

The Free

“If you don’t create a free market, a black market will emerge”

Market



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This year’s spring and summer were marked by two crucial topics that were a must for our institute to react to.

First, the idea of progressive taxation was yet again brought up by the social democrats. It is not without our help that this tax will not be implemented, at least not until the next year. Elaborating on other countries’ experience and our analysis we showed the detrimental consequences of progressive tax and offered sound solutions that would not annihilate Lithuania’s tax achievements.

Second, higher education reform was announced, although in mumbling. Society is being misled because the only emphasis of the reform is higher education fees, without explaining how and why these would lead to competition and higher quality. We rallied a pro-active campaign and regularly presented to the statesmen and public at large the reform’s essence and relevance.

Simultaneously we have been working in other areas: we held a press conference on the land regulation reform; presented analytical papers on the hot potatoes of the season - roaming and the introduction of Euro; revealed to society the untruthful reasoning behind the draft law on the MPs’ annuities, and reacted to other topics of urgency.

Sunny days to the holidaymakers, common-sense air conditioning to the working ones. Have a useful read!

Sincerely
Remigijus Šimašius
LFMI President

> LFMI LFMI Conference: How Should We Build the 2008 Budget?

On May 17th, the Lithuanian Free Market Institute convened a conference "How should the 2008 Budget be Drawn Up? Goal-orientation, Effectiveness and Transparency of Public Finances."

The topics under discussion were long-term Lithuanian public finances and public expenditure's management priorities, specifically national debt politics, methodology for evaluating expenditure's goal-orientation and effectiveness, programme-based budget's principles and public accountability. The prospects of making the budget formation more transparent and open to the public attracted wide attention. Lithuanian fiscal policies – budget deficit and debt - were also hotly debated.

Programme-based budget's importance to the Lithuanian financial system was analyzed by the President's adviser Ramūnas Vilpišauskas, state expenditure's efficiency was discussed by National Audit Office's 6th audit department's director Jolita Korzunienė as well as LFMI analyst Ignas Brazauskas. Parliament member Professor Kęstutis Glaveckas and Secretary of Ministry of Finance Edmundas Žilevičius highlighted the matters of budget formation and parliamentary hearings.

In the second part of the conference the analysts were called to a discussion panel. Gitanas Nausėda, Raimondas Kuodis, Remigijus Šimašius, Mantas Nocius voiced their differing opinions regarding the programme-based budget's formation, stressing that not a single country has managed to accomplish a purely programme-based budget formation. Nonetheless, impediments should be removed in order to improve the programme-based budget and increase its transparency and cost-effective use of resources.

> Tax Freedom Day 2007 falls on May 19th

It has been since 1993 that LFMI has been calculating and commemorating the Tax Freedom Day. From that time on it has steadily moved forward in the calendar. The tax burden's growth has slowed down since 1998.

LFMI calculates the tax burden as the ratio of projected total tax revenues to net national product, based on the internationally approved methodology. This methodology is used to calculate Tax Freedom Days in the USA, Canada, Great Britain, Poland, and other countries. This tax burden calculation does not encompass money expenditures and time lost due to tax administration. Also not included is government borrowing, which may become a tax burden in the future.

This year the Tax Freedom Day got further along in the calendar. It arrived a week later than in 2006. Although the gross domestic product is rapidly growing, the taxes are swelling even faster – both the relative (from 35.9% in 2006 to 38.4% in 2007) and the absolute tax burdens are growing. It is expected that the 2007 tax revenues will be 29 billion litas, which is almost 6 billion litas more than what was projected for 2006.

Interesting facts:

In 2007, per capita spending on law courts is 45 litas, the police department – 196 litas, state-owned vacation house "Baltija" – 0.37 litas, Vilnius University – 44 litas, Martynas Mažvydas National Library – 5 litas, Lithuanian Archers' Society – 0.53 litas, State Commission of the Lithuanian Language – 1 litas, political parties – 4 litas, reconstruction of the Royal Palace – 11 litas.

> LFMI Proposes the Introduction of a "Zero Budget"

Having carried out a thorough analysis of the current national budget, Lithuanian Free Market Institute proposes - in addition to the already implemented improvements - a more effective and transparent usage of public resources.

