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AGRICULTURAL POLICIES IN THE BALTIC COUNTRIES: PROCEEDINGS OF THE PARNU SEMINAR IN SEPTEMBER 1997

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Acknowledgements

This publication brings together the papers presented at the Workshop on Agricultural Policies in the Baltic Countries held in Parnu, Estonia on 18-20 September 1997 within the framework of the programme of work of the OECD Centre for Co-operation with Economies in Transition.

The Workshop was prepared by OECD in close collaboration with the Ministry of Agriculture in Estonia and special thanks are extended to all involved in the preparation, in particular Mr Ruve Sank and Mr Michael Ryan, who was also responsible for the preparation of this publication. Appreciation is also extended to all those who contributed papers to and participated in the discussions during the Workshop, especially to the rapporteurs Messrs A. Kwiecinski, M. Ryan and V. Vojtech.

FOREWORD

The agro-food sector in Estonia, Latvia and Lithuania has undergone dramatic changes since independence, including privatisation, and a reorientation of domestic agricultural support policies and trade measures. Policy makers have been faced with the difficult task of designing a new set of agricultural policies in the context of a more market-oriented environment, while at the same time trying to develop an economically viable and internationally competitive sector. This Workshop on Agricultural Policies in the Baltic Countries was the second to take place within the programme of work of the Centre for Co-operation with the Economies in Transition, and was held on 18-20 September 1997 in Parnu, Estonia. The Workshop brought together high level policy experts from Estonia, Latvia and Lithuania as well as representatives of OECD Member countries, Russia, Ukraine, and other international organisations. The first Workshop took place in Visby, Sweden on 13-16 October 1992 and focused on agricultural sector problems in the transition towards a market economy in the Baltic region.

The main objective of the Workshop was to provide a cross country comparison of the similarities and differences in agricultural policies across the Baltic region during the 1990s as well as some comparison with policy developments in other CEECs and OECD Member countries. The Workshop addressed three main topics: structural policies and privatisation in the agro-food sector; market regulation, price, and income support policies; and changes in agricultural trade policies and trade relations. The Workshop concluded with a discussion on the future challenges to policy makers in the region and identified potential areas for closer co-operation amongst the Baltic countries.

It was concluded that the evolution of agricultural policies and developments in the agro-food sector in Estonia, Latvia and Lithuania have been in line with the development of a market oriented approach to the sector. Privatisation of the upstream and downstream parts of the agro-food chain is almost complete, and restructuring and modernisation are continuing. In all three Baltic countries there is a strong emphasis on improving the productivity and competitiveness of the whole agro-food chain. Concerning agricultural policies, there is some movement away from the more distorting market price support measures to less distorting forms of support including assistance for improving general infrastructures and farm structures, rural and regional development, and environmental measures. Nevertheless, agricultural policy measures and instruments continue to differ between the Baltic countries, with different ownership structures and farm sizes emerging in the region, as well as different price support policies and border measures. However, with the implementation of the Baltic free trade agreement for agricultural and food products, as well as future membership of the WTO, agricultural policies and producer prices are expected to converge across the region.

The publication brings together a summary of the main issues addressed by the Workshop, together with a selection of papers presented to the meeting. The views expressed in this report do not necessarily reflect those of the OECD or its Member Countries. The report is intended as a background document for the high level meeting of Baltic Agricultural Ministers planned for the fall of 1998. It is made available to the public on the responsibility of the Secretary-General of the OECD.

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I. Introduction

Estonia, Latvia and Lithuania have made significant progress in developing their agricultural policies and trade regimes since becoming independent at the beginning of the 1990s. After independence, one of the most crucial policy goals in the three Baltic countries was to strive to rapidly integrate their economic and trade regimes into the global trading system. In order to achieve this goal, Estonia, Latvia and Lithuania set about developing their own marketing institutions and legal framework for aligning their domestic agricultural and trade policies with the system in operation in neighbouring European countries. The legacy of the former central planning system provided little in the way of institutions or experience, and all three Baltic countries started developing their different policies and institutions.

The Policy Workshop was divided into four sessions; each session focused on a specific policy area which was considered to be important for the development of the agro-food sector in the Baltic region. The discussions in each session concentrated on a cross country comparison of policy developments during the 1990s as well as some comparison with policy developments in other CEECs and OECD member countries. More specifically, the first session focused on structural policies and privatisation in the agro-food sector; the second session focused on domestic market regulation, price and income support policies; and, the third session concentrated on changes in agricultural trade policies and trade relations. Finally, discussions in the fourth session revolved around policy successes and failures in transition countries, as well as on future challenges to policy makers in the region and prospects for further co-operation between the three Baltic countries.

II. Summary of the Discussions

Session 1. Structural policies and privatisation in the agro-food sector

The purpose of this session was to examine and discuss progress in privatisation and structural adjustment of the agro-food sector in the Baltic region. For five decades, the agro-food sector in the Baltic countries was largely state-controlled with almost all agricultural land operated as either collective or state farms and upstream and downstream enterprises integrated into state owned hierarchical structures managed by orders from Moscow. After independence, restructuring and privatisation was applied as a means of developing a more competitive agro-food sector.

Agriculture

Privatisation and structural change in agriculture in the Baltic countries can be broadly divided into two periods: dramatic changes between 1991-1994 and more evolutionary movements since 1995. While, mostly for political reasons, all the Baltic countries applied restitution of former ownership rights as the principle means of privatising land, other aspects of land privatisation differed across the countries concerned. It was reported that the Estonian government policy was mostly driven by political

considerations and did not favour any particular type of farm structure. The actual outcome was the establishment of large scale farming with no support policies. On the other hand, Lithuanian authorities seemed to put more weight on the social aspects of the reform process with a preference for medium and small-sized family farms. The Latvian approach was somewhere in-between, with a clear preference for medium-sized family farms.

Participants noted some statistical difficulties in assessing the results of the reforms, in particular, the lack of a clear distinction between household plots and individual family farms. This could lead to a possible large margin of error in comparing the number of family farms, and their average size in the countries concerned. For example, three basic types of family holdings are identified in Latvia: family farms, household farms, household plots and gardens. In the other two countries only family farms and household plots are differentiated. The average size of so-called "household" farms in Latvia (7.9 ha) is larger than the average family farm size in Lithuania (7.6 ha), but the former is not considered a family farm because it is not registered as such. Furthermore, some misunderstandings also arise from inconsistencies in defining farm size by different types of land, for example, total land (including forest land), agricultural land, or arable land. A further problem arises from the rather weak system for collecting and processing statistical information in the Baltic countries and the low response rate to statistical questionnaires on agriculture, which tends to create some uncertainty over the results.

Despite these statistical difficulties, nonetheless, it can be concluded that large-scale farms are dominant in **Estonia**. In 1995 they accounted for 46 per cent of agricultural land (Table 1). This share has been declining slowly and at the beginning of 1997 it was estimated at 44 per cent. The number of family farms rose from 13 500 in January 1995 to 22 700 in January 1997, and their share in total agricultural land increased from about 19 per cent to about 35 per cent over the same period. The average size of a family farm was about 22 hectares in January 1997, including 14 hectares of arable land. Almost all 360 former collective and state farms have been transformed into 900 new corporate entities producing mainly grains and milk. Although they are still large-scale (about 500 ha of agricultural land on average), their smaller size has made them more manageable than their predecessors. However, it was pointed out that the majority of large-scale enterprises do not own the land they use, and this has tended to impede their development. Participants noted that land privatisation through restitution has proved to be rather ineffective in Estonia as 74 per cent of land has not been claimed by previous owners. As a result about 70 per cent of agricultural land remained in state ownership in 1996, and in most cases was operated by large-scale enterprises or left uncultivated. This share is by far the largest in all Baltic countries (Table 2). Some estimates indicate that between 20 and 30 per cent of agricultural land in Estonia was not used in 1997 due to financial difficulties in the agricultural sector. The land market is under developed in Estonia with very few transactions registered and the majority of leases are only for a short period covering one to three years. In co-operation with the FAO a revised land reform programme is being considered, which includes the creation of a new legal framework for long-term leases (up to 25 years), the sale of unused and unclaimed State land through limited or public auctions, and the provision of ownership titles to household plots.

It was reported that in **Latvia**, the process of restitution and privatisation has led to fundamental changes in the farming structure, resulting in a predominance of medium size family-type farms in the new emerging farm structure (Table 1). In order to promote this type of farm structure (similar to the pre-war structure), any approved applications for land, whether for restitution to previous owners or for new individual farms, were given priority over collective or state farms. As a result, about 95 000 family farms (October 1996) are now the cornerstone of Latvian agriculture, operating on 56 per cent of agricultural land with an average size of 23.6 hectares, including 13.7 hectares of agricultural land. About 157 000 "household farms" (not registered as family farms) with an average size of 7.9 hectares (4.9 hectares of agricultural land) occupy 33 per cent of agricultural land, and 167 000 household plots and gardens plots

with an average size of 0.9 hectares (0.7 hectares of agricultural land) occupy a further 5 per cent of agricultural land. In 1996 about 5 per cent of agricultural land was used by 474 private companies with an average size of 309 hectares (including 238 hectares of agricultural land). The remaining 1 per cent is used by specialised state enterprises, most often experimental farms, with an average size of 339 hectares (233 hectares of agricultural land). In recent years there has been a tendency for a decline in the share of land operated by private companies, household plots and household gardens and a significant rise in the share operated by family farms and "household" farms. Participants noted that despite significant progress in land privatisation (about 4 per cent of agricultural land was state owned in 1996, Table 2), only about one half of land owners have been able to register their ownership rights, and can use land as collateral for loans. It was also noted that the land market is not well developed in Latvia due to the slow process of land registration, legal constraints on the foreign ownership of land and the limited employment opportunities outside the agricultural sector.

Table 1. **Agricultural Land Use, 1995** [1]
(per cent of total agricultural land)

	Small farms: under 3 hectares	Medium farms: 3-100 hectares	Large farms: over 100 hectares
Estonia	35	19	46
Latvia	23[2]	58[2]	19
Lithuania	33	32	35

1. OECD estimates based on national sources.
2. The lower limit is five rather than three hectares.
Source: OECD.

In **Lithuania**, as a result of a rather radical approach to privatisation motivated initially by the government's desire to reduce the influence of the rural *nomenklatura*, and later by social and political goals to secure access to land for workers of the previous Soviet-type agricultural enterprises, a rather widespread distribution of land use rights (2-3 hectare plots) took place. These rights were later transformed into sales in exchange for investment vouchers. This approach generally complemented (but sometimes contradicted) the basic approach of land restitution to previous owners. In situations of conflict over land use, priority tended to be given to smallholders. Moreover, the 1991 legislation on privatisation required that all 1 160 *kolkhozes* and *sovkhozes* be declared bankrupt by 31 December 1991. Their assets were divided into 12 000 technological units, ranging from large-scale farms to individual units, grain stores, etc.

As a result, a small-scale farming structure is emerging in Lithuania, with the main sector consisting of 196 000 family farms, which occupy 38 per cent of agricultural land (average size 7.6 hectares in 1996). At the beginning of 1997, almost 380 000 household plots (average size 2 hectares), occupied 22 per cent of agricultural land. The third group of farms consists of agricultural companies which accounted for about 17 per cent of agricultural land, while the fourth group includes state farms and so called "garden plots" accounted for 13 per cent of agricultural land. The remaining 10 per cent of land was left unused. The number of family farms continues to increase while the numbers of household plots and agricultural companies are declining. However, household plots, despite their very small size, still

play a very important role in agricultural production, accounting for about half of all crop production and about a third of livestock production in Lithuania. Moreover, they fulfil an important social function for a large part of the rural population, in particular, for those who have lost their permanent jobs. Although the vast majority of agricultural land has been privatised (Table 2), the agricultural land market is not well developed, and demand for land is low due to the high degree of uncertainty and low level of profitability in the sector.

Table 2. **Agricultural land owned by the State in 1996**

	Per cent
Estonia	70
Latvia	4
Lithuania	13

Source: OECD estimates based on national sources.

Participants noted that in all three countries difficulties have arisen in establishing proper **legal titles**, with many conflicts between new owners and those who had worked the land during the Soviet period. The rather over-regulated land reform laws, complicated procedures for land registration, and the lack of qualified staff to carry out the necessary surveying and mapping operations have contributed to the slow pace of land restitution (especially in Estonia). As a result, only a small percentage of agricultural land was registered in the land registries (particularly in Estonia) and could therefore be considered as fully privatised. Also, investment in agriculture is severely inhibited by delays in land privatisation in Estonia, and the low level of profitability in the sector.

