers. The OECD's *Guidelines on Transfer Pricing*[24] and *Principles of Corporate Governance*[25] can be used as reference points.

Future activities

On the basis of the outcome of the two exploratory missions, two policy workshops are being prepared for 2000; the above issues will be raised on these occasions. These workshops will bring together experts from the Baltic region to assess the legal, institutional and regulatory framework required for capital markets and their development. This activity will deal with measures to mobilise domestic savings more efficiently through private and government security markets, thereby reducing excessive reliance on foreign savings, in particular those in the form of bank loans The purpose of the two workshops more generally will be to raise participants' consciousness of their responsibilities in relation to capital markets and to focus on best practices for the regulation of markets, consistent with international standards and practice.

At the conclusion of each workshop a statement of findings will be prepared reflecting the participants' agreed conclusions covering, *inter alia*, the following matters:

- The main topics which need to be addressed in securities and capital market legislation;
- The relevant international standards and practices;

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24 *Transfer pricing guidelines for multinational enterprises and tax administrations*, OECD Publications, 1998. See also the Internet at http://www.oecd.org/daf/fa/tr_price/transfer.htm.

25 *OECD Principles of corporate governance*, OECD Publications, 1999. The Principles are presented on the Internet at http://www.oecd.org/daf/governance/principles.htm.

- The institutional and administrative requirements (and attendant resource implications) for implementing capital market regulations and public debt management operations;
- Suitable areas for co-operation among participants in the Baltic region in developing and regulating their capital markets.

7. STATISTICS

7.1 DATA ASSESSMENT AND DISSEMINATION

Prior to 1999, the OECD's co-operation with the Baltic countries in the field of statistics was limited to invitations to attend the annual meetings of national accounts experts at the OECD and the collection of short-term economic statistics for a database on transition economies.

Activities in 1999

In January 1999, a project staff post was created for the Baltic Regional Programme at the OECD's Statistics Directorate (STD) (the post was filled in September 1999). STD staff visited statistical agencies in Estonia, Latvia and Lithuania in February and March 1999 to identify areas of statistics where technical co-operation could benefit both the countries and the OECD.

During this exploratory visit, the development of *quarterly national accounts* was identified as a suitable area for technical co-operation. All three countries are working to develop national accounts on a quarterly basis and confronted similar practical and conceptual problems. It was agreed to organise a workshop at the OECD for three national accounts compilers from each Baltic State. The agenda of this workshop, held in Paris from 5-9 July 1999, comprised the following subjects:

- Estimation of final expenditure on gross domestic product (GDP);
- Reconciliation of estimates from the production and expenditure sides;
- Estimates at constant prices;
- Measurement of informal and hidden activities;
- Treatment of agricultural production in quarterly accounts;
- Seasonal adjustment.

For each topic, the participants described their methods of estimation and this was followed by descriptions of practices in OECD Member countries.

Documents supplied by the participants for the workshop are now being used to draft a publication (to be published by mid-2000) that will describe the basic data sources and methods used by each country to compile their quarterly national accounts. It will also identify weaknesses in their estimates and indicate best practices. This publication should be useful both for national accounts compilers in the Baltic States and for users of these statistics at OECD and elsewhere.

The workshop identified a number of areas for future co-operation. These include measurement of the "non-observed" economy (hidden, illegal and missed), estimates of capital formation and measurement of GDP at constant prices.

The exploratory mission at the beginning of 1999 also identified *economic accounts for agriculture* (EAA) as a suitable area for technical co-operation. An important feature of agriculture in the Baltic States is that a significant part of total food supply comes from small "household plots". The current EAA system deals only with marketed production and, consequently, does not take account of food produced for own consumption by households.

The Baltic countries have extensive programmes of co-operation in statistics with Eurostat (the EU's statistical office), in order to support their applications for EU membership. OECD statistical activities must, therefore, be fully co-ordinated with the Eurostat programme. Therefore, STD staff maintain close contact with their colleagues in Eurostat, discussing Eurostat's priorities for statistical improvements in the Baltic countries and technical co-operation provided under the EU Phare programme.

Contacts have also been maintained with the International Monetary Fund to keep abreast of their technical co-operation with the Baltic countries in national accounts and prices, and the participation of these countries in the IMF's *Special data dissemination standard*.

Future plans

Following the July 1999 workshop, it was agreed that a similar event should be held in July 2000, and a number of possible agenda items were identified, including seasonal adjustment, credibility checks, and estimation of capital formation. It is likely that participation in the workshop will be widened to include representatives from Bulgaria, Romania and Ukraine (China is also expected to participate, as they did in 1999).

A report covering the sources and methods used to estimate capital formation in the Baltic countries, including discussions of best practice, is being planned and should be published by the end of 2000.

The OECD is revising the international system of *Economic Accounts for Agriculture* in co-operation with the Food and Agricultural Organisation (FAO) and Eurostat and is organising an expert Working Group meeting at the OECD in early 2000. One expert from each Baltic country will be invited to attend the OECD meeting to consider, in particular, how production from household plots can be incorporated into the revised EAA.

In the latter half of 2000, the OECD is hosting a workshop on measuring the "non-observed" economy to which representatives from the Baltic States will be invited.

7.2 THE DEVELOPMENT OF FOREIGN DIRECT INVESTMENT STATISTICS

The OECD assists in the Baltic countries' implementation of a comprehensive, reliable and timely statistical system, based on the recommendations of the OECD *Benchmark definition of foreign direct investment*[26].

