Trade and Trade Policy Development in Lithuania

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TRADE AND TRADE POLICY DEVELOPMENT IN LITHUANIA

In the less than four years since Lithuanian independence, trade and trade policy have changed rapidly; and longer run tendencies in policies and trade patterns are beginning to emerge. This paper provides a brief overview of the traditional prereform trading arrangements and reviews the key stages in policy development by the independent Lithuanian state, the major trade patterns and arrangements, and prospects for the future.

Soviet Period Trade Arrangements

During the Soviet period Lithuania was a net exporter of most consumer commodities and a net importer of a few agricultural raw materials (feed grains, feed concentrate, and sugar cane) and many other inputs for production and processing. The largest export earnings for consumer commodities came from livestock products and textile products. A large share of exports of basic food commodities was through state procurement for the federal, so-called all-union centralized fund. These commodities were afterwards allocated to other republics or designated for sales in foreign markets according to the central plan and central government trade arrangements. Purchases to the federal fund were not conducted on a competitive basis between the republics and the producing regions within them. Deliveries were made according to quantity allocation, not taking into account quality, price, or transportation costs considerations.

In 1990, the state delivery system to federal funds was replaced by intergovernment trade agreements, which specified product quantities, price, other trade related arrangements, that ceased existing from 1992 onward. Based on these agreements, Lithuania sold 139 tmt of meat and meat products, 1,089.5 tmt of dairy products in 1990, and 102.6 tmt of meat and 916.5 tmt of milk in 1991. During the same time, Lithuania purchased 1,059 tmt of grain, 87 tmt of raw sugar in 1990 and 771 tmt of grain and 66.2 tmt of raw sugar in 1991. These were also accompanied by the purchase of significant though declining amounts of agricultural machinery, seed and planting materials, veterinary medicine products, fertilizers, plant protection chemicals, and mineral feed additives.

In the almost complete absence of access to external markets, Lithuanian trade flows during that period were primarily within the Soviet Union. Only 11 percent of imports and 5.5 percent of exports went to or came from other countries (Table 1).

Table 1. Structure of foreign trade in the prereform period

Trade Categories	Total Value,	Trade via Moscow	Direct External Contracts	Joint Ventures	Total
	million rubles		percent		
Turnover					
1988	1,627.9	95.8	4.2	0.0	100.0
1989	1,796.6	94.5	5.3	0.2	100.0
Exports					
1988	586.7	34.5	1.5	0.0	36.0
1989	507.8	25.9	2.3	0.1	28.3
Imports					
1988	1,041.2	61.3	2.7	0.0	64.0
1989	1,288.8	68.6	3.0	0.1	71.7

In 1988 and 1989, before reestablishing its independence and starting economic reforms in general and agricultural reforms in particular, Lithuania was a net importer of goods from countries outside the USSR, and about 95 percent of this trade went through Moscow. Less than 50 percent of the foreign exports in 1988 and less than 33 percent in 1989 were for hard currency. Export data for 1988 indicate that less than 10 percent of the exports through Moscow were agricultural and food products while 20 percent of exports to Poland through direct contacts were processed food products.

Within the Former Soviet Union (FSU), the most intensive economic ties Lithuania had were with the Russian Federation, covering approximately 57 percent of total commodity exchange. During that period, trade with Ukraine accounted for 15 percent, Belarus for 9 percent, Latvia and Estonia for 8 percent, and the Asian republics of Caucasia, Moldova, Kazakhstan each under 3 percent of the total commodity exchange.

The main items that Lithuania imported from the rest of the FSU were energy and fuel (oil products, natural gas), construction materials, timber, paper, ferrous and nonferrous metals, coal, inputs for light manufacturing (cotton, wool, raw leather), plastic goods, and food commodities (mainly fruit, vegetables, and wines). The primary export commodities included various industrial equipment, processing equipment for the food industry, electrical equipment, farm machinery, synthetic fibers and yarn, woolen and linen fabrics, knitted goods, footwear, leather and fur products, household electric devices, agricultural and food products (fish, meat and dairy products, sugar and confectionery, fruits and vegetables, alcohol and tobacco products).