It is proposed to introduce budget justification and zero budget models from next year, and to involve the Parliament members into this procedure. Although the budget is formally allocated based on programmes, an unwritten practice currently exists whereby a smaller institution is in charge of one programme related to the institution's functions, while the larger institutions manage a few programmes.

In LFMI's opinion, one of the most important elements is the "zero budget" procedure, which is proposed to be included in the three-year strategic planning and budget formation cycle. Every three years each budgetary programme would have to justify its expenditures, whereby the programme would have to give well-founded reasons for its existence and to demonstrate the necessity of its functions and of the requested amount of money. During the "zero budget" procedure, which could be carried out during the Seimas' spring session, it would be possible to thoroughly examine each programme and to inspect whether all the expenses are in fact necessary and whether the same goals could not be reached with a more effective use of the resources. Most of the budget-related institutions would be included in the "zero budget" and expenditure justification procedure.

Each LFMI proposal is illustratively described in the policy paper. If the political willpower can be mustered up, a very big step forward could be made already in 2008. LFMI calls for the 2008 budget to be balanced and genuinely based on the programmes instead of the institutions.

> LFMI Warnings to the State Institutions Regarding the Consequences of Progressive Tax Introduction in Lithuania

LFMI analysed the Social Democrats' initiative to introduce progressive taxes and remarked on them as well as on the threats that may come up in the future. LFMI's experts' commentaries on this topic were regularly published in the media and became the pivot of broad public discussions.

It was not in the current Government's programme to introduce progressive tariffs. Instead, Government programme planned to increase the non-taxable minimum (which was introduced in 2007) and to decrease the overall rate of personal income tax (which is flat in Lithuania). Therefore the Lithuanian Social Democratic party's initiative to introduce progressive taxes contradicts the official Government programme.

The arguments that have been put forward let us conclude that a progressive tax system would not bring positive results for Lithuania and instead it would cause serious detrimental economic consequences and would set a precedent of not following the Government's programme. Moreover, it would complicate the personal income tax system which is still relatively simple.

When striving for prosperity, more competitiveness, formation of the middle class, the personal income tax must be kept flat and the overall rate must be decreased.

LAND MARKET

> LFMI Proposes Land Market Regulation Reforms



Giedrius Kadziauskas, LFMI's Senior Policy Analyst, Head of LFMI's research on employment regulations, business deregulation, land market regulation and the legislative process. Other areas of expertise: EU law and anti-corruption policy.

On May 3rd LFMI convened a press conference "Need for Land Regulation Reforms Is Triggered By the Never-ending Scandals." Land market regulation is one of the LFMI's strategic policy areas, our goal is to relegate the decision-making of the land use and territory planning to the private owners and their communities.

Essential problems are encountered in the land market regulation: owners are restricted by territory planning documents which not only fail to guarantee the neighbour's security but are also stiff, politicized and too complicated. The most harmed are the small entrepreneurs who have limited financial or political levers. Lithuanian land market regulation is facing continuous criticism not only by Lithuanian citizens and businesses: the essential problems are also pointed out by institutions observing international business environment and public administration, such as the World Bank, International Monetary Fund, etc. LFMI scrutinised the state of affairs and proposed taking up land market regulation reforms, highlighting that:

Status quo in land market is an obstacle to foreign investment.

- In 2007 International Monetary Fund's recommendations stated that "even if restitution is carried out, land use would still be complicated by prolonged and unpredictable territory planning procedures."

- BEEPS, a business enterprise survey carried out by the World Bank and Reconstruction and Development Bank has found that compared to 2002, in 2005 almost twice the number of companies claimed they had difficulties in starting to use land.

Land market regulation is one of the factors causing citizens' discontent.

- The Lithuanian corruption map according to the Lithuanian Chapter of Transparency International - among the five most corrupted procedures (as referred to by citizens and businessmen) two are related to the land market regulation: change of the land use and construction/reconstruction permits and collection of different institutions' approvals.

- Lack of land that could be used for new home construction is one of the reasons behind the high home prices in Lithuania.