This *Benchmark definition* provides the basic methodology and operational guidelines to national compilers of foreign direct investment statistics. In addition, for several years, the OECD has published such statistics for Member countries in its *International direct investment statistics yearbook*[27]. The liberalisation of FDI regimes of non-OECD Members, and the ensuing rise in direct investment flows to and from these countries, have created a substantial demand for reliable statistics of FDI flows and stocks for these countries. However, many non-Member countries still have inadequate FDI data collection and reporting systems.

FDI statistics in the Baltic countries

A common these across the three Baltic countries is the high priority attached to the statistical requirements of the European Union. All Baltic countries participate in the work of the Working Party on

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26 *OECD Benchmark definition of foreign direct investment: third edition*, OECD Publications, 1996. See also the Internet at http://www.oecd.org/daf/cmis/fdi/statist.htm.

27 *International direct investment statistics yearbook 1999*, OECD Publications, 1999. See also the Internet at http://www.oecd.org/daf/cmis/fdi/statist.htm.

Balance of Payments Statistics of Eurostat, which also deals with FDI statistics. Eurostat also provides on-site assistance to transition countries, carried out by experts from EU countries on a voluntary basis.

The OECD Secretariat organised a fact-finding mission in March 1999, together with the World Bank's Foreign Investment Advisory Service, to all three Baltic countries. The mission evaluated the progress made in the implementation of FDI statistics based on the methodology of balance of payments concepts. The mission also identified strong links between the three Baltic countries and the statistical requirements of the European Union. Time was devoted to this issue to have a good understanding of their involvement in the work of Eurostat to avoid any overlaps.

The mission found that all three countries had implemented the foundations of FDI statistics based, to a certain extent, on methodological standards in line with the recommendation of the International Monetary Fund and the OECD. They disseminate both flow and stock data, but the reporting systems and reconciliation between flows and stock will have to be examined more closely. Moreover, these are only first steps which need further refinements. For example, Estonia defines foreign direct investment as acquisitions of over 20 per cent of the companies' share capital, as opposed to the 10 per cent recommended in the OECD's *Benchmark definition*.

Some of the methodological issues do not create major problems as long as the current scope and coverage of the statistics are limited. However, with the increase of foreign interests in the Baltics, FDI statistics will have to deal with more complex issues and structures. Therefore, national compilers will need to make further improvements in their current systems by deepening their knowledge and expertise on specific issues. The mission identified a significant need for training, due to a high turnover of staff.

Future work

The OECD will organise a workshop and a seminar on FDI statistics on 16 and 17 November 1999 in Tallinn. The workshop will be devoted to a number of special issues: selected topics, data sources and reporting systems, survey methods, uses of the statistics. It will provide information on the experience in OECD countries and allow for an exchange of views and expertise. The seminar will provide a basic training in compiling agencies.

In the future, the OECD intends to maintain close contact with each of the Baltic countries and to continue to exchange expertise and provide technical assistance. FDI is a complex statistical application and will require a longer programme for the implementation of effective data collection and reporting systems.

8. SIGMA ACTIONS IN THE BALTIC REGION

SIGMA[28] is a joint initiative of the OECD and the European Union's Phare Programme[29]. While it is not part of the Baltic Regional Programme, it is included here, in view of its considerable work programme in the Baltic countries.

The initiative supports public administration reform efforts in thirteen countries in transition[30], and is principally financed by Phare. SIGMA advises on building modern systems of public administration in central and eastern Europe. Estonia, Lithuania and Latvia participate in the Programme.

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28 Support for Improvement in Governance and Management in Central and Eastern European Countries. For more information, see the Internet at http://www.oecd.org/puma/sigmaweb/aboutsgm.htm.

29 The Phare Programme is a European Community initiative which supports the development the countries of central Europe through future membership of the European Union Phare does this by providing grant finance to support its partner countries through the process of economic transformation and strengthening of democracy.

Since most of the countries covered by the Programme are candidates for membership of the Union, SIGMA gives top priority in its work to assisting their preparations to meet the criteria for EU accession, with special emphasis on financial control, public procurement, budgeting and external audit. In addition, SIGMA works on developing a professional civil service, as well as on strengthening policy capacities and administrative oversight. These are essential underpinnings for each country so that it can transpose and implement the *acquis communautaire*, and manage the European funds at the required levels of reliability and efficiency.

Within this strategic accession-driven framework, SIGMA carried out technical assistance activities of which 49 activities were reported for the Baltic countries between January 1998 and June 1999[31].

Examples of SIGMA activities in the Baltic countries

SIGMA organised “*peer reviews” of the supreme audit institutions* (SAIs) of Estonia and Latvia. Through this mechanism, SIGMA engaged experienced staff from external audit bodies in EU Member States to evaluate the position and the functioning of the two SAIs. The reviews led to SIGMA recommendations on improving organisation and staffing, as well as audit procedures. These recommendations, which are now being implemented, aim to create external audit systems which meet standards of good audit practice in EU Member States. Lithuania’s SAI has asked SIGMA to organise a review of its operations.

In Estonia, SIGMA *counselled on the preparation of a new Organic Budget Law*, and on the creation of a *central unit to co-ordinate public administration reform*. These efforts were reflected in the adoption of new budget legislation and the establishment of the unit. SIGMA also advised Estonia on developing a *financial control system* that meets EU requirements.