The agricultural sector traditionally has been and to some extent still is export oriented, with exports exceeding imports by 30 percent.

In 1989, trade in agricultural and food products accounted for 19.2 percent of total exports and 10.9 percent of imports (Table 2). One-third of meat production and approximately 40 percent of milk production were exported. In 1994 a significant part of agricultural and food product trade was re-exports. The share of re-exported agricultural and food products in total exports for the same category was 45.9 percent (agricultural products 26.7 percent; food products 64.3 percent). Re-exports in total trade constituted 34.6 percent of the country's exports. Including the re-exported items, the share of the agriculture and food industry in total exports in 1994 was 24.1 percent.

Table 2. Share of agricultural and food industry in foreign trade

	1989	1990	1991	1992	1993	1994
			percent			
Total Exports						
Agriculture and Food Industry	19.2	16.6	30.7	19.8	12.2	19.9
Agriculture	3.3	3.0	0.4	1.3	0.6	13.2
Food Industry	15.9	13.6	30.3	18.4	11.6	6.7
Total Imports						
Agriculture and Industry	10.9	6.1	5.1	11.5	4.2	11.6
Agriculture	4.3	1.8	2.5	4.7	2.4	5.9
Food Industry	6.7	4.4	2.7	6.8	1.8	5.7

Stages in Policy Development

In 1991 and 1992, immediately following independence, the Lithuanian government relied primarily on quantitative restrictions to influence trade and the effects of trade on the domestic market. Policy decisions were mostly reactive and designed to protect the domestic market from shortages and other external shocks. Uncertainty played a significant role in this policy response, since there were still many unknowns with regard to marketing institutions and infrastructure, trade opportunities, trade impacts, border controls, and the policies of neighboring countries. The result was an ad hoc system of export and import quotas and licenses. There were still some efforts in this period to make government-to-government arrangements on the exchange of specific goods with Russia and other Commonwealth of Independent States countries, but these were not reliable mechanisms.

In 1993, state trade monopolies were abolished, and trade began to be conducted by a variety of enterprises including trading companies, processors, and producers. Most quantitative trade restrictions were replaced with tariff measures, but there was no consistent policy among products and across time. The result was frequent changes in tariffs, often in response to particular events or pressures.

From 1994 to the present, more consistent trade policies have emerged that have begun to harmonize the trade regime with domestic and world market conditions and constraints. External pressures to establish consistent and transparent trade policies led to elimination of nontariff barriers and a switch to use of only ad valorem tariffs. Bilateral and multilateral agreements were signed to influence this process. Among the most influential were the International Monetary Fund (IMF) Memorandum in September 1994, the European Union (EU) Free Trade Agreement in January 1995, and the Memorandum on Foreign Trade Policy provided to the World Trade Organization (WTO) in late 1994. On April 1, 1995, a government resolution established a differentiated tariff system that includes MFN (conventional), preferential (under free trade agreements), and autonomous (sanctional) tariffs.

Under laws passed to establish agricultural and trade regimes, tariff rates are set by government resolution and other legal acts not requiring Parliament's approval. Preferential tariffs are established in bilateral or multilateral agreements. External constraints on trade policy decisions include IMF and World Bank Memoranda and the need to keep policies consistent with WTO standards in anticipation of Lithuania's WTO accession. Further trade policy liberalization is planned, according to commitments made to IMF, to not increase tariff rates, not introduce or use quantitative restrictions, and gradually reduce the average tariff norm for the primary products in the consumer food basket. The average duty for most of the products is now between 30 percent and 40 percent. Relatively high import duties are applied on eggs (35 percent ad valorem), on meat, milk and dairy products (20 to 30 percent), butter (50 percent), potato starch (50 percent), cut flowers (50 to 30 percent), cereals, flour and combined fodder (30 percent), cereal grouts (50 percent), preserved meat and fish (40 to 35 percent), and sugar (70 percent).

Trade Patterns in the Transition

The total trade balance was slightly positive in 1991, but became and remained negative in 1992 ($250.4 million), 1993 (-$272.8 million), and 1994 (-$346.4 million). The primary reason for the negative total trade balance is related to trade in fuel and energy resources that mainly were imported from Russia. In 1994 fuel and other mineral products constituted 32.7 percent of the total value of imports, machinery and electrical equipment were 16.5 percent, chemicals were 8.8 percent, and transport equipment was 6 percent.