The current territory planning system is unsuitable to business and to the people, because

- Planning is stiff and can hardly keep up with the changing realities.

- Central territory planning system does not guarantee stability, because even the general plans are often changed.
- Due to complicated procedures mistakes are made in the plans.
- Central planner's power to make one decision or the other may give rise to corruption.
- Neighbours are not key-players when important matters are being arranged; often the neighbours are left without a real possibility to influence development in their neighbourhood, even though officially community's involvement is encouraged and is supposed to secure a consent.

It is mistakenly assumed that the land market regulation costs nothing to the citizens. Another common belief is that we can achieve perfect territory planning if we "properly educate" the officials that create and administer the plans. It is groundlessly claimed that planning must be left to the state and that the private businesses will never provide "public goods" – parks, parking lots, playgrounds, and so on.

The guidelines for the improvements should be:

The primary goal of the land market regulation should be to **guarantee the best possibilities for Lithuanian citizens to use their land and to protect their property's security** – it is important to safeguard property from other owners', the state's, and municipalities' activities.

General plans should outline only the primary expansion trends and thoroughly specify state investments, so that the private players could adjust to it. **General plans should not plan private investments and activities.**

Territory planning has to ensure the interests of the people directly involved with the changing territory – the neighbours. Neither regulations stating the land use conditions nor a formal neighbours' involvement in the planning process cannot guarantee a mutually satisfactory agreement; furthermore, it inhibits sustainable community's expansion based on long-term consent. This is why futile community's involvement should be rejected, while planning based on private agreements among neighbours should be encouraged.

Immovable cultural heritage protection has to be based on private property protection principle and to ensure that property is used and therefore preserved. Protected territories would regain their value if they are privatized and their long-term protection is ensured.

If territory plans contained less demands regarding land's function and the owners could choose the economically most attractive option, **land's supply would increase**, thus:

- creating conditions for home prices to decrease
- decreasing the pressure to build homes in territories of heritage and protected nature's objects. Incentives for corruption would also decrease.
- after market prices decrease, the Government will be able to finish restitution providing compensations based on real land market prices.

ENERGY POLICY

> Private Capital in Energy: a Necessity rather than a Danger



Žilvinas Šilėnas, LFMI's Senior Policy Analyst, *Head of LFMI's research on Energy policy, international trade, transport policy.*

The new nuclear power plant attracted a lot of public attention and brought under criticism private capital participation in the power plant project. In early May weekly magazine "Veidas" published a commentary by LFMI senior analyst Žilvinas Šilėnas.

National investor carrying out the new nuclear power plant project will be made up of Lithuanian Energy, Eastern Distribution Networks and Western Distribution Networks. Most of the discussions concern private capital participation in the national investor. Some are anxious that "questionable" money will accompany private capital or that private investors may be representing shady interests.

It can be debated whether the national investor was created in the most suitable form, yet in this case the discussion concerns whether private capital can participate in a nuclear power plant project. However, private capital's influence is significantly overrated. First, after becoming part of the national investor, NDX Energy will lose its controlling share of Western Distribution Networks and will instead receive Lithuanian Energy shares, thus no longer remaining a controlling shareholder and not having a decisive say in the national investor's body, where the government will be the ultimate decision-maker. Second, the national investor will own at most 34% of the nuclear power plant, which further decreases Lithuanian capital's share and influence on the nuclear power plant project.

The paradigm that state capital is somehow "safer" than private is completely false. Private capital's goal is profit, so this type of capital is striving for an effective and economically valuable performance of the company. Meanwhile state capital is controlled by politicians who are guided by all sorts of interests and are difficult to predict. Concerning the threats to the project, the likelihood that politicians of different nations will not agree among themselves is much higher than the threats attributed to private capital. Populist rhetoric, such as "Latvians give Lithuanians the power plant as a gift" or "Our trash, thus our power plant" is effective in the political circles of all countries. In private sector the question of who the power plant should belong to would be effortlessly solved by money.