Different approaches to land privatisation and farm restructuring contributed to the diverging trends in agriculture's contribution to GDP and its share in total employment in the three countries. The Estonian approach, preserving a relatively large part of agricultural land as large scale farms combined with restructuring of these farms, contributed to a significant decline in agricultural employment. As a result, the share of agricultural employment in total employment fell from 12 per cent in 1989 to 7 per cent in 1996, and coincided with a sharp decline in the sector's contribution to GDP (Table 3). The relatively good macroeconomic performance of Estonia and emerging new employment opportunities in non-agricultural sectors (particularly in services) absorbed some of the labour released from agriculture and has helped to reduce the social pressures in rural areas. However, the rate of unemployment in rural areas in Estonia remains high and has reached 20 per cent in some regions. A continuation of land privatisation and the emergence of smaller scale farming may result in some future employment opportunities in the sector.

It was reported that in Latvia and in Lithuania, land privatisation has resulted in farm fragmentation and an increase in employment. In effect, agriculture has tended to acquire more labour than it did under the collective system and the share of agricultural employment in total employment has increased, contrary to the decline in the sector's contribution to GDP in these two countries, thus indicating a decline in labour productivity (Table 3). Lack of alternative employment may be a major impediment to further farm restructuring and efficiency gains in agriculture, especially in Lithuania and in Latvia.

Table 3. **Agriculture's share in GDP and Employment 1989-96**

	Share in GDP %			Share in employment %		
	1989	1994	1996	1989	1994	1996
Estonia	17.8	7.4	6.4	12.0	8.0	7.0
Latvia[1]	10.2	9.4	8.7	13.0	17.4	17.3
Lithuania	26.5	7.5[2]	8.5	17.6	23.3	24.5

1. Includes hunting, forestry and fishing.
2. Methodology modified in 1994 and backdated to 1992, contributing to the apparently dramatic fall in the share of agriculture in GDP in 1992 and subsequent years. For example, according to the old methodology, agriculture's share in GDP in 1992 was 21 per cent while the revised methodology put it at 11.5 per cent.

Source: OECD.

Upstream and downstream sectors

Participants agreed that privatisation of the input supply industries ("upstream" sector) and of processing and trading industries ("downstream" sector) combined with the creation of competitive commercial links between all agents in the food chain are essential for revitalising the agricultural sector in the Baltic countries. The degree of privatisation of upstream and downstream enterprises varies across the three countries. In Estonia and Latvia, privatisation was virtually completed by the end of 1995, whereas in Lithuania, the process was slower with between 75 and 95 per cent of agro-food enterprises, depending on the branch of industry, privatised by the end of 1996. In all three countries, privatisation proved to be difficult due to a heavy burden of outstanding debt, outdated processing facilities and falling consumer demand, resulting in substantial under utilisation of productive capacity.

In all three countries, but particularly in Lithuania and Latvia, preferential treatment in privatising the agro-food industries was given to agricultural producers so as to promote vertical integration in the food chain. It was noted however, that this approach tends to crowd out domestic and foreign investment. Moreover, agricultural producers lack capital as well as technical, marketing and business skills to contribute to the development of these industries. As a result, this has tended to slow down the much needed restructuring of food processing enterprises (particularly in Lithuania), hindered improvements in efficiency, and contributed to lower farmgate prices for many products. All three countries used investment and/or compensation vouchers to a large extent in the privatisation of their agro-food sectors in addition to direct sales for cash. Also, it was reported that foreign investment has played an important role in the restructuring and privatisation of selected agro-food enterprises in Estonia, but to a much lesser extent in Latvia and Lithuania, mainly due to less favourable investment conditions in these two countries.

Session 2. Market regulation, price and income support policies in the Baltic countries

The purpose of this session was to identify and discuss the similarities and differences between price and income support policies in the Baltic countries. The three Baltic countries came through a difficult period of transition from command and control economies involving high subsidisation of agricultural production and food consumption to independent market oriented economies. In the early years of reform this process was characterised by macroeconomic instability and difficulties linked to the loss of the Soviet Union market and the opening of world markets. These factors forced the agro-food sector in the Baltic region to adapt to new market realities and changing macroeconomic conditions.

Macroeconomic framework

For all market economies, and for economies in transition in particular, a stable macroeconomy for the implementation of agricultural policies is crucial. All agricultural policy measures applied should be closely analysed in the context of the macroeconomic conditions. After the period of large macroeconomic shocks in the early years of the reforms, the Baltic countries have made good progress in macroeconomic stabilisation. At this juncture, the Baltic countries face a somewhat different set of challenges in relation to macroeconomic stabilisation. All three countries have brought their annual inflation down to about 10 per cent in 1997, and economic prospects have been greatly enhanced. However, one area of concern is the increasing current account deficits in all three countries. Growth in the Baltic countries has been largely demand driven, with substantial capital inflows supporting the current account deficits. Many of these capital inflows appear to be short term, and weak current accounts may be indicative of problems in competitiveness and incomplete restructuring.

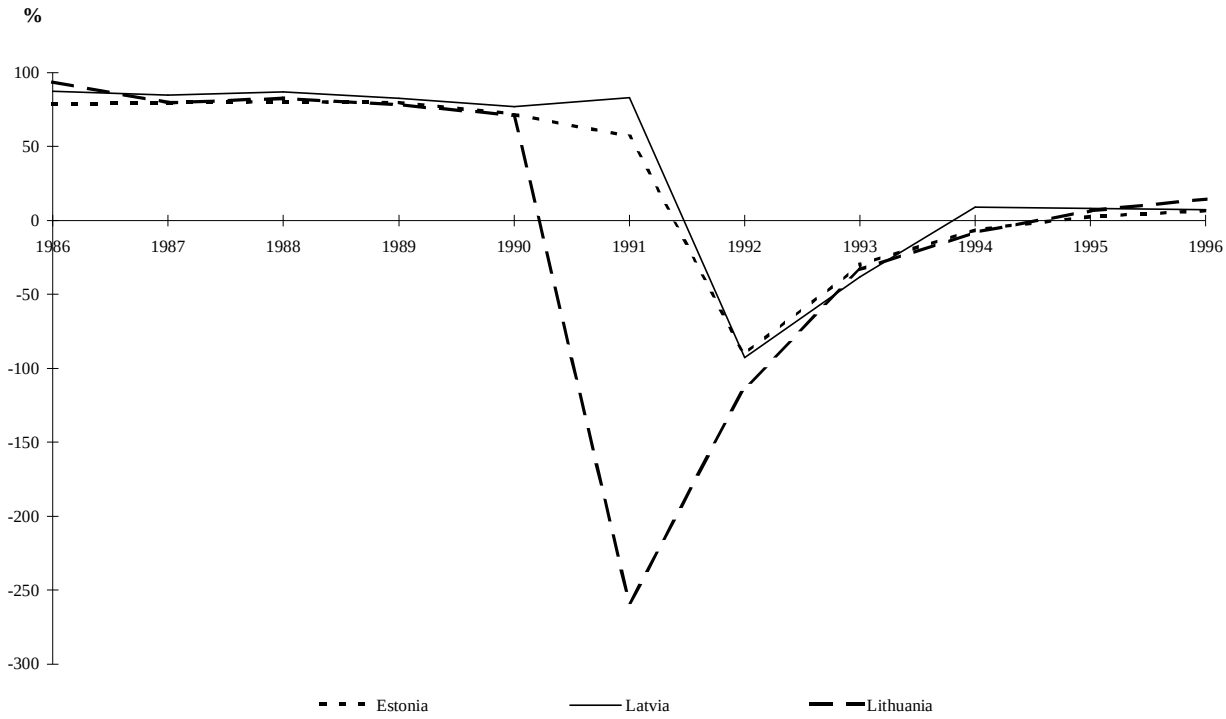
The current macroeconomic situation limits any substantial increase in budgetary support to the agro-food sector, while market price support through higher consumer prices is unrealistic due to the high share of household expenditure on food. Nevertheless, in recent years the three Baltic countries have tended to increase their share of total budgetary expenditures allocated to the agricultural sector.

Evolution of support to agriculture and related policies

It was reported that the PSE and CSE estimates for the three Baltic countries for the 1986-1996 period reflect to a large extent developments at the end of the Soviet era, and changes during the early reform period. Prior to the 1992 reforms and accompanying macroeconomic changes, the level of support as measured by the percentage PSE ranged from 70 per cent to over 90 per cent, which was substantially higher than the estimated 45 per cent for OECD member countries in the same period. Market price support was by far the most important PSE component. In the absence of consumer subsidies, this would have imposed a substantial burden on consumers. However, with price liberalisation policies introduced at the beginning of the 1990s, producers in the three Baltic countries experienced a sharp drop in support. This was largely due to the devaluation of the official exchange rates and to reduced subsidies. The policy of a stable nominal exchange rate combined with high inflation led to a strong appreciation of domestic currencies in all Baltic countries. With the appreciation of domestic currencies the PSE estimates increased, and in 1996 were estimated at 7 per cent for Estonia and Latvia, and 14 per cent for Lithuania (Figure 1). While the current level of support is lower than the OECD average, it is moving closer to the level in CEE-OECD member countries, such as Hungary and the Czech Republic.

Figure 1. **Agricultural support in the Baltics (1986-1996)**

Percentage PSE



During the early years of reform (1992-1993), the effect of agricultural policy measures was eroded by macroeconomic instability, and in particular, high rates of inflation. Hence, macroeconomic stabilisation and general economic recovery were more important determinants of support than specific agricultural policy measures. In recent years, the macroeconomic situation has stabilised, and support to the agricultural sector is more strongly influenced by agricultural policies. A more detailed analysis of support to agriculture and related agricultural policies is given for the period 1993-1996. This analysis is based on the evaluation of the two main components of the PSE:

- Market Price Support (MPS), which reflects the impact of price support policies; and
- Other Support (OS), which reflects the total budgetary support to agriculture.

a) Price support policies

Since the beginning of the reforms the Baltic countries have applied different price support policies. While **Estonia** completely liberalised its economic system, Latvia and Lithuania took a more gradual approach to liberalisation. Participants noted that in the agricultural sector, Estonia applied a liberal market policy with no border measures and no market interventions. Therefore, up to 1997 there were no market price support policies in Estonia. However, it is important to note that in the early years of the reforms, an undervalued exchange rate protected agriculture. This protection disappeared with the appreciation of the Estonian Crown, and has led to growing domestic pressure for the introduction of import tariffs on some agricultural and food products.

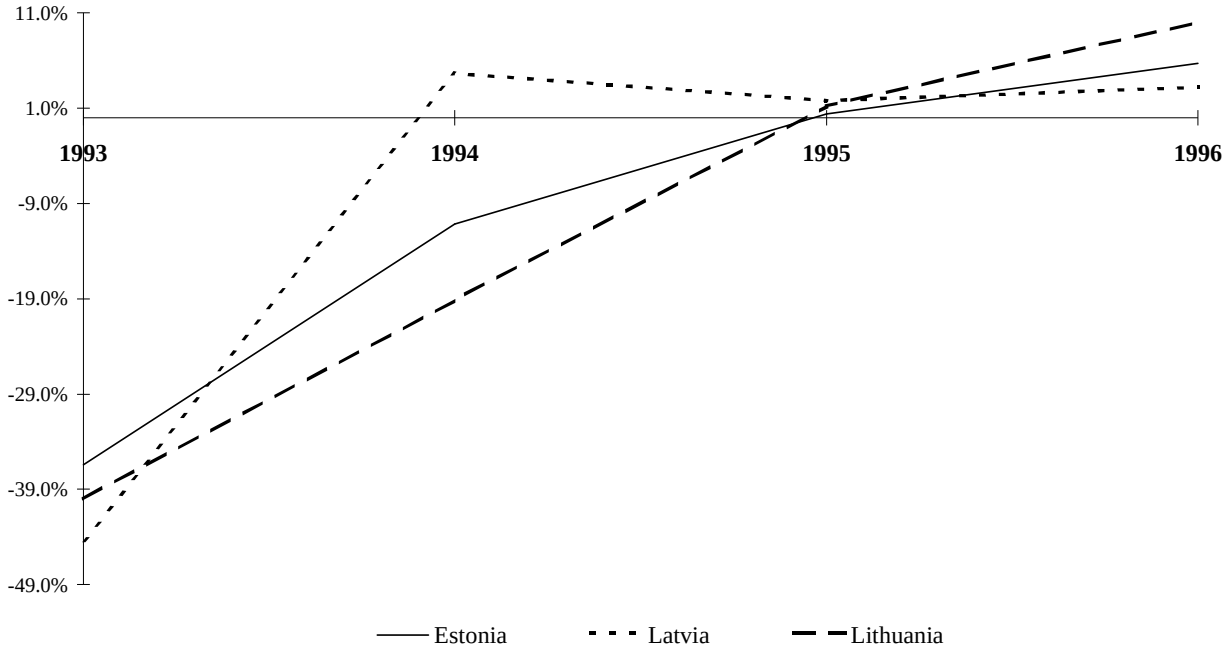
In Latvia and Lithuania, direct state intervention in domestic markets was limited during the early reform period mainly due to budgetary constraints. However, greater divergences have appeared in recent years. For example, **Latvia** limits market intervention to purchases of grains by the State Grain Bureau, while most of the market price support is provided through border measures which were introduced during 1994 and 1995. Since August 1997, border measures have been limited to import tariffs. Quantitative restrictions on grain imports and the import ban on sugar were abolished. However, the State Grain Bureau has been given a virtual monopoly on grain imports as it imports at zero tariffs, while the other importers are paying tariffs of US$40 per tonne for wheat and rye and US$125 per tonne for other grains. On one hand, this measure prevents prices from rising above the world price level (in the event of shortages on the domestic market), but, on the other hand it gives the Grain Bureau a strong influence on domestic markets and impedes competition.