In recent years the most substantial increases in foreign trade have been with Germany, The Netherlands, and Italy. The largest Lithuanian partners in 1994 were Russia, Germany, Ukraine, Latvia, Belarus, Poland, and The Netherlands.

In 1994, the main commodity export groups included mineral products (16.6 percent of total export value); textiles (12.3 percent); machinery, electric equipment, television and sound recording, and reproducing equipment, parts and associated equipment (12 percent); chemical production and related industries (10.7 percent); and livestock (9 percent).

The balance of trade in agricultural and food products has remained positive since 1993 (Table 3), but it declined from \$135.9 million in 1993 to \$38.9 million in 1994. Although exports declined by 7 percent, the main reason for the lower trade balance was a 41.8 percent increase in imports. The trade balance improved with only two regions, Baltic countries (+\$10 million) and CIS countries (+\$3.7 million). From 1993 to 1994 Lithuania switched from a net export to a net import position with the European Union, Asia, Africa, and Australia but retained its net export status with the Baltics, Central European Free Trade Association (CEFTA) countries, and the CIS.

Table 3. Pattern of agricultural and food exports and imports in 1993 and 1994

Regions	1993		1994	
	Exports	Imports	Exports	Imports
	thousand litas			
Europe	616,665	379,711	576,160	673,648
EU	369,622	240,770	314,403	367,876
CEFTA	160,445	64,720	136,988	115,564
Baltics	403,63	27,363	89,078	37,000
Other	46,235	46,859	35,690	153,208
CIS	612,367	275,716	573,657	222,080
Asia	11,044	7,710	9,015	13,143
Africa	4,983	213	1,238	10,462
North and South America	13,991	52,282	10,351	94,991
United States	2,331	38,523	2,134	80,323
Australia	194	74	113	707
Total	1,259,245	715,705	1,170,533	1,015,031

Europe and the CIS were the destinations for 98 percent of Lithuanian exports in both years, and they were about evenly divided between the two regions (Figure 1). The European Union alone accounted for 29 percent of exports in 1993 and 27 percent in 1994, while Russia accounted for 32 percent in both years (Figure 2). The share of exports going to the Baltics (mostly Latvia) increased from 3 percent in 1993 to 8 percent in 1994.

The principal source of imports both years was Europe, but the share from this region increased from 53 percent in 1993 to 66 percent in 1994 (Figure 3). The second important source has been the CIS, but this declined from 39 percent in 1993 to 22 percent in 1994. Russia is not the major source of these goods, and its share alone declined from 12.7 percent to 7 percent. Meanwhile, the U.S. share increased from 5 percent to 8 percent, mostly due to food aid shipments.

The primary exports in 1994 were milk products, live animals, and meat products, accounting for 44 percent of total exports (Table 4). Other product groups accounted for less than 10 percent of the total. More than half of the dairy products went to Russia and The Netherlands (Figure 5), while half of live animals and meat exports went to Poland, Latvia, and Russia (Figure 6).

On the import side, only fruits and vegetables stand out as a major group, accounting for 18 percent of the total. Most imports, in fact, were scattered among a large number of products that together composed 41 percent of the total.

Table 4. Composition of Lithuanian product trade, 1994

Product Group	Exports	Imports
	percent	
Milk and Milk Products	24	2
Live Animals and Meat Products	20	5
Fruit and Vegetables	9	18
Grain and Products	9	5
Beverages	6	8
Chocolate Products	5	4
Fish and Products	4	8
Sugar	3	2
Tobacco Products	3	8
Other	17	41

The product composition of the major export markets varies considerably. Lithuanian exports to Russia in 1994 cover a wide range of products, but live animals dominated Poland's imports for further reexport in most cases; dairy products and fruits and vegetables dominated German'y imports; and dairy products were nearly 75 percent of imports by The Netherlands (Table 5).