> LFMI Analysis "On the Propriety of the Price Rise for Heating and Hot Water"

Price regulation cannot guarantee low prices or that in the long run regulated prices will be lower than unregulated ones. When

prices of energy resources are increasing, heating price regulation cannot guarantee low prices for the consumers and can obstruct or distort price signals that could signal the consumers to alter their behaviour (decrease consumption, invest in energy-efficient endeavours, etc.)

Social policy decisions mixed with energy policy distort price signals to the consumers. State aid to heating reduces incentives to decrease heating consumption and pursue a more efficient heating use when its prices are rising, which would happen in market conditions. If the state decided to support the less well-off citizens, then direct financial aid unrelated to their actual consumption would reduce the distortion of price signals and allow consumers to make more efficient decisions.

Centralized heating has a tendency to cost more in the smaller towns compared to the cities. Incomes of the city dwellers tend to be larger than those of the smaller towns. This is why consumers are expected to be further dissatisfied with centralized heating prices, especially the ones in the smaller towns.

Price rises of one kind of energy resources raise the demand for a different kind of energy resources, which in turn raises energy resources' prices. In the long run, facing a prospective global energy price hike, it is impossible to entirely protect oneself from price rises by diversifying one's energy resources. In the long term energy resources' diversification can at best protect one from sudden price changes.

The creation of a regulated monopoly whereby one market player is granted monopoly rights is a widespread yet malicious practice that distorts the market and establishes a regulation-based monopoly market structure.

The main problem concerning centralized heating prices arises not only because heating prices are rising, but also because heat is not used efficiently in Lithuania, so that a relatively large amount of heat is used for home heating. Hence, the only and efficient way to reduce the rising expenses on home heating is to decrease the overall heat usage. A reduction in heat usage without reducing the well-being can only be achieved with a more efficient heat use: heat use optimization, modernization and thermal insulation.

This is hardest to achieve in apartment buildings due to the collective decision's difficulties. State actions in this area, such as compensations for the heat system, an unclear position regarding its support for thermal insulation, price regulation and limiting competition, reduce the incentives for a more efficient heat use. Hence, government policies should allow people to feel the incentives for an efficient heat use.

ECONOMIC POLICY

> Yes to Euro, but not at any Cost



Vytautas Kuokštis, LFMI's Policy Analyst

On May 25th LFMI analyst Vytautas Kuokštis made the following speech at a discussion **“Strategy for Price Stability and Prospects for Euro Launch in Lithuania”** organised by Parliamentary Committees on Budget and Finance and European Affairs at the European Information Centre of the Lithuanian Parliament.

The Lithuanian Free Market Institute reminds that the major goal of the Euro launch should be Lithuania's long-term economic growth and its sustainability and competitiveness.

The launch of the euro should be treated as a tool to attain these goals, rather than a goal in itself. It's unquestionable that the introduction of the euro in itself would present advantages, such as facilitated trade with the euro-zone countries, stronger investors' confidence in Lithuania, bigger price comparability and an entirely eliminated risk of the exchange rate fluctuations. However, both the launch of the euro and measures intended to its facilitation may exert positive as well as negative effects. These should be taken into account while debating the euro launch.

The National Plan for the Euro Launch emphasises that it is crucial to safeguard consumers' interests. A number of measures have been envisaged to that end: publicizing the cases of abuse in the media, calling on businesses to sign treaties on good business practice and the like. Although these measures may bring certain results and help avoid a likely turmoil during the euro launch, they would not be material to price stability.

The most important and proper instrument to avoid increases in prices and to protect consumers' interests is to allow natural competition among companies. If the market is competitive, any attempts to raise prices through abuse would act against the seller and not against the consumer.

> It Takes Efforts and Nerves to Start a Business in Lithuania

Lithuania was ranked 16th in World Bank Group's "Doing Business" project, which surveys business regulations. According to this project Lithuania's highest ranking is in the ease of contract enforcing (4) and registering property (3). Lithuania's worst rank is in employing workers, where it ended up only in 119th position.

Companies are burdened by bureaucratic and administrative regulations. 152 controlling institutions operate in Lithuania. There are 330 permits (excluding licenses) that are required to begin and expand various business activities.