It was noted that in **Lithuania** the regulation of agricultural product prices increased considerably in 1995 and 1996. Purchase quotas and minimum marginal purchase prices were set in 1996 for the main agricultural products. The other component of market price support was provided by border protection. On average, customs tariffs for agro-food products range from 20 to 30 per cent, however for some products (e.g. butter, sugar, etc.), the tariffs are substantially higher. In addition special licences are required for importing certain commodities under tariff quotas. In 1995 and 1996 temporary export subsidies were introduced to remove the surplus production of beef and dairy products from the domestic market. In 1997 the agricultural price system changed, and a new Rural Support Fund replaced the State Fund for the Support of Agriculture and the Fund for the Support of (individual) Farmers. In essence, the policy of price regulation has been altered and replaced by direct payments to farmers. Furthermore, direct payments are channelled to agricultural producers to partly offset the cost of acquiring high quality breeding stock, high quality seeds and seedlings. Together, these direct payments represented about 62 per cent of total budgetary expenditures on agriculture in 1997. While these programmes are called “income support measures”, they are not production neutral, as they are closely linked with specific products and inputs, and are not specifically targeted to low income farmers.

Although the three Baltic countries have been implementing a different range of market price support policies, the evolution of market price support shows a similar trend over the period 1993 to 1996 (Figure 2). The different policies had little influence in the period of negative MPS, when the main driving force was the real appreciation of the local currencies. Since domestic prices have come closer to world market prices (for some products), the market price support policies are increasingly supporting domestic prices. This can be illustrated by developments in 1996 when the MPS in Lithuania increased more sharply than in Estonia and Latvia. However, macroeconomic conditions (low GDP per capita, budgetary constraints, etc.) limit the potential for further agriculture and food price increases. It was pointed out that it is difficult to support agricultural prices when average household expenditure on food is around 50 per cent (Latvia, Lithuania) of total household expenditure. Experts from all the Baltic countries recognised that market intervention to support prices is too costly to the budget, and its role will be even more limited in the future. In general, both Latvia and Lithuania are switching to direct payments to producers and moving away from market price support type policies.

Figure 2. **Share of Market Price Support in Value of Production**

Per cent



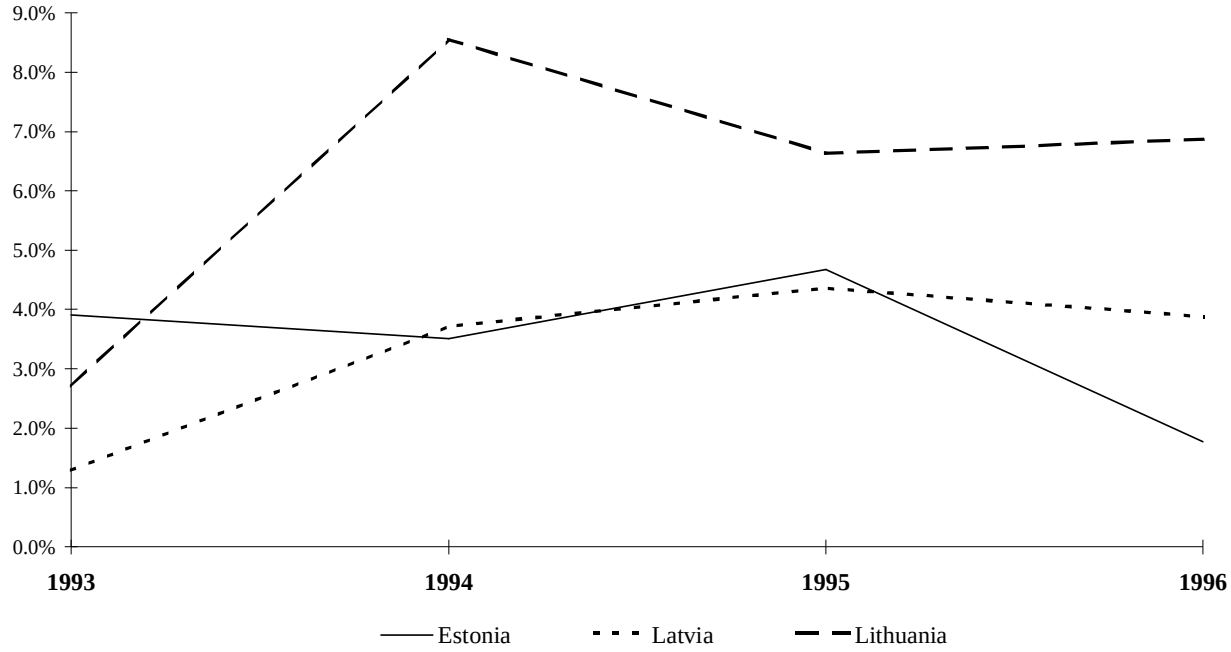
b) Other support to agriculture

Other support to agriculture represents specific budgetary expenditures supporting agriculture directly (direct payments, input cost reduction) or indirectly (general services). The level of other support, measured as a share of budget expenditures in value of agricultural production, has been relatively low for all Baltic countries (Figure 3). The policy measures which were introduced in 1997 and which are expected to be implemented in 1998 indicate a clear move towards higher budgetary allocations to agriculture. More specifically, Latvia and Lithuania in formulating their budgetary legislation have set explicit shares of 3 per cent, and 10 per cent respectively, of total budgetary expenditures to be allocated to the agricultural sector.

Participants noted that prior to 1996, **direct payments** to agriculture were limited, with Estonia having no direct payment type programmes, while in Latvia and Lithuania such programmes formed a small part of total support. In 1996 Latvia and Lithuania, and later Estonia, introduced agricultural policies which involve a large direct payment component. Many of these direct payment type programmes incorporate payments to reduce input costs and payments to improve farm infrastructures. Other direct payments are linked to specific volumes of production of certain products (Lithuania) to help compensate for the relatively low farmgate prices. Also, it was reported that the Estonian government intends to introduce direct payments for milk producers (payments per milking cow where the average milk yields are higher than 4000 kg per year), and grain producers (payments per hectare) in 1998.

Figure 3. **Share of Budget Expenditures in Value of Production**

Per cent



Several programmes financed from the state budget were aimed at reducing the cost of inputs such as fertilisers, feed and machinery. In the pre-reform period, important **input subsidies** were applied in all Baltic countries. Following price liberalisation most of these subsidies were abolished, and this in turn led to a deterioration in the terms of trade for agriculture. In recent years some of these input subsidies were replaced by direct payments to farmers in order to partly compensate for higher input prices. However, it was stressed that the main objective of these programmes was to promote greater efficiency in the sector by subsidising high quality inputs.

Another important type of input subsidy in all Baltic countries is the provision of **finance and credit support** which has been extended to agricultural producers in an attempt to overcome the shortage of capital in the sector. In Estonia this was the only support given to agriculture (up to 1995), apart from support through general services. However, in 1997 Estonia introduced for the first time capital grants. Finance and credit supports were provided through two basic schemes:

- preferential credits and capital grants financed from the state budget;
- preferential credits from commercial banks (domestic or foreign) with state guarantees and/or interest subsidies paid from the state budget.

The first type of preferential credit tended to be dominant in **Lithuania**. Under the 1997 agricultural policy framework, several possibilities exist to partially finance investments in agriculture from the state budget (25 per cent for the purchase of agricultural machinery; 20 per cent of the cost of investments under priority investment programmes; and, 20 per cent of the cost of investments in new

businesses that support agriculture in less favoured areas). In 1997, expenditures on finance and credit support programmes accounted for almost one-third of total state expenditures on agriculture.

The second type of support was more important in **Estonia** and **Latvia**. This type of support to agriculture, especially that provided through commercial banks (which approve the investment proposal and draw on their own credit resources) is less distorting, as regards resource allocation, than input specific subsidies. However, the Latvian government has indicated that it also planning to provide more financial support for investment in agriculture through capital grants financed from the state budget.

Overall evaluation and results

Most of the recently introduced support programmes in the Baltics (direct payments, credit subsidies, market price support, etc.) have been justified on the basis of inadequate infrastructures, low profitability and adverse terms of trade for agricultural products. Participants from the Baltic countries expressed this view several times during the Seminar. However, the methodological and practical difficulties of measuring the economic performance of the agricultural sectors in the economies in transitions are enormous. One particularly serious aspect of the problem is the danger of inappropriate policy decisions being made based on analyses of inadequate and misleading data. The former practice in the Baltic states (as in other CEECs and NIS) consisted of an aggregation of individual farm enterprise accounts to generate aggregate measures of what was often termed “profitability” of the sector. This practice continues to create difficulties in the generation and interpretation of meaningful economic performance indicators. Some Baltic countries (Estonia, Latvia) are now using SNA methods to produce internationally comparable indicators such as value added in agriculture, but also persist in presenting aggregate farm profitability results as reliable indicators of sectoral performance. The accounting approach also suffers from a tendency to exaggerate production costs by the inclusion of fixed factor costs (for example; land, buildings, etc.) which inevitably lead to apparent losses for the sector. This can again encourage a policy of price support or other type of support linked with agricultural production based on cost plus criteria.

Much of the discussions on the future design of agricultural policies in the Baltic countries were linked with the perspective of joining the EU. It was clear from the discussions that the Baltic policy makers are not only looking to the CAP mechanisms and levels of support, but are also aware of the necessity to compete on the EU market. In this respect, the introduction of CAP type policies is considered to be inappropriate as the CAP continues to evolve, and the main policy goal in all Baltic countries is to improve competitiveness in the whole agro-food chain. All available estimates of competitiveness at the farm level ignore the widespread problem of the relatively high transaction costs post farm gate. Products which appear to have a low farmgate price may be uncompetitive in the EU market (and international trade in general) because of these costs, which are inflated by the underdeveloped state of the infrastructure of the food and distribution chain, as well as infrastructural weaknesses in the provision of working and investment capital.

Although the current level of support estimated by PSEs is low in Baltic countries, price support policies and other support policies directly linked with agricultural production need to be implemented carefully because of their long term effects. In this respect looking for trends in the PSEs is more important than the level of support in any one year. State intervention usually results in resistance to any reduction in prices for regulated agricultural products that might be dictated by market conditions and could contribute to further pressure to extend agricultural support and protection and reduce competitiveness. Similarly, once introduced, it is politically sensitive to phase out budgetary support programmes linked with agricultural production. Experience with market intervention in OECD countries

shows that policies originally designed as temporary measures to stabilise markets and to ease adjustment problems in agriculture invariably result in increasing support and protection for agriculture. The negative consequences are well known: increasing budgetary burdens and higher prices for consumers; economic costs due to delayed structural adjustments and misallocation of resources; and reduced efficiency and international competitiveness in agriculture and the food industry. These costs have to be borne by society in one way or another, and for the economies in transition, in particular, these costs may have a negative impact on overall economic development. The economies in transition, when formulating their new agricultural policies, can learn from the OECD's experience and try to avoid such inefficient and costly policies. Improved price information systems could also contribute to greater transparency and allow markets to function better, thus reducing demand for state intervention in agricultural markets.

Session 3. Agricultural trade policies and trade relations

This session focused on agricultural trade developments, trade flows and trade relations in the region. Participants noted the different approaches taken by the three countries to the introduction and implementation of border measures on trade in agriculture and food products since independence. Concerning regional trading arrangements, high priority is given in all countries to the implementation of the BAFTA. All three countries continue to discuss possible adjustments to their Association Agreements with the EU and are at an advanced stage of negotiating membership of the WTO. The Baltic countries also have considerable interest in membership of the CEFTA, in particular Lithuania, while Estonia is still negotiating a bilateral free trade agreement with Russia.