Lithuanian import patterns also varied by source (Table 6.) Nearly 50 percent of imports from Germany were fruits and vegetables, beverages, and spirits. Nearly 60 percent of imports from Poland were fruits and vegetbles, beverages and spirits, and fish products. These patterns may vary greatly

Table 5. Product structure of Lithuanian exports to main importers in 1994

Product Groups	Importing Country			
	Russia	Poland	Germany	The Netherlands
	percent			
Dairy Products	23	7	11	74
Live Animals, Meat and Products	6	59	6	12
Fruit and Vegetables	10	0	40	0
Grain and Products, Starch	1	6	0	0
Beverages and Spirits	12	1	0	0
Cocoa Products	12	0	0	0
Fish and Products	4	3	0	1
Sugar	6	0	1	0
Tobacco Products	2	0	0	0
Fats and Oils	1	0	0	0
Other Food Products	22	6	7	1
Other Processed Products[a]	0	19	33	12
Total	100	100	100	100

[a]Processed products not in European Union CN (Combined Nomenclature) codes 1-24 (Agriculture and Food).

Table 6. Product structure of Lithuanian imports from major exporters in 1994

Product Groups	Exporting Country			
	Germany	Poland	USA	The Netherlands
	percent			
Dairy Products	5	1	0	2
Live Animals, Meat and Products	6	2	0	10
Fruit and Vegetables	37	19	1	38
Grain and Products, Starch	3	7	4	3
Beverages and Spirits	11	23	3	5
Cocoa Products	3	2	0	14
Fish and Products	1	15	3	5
Sugar	3	2	0	3
Tabacco Products	3	0	1	1
Fats and Oils	11	4	0	2
Other Products	19	23	87	16
Other Processed Products [a]	1	0	1	0
Total	100	100	100	100

[a]Processed products not in European Union CN codes 1-24 (Agriculture and Food).

from year to year, because trade has not yet reached a stable mixture. Many transactions are opportunistic and may not lead to long-term arrangements. For example, Poland's live cattle imports were the result of special circumstances that may not be repeated.

Trade Arrangements and Agreements

Trade with the European Union was regulated by MFN tariffs until January 1995, when the preferential agreement (Free Trade Agreement) came into effect. The agreement sets up a six-year transition for agriculture, during which Lithuania will apply rather high protection levels (import duties) that are gradually reduced in small increments until the end of the period. The agreement reduces EU duties by 60 percent over three years for limited imports into the European Union; namely for pork (1,000 mt), for chicken (500 mt), for skim milk powder (2,900 mt for the first year increasing to 3,500 mt in the third year), for butter (1,000 mt increasing to 1,200 mt), and for cheese. For skimmed milk powder the quantities delivered exceed by far the existing quotas, whereas the quotas for butter and for pork will probably not be fulfilled. Reduced duties without quantity restrictions have been set for black currants, natural honey, apple juice, and some vegetables.

An arrangement for live bovine animals permits imports of 3,500 bovine animals (at 25 percent of regular import duty) and 1,500 mt of beef (at 40 percent of the regular import duty). These quotas are specified by the EU as a global quota for Lithuania, Estonia, and Latvia.

Reduced EU trade barriers will not necessarily lead to increased exports immediately. Time will be needed to reduce obstacles associated with certification, lower product quality, packaging deficiencies, and other marketing infrastructure problems. On the import side, a quota administration system has been established but still needs time to operate effectively. As a consequence, imports of EU products are likely to exceed quota levels for some time.

A free trade agreement among the Baltic countries was signed on April 1, 1994, but does not yet include agricultural and food products, which still use MFN tariffs. Agreement on these products was delayed by differences in domestic and trade policies. Estonia has no tariffs, Latvia has tariff rates that are set by legislation, and Lithuania has tariffs set by government resolution that are more easily changed than the legislated tariffs in Latvia. Although prices have been converging during the last two years, Estonian prices are generally the lowest and Latvia's are generally the highest. The next step in trade relations is likely to be an agreement on Trade and Trade Relations on Agriculture, Food, and Fish Products currently under discussion. A Baltic Customs Union is also under consideration as an interim step before all three countries join the EU.