In Latvia, SIGMA helped the Ministry of Finance draft a new law on *public procurement*, establish a procurement monitoring department and perform basic training for the department’s staff. SIGMA also advised Lithuanian officials on the preparation of law on public procurement.

As part of a process of modernising expenditure management procedures in Lithuania, SIGMA advised on *integration of capital and operational budgeting*.

SIGMA has facilitated participation in European *professional networks* (on external audit, civil service, network of schools and institutes of public administration in central and eastern Europe) of representatives of Baltic administration.

At the request of the Commission, SIGMA developed baselines and contributed to the Commission’s regular reports on progress for all of the candidate countries including the three Baltic Republics.

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30 Albania, Bosnia-Herzegovina, Bulgaria, the Czech Republic, Estonia, the Former Yugoslav Republic of Macedonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

31 See the report *SIGMA Activities, January 1998 - June 1999.*

III. Programme management

Working groups on the Baltic regional programme

The annual programme of work for the Baltic Regional Programme is prepared and implemented by the OECD's Centre for Co-operation with Non-Members (CCNM), in consultation with its interlocutors in the Baltic countries. In each of the Baltic capitals there is a working group on the implementation of the Baltic Regional Programme co-ordinated by the Ministry of Foreign Affairs. The members of these groups are representatives from different ministries, governmental organisations and institutions. In Lithuania, the group has been established by a resolution of the Prime Minister. The size of these groups varies from 10 to 19 members. Their purpose is to follow the Programme implementation and to make proposals on future priorities. The members of these groups are also involved in the co-operation with other international organisations like the EU and WTO. Among the Baltic countries, the Ministries of Foreign Affairs maintain informal contacts in order to exchange information and views concerning the Programme. Furthermore, in each of the Baltic embassies in Paris there is a contact person for the Programme.

The successful implementation of the Programme owes much to the Baltic countries' active participation in the activities and their interest in developing the programme together with the OECD.

Preparation of the work programme

The Programme is based on the expected volume of voluntary financial contributions which constitute the largest part of its budget. As part of the programme preparation, CCNM staff visit the Baltic countries and most donor countries at least once a year to discuss implemented activities and future orientations. The topics related to the programme budget, major events and implementation are also discussed with donor delegations at the OECD. The timing of different activities and the individual activity budgets are discussed with the directorates responsible for the implementation of these activities. OECD officials and consultants responsible for individual activities also undertake regular missions to the Baltic countries.

On the basis of such contacts between the OECD Secretariat, donors and the Baltic countries, as well as the outcome of the policy reviews conducted under the Programme, the OECD will formulate medium-term objectives for the Programme. These objectives, indicating its expected achievements over a multi-year period, will constitute yardsticks to gauge the progress made in the Programme implementation. During 1999-2000, there will be five such reviews: the Baltic regional economic assessment and policy reviews on competition, education, foreign direct investment, and reform of insurance and pension systems. For the second half of year 2000, a review of social and labour market policy is foreseen.

Participation in the activities

All activities under the Programme are open to participation by any OECD Member country. Furthermore, the activities of the Baltic Regional Programme cover all three Baltic countries, Estonia, Latvia and Lithuania, all of which do indeed participate actively in all activities.

In line with the practice of the former Baltic Rim Economic Forum (see Chapter I), some activities are opened to participation by north-western Russian regions. Thus, Kaliningrad, Karelia, Novgorod and Saint Petersburg have been invited to participate in the Baltic Forum for Entrepreneurship and Enterprise Development (FEED). Karelia, Kaliningrad and Saint Petersburg are participating in the activities on competition policy. Furthermore, the symposium on *Enterprise development and foreign direct investment strategies in the Baltic Rim,* in September 1999 in Saint Petersburg (see section 4.4), attracted participants from nine Russian regions (Archangelsk, Kaliningrad, Karelia, Komi Republic, Leningrad *oblast,* Murmansk, Novgorod, Pskov and Saint Petersburg).

Budget

The Council agreed to establish the Baltic Regional Programme on the condition that at least 75 per cent of its funding would come from voluntary contributions.

This funding condition has been met. In the OECD's own 1998 budget, 762 300 French francs[32] was allocated to the Baltic Programme, while for 1999, the allocation amounted to 856 295 francs. In both years, several Member countries, as well as Estonia, have responded generously to the OECD's request for voluntary contributions, with the result that, for 1998 and 1999, totals of 4.91 million and 4.89 million francs, respectively, in voluntary contributions were received. Consequently, in 1998, 86.6 per cent of the programme budget was funded by grants; in 1999, the percentage was 85.1. These grants include in-kind contributions by Finland and Sweden in the form of their direct sponsoring of one project staff member each. Details on the budget are to be found in annex 3.

With some minor exceptions, the grants have been made towards the programme as such, *i.e.* without earmarking individual activities. This has provided the essential flexibility for ensuring a smooth implementation of the programme. Indeed, earmarking might lead to lobbying with donors by special interests, with the result that the overall co-ordination of the Programme is thwarted and that its priorities are dictated by the effectiveness of the various lobbying efforts rather than by policy considerations and mutual interest.

Evaluation

The BRP depends heavily on financial grants and the donor countries have stressed the importance of a thorough evaluation of the Programme. This evaluation takes place by means of *(i)* annual programme review missions by the Secretariat in the Baltic capitals and their feedback on the implemented activities; *(ii)* annual evaluation meetings at the OECD.