The three Baltic countries have benefited from the rapid development of trade relations with western European countries due to their macroeconomic stabilisation programmes, efforts towards trade liberalisation and geographic proximity. During the early 1990s, Estonia, Latvia and Lithuania made strong efforts to reorient their trade in agriculture and food products to EU countries, although in more recent years the three Baltic countries have attempted to build on their traditional trading links with the countries of the FSU.

Evolution of agricultural trade measures

Prior to independence, Estonia, Latvia and Lithuania were part of the USSR and thus of the COMECON trading system, and the agricultural sector in all three countries specialised in producing and supplying livestock products to other republics of the SU. In the mid-1980s, the Baltic region supplied about 15 per cent of the Soviet Union's requirements for meat and dairy products. Following the breakdown of the COMECON, one of the most important policy goals in the three Baltic countries was to strive to integrate their trade regimes into the world trading system. Some of the most important measures implemented in all three countries included the liberalisation of domestic prices and trade, the abolition of the state monopoly on foreign trade, the elimination of export controls and the restructuring of tariff measures.

Of the three Baltic countries, Estonia adopted the most open trade regime with a completely open and liberal system for agro-food and other products. On the other hand, Latvia and Lithuania took a more cautious approach to trade liberalisation for agricultural products, and during the period 1991-1993 implemented various quantitative restrictions on exports and imports. However, since 1994/95 most of these quantitative restrictions have been reduced, and largely eliminated for agricultural products and replaced by a system of tariffs. This system consists of three broad types; conventional or MFN tariffs, preferential or tariffs under free trade agreements, and autonomous or sanctional tariffs. For example in 1995/96, Lithuania had an average tariff rate of 28 per cent on a basket of food products, while Latvia had

a tariff rate of 40 per cent on live animals and meat, 55 per cent on dairy products and 30-40 per cent on fruits and vegetables.

Apart from Estonia which has maintained a very open trading regime, agricultural trade policies in Latvia and Lithuania have been quite inconsistent across commodities. For example, Lithuania has used both export subsidies on products such as milk and meat products, and at the same time applied quantitative restrictions in the form of quotas on exports of grains (abolished in August 1997). Latvia has also applied export subsidies on dairy products, and impediments in the form of license requirements for grain exports. During the early 1990s, import and export measures on agricultural trade were relatively limited as the undervalued exchange rates in the three Baltic countries provided considerable protection to domestic producers. However, as the exchange rates have appreciated significantly in more recent years, there has been increasing pressure for the introduction of additional measures to protect domestic producers.

Participants noted that while import tariffs in Latvia and Lithuania have gradually declined in recent years, they are still significant in both countries. Part of the discussion focused on the fact that where tariffs are implemented, the revenues deriving from such measures could be used to help in the restructuring process. Unlike many of the transition economies, the three Baltic countries have not resorted to import surcharges on agricultural and food imports, while other non-tariff barriers in the form of automatic licensing have been used only in Latvia. As regards quantitative restrictions on agricultural imports, both Latvia and Lithuania have applied such measures on an *ad hoc* basis. A summary of the import and export measures that were in operation in the Baltic countries for the main agricultural products in 1996 is shown in Table 4.

Table 4. **Summary of Import and Export Measures for the Baltic Countries (1997)**

	Import Tariffs	Import Subsidies	Import Quotas	Export Subsidies	Export Tariffs	Other Export Measures
Estonia	zero	n.a.	n.a.	n.a.	n.a.	Export Market promotion
Latvia	40% (aver.tariff) dairy 55%	n.a.	grains	dairy products	n.a.	licenses for grain exports
Lithuania	28 % basket of goods	n.a.	import tariff quotas	dairy & meat products	up to 60 %	Export market promotion

n.a. Not applied

Concerning export measures, it was noted that both Latvia and Lithuania have used export subsidies on dairy exports intermittently in recent years, while Lithuania has also applied export subsidies on meat products. Also, it was reported that Lithuania had imposed quotas on grain exports in 1996, while Latvia has operated a grain export licensing system. Furthermore, all three Baltic countries have introduced various schemes for promoting agriculture and food exports.

One area of concern in all three countries is the growing demands from agricultural producers for an increase in protection to the sector in light of concerns over the low level of domestic production and the rapid growth in food imports. Moreover, the rapidly appreciating real exchange rates in all countries have eroded the competitiveness of exports and contributed to the growth in imports. The continuing

deterioration in the agricultural terms of trade has led to calls for more protection and intervention in agricultural markets. For example, participants reported that the Estonian government is considering the introduction of limited import tariffs for pork products, but as yet, no final decision has been made.

Agro-food trade flows

While agriculture's share of GDP in the three Baltic states has fallen during the transition period (estimated in 1996 at 6.0 per cent Estonia, 9.6 per cent Latvia and 8.5 per cent Lithuania), the share of agro-food in the Baltic countries' exports and imports is significant. The share of agricultural and food products in total exports fluctuated widely in all three countries during the early transition years, but it has tended to stabilise at a lower, but similar level in all three countries in 1996 (Table 5). On the other hand, the share of agriculture and food in total imports has increased in all Baltic countries with the largest increase recorded for Lithuania.

Table 5. **Share of Agro-food in total exports and imports for the Baltic Countries**

	Agro-food share of total exports (%)		**Agro-food share of total imports (%)**	
	1993	1996	1993	1996
Estonia	25	16	15	16
Latvia	17	17	7	14
Lithuania	7	18	2	13

Discussions focused on the growing imbalance in agro-food trade in all three Baltic countries. During the early years after independence all three States were net exporters of agricultural products, but since 1994 trade in agriculture and food products has been growing rapidly in all Baltic countries, with imports increasing at a faster rate than exports. More specifically, in 1996 all three countries became net food importers. While Estonia recorded a deficit on its agro-food trade balance for several years, this deficit was estimated at US$172 million in 1996, while the estimated deficits for Latvia and Lithuania were much smaller at US$67 million, and US$21 million respectively. The agro-food trade deficit contributes to the overall balance of payment deficit in the three countries and is of particular concern in Estonia. Preliminary estimates for the first half of 1997 indicate a further deterioration in the agro-food trade balance in all three countries, however, agro-food exports are expected to increase in the latter part of 1997, driven by a strong crop harvest in the region.

The product composition of exports and imports is similar for the three Baltic countries, with dairy products, livestock and meat, fish products and beverages accounting for the majority of food and beverage exports, while imports consist largely of high value-added food products, tobacco, beverages, feed grains, fruits and vegetables. Moreover, in recent years, Estonia has imported substantial quantities of beef, pork and poultry meat, in addition to feed grains. Re-exports represent a growing share of food and beverage exports from the Baltic region. An increasing proportion of food and beverage exports is attributed to re-exports, which are increasing most rapidly for Lithuania. Also, unregistered trade is estimated to be quite significant for all three countries.

Concerning the pattern of trade, Estonia, Latvia and Lithuania have recorded substantial deficits on their agro-food trade balances with the EU, which increased significantly in 1996 for all three countries. However, the Baltic countries have a significant surplus on their trade balance with the New Independent

States, in particular Russia, Ukraine and Belarus. Between the three countries, trade in agro-food products is relatively small, less than 10 per cent of total trade, as the product composition of imports and exports is very similar for the countries. However, since the implementation of the BAFTA in January 1997, preliminary estimates suggest that trade between the Baltic countries has shown some increase, with agricultural products moving from the lowest cost country in the region to higher priced neighbouring markets. Over time, the flow of agricultural products across the Baltic region is likely to result in some harmonisation of retail and producer food prices in all three countries.

More specifically, the share of agro-food exports shipped from the Baltic countries to the NIS has increased rapidly in recent years, for example, in 1996 it was estimated at 59 per cent for Estonia, 63 per cent for Lithuania and 72 per cent for Latvia. On the other hand, exports to the EU in 1996 fell to 20 per cent for Estonia, and 18 per cent for Lithuania, but increased to 15 per cent for Latvia compared to 1995. On the import side, the EU's share of agro-food imports to the Baltic countries has continued to increase and for 1996 was estimated at 64 per cent for Estonia, 45 per cent for Lithuania and 51 per cent for Latvia. In recent years, imports of agricultural products from other CEECs have also shown some increase, while imports from the NIS have fallen sharply.

In addition to a range of border measures in many agro-food importing countries, exports from Estonia, Latvia and Lithuania are constrained by a variety of domestic impediments including, inadequate market infrastructures, lack of information on health and safety standards, packaging, etc., unclear and frequently changing domestic regulations, and an underdeveloped banking and financial system. Concerning market infrastructures, deficiencies in the area of telecommunications and customs administrations have inhibited the development of trade in the Baltic region, especially trade in agricultural products. In addition, packaging, health and safety standards in the EU represent a formidable challenge for Baltic exporters. In the case of exports of livestock and livestock products, sanitary and phytosanitary measures and differences in required standards often limit agricultural and food exports from the Baltic region.

Agricultural trade relations

Integration into the global trading system has been enhanced by the implementation of multilateral, regional, and bilateral trading arrangements in the three Baltic countries. For trade in agricultural products, one of the most important areas relates to future membership of the WTO, and adherence to the conditions of the Uruguay Round Agreement (URA) on agriculture.

World Trade Organisation

Participants noted that Estonia, Latvia and Lithuania have submitted formal requests to join the WTO and are in an advanced stage of negotiating membership. Under the terms of the agreement, all-non tariff measures affecting agricultural trade will be converted to tariff equivalents, and all new tariffs are to be reduced by 36 per cent over a six year period, with a minimum reduction of 15 per cent for each tariff item. There are also provisions for a 36 per cent reduction in direct export subsidies in value terms and a 21 per cent reduction in the volume of subsidised exports over the same time period. The potential effects of the Uruguay Round Agreement on the agro-food sector in the Baltic countries are complex and depend on several factors, including domestic agricultural policies, and the extent of restructuring of the agro-food sector. For the Baltic countries, in particular, Lithuania and Latvia, adjustments will have to be made in their agricultural and trade policies to meet the commitments under the three pillars of the URA for agriculture, namely, market access, export subsidies and domestic support measures. As support to agriculture is low in all three Baltic countries (as reflected in the low PSE estimates) compared to the EU

or OECD average, membership of the WTO is expected to have a positive future impact on the agro-food sector in the Baltic countries.

Association Agreements

It was stressed that the three Baltic countries signed Association Agreements with the EU in June 1995, which effectively subsumed the benefits the Baltic countries had under the free trade agreements with the EU (which were concluded in mid-1994). In essence, the Association Agreements give the Baltic countries full status of associated countries vis-à-vis the EU and envisaged full membership of the Union at some future time. Moreover, these agreements establish a framework for strengthening co-operation between the Baltic countries and the EU in many areas including agriculture, trade liberalisation, political dialogue, technical assistance and the harmonisation of legislation. One of the key features of the Agreements is the principle of asymmetry, with special preferences given to the Associated Countries to promote exports to the EU, with the exception of Estonia. However, despite these preferences, EU agro-food exports to the three Baltic countries have increased more rapidly than Baltic exports to the EU.

Several factors were identified as impeding the Baltic countries from filling their allocated quotas for agro-food products under the Agreement. One of the major impediments relates to the lack of information and familiarity with EU procedures, which tend to be quite complex. In addition, the quarterly administration of preferential quotas tends to inhibit the full utilisation of annual quotas, especially for products which have a large seasonal component; the allocation of quotas to EU importers instead of Baltic exporters has also acted as a limitation (distribution of economic rents), as have quality standards. It was noted that at present there are no EU approved cattle or pig slaughtering facilities in any of the Baltic countries. However, the Baltic countries in bilateral discussions with the EU are attempting to reduce the most restricting impediments to trade in agro-food products.

Baltic Agricultural Free Trade Agreement (BAFTA)

The Free Trade Agreement among the Baltic countries (BFTA) was signed in 1993 and came into force in April 1994. However, trade in agriculture and food products was excluded from this agreement. A separate agreement covering agriculture (BAFTA), food and fish products was concluded in June 1996 and came into force on 1 January 1997. Effectively, this agreement provides for completely free trade in agro-food products of domestic origin. The implementation of the Agreement is likely to provide a significant challenge to all three countries since domestic agricultural policies and border measures are significantly different across the region. The three countries have chosen quite different farm support policies based on the importance of the agricultural sector in their respective economies as well as the political orientation of their country. Both Latvia and Lithuania have given a high priority to the agricultural sector and during the transition period have protected it from both domestic and external competition. Moreover, future agricultural trade policy developments in Estonia, Latvia and Lithuania will be strongly influenced by the BAFTA.