Although the three Baltic countries are similar, there seems to be enough specialization to encourage significant trade. For example, Coca-Cola produces Sprite in Estonia and Coca-Cola in Lithuania and sells both in each country. In 1994 Lithuanian trade with Estonia included 59 exported products valued at $5.2 million and 41 imported products valued at $6.4 million. Contributing to the negative trade balance are higher Lithuanian prices, more Estonian joint ventures producing competitive products, and products that are trans-shipped through Estonia, processed further in Estonia, and then declared to be of Estonian origin. In 1994, Lithuanian imports from Latvia were only $2.8 million compared with $17.1 million in exports. Despite the fact that the two countries have similar tariffs, higher Latvian prices for many products are the main contributor to the positive trade balance.

The CIS region used to be a traditional market for Lithuanian products, but this exchange of goods under the Soviet system was not really trade but a delivery system not driven by competitiveness and market forces. In recent years trade with this region has been hampered by declining demand, lower market prices, payment problems, high transactions costs, competition from former Council on Mutual Economic Assistance (COMECON) countries, and competition with subsidies, export credits, and food aid provided by the European Union and the United States. Trade policies have also been very erratic. Russia only began appling MFN tariffs to Lithuania in January 1995, after a period when sanction tariffs of double the MFN were applied. Lithuania now has trade agreements with Ukraine, Belarus, Russia, Kazakhstan, and Tajikistan. Negotiations are currently in progress with Moldova, Turkmenistan, and Azerbaijan.

Prospects for the Future

Policies and trade patterns are beginning to stabilize, but many transactions are short term in nature and many problems remain. The process of accession to the WTO will resolve some trade policy issues such as tariff bindings, import access, the availability of export subsidies, and customs valuation procedures. Bilateral negotiations associated with WTO accession may result in some additional trade arrangements with countries other than those that already have preferential tariffs. The WTO process, in general, will require Lithuania to make further progress in defining domestic and trade policy regimes in a consistent and transparent framework.

It is expected that European countries will continue to be Lithuania's main trading partners in the medium term. Exports to the European Union will continue to face problems associated with product quality, variety, packaging, and competitiveness. These problems can be reduced with increased investment in marketing infrastructure and modern production and processing facilities. Certification of processors and accreditation of testing laboratories needs to be accomplished. As these problems are solved, the European Union's high levels of protection and export subsidies are likely to remain a significant obstacle to Lithuanian competitiveness. Two of the three European Free Trade Association (EFTA) members who joined the European Union in 1995, Sweden and Finland, had free trade agreements with Lithuania. Trade barriers in these countries will now increase, since they have harmonized border measures with the European Union.

The Central European Free Trade Association (CEFTA) countries have been the second largest trading partner in Europe after the European Union. Poland accounts for more than 70 percent of this trade, both for imports and exports. Lithuania and Poland are now negotiating a free trade agreement that may later lead to membership in the Central European Free Trade Assocation. However, agricultural and food products are not currently included in CEFTA and will likely limit participation in any future agreement.

Trade with other Baltic countries is likely to remain significant but not large, due to the small size and similarity of the economies. If a limited trade agreement for specified quantities of agricultural and food products can be concluded and policies begin to converge, a customs union including these products could be viable within two or three years. This could be seen as a step toward joining the European Union as a group later on.

Preferential trade agreements with CIS countries should help to improve trade with this region. Lithuania cannot reestablish its traditional trade levels with this region but must develop new trade relationships on a competitive basis. Further liberalization of prices and policies in these countries will reduce the price disadvantage of Lithuanian products and reduce the need for subsidies. As inflation is reduced and economies again begin to grow, this region will become a more viable market for imported goods. Stabilization of trade and domestic policies and development of reliable transactions and payments procedures will also be needed to reduce the uncertainties of trade with this region. These improvements will be facilitated as these countries meet the conditions for accession to the World Trade Organization.

Thus, future prospects for Lithuanian exports and imports depend on improved external conditions as well as better domestic and trade policies and international marketing infrastructure and experience.