Labour market regulation is one of the most important business environment problems. Lithuanian Labour Code specifies that a working week cannot exceed 40 hours, including overtime – 48 hours. However, overtime work is usually prohibited, apart from legally enacted exceptions and when this is agreed upon in collective agreements.

In many other European Union countries working time regulations are more flexible. Small and medium enterprises require flexibility in order to adapt to market conditions. Companies either do not abide by these regulations, or they do abide and incur extra costs.

Another impediment to business is large taxes on labour. Lithuania's 27% personal income tax rate is much higher than rates in other Eastern and Central European countries. For example, in Estonia the rate is 22% (in 2009 it will be reduced to 20%), in Latvia – 25%, in Slovakia – 19%. It is worth mentioning that there are no "ceilings" on social insurance contributions which impedes the creation of high value-added jobs.

Business expansion conditions are significantly worsened by the land market regulations. A complicated territory planning system makes the owner's options for land use extremely limited. If the owner needs to change his land's "designation", he has to go through complicated "detailed planning" procedures. Due to significant bureaucratic impediments it usually takes from half a year to a much longer period to receive a construction permission.

> Lie and Manipulations in the Nation's Name

In June LFMI made a press release regarding untruthful information presented in the covering letter of the draft law that aimed to institute MPs' annuities. A successful campaign followed this disclosure and as a result the draft law was declined. "Verslo Žinios" published LFMI's communiqué on the MPs' proposal to introduce annuity payments to parliament members:

Parliament members' ambition to introduce annuities for themselves is reasonably criticized for various reasons. Only a few of those reasons are not related to the actual annuity payments and deserve more attention. Those proposing annuities officially claim in the covering letter that "all European countries provide this type of social guarantees to their ex-parliament members." Thus, we are the only ones not protecting our parliamentary democracy.

Yet this is a blatant lie. In most countries the annuities are simply paid as pensions. For instance, in Belgium the pension to ex-parliament members is paid when they attain 58, in Greece and Italy – 60, in Spain and Germany – 65, in Portugal and France – 55. Other countries, such as Slovakia, Slovenia and Latvia do not have separate pension systems for the MPs at all. In 2004 Ireland narrowed its privileges for members of the parliament who will now start receiving pensions only at the age of 65. Since 2003 Estonia eliminated the same system that is being proposed in Lithuania and does not extend any special privileges to members of the parliament.

> What Did Not Happen in Higher Education, Yet Should Have Happened



Dr. Remigijus Šimašius, LFMI's President, *Areas of expertise: energy, general economic, competition and privatization policy, educational reform and the regulation of the non-governmental sector, tax policy and state finances issues*

LFMI published numerous articles and commentaries regarding the higher education reform. Writings on this topic appeared in popular websites, newspapers, etc. In May, weekly newspaper "Atgimimas" published a commentary by LFMI President Remigijus Šimašius:

A considerable number of lecturers and students have matured for important mutual obligations. A survey of students has shown that most are ready to pay for education if in turn they receive better services. An increasingly larger part of lecturers is tired of pretending they receive a normal salary. A substantial part of them are also tired of pretending there's no widespread research imitation, plagiarism, and a lecturing anti-culture (although the latter is not as extensive – bad lecturers, unlike the plagiarisers and imitators, do not receive incentives to continue their behaviour.)

Research imitation is best illustrated by the correlation between high positions in some universities and co-authorship of tens or even hundreds (!) of published papers per year. Equally telling are large "research-practice" conferences where research accomplishments are presented in five or seven minutes.

It is often said that higher education should be financed because it is a public good or because state financing would reduce social disparities. Unfortunately, it has long been known that higher education is first and foremost a private good, because it benefits the student himself. The extent to which this good can become public (because it is better for each society when its members are educated) depends on the opportunities the state provides to the gifted and already educated people.

Social disparities are not reduced by higher education financing: according to the research, they are increased, because for various reasons these disparities appear already in primary schools. The subsequent financing of students (something even the reform's initiators don't wish to reject) only provides additional subsidies to those who are usually from richer families and will earn more in the future.