Discussants noted that with the implementation of the BAFTA, there is likely to be growing pressure for harmonisation of border measures, and domestic prices and policies across the region, as well as some movement towards the creation of a full customs union. Also, it was noted that implementation of the rules of origin regulations in the Agreement is likely to create additional difficulties. Differences in standards and certification requirements, custom procedures and regulations are likely to result in further pressure for a move toward convergence of these measures and regulations in the medium term. Finally, free flows of raw material and processed food products within the region would lead to convergence in producer and consumer prices.

The potential economic and political benefits to the Baltic countries of a relatively large free trade area for agricultural products include a large consumer market, reduced transaction costs, improved investment climate, lower consumer prices, greater opportunities to build a competitive agro-food industry through scale economies, mutual support in trade negotiations and political solidarity. On the other hand, there are costs associated with the implementation of the Agreement, as well as the loss of some degree of national autonomy in policy making. While it is somewhat premature to assess the impact of the BAFTA, preliminary trade statistics for the first eight months of 1997 indicate that trade in agricultural and food products between the three Baltic countries has increased compared to the same period in 1996.

Central European Free Trade Agreement (CEFTA)

The CEFTA is the main regional trading arrangement in Central Europe involving six members: the Czech Republic, Hungary, Poland, Romania, Slovak Republic, and Slovenia. The Agreement provides for general free trade in all products, with a gradual reduction in impediments to trade in agro-food products leading to free trade in 2000. While the three Baltic countries have bilateral trade agreements with most of the CEFTA members, only Lithuania is at an advanced stage of negotiating full membership. However, certain criteria have been set for any new member, including full membership of the WTO and an Association Agreement with the EU. Although the CEFTA allows for freer trade in many agro-food products, the agreement is less liberal than the BAFTA which allows for comprehensive free trade in all agriculture and food products.

Session 4. Future challenges and prospects for co-operation

Session 4 examined the various policy and programme successes and failures in transition economies and identified several policy areas for future co-operation, as well as emerging challenges to policy makers in the region. Discussions focused on the issue of food security in the Baltic region and the frequently misunderstood concepts of food security and food self sufficiency. It was noted that when the concept of food self sufficiency is substituted for food security, attempts to maintain a high rate of food self-sufficiency usually incur a serious misallocation of resources, including high domestic prices as well as export subsidies to dispose of surpluses. Participants also discussed the tendency in many of the transition economies to adopt CAP-type policies in their agricultural sectors. While domestic pressure in all the Baltic countries has been growing to introduce such policies, so far the Baltic countries have largely managed to avoid such policies, although policies introduced in Lithuania in 1996 have tended to move somewhat in that direction. Discussants stressed that the adoption of such policies would not only require substantial budgetary expenditures, but would also postpone much needed restructuring of the agro-food sector and the development of an internationally competitive agro-food sector.

Participants also noted the role of agriculture in rural development in the Baltic countries and other transition economies. Discussants focused on the decline in the role of agriculture in the general economy as well as the declining role of agriculture in rural areas. However, the lack of rural support services and social institutions has resulted in an additional burden being placed on the agricultural sector to provide these services in rural areas. The lack of alternative employment opportunities outside of agriculture in rural areas is of major concern in the three Baltic countries, and attempts are being made to address these problems by developing more integrated and coherent rural and regional policies.

III. Concluding remarks

A major focus of the Agricultural Policies Workshop was a cross country comparison of the similarities and differences in structural adjustment and privatisation policies; market regulations, price and income support policies; and, agricultural trade flows and trade relations. While Estonia, Latvia and Lithuania have made significant progress in overall market orientation, the degree of progress achieved in these three policy areas varies substantially between the three countries. Many existing policy difficulties remain to be addressed in the region as well as new challenges, which together, provide ample scope for closer future co-operation and co-ordination of agricultural policies amongst the countries in the region.

The discussions in Session 1 focused on the privatisation of agricultural land and the emerging farm structures in the Baltic countries. More specifically, participants noted the emergence of relatively large scale farms in Estonia compared to medium sized farms in Latvia and small scale farming in Lithuania. However, the agricultural sector in all three countries continues to face several common problems including: the adverse terms of trade for agricultural commodities, low incomes, low productivity, and in addition intensive competition on domestic and export markets. Moreover, inefficiencies in the downstream food processing and distribution sectors have impeded development of primary agriculture and reduced competitiveness. During the debate, several additional questions emerged that require further clarification including: what measures are being taken to prevent excessive farm fragmentation? what is the policy response to the increasing amount of unused agricultural land? and what policies are being used to promote competition in the upstream and downstream sectors?

Support to the agricultural sector in the three Baltic countries remains low compared to the level of support in the EU and many other OECD countries. Policies have varied substantially between the countries, from no market price support policies in Estonia to an increasing level of such support in Lithuania. However, there is growing domestic pressure in all Baltic countries for increased government budgetary assistance to the sector due to the difficult financial situation on many farms. In response, Estonia, Latvia and Lithuania have all introduced different types of direct payments and credit subsidies. Furthermore, there is increasing emphasis in all Baltic countries on policies which are aimed at developing rural areas and protecting the environment. While much of the discussions concentrated on the changing level and composition of the PSEs in the three Baltic countries, several issues emerged which require further discussion and debate, such as the lack of emphasis in the Baltic region on agricultural income support programmes and the policy implications of future membership of the EU on developments in the agriculture and food sector in the region. Another issue requiring further debate relates to current market failures (linked to the transition process) and the extent to which these failures (e.g. lack of market institutions and price information systems) have been used to justify an increase in market regulation and budgetary support to the agro-food sector.

The overarching goal of the Baltic countries has been to liberalise agricultural trade and prices and to integrate their agricultural trading regimes into the world trading system, Estonia, Latvia and Lithuania have taken quite different approaches as to agricultural trade liberalisation. From the beginning, Estonia has maintained a very open and liberal agricultural trade regime, while Latvia and Lithuania have operated a system of tariffs, quotas and licensing arrangements. All three countries have signed Association agreements with the EU and are currently at an advanced stage of negotiations regarding membership of the WTO. Despite the fact that the three countries have substantially different border measures, nonetheless, they have negotiated the BAFTA which involves comprehensive free trade in agricultural and food products. During the discussions, participants focused on border measures as well as on trading arrangements which gave rise to several interesting questions for future discussion. For example, the likely impacts on the BAFTA of Estonia joining the EU in advance of Latvia and Lithuania,

and the likely impacts on the BAFTA of Lithuania joining the CEFTA ahead of Latvia and Estonia. Other issues requiring further debate include the growing concern over health and sanitary standards and their implications for trade in food products, as well as the likely impacts of WTO membership on the agro-food sector in the Baltic region. Also, further debate is needed on ways of improving the co-ordination and harmonisation of border measures within the context of the BAFTA.

OPENING REMARKS

Andres Varik *

It is with great satisfaction that I welcome Mr Raidl, Deputy Head of the Directorate of Food, Agriculture and Fisheries at the OECD, Mrs Trzeciak-Duval, the Head of the Division for Relations with Economies in Transition, as well as Mr Kwiecinski and Mr Ryan who have been dealing in particular with the problems of Estonia. I would also like to express my sincere appreciation to the OECD for holding the present seminar.

The OECD enjoys an excellent reputation and is well-known for the high quality of its work. They are particularly well known for their accuracy, judgement, objectivity and the thoroughness of their analysis and the interest they have shown in agricultural policies in Estonia, Latvia and Lithuania is of great satisfaction to us.

I would equally like to express my appreciation to the Scandinavian countries as well as to various experts for their interest in this domain and the support they have provided for the research that has been undertaken on agricultural policies of the Baltic countries.

Although Estonia, Latvia and Lithuania distinguish themselves in many ways, for example, each has its own language (although Lithuanian and Latvian are very similar), we do share a common heritage in our agricultural policies, which is a reflection of our former ties to the Soviet Union. For this reason, it is to our benefit to participate together in this seminar

I would finally like to welcome our Latvian and Lithuanian colleagues who have faced the difficult task of reshaping agricultural policies in the face of scarce availability of resources. The Estonian delegation, which consists not only of agricultural officials but also officials from the Ministries of Finance, Foreign Affairs and Economic Affairs, and representatives from the Bank of Estonia and the scientific community, will profit from this seminar in their preparation for next year's meeting at ministerial level on agricultural policies in the Baltic countries.

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* Minister of Agriculture, Estonia.

OPENING REMARKS

Herbert Raidl *

It is a great pleasure to welcome you here today on behalf of the OECD, and to transmit the warmest wishes from the Secretary General of the OECD and the Director of the Centre for Co-operation with Economies in Transition (CCET).

I would like to thank, in particular, the Estonian Ministry of Agriculture for inviting us to hold the Workshop in this beautiful resort of Parnu for three days. I would also like to thank the policy experts and government officials from Estonia, Latvia and Lithuania who are here today, as well as experts and officials from neighbouring countries, in particular Finland, Sweden, Denmark and Poland, other OECD Member countries, and policy experts from Russia and the Ukraine.

This workshop on agricultural policies in the Baltic countries is part of the programme of work activities between the OECD and the three Baltic countries in agriculture. The workshop follows-up on the publication in 1996 of three comprehensive studies *Review of Agricultural Policies* for Estonia, Latvia and Lithuania. These reviews, in addition to providing an account of agro-food policy developments during the 1990s, also quantify the level of support to agriculture arising from a range of policy measures. A further part of the co-operative work programme involves the preparation of a country chapter for each of the Baltic countries on changes in agricultural policy developments. These chapters are published as part of the annual report *Agricultural Policies in Transition Economies: Monitoring and Evaluation*.

The main purpose of this workshop on agricultural policies in the Baltic countries is to provide the opportunity for a detailed discussion of some of the key agricultural policy issues in the three countries. This workshop provides the opportunity for a cross-country comparison of the following three issues: structural policies and privatisation in the agro-food sector; market regulation, price and income support policies; and, trade policies and trade relations in the Baltic region. The discussions and findings of this high level expert workshop will be published in a Proceedings Report which should be completed by the end of the first quarter of 1998. Moreover, the *Proceedings Report* will be used as a substantial input into the Ministerial Meeting which is scheduled to be held in the second half of 1998.

I look forward to the papers that will be presented as well as the discussions that will take place both during and outside the meeting over the next three days.

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* Deputy-Director, Directorate for Food, Agriculture and Fisheries, OECD.

STRUCTURAL POLICIES AND PRIVATISATION IN ESTONIA

V. Loko and M. Sepp[*]

I. Background

Since the restoration of Estonian independence in August 1991 and the introduction of a national currency in June 1992, the country's economy has adjusted much better to market conditions than was expected. The post-reform monetary policies of both the National Government and the Bank of Estonia have largely contributed to this development, as did the fixed exchange rate of the kroon to the German mark during the monetary reform (1DEM - 8 EEK), the latter being possible due to a strongly undervalued kroon.

Estonia has enjoyed balanced budgets and positive balance of payments from 1993 to 1996. Among the factors contributing to this situation is, for example, that even though the consumer price index has quadrupled since 1992 (in 1995 the increase was 29 per cent and in 1996 23 per cent) wages have increased in the same proportion, thus leaving real wages constant. Another example is the increasingly negative trade balance which has been offset by a positive balance in services, mainly sea transport, as well as by the balance of transfers in particular foreign aid and surpluses on the capital and financial accounts.

Liberal market and trade policies continue to receive strong support in Estonia, although there is growing concern as to how these policies are affecting the agricultural sector. Despite a 3 per cent growth in the national GDP in 1995 and 1996, this has had little impact in agriculture. Nor is it expected that should Estonia's application to the European Union be approved that this will have any effect as agriculture has played only a minor role in the present negotiations. While the Association Agreement currently in place with the EU includes food products, only small quotas have been made available for food exports to the EU.

In addition, the privatisation process and land reform laws of Estonia tend to be complicated and over-regulated. There is a limitation on land that may be purchased by large-scale enterprises so as to avoid potential problems for future development; since 1996, however, this restriction has been somewhat alleviated. Nevertheless, there continue to be disparities in the competitive conditions given to different types of enterprises. Only producers who have a turnover of under 35 000 EEK per year are exempt from income tax and those with a turnover under 250 000 EEK are exempt from value-added tax (the normal rate is 18 per cent). In so far as the land market is concerned, this is developing slowly due to the low profitability of the agricultural sector, as well as to the fact that land rent rates are approximately the same as land taxes. There have been intensive discussions on the acceleration of land reforms, but as land measurement is a slow process, there seem to be no realistic options at the present time.