Figure 1. Lithuanian exports of agricultural and food products by regions in 1993 and 1994

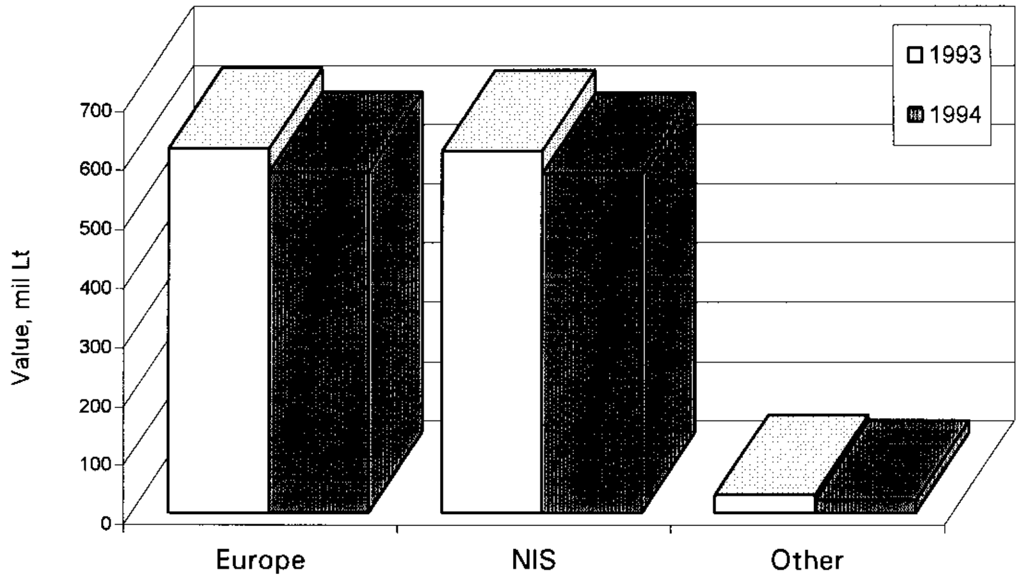


Figure 2. Lithuanian exports of agricultural and food products by country in 1994, %

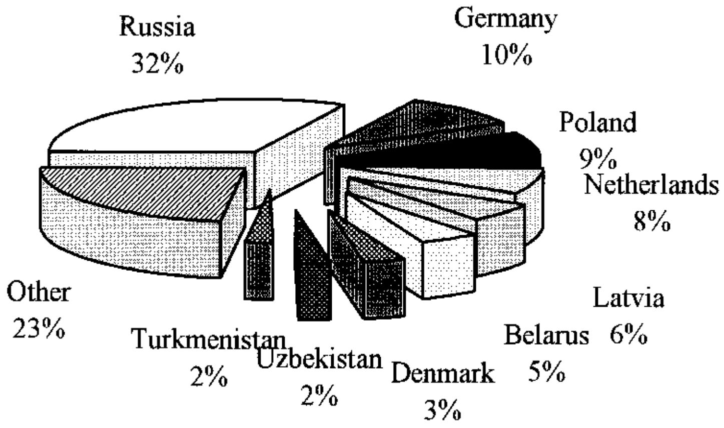


Figure 3. Lithuanian imports of agricultural and food products by region in 1993 and 1994