During the programme review missions meet with the countries' working groups on the Baltic Regional Programme. All the implemented activities have been reviewed with responsible ministries or governmental institutions. Requests for new activities are often made on such occasions, whereas no requests have been made to terminate any.

The evaluation meetings provide for dialogue between the Baltic countries and the OECD Members, thus offering the necessary transparency. The first one was held in Paris on 23 April 1999, *i.e.* about one year after the OECD Council had adopted the Programme. For this meeting, all the Baltic countries prepared strategy papers explaining how they use the Baltic Regional Programme to meet their respective strategic government objectives. All strategy papers were signed at ministerial level[33].

The next annual meeting is set for March or April 2000. A summary of the discussion at the April 1999 evaluation meeting is presented in annex 2.

Staff

The day-to-day management of the Baltic Regional Programme is in the hands of a unit in the CCNM which is also responsible for two other CCNM programmes. One staff member in this unit has been assigned full-time with the co-ordination of this Programme.

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[32] One French franc equals 0.1524 euro.

[33] Soon available on the Internet at , at http://www.oecd.org/sge/ccnm/about/baltic.htm.

The activities are implemented by the regular OECD staff, as well as by designated project staff members, full-time consultants, single-task consultants and auxiliary staff. Most of these work for the Baltic programme for only part of the time.

Project staff

Project staff positions are created by the OECD Council for a limited period and for one or more specific tasks. These positions offer several benefits which cannot be offered to consultants or auxiliaries; hence, the creation of project posts facilitates the recruitment of highly qualified staff with limited resources. Several project staff posts have been created in whole or in part for the Baltic Regional Programme, two of these in the form of in-kind contributions; the post of programme co-ordinator at the CCNM is an in-kind contribution from Finland, while Sweden is paying for the post of a junior staff member who will be assigned to various assignments within this Programme after his present assignment to the Baltic regional assessment.

A statistical expert is paid for in full by the grants for the Baltic Programme as a project staff member. Project staff members paid for part of their time from these grants are: one expert assigned to the Baltic FEED, one expert assigned to the review of insurance and pension reforms, one tax expert and one auxiliary for the tax programme.

Seconded staff

The National Bank of Poland provided an in-kind contribution in the form of a consultant on foreign direct investment statistics, who was seconded to the OECD from September to November 1999, inclusive.

Visiting experts

The objective of this visiting expert programme is to introduce a small number of officials from Baltic countries with the operations of the OECD by offering them traineeships.

The first group of visiting experts is from the Baltic Ministries of Foreign Affairs, which are responsible for the co-ordination of the Baltic Regional Programme in the Baltic capitals. These visiting experts have already a good general knowledge on the OECD and the Programme.

The traineeships have a duration of six months, during which the trainees are working on different assignments under the Baltic Regional Programme and learn how the directorates prepare and implement the activities.

During 1999, officials from two Baltic countries joined the OECD as visiting experts. Between April and October 1999, Mr. R. Pettai, Second Secretary at the Estonian Ministry of Foreign Affairs, assisted in the preparation of the corporate governance seminar to be held Vilnius, October 1999 and of the workshop on foreign direct investment policy on 17 November 1999 in Tallinn.

Ms M. Krešlina, Senior Desk Officer at the Ministry of Foreign Affairs of Latvia, joined the OECD in September 1999 to assist in the preparation of the insurance and pension reform seminar to be held in Vilnius, 22-23 November 1999. Starting in January 2000, she will be working on the review of education policy of the Baltic States. She will also help to develop labour market and social policy themes for future review.

The third Baltic visiting expert, from Lithuania, is expected in to join the OECD in 2000.

Co-operation with other international organisations

The OECD Baltic Regional Programme has established contacts with the following international organisations: European Union, Council of Baltic Sea States and Nordic Council.

European Union

All the Baltic countries are in the process of accession to the European Union and benefit from the EC Phare programme (see section II, 8). Therefore, EU assistance is primary focused on the adoption by the Baltic countries of the *acquis communautaire* and, in particular, on priorities identified in the Accession Partnership and National Programme for the adoption of the *Acquis*.

The Baltic Regional Programme differs from the accession-driven focus and conditionality of the EC Phare assistance. It is targeted at the development of best practices for policy formulation, strategic planning and increasing institutional capacities through the provision of a variety of well-tested policy options of the OECD Member countries rather than a single, ready-made solution. Therefore the advice provided by the OECD does not create any duplication, but rather complementarity and supplementarity with other the EU Programme.

The OECD is well aware of the high priority Baltic countries give to accession to the European Union. Members of the OECD Secretariat have had regular informative contacts with representatives of the European Commission and have encouraged the EC to participate in the Programme activities.

Council of Baltic Sea States

The twelve-member[34] Council of Baltic Sea States, established in 1992, serves as an overall regional forum focused on the needs for intensified co-operation and co-ordination among the Baltic Sea States. The members are represented by their Ministers of Foreign Affairs. The aim of this co-operative body is to achieve a genuinely democratic development in the Baltic Sea region and a greater unity between the Member countries, as well as to secure their favourable economic development.

There have been regular contacts between OECD and CBSS at Secretariat level and between the OECD Secretariat and the Committee of Senior Officials of the CBSS, the purposes of which have been to exchange information and, where possible, set up joint activities. Indeed, the CBSS joined the OECD in organising the symposium in Saint Petersburg in September 1999 (see section 4.4).