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* Estonian Institute of Agrarian Economics.

In general, the transition to a market economy in the agricultural sector has been difficult. With the collapse of the Soviet Union, Estonia lost its eastern markets and the liberalisation of prices in 1992 had a significant impact on profitability and agricultural output. The large-scale privatisation processes carried out between 1993-1995 were quite extensive in the agricultural sector and its application was guided by two separate laws. The main characteristic of these reforms was the return of collectivised property to its former owners and the division of the remaining property among workers, according to the number of years they had already worked on the farm. Land reforms were characterised primarily by the restitution of land or compensation to former landowners or their heirs.

Table 1: **The status of agricultural land holdings (January 1997)**

Type of farm	Number of farms	Arable land in production (thousand ha)	% of total arable land production	Gross agricultural output, 1996 (million EEK)	% of total gross agricultural output 1996
Household plots	45 000[1]	193	21,3	2 052	29,5
Family farms[2]	22 722	319	35,2	1 630	23,5
Farm enterprises	898	395	43,5	3 262	47,0
Total	68 620	907	100,0	6 944	100,0

1. Approximate estimate.
2. These farms are called "private farms" in some classifications, although all farms today are private. They differ from enterprises in that they are owned by a single family; and they differ from household plots by virtue of their larger size. Family farms averaged about 22 hectares in 1996. All restituted lands fall in this category and it is anticipated that the number of family farms will increase at the expense of both enterprises and household plots as the remaining claims are processed.

In addition to the land area recorded in Table 1 (end of 1995), the State held 226,371 hectares of unused farmland due to the abandonment of land during the 1990s. This phenomenon has a regional dimension in that it is much more pronounced in the south-eastern part of Estonia than elsewhere.

In 1996, the Food and Agricultural Organisation (FAO) and the Estonian Ministry of Agriculture signed an agreement on a national agricultural strategy. Ten task forces were created consisting of three to five participants, each with the following missions: to examine price and trade policies, the structure of agricultural production, the food processing industry, the financing of agriculture, support for family farms, environment protection, social policy, natural resources, fisheries as well as the creation of a basis from which to build up the Ministry's capacity for policy analysis.

II. Developing different forms of entrepreneurship †

In order to protect rural life and to at least maintain the present agricultural production capacity it is essential to preserve existing forms of entrepreneurship. Two considerations must be taken into account

† The following sections rely heavily on the contribution of R. Norton, consultant with the FAO, to the FAO/Estonian report on a national agricultural strategy.

when developing agrarian policy reforms in Estonia. First, although the present structure is based on economic considerations that prevailed in the past, it is necessary to preserve this basis for a rational use of the present production base. Second, the advantages of large-scale production (the more effective use of fixed assets, realisation in bulk, etc.) cannot be ignored by policy-makers.

a) Subsidiary households plots

This category includes primarily those people who have worked in former state and collective farms. According to the present laws they can use two hectares of land situated close to their residence. In taking into consideration future perspectives, part of households plots should be transformed into private farms.

b) Re-establishment of private (family) farms

The re-establishment of the private farm system was initiated by those living in the country and working in agriculture, and since this movement began relatively few legal successors have arrived to reclaim the land. Some of those who participated in this process were fortunate enough to benefit from existing farm structures as well as favourable conditions providing machinery and inventory. Gradually, however, conditions have become more difficult, making it unrealistic to expect new farm entrepreneurs to develop. The main obstacle to growth remains the uncertain future reserved for what is considered as "subsidiary farms", and which occupy almost half of all agricultural land. The difference between the status of "a private farm" and "a subsidiary farm" is a legal one which entails a legal land registration for the first, while the second does not benefit from this advantage. This is one of the major problems to be tackled by the land reform policies.

c) Developing large-scale enterprises

In 1995, agricultural enterprises possessed on average 471 ha for field crops, approximately 600-650 hectares of field, and a total area of 1400-1500 hectares. Although in size, the number of hectares is sufficient, in a number of cases the land is fragmented and it has become necessary to find a solution for providing them with compact territory. In many cases, the secondary services (repair shops, grain storage centres) have been separated from the original farm enterprises to become independent. In such cases, it has also become necessary to find possibilities for re-consolidating these subdivisions; to date the legal-economic scope of such a reconsolidation remains vague.

III. Overall orientations for a new land reform policy

On the basis of the information presented in Table 2, it can be concluded that while the Land Reform Law of 1991 has laid the basis for the progress to date with regard to restitution of land to former owners and their descendants, this has proven to be an inadequate instrument for the privatisation of the remaining unclaimed but cultivable lands, approximately two-thirds of all agricultural land. It is clear that the fundamental orientation of a new land reform policy should be to redefine the process so that it adequately covers agricultural enterprises, household plots, and unused and unclaimed agricultural land. The present situation in which the State is the owner of two-thirds of the country's agricultural land is not viable in the long run. It does not establish a basis for improving the economic efficiency and competitiveness of the sector, which are essential for its survival.

In designing new solutions, attention needs to be paid to the weakened economic state of the sector, and consequently new forms of land tenure need to be explored, such as long-term tradable leases. The legislative framework for such leases does not presently exist, but can be created. For the same

reason, it is necessary to be realistic about the prices at which land will be sold to those who are already working it. Also, clearer guidance for local governments, especially parishes, is necessary in regard to land reform. While the process should be implemented primarily at the local level, the present framework is too flexible and therefore open to abuse at the local level.

Further consideration is required as to how to handle the flows of governmental revenues that will emerge from an accelerated land reform. Adequate formulas need to be devised for the sharing of such revenues between national and local governments, and institutional arrangements need to be made that will ensure that most of these revenues are returned to rural areas in the form of improved infrastructure and services.

Table 2: **Current Situation of Land Reform in Estonia**

Characteristic of the land	Land Claimed 25.8 % restituted already 530 000 ha restituted in future 130 000 ha		Land without claims 74.2 % For privatisation 1 722 000 ha 67.5%
Land owned or used by	former land owners and their heirs; 20.7% own and use the land, 5.1% have claimed it only		mostly the former State farms and collective farms, but there is a significant amount of unused land
Fixed assets	landowners generally own the fixed assets	land is claimed generally without the fixed assets	fixed assets acquired by labour shares
Land use objectives	agriculture and other activities	often to sell or rent the land	agriculture and other activities
Motivation to farm	moderate to high	often low	1/3 moderate 1/3 low 1/3 have lost the motivation
Technology requirements	extension, finance needed	Not known	excessive amount of labour; needs finance to change old technologies

IV. Suggestions for a Revised Land Reform

The following preliminary suggestions attempt to outline how a revised agrarian reform could be structured. They consist of five interrelated proposals that are designed to deal with the issues outlined above:

- *Proposals for unused State lands*. Following the provisions of the Land Reform Law (October 1991), all of the more than 200 000 hectares of unused and unclaimed State land should be privatised at limited or public auction. In preparing the land for selling, it is important that fragmented plots be brought together in compact farms. Sizes of parcels need to be defined for purposes of the privatisation

and they should vary, although upper and lower limits need to be established by policy. For example, it could be decided that they should not be less than 10 hectares nor greater than 250 hectares. In view of the crisis of profitability in agriculture, financial conditions similar to the following should be established for the sale of these parcels:

a) Minimum auction prices should be low, following the above discussion of land prices. It is suggested that one-half of the tax assessment value be used. It is far more important to put these lands into private hands that will use them, than to wait for an undefined period of time for a possible better price.

b) The required down payment should be 10 per cent.

c) A special State fund should be established to issue mortgages for 15 years at a special interest rate of 5 per cent, and to collect the mortgage payments for the Treasury. The mortgage payments shall be apportioned between national and local governments according to a prescribed formula.

d) In the event of serious arrears in the mortgage payments, the purchaser of the land could be given 120 days to arrange a private sale of the land to another person or enterprise who can take over the mortgage payments. Failing such a sale, and if the arrears still exist at the end of the specified period, the land will be repossessed by the State agency and auctioned again. However, by extending this transition period, the possibilities are reduced of the State having to incur the administrative costs of repossession and auction again. In addition, a measure of economic fairness is extended to the farmer who originally purchased the land and made an attempt to become viable.

e) If no buyers place bids at the original auction or sale of a piece of land, then within 90 days the parcel should be offered again at auction for long-term leasing (under a 25 year transferable lease). The minimum lease rate at the auction should be 10 per cent of the minimum sale price specified in step a) above.

f) If there are no bids in the leasing auction either, then the parcel should be retired from the market, and the process should be started again one year later with a new auction.

- *Creation of the legal framework for leases*. The legal figure of a 25 year transferable agricultural lease needs to be created. Under such a figure, the leasehold should have full rights to produce, invest in the land, sell part or all of the lease, or sub-lease all or part of the lease, subject to being current on the lease payments. The State agency created to handle the mortgages under point 1) above should manage the leases on State land and collect the lease payments for the Treasury and local governments, to be apportioned between them according to a prescribed formula. The legislation creating the framework for long-term leases should make it clear that such leases may be used for loan guarantees and that financial institutions may take possession of the lease in the event of default. (This kind of clause is subordinate legally to the interest of the State over that of a private lending institution.) At the expiration of a 25-year lease, the parcel should be auctioned for sale again, but the last leaseholder should be given the right to equal the highest bid for the land, thereby becoming its owner.

- *Privatising lands of agricultural enterprises*. Notwithstanding the auction procedure followed for unused State land which is not claimed by previous owners (see above), a different procedure is recommended for the land of agricultural enterprises which has not been claimed by previous owners.

The principles governing the "privatisation" of enterprise lands could be developed along the following lines:

a) The current members of the enterprise, as defined by holders of labour shares, or stock shares if a shareholding company has been created, should be empowered to decide the form in which the land shall be privatised (by type of parcel), according to the options described in paragraph d) below.

b) The current members of the enterprise would have the first right to possession of the land. Only in the event of their unwillingness to enter into the corresponding financial obligations, and keep current on them, should the land be auctioned.

c) The initial form of possession of the land could be 25-year transferable leases. At any time after the fifth year, the leaseholder would have the right to convert the lease to a mortgage, and he or she (or the enterprise) would be credited with the sum of lease payments made as a down payment on the purchase. If such right is not exercised during the lifetime of the lease, then at the end of the 25 years the land would be sold at auction. Again, the last leaseholder would have the right to equal the winning bid at the auction.

d) Regarding the form in which the land of the enterprise shall be "privatised" by the above procedures, the holders of labour shares in the enterprise, or stock shares if a shareholding company has been created, should decide on its form by vote (1 share = 1 vote), choosing among the following three options:

- Privatising all the land of the enterprise as a single entity.
- Dividing the lands into a minimum of two and a maximum of five parcels, each of which would be privatised.
- Dividing the land completely into parcels, one per member of the enterprise according to the number of shares that he or she holds.

The new State agency in charge of leases and mortgages should bear the cost of surveying and registering the parcels, under all options.

- *Titling household plots*. Holders of household plots should be given full freehold title to their plots, and all the costs of surveying and titling should be covered by the state. No price should be charged for the plot as long as it does not exceed three hectares, and the holder of the plot is a current or former member of a State farm or collective farm. The legislation in this area could allow an additional area from three to a maximum of five hectares to be leased or purchased by the household, under the price conditions described in sub-sections 1) and 2) above (one half the tax assessment value, 10 per cent down payment in the case of purchase, etc.). Area beyond 5 hectares would not be considered part of the household plot for purposes of the land reform.

- *Titling procedures*. Titling procedures and procedures for registration of land in the cadastre should be modernised and accelerated so that all agricultural properties, leasehold and freehold, enterprises and family farms and household plots, are surveyed and recorded in the Title Book within five years.

- *Municipal lands.* In the case of State agricultural land which is both unused and unclaimed, it could be desirable to allow transfer of portions of it to parishes and counties for educational, scientific and recreational uses. Perhaps up to 100 hectares per parish and 1 000 hectares per county could be transferred at no cost for such purposes, provided that the land is determined to be both unused and

unclaimed as of a given date. A policy of this nature should be co-ordinated with the proposal to create local forests for public uses.

Clearly, variants of these approaches could be considered, but the essential conclusion is that it is necessary to revise the existing land reform legislation so that it deals more adequately with the cases of agricultural enterprises, household plots and unclaimed lands. Approaches along the lines indicated above would finally integrate the agricultural reform and the land reform, as well as laying a basis for agricultural growth and improvements in efficiency. They would also make a strong contribution to alleviating rural poverty and the associated rural social problems.