It would be great if politicians, public officials, experts and administrators of higher education institutions realised that the state has to liberate those institutions and let them compete on the market. Unfortunately, this has not happened yet, which is

why we cannot expect better undergraduate studies for an acceptable expenditure. I will not judge what good studies entail and what expenditures are acceptable, because this should be decided by the students. The market is the only mechanism that would ensure their voice is heard, and it would be the students who pay for their choice and not the less gifted members of the society.

> Initiative group's petition FOR HIGHER EDUCATION REFORM

On June 12th an initiative team made up of public figures put forward a petition in favour of a higher education reform. Political forces are encouraged to immediately sign an agreement on a reform of education and research system that would be based on fundamental principles.

Principles based on which the higher education reform should be carried out:

- students' right to quality education will be best ensured by a higher education system where all public and private institutions providing proper education and advancing the research were guaranteed equal conditions; thanks to a freely-moving "student's basket" of funds, which is a crucial element in higher education institutions' competition, the student would become the studies' key player and would determine its optimization;
- dedicated and impetuous lecturers' as well as researchers' right to a respectable salary and normal research conditions would be best guaranteed by competition-based research projects' financing and higher education fees not regulated by the state; thanks to those fees, institutional motivation would increase to organize better studies and research, encourage employees and most gifted students;
- the right to equal opportunities to realize one's abilities and professional goals would be guaranteed by a publicly available, market-provided and state-guaranteed loan system; together with goal-oriented state support and realistic stipends to socially disadvantaged and most gifted students, their responsibility as well as careful choice of studies would be encouraged.

> LFMI's comments on Tomorrow's Framework

In response to the European Commission's invitation and continuing its work on knowledge society's issues, LFMI submitted its commentary to Tomorrow's Framework.

LFMI strongly supports the European Commission's goal to move towards a more competitive and dynamic telecommunications market that would significantly enhance the region's competitiveness and improve the citizens' welfare. The Institute realizes that by updating the regulatory framework, the Commission acknowledges inevitable technological changes in this sector and a convergence of the media, telecommunications and IT industries.

In its remarks to the European Commission LFMI states "We support the Commission's attempts to liberalize the market because we also believe that regulation should not be catching up with technological progress but rather it should be simplified so as to encompass any potential advancement. Otherwise, if we limit consumers' access to innovations, new business models and higher quality services, we will obstruct competition instead of facilitating it."

The Institute proposed a package of recommendations that could evolve into a constructive discussion with the European Commission.

The whole study in English can be found at: http://www.lrinka.lt/index.php/research/lfmis_comments_on_the_tomorrows_framework/3856

Trial By Roaming

LFMI Senior Analyst Žilvinas Šilėnas

According to LFMI's Senior Analyst, if it is proposed to regulate roaming prices, then there are hundreds of other areas for possible EU intervention.

Taken over by unprecedented kindness, European parliament members have decided to grant Europeans cheaper holidays and announced a reduction in roaming prices. That's great! But why limit themselves only to roaming prices? Whilst inspired, why not reduce the prices of tours, cruises, sunscreen or refreshments?

I bet that if the European Commission meticulously analyzed the prices in Basanavicius street in Palanga (the main street in a popular Lithuanian summer resort), they would definitely find out that rooms cost more during the summer than in winter, that a "photo with a monkey" clearly costs more than the photo's printing paper and the monkey's services, or that drinks in the bars and hotel rooms are sold with socially irresponsible "excess profits."

Although the absurdity of such proposals is obvious (I hope it is), thanks to great phrases, much numbers and colourful diagrams the EU's initiative to reduce roaming prices seems rather smart. Yet this is one of the most barbaric planned economy exercises.

The level of roaming services' prices does not speak of a market failure, yet the exact opposite – that the market functions. In contrast to a popular rhetoric, consumers do have a choice not to use roaming services – by pressing the red button. If they are dissatisfied with roaming prices, they can choose among plentiful alternatives – a different (even foreign) provider, landlines, buy phone cards, use IP phones, e-mail and other service. One has to acknowledge that in this case the freedom of choice is more abundant compared to many other everyday economic dealings.