Nordic Council of Ministers and Nordic Council

The Nordic Council is a joint co-operative body for the Nordic parliaments and governments. The Nordic Council of Ministers is a governmental co-operation body. There have been some contacts between OECD and both Councils at secretariat levels, resulting in an agreement to exchange information on each others' work programmes.

Missions and visits

High-level visits

Mr Kumiharu Shigehara, Deputy Secretary-General of the OECD, visited Estonia, Latvia, Lithuania and Finland from 15-22 October 1998. This was the first high-level mission to the Baltic states since the March 1998 adoption of the Baltic Regional Programme. Mr. Shigehara met with Heads of Government

[34] Denmark, Estonia, Finland, Germany, Iceland, Latvia, Lithuania, Norway, Poland, Sweden and the European Commission.

and State, Ministers of Finance and Foreign Affairs, central bank Governors in each of the Baltic states, and delivered a keynote address at the conference on *Economic Development in the Baltic Region: the Path Ahead* (see chapter II, section 1). During this mission, the governments of all the Baltic countries confirmed their political support at the highest level for the Baltic Regional Programme and the high priority they are giving to co-operation with the OECD. Each of the Baltic states also reaffirmed its interest in eventual OECD membership.

The following high-level visits took place during the reporting year.

15-22 October 1998	Mr K. Shigehara, OECD Deputy Secretary-General; visit to Lithuania, Latvia, Estonia and Finland
26 January 1999	Mr V. Adamkus, President of Lithuania; visit to the OECD
18 February 1999	Mr R. Mälk, Minister of Foreign Affairs of Estonia; visit to the OECD
11 March 1999	Mr J. Leimann, Minister of Economic Affairs of Estonia; visit to the OECD
9 July 1999	Mr V. Birkavs, Minister of Foreign Affairs of Latvia; visit to the OECD
9 September 1999	Mr. V. Učaskas, Vice-Minister of Foreign Affairs of Lithuania, visit to the OECD

CCNM missions

The following programme preparation and review missions were undertaken, or being planned, by CCNM staff during the reporting year.

9-11 December 1998	CCNM staff mission to Norway and Latvia
15-23 February 1999	CCNM staff mission to Estonia, Lithuania, Finland, Sweden and Denmark
18-21 October 1999	Mission led by Mr E. Burgeat, Director of the CCNM, to Estonia, Latvia and Lithuania
4-5 November 1999	CCNM staff mission to Norway and Finland

ANNEX 1

BALTIC REGIONAL PROGRAMME: ACTIVITIES BETWEEN OCTOBER 1998 AND DECEMBER 1999

Subject	Dates	Location
1. The path ahead, Economic development in the Baltic region; conference	20-21 Oct 1998	Tallinn
2. Baltic agricultural policies, meeting at ministerial level	26-28 Nov 1998	Riga
3. Baltic FEED[35], working party 1	11-13 Nov 1998	Helsinki
4. Corporate and personal income tax, workshop	1-5 Mar 1999	Vilnius
5. Baltic FEED, working party 2	30 Mar-1 Apr 1999	Jönköping
6. Baltic Regional Programme evaluation meeting	23 Apr 1999	Paris
7. Competition policy seminar	24-28 May 1999	Riga
8. International taxation, workshop	7-11 Jun 1999	Tallinn
9. National accounts workshop	5-9 Jul 1999	Paris
10. Symposium on Enterprise Development and FDI Strategies in the Baltic Rim	20 Sep 1999	Saint Petersburg
11. FEED annual meeting	28-30 Sep 1999	Riga
12. Tax policy and administration, workshop	4-8 Oct 1999	Riga
13. Property taxation, workshop	18-22 Oct 1999	Budapest
14. Corporate governance seminar	21-22 Oct 1999	Vilnius
15. Regional economic assessment seminar	8 Nov 1999	Paris
16. Foreign direct investment statistics seminar	16 Nov 1999	Tallinn
17. Foreign direct investment policy seminar	17 Nov 1999	Tallinn
18. Insurance and pension reform seminar	22-23 Nov 1999	Vilnius
19. Steering group Baltic FEED	14 Dec 1999	Jönköping

Baltic tax training programme(1996 - 1999)

1. Audit of large companies I	14-18 Sep 1998	Riga
2. Taxpayer services	14-18 Sep 1998	Vilnius
3. Risk analysis and special tax audit	28 Sep - 2 Oct 1998	Copenhagen
4. Course development; personnel management	28 Sep - 2 Oct 1998	Riga
5. Taxpayer service	12-16 Oct 1998	Riga
6. Counteracting corruption	26-30 Oct 1998	Copenhagen
7. Administration of income tax	2-6 Nov 1998	Copenhagen
8. Audit of large companies	23-27 Nov 1998	Riga
9. Personnel management, tax workshop	18-22 Jan 1999	Riga
10. Internal audit, tax workshop	1-5 Mar 1999	Riga
11. Personnel management, tax	14-18 June 1999	Riga

35 Forum for Entrepreneurship and Enterprise Development

ANNEX 2

First annual evaluation meeting of the Baltic Regional Programme, 23 April 1999

SUMMARY OF THE DISCUSSION

This evaluation meeting was held about one year after the Council's approval, in March 1998, of the Baltic Regional Programme. The meeting was convened in response to requests from several countries, in particular those providing voluntary contributions, that the programme be regularly and thoroughly evaluated. The meeting was attended by Delegates from 22 OECD Member countries, the European Commission, Estonia, Latvia and Lithuania.