Auctions of land, for sale and for lease, and the other administrative measures proposed above would be carried out mostly by local governments and by parishes with the co-operation of counties. However, the national Government would have a supervisory role. By its nature, land policy must be carried out mostly at the local level, but for an issue of overriding national importance like the land reform, it is essential that local governments be given more guidance by national legislation and national authorities than they have been given so far in this process. The idea of Land Capital has been developed in agricultural strategy; it is not, however, possible to analyse it here.

V. Structure of food industry

In order to present a better analysis of the present situation in Estonia, Table 3 presents a general comparative overview with Finland. Certain differences between the two countries' economic situation should be kept in mind. In Estonia, the share of milk processed is 67 per cent, and in Finland 96 per cent; the share of meat is 57 per cent in Estonia and for Finland it has been estimated at 100 per cent. This means that the share of employment in the Estonian food processing industry is underestimated when compared with Finland. The Estonian milk and meat-processing industries are probably producing more processed products than the figures indicate. For example, although the share of whole milk products is higher in Finland, where processing is cheaper, the Estonian milk processing industry also uses imported milk products for re-export, but which is not included in the data concerning the quantity of milk processed. However, imported meat was included in the Estonian data.

The following conclusions may be drawn on labour productivity. Although the share of employees in the population working in the food processing industry is twice as high in Estonia than in Finland, labour productivity in Estonia is two times lower. This estimate should be considered as a minimum due to higher living standards and consumption of food products in Finland, and, as mentioned earlier, the fact that a large percentage of milk and meat products are not processed in Estonia.

By value of production, labour productivity in the Estonian food processing industry is 10,9 times lower than in Finland, in the meat processing industry 12,4 times lower, and in the milk processing industry, it is 9,8 times lower. Compared with product quantity, this means that meat product prices are 4,5 times higher in Finland than in Estonia and milk product prices 4,6 times higher.

Table 3 : **Comparison of the food processing industry in Estonia and Finland**

	Estonia 1995	**Finland 1994 EEK 1FIM=2,65EEK**
Population	1 476 301	5 120 000
Food processing industry total employees	**26 970**	**48 060**
Percentage of population	1,83	0,94
production mill.	7 554	146 815
per employee	280 082	3 055 450
fixed assets mill.	3 252	80 512
per employee	120 578	1 675 245
Meat processing employees	**4 233**	**10 492**
Percentage of population	0,29	0,20
production mill.	1 241	30 160
per employee	293 148	2 875 250
fixed capital mill.	772	
per employee	182 377	
processed meat	54 000	306 000
ton per employee	13	29
meat consumption kg/person	50	61
Milk processing employees	**4 126**	**7 235**
Percentage of population	0,28	0,14
production mill.	1 883	40 924
per employee	456 346	5 656 385
fixed capital mill.	481	
per employee	116 578	
processed milk	472 300	2 200 000
ton per employee	114	304
milk consumption kg/person	291	
Wages in food processing per year	**35 000**	**336 550**

The Finnish food processing industry has 13,9 times more fixed assets per employee than Estonian, and this may be the result of a higher level of prices for fixed assets as well as a higher level of fixed assets per employee at fixed prices.

In 1995, wages in Estonia were approximately eight times lower than in Finland, which may be considered as an average labour productivity difference between the two countries' economies as a whole.

Finally, it would appear that the Estonian food processing industry has (compared with Finland), a higher labour productivity than the economy, on average.

VI. Food industry privatisation

The privatisation of state enterprises has been the most important economic measure after price liberalisation in the transition period. As a first step, the enterprises concerned were transformed into state joint stock companies. After that, the real privatisation of the agro-food sector started and reached its peak in the 1994-1995 period.

Three methods were used for the privatisation process:

- offer for sale of the property of an enterprise, its components or its stock by a tender with preliminary negotiations;
- offer for sale of the property of an enterprise, its components or its stock by a public of restricted auction;
- public sale of shares on the stock exchange.

In some cases, enterprises were privatised as joint ventures (by the state investing the assets as equity into a newly established company) or being declared bankrupt under the terms of the Law on Bankruptcies. During bankruptcy proceedings, if the enterprise remains insolvent, the receiver may sell the property of an enterprise to the buyer who offers most money. Under the bankruptcy legislation, Pärnu Milk Combine, Tallinn Milk Combine and Võhma Meat Combine were privatised.

There has not been any physical restitution of property of upstream and downstream industries.

As regards the privatisation of large enterprises, the most intensive period was in 1994-1995. The Estonian Privatisation Agency (EPA), established in September 1992 along the lines of Germany's Treuhand, is in charge of privatising medium and large state-owned enterprises. The EPA is funded by the state budget and was originally attached to the Ministry of Finance. After the 1995 elections, however, it was placed under the control of the Ministry Economics.

The agro-food sector was subject to certain exceptional provisions that did not apply to other sectors. They were set out in Article 32 of the Law on Privatisation and concerned in particular state-owned grain mills, milk and meat processing enterprises and Estonian Agricultural Machinery (EPT). According to Article 32, preferential treatment in buying upstream and downstream enterprises was given to co-operatives formed by those who use inputs produced by upstream sector or who produce agricultural products for processing. These so-called processing co-operatives consisted of different farms such as family farms, household plots and/or co-operatives with the same product specialisation. Very often, they had been especially established for the privatisation of corresponding downstream industries.

VII. Structure of food enterprises

There are many small producers in this sector. For example, at the beginning of 1997 28 milk processing and 184 meat processing businesses were registered for veterinary licences. The Statistical Office of Estonia also publishes data for large-scale (over 50 employees) producers (see Table 4).

Table 4 : **Industrial sales by field of activity**

Field of activity	Number of enterprises	Sales 1995, million kroons	Sales total industry million kroons	Share of large enterprises %
Total	**604**	**20994,4**	**26004**	**0.81%**
Manufacturing	578	17148,7	21349	8.0
manufacture of food products, beverages and tobacco products	119	6839,3	7609	9.0%
production of meat and meat products	15	1062,5	1232	8.6
production of fish and fish products	19	983,1	1072	9.2
manufacture of dairy products	20	1760,9	1886	9.3
manufacture of grain mill products	5	67,5	80	8.4
manufacture of prepared animal feeds	5	280,4	294	9.5
manufacture of bakery products	18	653,3	756	8.6
manufacture of beverages	23	1563	1563	10.0

In 1995, 119 large-scale enterprises in the food processing industry (over 50 employees) accounted for 89,9 per cent of the total amount of sales; the average production amount was almost 60 million kroons per enterprise. Food processing is more concentrated than other activities and there has been a recent tendency towards further concentration of the processing industry, particularly in milk processing. In 1996, for example, the milk processing concern "*Ühinenud Meiereid*" (United Milk Processors) was created and includes three of the four largest enterprises and processes approximately half of Estonian milk. It also intends to establish milk processing subsidiary in Russia. Milk processing co-operatives belonging to milk producers have created a central co-operative which processes approximately 20 per cent of Estonian milk.

The food processing group ETFC was also created and has become the largest meat processing enterprise in Rakvere (half of Estonian meat processing capacity), the third largest in the production of milk, the largest pork producing enterprise, etc. In May 1997, the Rakvere meat processing enterprise purchased a meat processing enterprise in Riga which produces 20 per cent of meat processed in Latvia.

There are very little statistical data on upstream industries. As a general rule, these enterprises have been privatised and, in most cases, have adapted to the new conditions.

In conclusion, although there are major structural problems in Estonian agriculture, it is the problems related to profitability that are of major concern. Structural problems related to up- and downstream industries do not need state interference.

AGRICULTURAL BRANCHES AND TYPES OF ENTREPRENEURSHIP

Òina Rijniece *

Since the last meeting in Paide, Estonia, significant developments in the agricultural sector have taken place in Latvia. In particular, the Agricultural Law was passed on 10 September 1996 at the plenary sitting of the Saeima (Latvian Parliament). In protest against governmental agricultural policy, a meeting was organised by the Farmers Federation to coincide with this plenary session. As a result, it was decided that a new conception of the development of rural environment and agriculture should be developed and presented to the Cabinet of Ministers by 31 March 1998. The Cabinet has since accepted a national programme for the development of small and medium-sized enterprises (SME) and in June 1997, adopted the law "On regions lagging behind".

Ministers were in fact concerned with the problems of Latvia's pre-accession process into the EU and the government's ability to adapt to the EU Common Agricultural Policy. It is not yet clear how agricultural policy will develop in the future. One of the main pre-conditions for becoming an EU member is a functioning market economy. One of the principle problems to be resolved pertains to forms of ownership -- private or national -- and how this will be successfully applied to the privatisation process.

Privatisation and land reform in Latvia have been ongoing since 1991. Land reform began with the transformation of the former large-scale collective farms into 613 share-holding companies; only 130 continue to operate today and they occupy only 8 per cent of agricultural land. At the same time, there are about 300 000 private farms and subsidiary plots (homelands) occupying 90 per cent of agricultural land. The average size of private farms is 23,6 hectares (13,6 ha of agricultural land).

The privatisation of secondary production -- processing of primary agricultural production (milk, meat, grain, etc.) -- began at the end of 1992 and was conducted according to five special laws. The privatisation of the milk processing industry had already begun prior to this date when 75 milk collection centres and primary processing enterprises were transformed (without compensation) into co-operative companies. Later, 15 large milk-processing plants were privatised. Co-operative companies had the possibility to purchase up to 70 per cent of stocks, but for grain processing and bread producing co-operative companies and their unions this was increased to 75 per cent. However, due to lack of money and misjudgement, the quotas have not been fully purchased.

* Ministry of Agriculture, Latvia.

		Number	Total area (thous. ha)	Percentage	Agricultural land (thous. ha.)
1.	Farms	94 905	2 238.5	58.6	1 297.9
2.	Households	156 600	1 241.8	32.5	765.6
3.	Household plots and gardens	166 000	142.4	3.7	119.8
4.	Individual orchards	81 902	7.4	0.2	5.4
5.	Companies	474	146.6	3.8	112.8
6.	Specialised State companies	81	27.5	0.7	18.9
7.	Other types of entrepreneurship	631	16.5	0.5	8.9

There are, at present, approximately 300 000 private farms and subsidiary plots as well as about 500 agro-food processing enterprises. The privatisation of all sectors began on an equal footing, but the best results have been achieved by those enterprises with effective and competent management, as well as by those who have formed partnerships with foreign enterprises.

Currently, 31 per cent of Latvia's inhabitants live in rural areas. Agricultural production and other connected branches provide employment and income to one-third of the country's working population. Substantial changes have occurred in the types of ownership which today is dominated by the private sector. Private enterprises employ 88 per cent of the agricultural labour force whereas State enterprises employ only 12 per cent. The following data characterises the rural situation in Latvia:

- Agriculture employs 17 per cent of Latvia's labour force;
- Income for rural inhabitants per capita a year is 175 lats;
- Agriculture accounts for 9 per cent of the GDP;
- Efficiency of agricultural production compared with other branches is twice as low.

With respect to the restructuring of agriculture in Latvia, there are two dominating tendencies:

- it is inevitable that the number of those employed in agriculture will decrease (in Europe this figure has decreased from 20 per cent to 5 per cent on average);
- the best possibilities for development are those farm enterprises able to implement the so-called *economies of scale,* as well as the modernisation and development of production.

Hence, the main tasks for the Structural Funds for Rural Development would be the following:

- to support modernisation of conventional farms and diversification of agricultural production;
- to create possibilities for alternative employment in rural areas and to support SMEs.

It is clear that the concept of *agricultural development* should be changed to *rural development.*

A vital question concerns the definition of *countryside.* Several elements define this word. First, countryside is synonymous with food; it is also associated with the maintenance of ethnic culture and

community. We could also add that sustainable rural development is not possible without the maintenance and utilisation of forests -- a very important element of the rural environment.

We are presently searching for alternative opportunities of employment for rural inhabitants in other branches of management which provide new sources of income. It is important for Latvia to use all possibilities provided by the EU Structural funds, as well as *Rural Development Project* of the World Bank (credit line). As of 1998, new state subsidy programmes will be implemented in Latvia. These programmes will include support for the maintenance of rural landscapes, as well as the restructuring, diversification and development of agricultural and other rural enterprises, particularly for SMEs, rural services, the utilisation of local resources, and rural tourism.