EU head officials are correct that roaming services are profitable. Yet this statement does not prove that their prices are "too high", because its very meaning is subjective. The price that a consumer who has a freedom of choice pays for a service is the "right" price. The fact that the consumer chooses roaming instead of going to a kiosk to buy a phone card demonstrates his freedom of choice and not a market failure. At the end of the day, if the guiding star of economic policies was the question "Wouldn't you like to pay less for good X?" then the prices of all goods and services would have to be cut.

Many would say that such price regulation is just because the companies do not inform about their roaming tariffs, so that consumers are unpleasantly surprised once they receive their phone bills. Yet a grown up consumer knows that one should also read the writings in small font (if the consumer is still a child, his parents should explain to him.) Ultimately if the consumers' inability to read the fine-print is the justification for the intervention, EU should require to increase the font size, not to reduce prices.

EU arguments that the enforced regulations will promote competition in the roaming market are completely unconvincing. First, the limitations placed on providers' prices will limit rather than boost price competition. Second, nothing appeals to competitors more than profit. If profit significantly decreases in the roaming sector, less rather than more potential competitors will be attracted. According to GSM Association's data, about a quarter of roaming services either will not be provided or will be provided at a loss, and the smaller providers will be particularly affected.

It is very likely that roaming services' revenues significantly contribute to the financing of technological innovations', quality of service or even that of local calls. Thus, to compensate for those losses the companies may increase the local calls' tariffs or invest less into development and quality.

The regulation's effect will be such that the frequently travelling and relatively better-off consumers will benefit, whilst the situation of those not travelling or rarely travelling will worsen. (Even if local tariffs will not go up due to competition pressures, it is likely that companies will have to reduce development and quality investments, meaning an improvement for the frequently travelling consumers' segment will be paid by all the other consumers.)

Having in mind the Lisbon rhetoric, the need for the EU to become more competitive, to develop high and middle technologies, it is obvious that the private companies' profit reduction will have negative consequences for private research investments and possibilities to expand into foreign markets. How will real rather than artificial state-financed "champions" be created in the EU, if the EU eliminates profits in the profitable segments of the market? If the EU really cares about its citizens' money, then before regulating private sector's prices they should stop the yearly Brussels – Strasbourg voyage, stop financing the "world's largest passenger plane" or the duplicated satellite navigation system with taxpayers' money, and generally not to favour ineffective EU producers.

Of course, the proponents of state intervention can claim that the GSM standard and liberalized telecommunications sector were created thanks to the EU's initiative. Yet in the best case scenario the GSM standard is only a partial success, and it does not prove that a similar standard would not have been created without EU's intervention. Meanwhile liberalization was simply a correction of a previous state intervention.

Finally – a warning to the EU consumers who appear to be very satisfied with the EU's decision. The state cannot grant anything, because it does not produce anything. The only "gifts" that the state can give are taken from other taxpayers. This is why the state should not attempt to grant what it does not possess, leaving the role of the Santa Clause to those who produce those gifts – private initiatives. Hence it is not surprising that the state's most successful moves in economic politics (e.g. deregulation, liberalization) are mere corrections of the previous officials' interventions.

It is precisely due to private initiative that one can call from a sunny Spanish beach to a less sunny Finland using a hand-fitting phone and complain about the sound quality. It is very easy to take it as given and ask "Has it ever been different?" Making private companies reduce their product prices the EU will achieve popular short-term results. Yet when lying on a beach in a few years time you decide to call home, do not be surprised if your phone has no reception.

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The Free Market is published by the Lithuanian Free Market Institute – an independent non-profit organisation established in 1990 to advance the ideas of individual freedom and responsibility, free market and limited government. Our motto is

If you don't create a free market, a black market will emerge

The founders of LFMI are – Prof. Kęstutis Glaveckas, Nijolė Žambaitė, Dainius Pupkevičius, Petras Auštrevičius, Elena Leontjeva and Darius Mockus.

LFMI pursues its mission by conducting research on key economic policy issues, developing conceptual reform packages, submitting policy recommendations at the legislative and executive levels, drafting and evaluating legislation, and launching public campaigns. LFMI's activities also include sociological surveys, publications, conferences, workshops, and lectures.

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