1. Key policy issues dealt with under the Programme

To illustrate the way in which the Baltic Programme is operated, participants were informed of progress in some key activities implemented under the programme: *(i)* the regional economic assessment, *(ii)* agriculture and the agro-food industry, *(iii)* entrepreneurship and enterprise development, *(iv)* taxation policy.

The *regional economic assessment* is a first in the sense that it is a joint study of three countries. It is a multi-disciplinary project, dealing both with macroeconomic policies and structural policies in the areas of banking, labour and social policy, foreign direct investment (FDI), enterprise reform and agriculture, and considered the flagship activity of this year's Baltic programme. The interaction between the Baltic countries and the Secretariat has been very active and fruitful. The countries will be able to comment on a first draft of the assessment in September, before a subsequent draft is submitted to the seminar planned for 8 November 1999.

The OECD-Baltic co-operation in the field of *agriculture* dates from 1992. It has included the publication of agricultural policy reviews of each of the countries and annual policy evaluations, as well as a Ministerial level meeting in Riga in November 1998. It has introduced OECD methodologies to the Baltic countries and strengthened their commitment to make their agricultural sectors more competitive. Producer and consumer support estimates (PSE/CSE) have been calculated for the most significant commodities, showing that government support for agriculture has been low (though currently rising under the influence of low commodity prices and the Russian crisis). Important orientations of future work will be the further development of a sustainable and competitive agro-food sector, diminishing further the dependence on trade with countries belonging to the Commonwealth of Independent States, and the removal of barriers to trade in food products.

Entrepreneurship and enterprise development are discussed in the Baltic branch of the Forum created for these purposes ("FEED"). The Forum is designed to foster entrepreneurship (the "agent of change") by improving the structural conditions for enterprise development in the Baltic countries, facing the challenge of requiring a conducive framework of institutions, well-designed government programmes and an entrepreneurial culture. In addition to developing policy guidelines for this purpose, the Baltic FEED provides a conduit for exchanging experience by organising annual meetings, supplemented by meetings of two working parties.

As with agriculture, OECD-Baltic co-operation in the field of *taxation* predates the adoption of the Baltic Regional Programme. From 1996 onwards, a Baltic tax training programme has been implemented, which has been instrumental in modernising national tax legislation and implementation, and in designing double taxation avoidance treaties. The programme will be followed by a series of more policy-oriented seminars in 1999 and beyond.

Brief presentations were also made of selected future activities: the reviews of competition policy and FDI policy, as well as insurance and pension reform.

2. The Baltic Regional Programme: Strategic challenges and objectives

a) Presentation of the strategy papers by Estonia, Latvia and Lithuania

The Delegations of Estonia, Latvia and Lithuania each presented their strategy papers[36], stressing the following points in particular.

- The Programme provides a vital contribution to the Baltic countries' sustainable economic development and integration into the market-oriented global economy. It has helped these countries *i.a.* in attracting foreign direct investment, modernising legislation on tax and competition, confirming its low level of government support for agriculture and in developing policies to foster the development of small and medium-sized enterprises.
- The Programme covers issues which are not addressed by other organisations, *i.a.* in the field of taxation, competition and FDI.
- The Baltic countries rate many, if not all of the activities included in the Programme as high-priority items. The regional economic assessment and the work on taxation, competition, FDI, agriculture, as well as the Baltic FEED, were mentioned most frequently as cases in point. Support was also expressed for future work on social and labour issues, statistics, insurance and pension reform and education policy.
- Each of the Baltic countries has created a co-ordinating body for this Programme in which all Ministries involved in the programme's work participate.
- The Baltic countries are willing to contribute financially to the Programme.

b) Evaluation of the Programme to date

The discussion was focused on four broad issues: *(i)* co-ordination matters, *(ii)* the activities and their implementation, *(iii)* the effect of the Russian crisis, *(iv)* general policy matters.

(i) Co-ordination

The Baltic countries' contributions to the Programme are co-ordinated internally by the designated committees (see above), chaired by their Foreign Ministries. Since the participants are usually also responsible for the work with other international organisations, there are no major problems in co-ordinating the OECD's programme with the programmes of others. The OECD provides added value to the Baltic countries' co-operation with other international organisations, in particular by its multidisciplinary character, the way it involves civil servants in its work, the composition of its membership (which comprises most industrialised countries and a very large part of the countries' trading partners). The work of EU Phare, for example, is aimed at achieving the *acquis communautaire* and does not address other matters in the field of *e.g.* taxation, competition and foreign direct investment that are dealt with under the OECD's Programme. The Programme also distinguishes itself by its demand-driven character.

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[36] These strategy papers will soon be on the Internet, at: http://www.oecd.org/sge/ccnm/about/baltic.htm.

(ii) The activities and their implementation

Some Member country delegates suggested that the Programme be concentrated on a more limited number of high-priority activities. The Baltic countries indicated that the present programme, also because it is demand-driven, represents their highest priorities, or some medium priorities and that, if the resources are insufficient to implement all activities, they would prefer to look for additional resources rather than reduce activities.