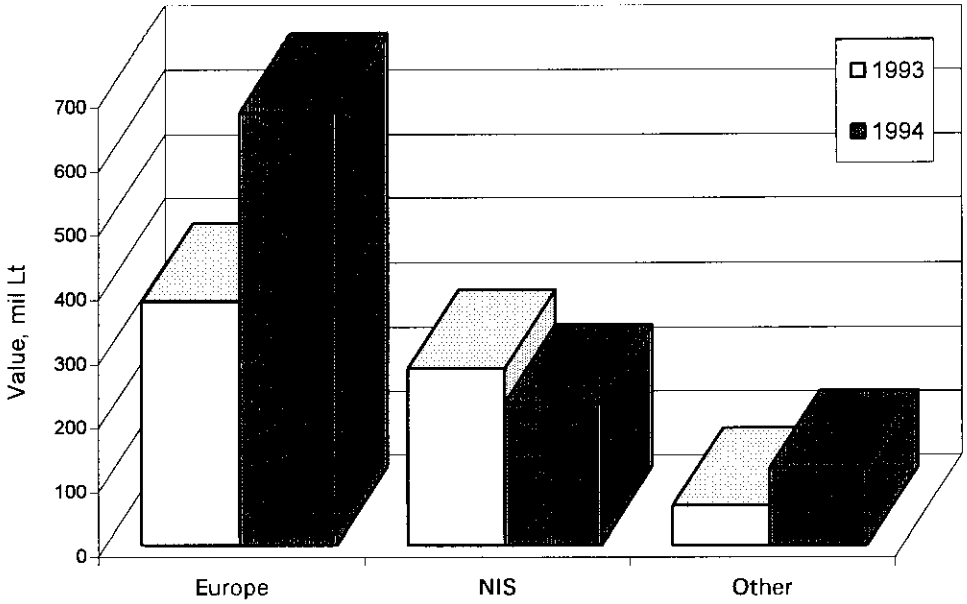


Figure 4. Lithuanian imports of agricultural and food products by country in 1994, %

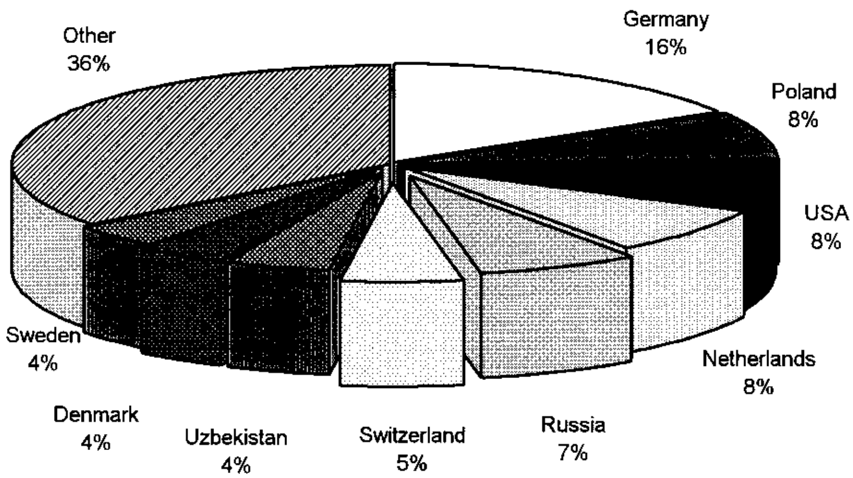


Figure 5. Sructure of dairy exports in 1994,%

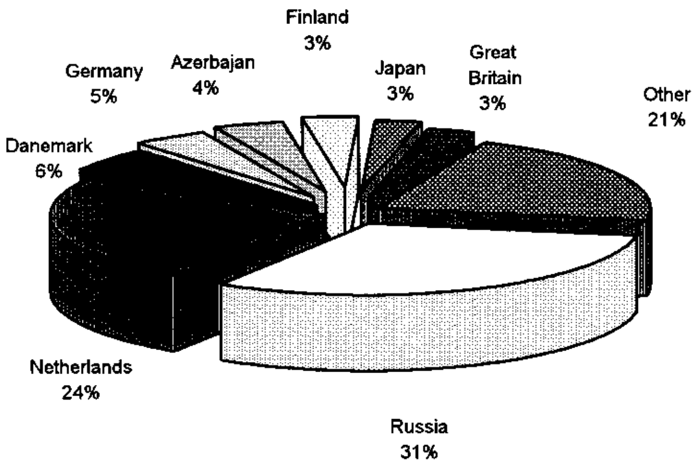
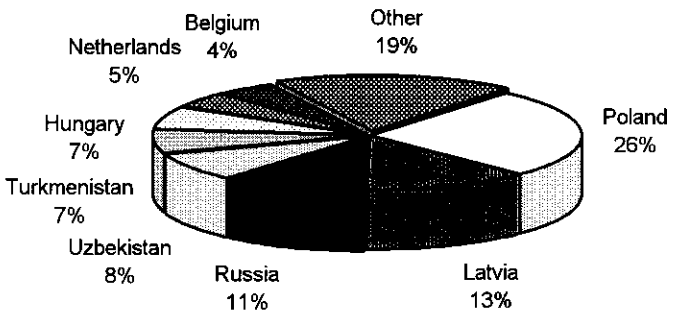


Figure 6. Sructure of meat exports in 1994,%



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