The question was asked what the results of the Programme had been. Since the Programme has not been actively implemented for more than half a year, the most conspicuous results can be observed in the areas where the OECD's co-operation with the Baltic countries predates the adoption of this Programme. The orientation of the OECD's work in the region has moved from largely technical advice and training to a stronger focus on policy dialogue. As a general matter, the OECD's work has helped both public and private entities perform more strongly and, furthermore, the sharp rise in FDI flows into the Baltic countries bears testimony to the effect of the OECD's work. One of these areas is taxation, where the OECD's work has helped the countries to modernise tax laws, train tax officials and design double-taxation treaties. Another area is FDI policy; the OECD has published *Investment Guides* for each of the Baltic countries and the participation of these countries in the Negotiating Group for the Multilateral Agreement on Investment has helped them to (re-)design bilateral investment treaties. In the field of agriculture, the OECD has published policy reviews for each of the countries; the PSE/CSE measurements have affirmed the high degree of market-orientation of the Baltic agricultural policies and have facilitated their WTO accession. As to competition, the OECD's work has guided the review of legislation and the related institution building. Further important results are to be expected from this year's work programme, including the FEED guidelines.

As to the question whether progress is lagging in any area, the general conclusion was that it is too early to tell and that this is an issue for the next evaluation meeting.

(iii) The effect of the Russian crisis

Several delegates inquired to what extent the Baltic economies had felt the impact of the Russian crisis. As a general rule, this impact has been limited, thanks to their strong orientation on the EU countries and other OECD Members: about two-thirds of their trade is with the EU, whereas the share of their trade with Russia has dropped below 10 per cent. The contagion effect, due to a greater risk awareness among investors in emerging markets has been less severe than anticipated: foreign investment has continued to increase after the Russian crisis broke. Nevertheless, there have been more visible negative effects in certain sectors which depend relatively strongly on Russia, in particular agriculture, fisheries and transport.

(iv) General policy matters

The question was asked whether the Baltic countries see each other as partners or competitors for the attraction of foreign investment. The Baltic countries recognise the importance of promoting their region as such for this purpose, and they have joint institutions to deal with this, but there is also a degree of competition, and certain incentives (such as free economic zones) are used to attract FDI to individual countries.

The Baltic countries are developing their free trade area (BAFTA). Agreements on industrial products and agricultural products are in place and agreements have been reached on government procurement, non-tariff barriers, mutual recognition and product certification. Complementary agreements are in preparation on free labour movement, sanitary measures, technical barriers to trade and services.

Lithuania intends to join the Central European Free-Trade Area (CEFTA) once it meets the preconditions, which are that the country has concluded an EU Association Agreement, that it is a Member of the World

Trade Organisation and that it has bilateral trade agreements with all CEFTA members. A present it has such agreements with most CEFTA members, while those with Bulgaria and Romania are in preparation. Estonia and Latvia also have, or are preparing, agreements with these countries, but are not seeking CEFTA membership. Latvia has been admitted to the WTO, while Estonia is expected to accede very soon. Delegates encouraged the Baltic countries to maintain the momentum of market opening in the context of their effort to integrate into these and other international structures.

Government intervention in agriculture has been limited in the Baltic countries and further limitations, such as the elimination of minimum import prices where they still exist are planned in line with the conditions for WTO accession.

The need to strengthen tax legislation and administration, and other means of reducing the size of the informal economy has the attention of the Baltic countries' governments. Lithuania estimates the size of its "black" economy at 17 per cent of its total economy; no estimates were given by Estonia or Latvia.

Resistance to economic transformation has been evident in the more traditional sectors, in particular agriculture. The ways to overcome such resistance are to ensure the process is effective and thus shows positive results, to see to it that the benefits of economic transformation are equitably shared and to point out that small economies can not develop successfully without opening up to the world.

c) Future orientation

Two additional activities were proposed from the side of the Baltic countries: environmental policy and statistics. The Secretariat observed that, so far, the Baltic countries had participated in the OECD's thematic programme on the environment and that, for the work on statistics in the Baltic Programme, a project staff member was being recruited. Of course, the feasibility of any additional activities would depend on the availability of funding.

The Secretariat explained that it would work with the Baltic countries in further developing measurable medium-term objectives for the programme and in elaborating the details of the programme of work for 2000. In doing so, it would pay attention to ways of better integrating the various policy issues at governmental level. The economic survey may provide guidance in this respect.

The Secretariat observed that part of the 1999 work programme had been financed from 1998 resources, so a higher budget would be needed for 2000 just to maintain the current level of activity. The heavy reliance of this Programme on voluntary contributions make it desirable that the contributing countries make a multi-year commitment to provide funding, not earmarked for specific activities, so as to ensure the continuity of the Programme over time.

Although their main priority is with the Regional Programme, which is tailored to their demands, the Baltic countries also participate in some thematic OECD programmes, a participation which some speakers encouraged.

Concluding remarks by the Chairman, Ambassador Egbert Jacobs

Let me try to sum up. To begin with, this meeting is the first of its kind and, in that respect, the Baltic Regional Programme is the guinea pig in the OECD's outreach evaluation efforts. It has, therefore, been a valuable conference. Secondly, there is consensus among delegates that the meeting was well prepared, that the Secretariat produced excellent documents and presentations, for which we are grateful, and that the presentations by each of the Baltic delegations were of the same good quality. Thirdly, as many delegations were interested in co-ordination questions, my impression after our debate is that there are no major problems in the field of co-ordination; not within the Baltic countries - which can be attributed to the organisational set-up in the respective capitals, as well as to the fact that they have small bureaucracies with all its implicit advantages. There was no major co-ordination problem either with other international organisations' efforts. The EU Phare programme was mentioned as a case in point: it focuses on the *acquis communautaire* and does not cover important fields on which the OECD is focusing, such as investment policies, competition policies and other structural subjects.

A fourth important element which I retain from the meeting, is the fact that financial contributions, which come mostly from voluntary sources, are not earmarked for specific parts of the programme, which of course increases flexibility accordingly. Fifth, it emerges clearly what is the OECD's added value in the co-operation with the Baltic countries, and what are its specific characteristics: it is the multidisciplinary character of the OECD's work and the OECD's institutional set-up within the Secretariat, its apparent capability to have the various intra-Secretariat institutions work and operate together, as well as the global character of OECD, which gives the Baltic countries access to experiences and practices from all over the world.

A sixth element concerns the state of implementation of the OECD recommendations and the results. The Baltic delegations could more or less *uno sono* point out that they have made the greatest headway in implementing the recommendations of the OECD Secretariat in the field of taxation. In particular, the avoidance of double taxation was mentioned. The investment legislation was mentioned as another example where OECD recommendations are actually being integrated into Baltic policies. The redesigning of bilateral investment protection agreements as one of you called it. The competition legislation and its institutional build-up, the various policy reviews -- economic policy as well as agricultural policy -- were also mentioned. I noticed as a seventh element that various Member delegations, as well as the Baltic guests, have pointed out that the Baltic Regional Programme has a strong demand-driven character. This answers the Danish question on ownership of the programme. The Baltic Programme is very much a demand-driven programme and thus by definition within the category of a high degree of ownership, the more so where the Baltic countries are already contributing financially to the Baltic Programme - or are going to do so. As an eighth element, I retain that it has been stressed, and rightly so, that the beneficiaries of the Baltic Programme are not only the Baltic countries themselves: of various aspects of the Baltic co-operation programme, and subsequently of Baltic policies, the OECD Members are beneficiaries as well. OECD Members should not lose sight of this.

As far as the near future is concerned, two proposals have been floated for new elements, namely environment and statistics. Obviously, this has to be worked out with the Secretariat. The Secretariat has rightly stressed that there should be budgetary headroom for this, the more so since we have been informed by the Secretariat that part of this year's programme has been funded by 1998 money, which means that a higher level of funding will be necessary in 2000, just to maintain the present level of activity. The Secretariat has stressed that, for both managerial and substantive reasons, the continuity in the financing of the programme has to be assured (*i.e.* in the form of a multi-year political commitment).

This Baltic Programme is at an early stage of implementation: it was adopted by Council in March 1998 and it has been gathering steam for about six-seven months. This evaluation meeting was very timely because it allows for shifts in emphasis. I have the impression, however, that neither the Baltic countries, nor Member delegations, feel an urge to shift the focus of this programme. There may be corrections of details, to be worked out between the Baltic delegations and the Secretariat, but my overall impression is that, at present, there is no need for a policy shift within the Baltic Programme. It is important to note this on this occasion. We have worked hard today. I think that the essence of today's meeting is that the Baltic Programme is well on track. I refrain from summing up the general policy questions that have been addressed to the Baltic delegations: you will find them, as well as the answers, in the official report of the Secretariat.

Thank you colleagues. This ends my summing up.

ANNEX 3

Budget

The following table lists the grants received and their disbursements (excluding some smaller grants for tax training, administered separately from the Baltic Regional Programme). Information on the funding from the OECD's "own" (part 1) budget is added for information. A part of the 1998 grants was used to elements of the 1999 programme that had resources to be committed for at the beginning of the year, such as staff contracts. Since only little of the 1999 grants will be available to do likewise for 2000, a larger volume of grants will be needed for 2000 to ensure the continuation of the programme on the same level.

GRANTS		(x 1000 Fr. francs)	
Programme grants	**1998**	**1999**	
Denmark	528	528	
EC Phare	390	0	*(Education Review Latvia)*
Estonia		120	
Finland	1,323	1,290	
Finland	0	308	*(Foreign direct investment)*
Iceland	50	60	
Norway	816	800	*(Excludes grants for tax training)*
Poland	200	200	
Poland		30	*(Education Review Lithuania)*
Sweden	1,169	1,095	
Total	**4,476**	**4,431**	
In-kind contributions	**1998/'99**	**1999/2000**	
Finland	434		
Sweden (SIDA)		460	
Poland		P.M.	*(Paid directly by Poland)*
All grants	**4,910**	**4,891**	
P.M.: OECD budget (part I)	*762*	*856*	*(For staff salary and overhead)*
P.M.: Total budget	*5,672*	*5,747*	
P.M.: Grants (% of budget)	*86.6*	*85.1*	
DISBURSEMENTS	**1998 grants**	**1999 grants** *(Jan - Sep 1999)*	
1. Missions	899	544	
2. Meetings	898	947	
3. Consultants/auxiliaries	1,927	1,250	
4. Project staff	722	1,139	
5. Other	67	17	
6. To be disbursed	397	994	
Total	**4,910**	**4,891**	
P.M. Organisation (1+2)	*1,797*	*1,491*	
P.M. Human resources (3+4)	*2,649*	*2,389*	

ANNEX 4

Bibliography

The following publications have all been issued by OECD Publications. More information about OECD publications is available on the Internet, at http://electrade.gfi.fr/cgi-bin/OECDBookShop.storefront, or at http://www.oecd.org.

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