STRUCTURAL CHANGES AND PRIVATISATION IN LITHUANIA'S AGRICULTURAL AND FOOD SECTORS

Arvydas Kuodys *

I. Introduction

Lithuania, like other Central and Eastern European countries, is reforming old policies and preparing new legislation in view of eventual integration into the European Union. The significant changes this implies to the country's agricultural policies have provoked heated debates. Although the role of agriculture has diminished since 1990, it along with forestry continue to be central sectors of the Lithuanian economy, producing nearly one ninth of the GDP and employing a fifth of the country's workforce. In addition, agricultural and food products make up approximately 18 per cent of Lithuania's export. In essence, national agricultural development ensures a dynamic countryside, it guarantees food supply, and it ensures the country's stability and independence.

The rural population of Lithuania, in contrast to many other countries, is actually increasing. Despite a decrease in the birth rate and an increase in emigration, urban and rural reforms have obliged some city-dwellers to move to the country. Today, close to one third of the population lives in rural areas.

Until 1990 the level of food consumption was quite high in Lithuania given the relatively low food prices. Since 1991, however, consumption patterns of all food products, as well as the food products themselves, have been changing with an increasing emphasis on vegetarian food. Food expenses still comprise, however, more than half of the family budget, though this is slowly decreasing. In comparison to 1990, consumption of meat and diary products in 1996 increased between 44 and 48 per cent, the consumption of bread and cereal products by 25 per cent and that of vegetable oil and margarine by close to 50 per cent.

Although agricultural production in Lithuania is decreasing, this sector is still capable of supplying the population with the main food staples. However, it should be noted that if food consumption was to comply with Western nutritional norms, there would be a scarcity of some products. Therefore, the current food surplus is a relative one.

II. Structural changes to agricultural policy

Structural changes in the agricultural sector began in 1989 when the Law on Peasant Farm came into effect. According to this law, those people wanting to establish a farm could receive up to 50 ha of farmland with the restriction that they could not sell the land. Since the fall of 1989, close to 5 000 such farms have been created and their level of production has been satisfactory.

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* Lithuanian Institute of Agrarian Economics.

The decision to expand the personal home farm programme was taken in 1990 with the intention of strengthening the farmers' independence vis-à-vis former leaders of collective farms and Soviet kolhozes. Accordingly, farmers were allowed to increase their farm acreage by up to three hectares with the result that farms became significantly larger. For the unemployed, this programme has also been beneficial in that they have been able to take up a productive activity. Two handicaps, however, characterise this programme. First, many former landowners are confronted with difficulties when trying to regain their property rights, and, secondly, there are too many small-scale farms whose size implicate a low-level of production capacity and limited personnel (usually limited to family members), although they do contribute to the overall production level.

III. The privatisation of agricultural enterprises property

The basic agricultural reforms began in early 1992 with the privatisation of the Kolhozes' property and collective farms, as well as the return of land to former landowners or their heirs. The privatisation of agricultural enterprise properties was quickly, but painfully, implemented. Whereas before 1993, 12 000 agricultural enterprises existed, these were replaced with 6 000 new enterprises, of which 4 500 received the status of "agricultural company". These are co-operative type share companies which lease land from landowners or the State, with the enterprise itself belonging to its workers.

IV. The privatisation of land

Although the privatisation of agricultural property is over, the privatisation of land is continuing. There are several reasons as to why this has taken longer than anticipated. Until early 1997, 230 000 decisions were made concerning either the return of property rights or its equivalent, or for providing former landowners with compensation in lieu of regaining their land ownership. Though different forms of compensation were offered: cash, forests, peat-bogs, shares in newly-privatised industrial enterprises, housing lots, etc., people have been reluctant to take this as the State budget does not in reality allocate the means necessary to provide cash compensation to pay for the land. In general, a large part of agricultural land has not been returned to former landowners or their heirs.

There is hope, however, that after approval on 1 July 1997 by the Parliament of the Republic of Lithuania of the Law on the Restoration of the Property Rights for the Remaining Real Estate in Lithuania, land return procedures will be quicker and less complicated. The Law of the Land that has been in force since mid-1994 gave the right to landowners to sell, give, mortgage or lease their land thereby creating a market for land. However, given the lack of financial resources, agricultural land is not actively traded, although there are some exceptions such as in urban areas and regions where fertile land is available. Approximately half of the landowners lease their land to agricultural companies or natural persons and either postpone farming themselves or look for an opportunity to sell their lot. Due to lack of demand for agricultural products, however, the rental price can be low in the poorer regions and too much land remains unproductive for no apparent reason. There exist, as a result, good opportunities to buy land in bulk with the prospect of selling it at a good price in the future.

V. The establishment of agricultural farms

The establishment of agricultural farms depends on the pace of restoring land property rights. These types of farms are increasing, but the actual figure is difficult to determine as many properties are not officially registered. At the beginning of 1997, nearly 200 000 landowners owned 38 per cent of the

farmland. They cannot, however, all be considered as farmers as the average size of the farm is approximately 7.6 hectares. As of January 1997, there were 47 000 registered farmers in the Farmers' Register, but it is expected that once the Rural Support Fund, established in early 1996, begins operating at full speed the actual registration of farmers will increase. In 1996, they produced 21 per cent of the total food production, of which 42 per cent was sugar beets, 31 per cent grain, and 18 per cent potatoes. Farmers did not produce much meat because they lacked a solid financial base from which to invest. In 1996, they produced 18 per cent of the country's milk consumption and 15 per cent of the country's meat consumption. It has been estimated that the largest harvest of grain, sugar beets and potatoes came from the larger farms (30-50 ha and larger), but these farms are not numerous.

Lithuanian farms are only beginning to be modernised. In comparison to West European farms, they have two to three times less technology with the result that productivity remains low with much of the work still being done manually or with out-dated technology. The Rural Support Fund foresees not only the development of farms, but their financial/technological base as well.

Co-operatives have also developed slowly in rural areas, even though the programme on the Development of Agricultural Co-operation was prepared several years ago. At present, only 200 registered agricultural co-operatives exist, most of which are small in size with an equally small turnover. This is due not only to a psychological factor impeding development of co-operatives, but also to an unfavourable tax system and laws. Though the State, through the Fund of Rural Support, supports these types of farming co-operatives, it has become apparent that legal changes are necessary.

VI. Agricultural companies

Agricultural companies created from former agricultural enterprises before the reform took effect have made a huge impact on agricultural production and particularly in providing services to residents of rural areas. In 1996, they used 24 per cent of the land and their contribution to the total agricultural production was 27 per cent (it decreased by 3 units). At the beginning of 1997, they owned 38 per cent of the livestock, 48 per cent of pigs, and 24 per cent of Lithuania's horses. They produced 47 per cent of the country's meat production and 16 per cent of the milk production.

Between 1993 and 1996, the number of agricultural companies still in operation was reduced by half. The main problem confronted by these companies stemmed from the varied interests which motivated the participation of their members and the lack of strong management to resolve problems arising from these conflicts. At the time these companies were created, they were comprised of the same co-operative workers as under the socialist system (only those who wished to become independent farmers did not take part in this transfer) so that although the system was new, the mentalities themselves did not change radically. Many members did not feel as if they were truly part-owners of the company's property and consequently did not try to improve the quality of their work. The more active members, who usually owned a smaller number of shares, were interested in earning more and were dissatisfied with those who did not work, yet received dividends and continued to receive many services from the company (personal agricultural cultivating land, harvesting, etc.) thereby creating an expensive financial burden on the company. In addition to these two groups, there exists a third group made up of people who wish to leave the company and receive their shares in the form of cash at the current land market value. It is difficult to co-ordinate these different interests, particularly in view of the fact that many heads of company are ill-suited to their position.

In analysing the data of agricultural companies leasing land in 1995-1996, it is possible to observe the following trends: the number of workers decreased by 8 per cent, income increased by 45 per

cent and profit increased by 73 per cent. Although there was also an increase in short-term debts, the percentage of the increase was three times smaller than the profit margin.

After dividing these companies into four groups based on their profits, nearly 30 per cent suffered losses in 1996, 3.4 per cent had neither profits nor losses, 61.3 per cent increased profits up to 100 000 Lt, and 5.7 per cent increased their profits by over 100 000 Lt. Therefore, one third of these companies did not gain any profits but continued to receive the same credits as before, thus earning an income despite failing to cover their production costs.

There are few financially healthy companies, yet these are expanding their activities, leasing more land, and re-organising the structure of the company. In well organised companies, the number of members is decreasing due to a greater concentration of shares allowing for the development of financially strong individual farms which hire workers rather than depend on the work of family members.

VII. The privatisation of food industry enterprises

The Law on Primary Privatisation of Country's Estate, which came into effect on 1991, marked the privatisation of the food industry and agrarian services. As was the case in the privatisation of agricultural companies, shares were distributed among workers in the food sector with workers having the right to purchase up to 30 per cent of the enterprise. The privatisation process, however, has been a slow one. In order to obtain foreign currency, ten enterprises were put up for sale in 1992, but only two, namely Kaunas confectionery and Klaipeda tobacco factory, were privatised in this way. The others did not attract much foreign attention.

In 1992 the Government enacted a special law on the privatisation of enterprises that process agricultural products and provide agrarian services. This law stipulated that half of the enterprise could be owned by the producers of agricultural products and the people who were using agrarian services. The number of shares allowed to be purchased was based on the amount of agricultural production sold to the enterprise that was being privatised and the value of the services that the enterprise provided to the farmer. This was inspired by the desire to promote vertical integration of the producers with the processing industry as well as the structures of agrarian services. After obtaining 50 per cent of the shares, farmer-shareholders could participate in the management of these enterprises, including the sale of the produce and the distribution of profits.

During the first stage of privatisation, which lasted from the fall of 1992 until the spring of 1994, farmers were passive because shares were too expensive and their purchase was a complicated process, particularly for agricultural companies. The capital of 30 per cent of milk enterprises, 13 per cent of grain enterprises and 8 per cent of meat enterprises was sold.

The second stage of the privatisation process began during the summer of 1994. As an incentive, shares were sold at 2.5 per cent of their nominal value to agricultural land users. As a result, the level of privatisation exceeded 50 per cent as two fifths of the enterprises were privatised.

The third stage of privatisation began in 1995. The price of the shares at this stage remained the same for farmers as in the second stage, but the quota of the share purchased increased fivefold.

The level of privatisation among independent enterprises is not the same. Nearly 90 per cent of the capital has been sold, with half of the enterprises having sold all their allocated shares to agricultural producers. Private capital reached 95 per cent in grain enterprises and farmers make up for 44 per cent;

meat enterprises have respectively 93 per cent and 32 per cent, milk enterprises respectively 77 per cent and 31 per cent, and sugar enterprises, 46 per cent and 45 per cent.

The full production capacity of most enterprises and industries is not used due to the restrained market for their goods. As well, the lack of investment does not allow for some of these enterprises to update their equipment and a considerable part of their estate is in debt. A serious competition between huge enterprises and newly established individual and co-operative enterprises has begun. This is exemplified by the meat industry where several hundreds of small enterprises exist in addition to ten huge companies which account for one fifth of the production capacity. In recent years nearly 100 small grain processing enterprises were created and process nearly one third of cereal products. The concentration of production is also seen in the dairy industry. One third of the big enterprises process nearly 70 per cent of the milk. Nearly half of the dairy enterprises had losses in 1996 and gradually became subsidiaries of the big enterprises or changed their activities' to become centres of milk distribution.

Government attempts to integrate farmers and enterprises belonging to the processing industry have not yet had any results. Only one large dairy enterprise was reorganised into a co-operative in the spring of 1997 under the initiative of its president. Although farmers are attracted by the idea of co-operation with industry, they are not well organised and cannot significantly influence the decision-making of the enterprises. They are also hesitant to co-operate with suppliers of raw materials as there is no lack of such resources.

VIII. Agricultural policy

The agrarian policies of the Lithuanian Government have much in common with those of the European Community. This is reflected in the Government's programme as well as in the national programmes of the Development of Agriculture and the Support of Agriculture and Farmers. Ten per cent of the State budget is allocated to support agriculture. To date most of it is has been allocated for the implementation of the tools necessary for the economic regulation of the agricultural market and towards maintaining the income of agricultural producers. At the same time, structural reforms have also taken place. Funds from the Rural Support Fund are used to help farmers establish themselves, to promote co-operation, to modernise farm equipment, to help develop an agricultural policy respectful of the environment, to promote research and quality development, as well as to expand their exports and implement consultation systems for agriculture. Farmers from poorer regions are encouraged by the Rural Support Fund to restructure their activities in order to become less dependent on the fertility of the land. Production of traditional and non-traditional products, the development of professions and trades, and the development of tourist attractions in rural areas are also foreseen in business plans. Regional policy will be gradually developed on the basis of State policy, but this will require greater efforts and qualified decisions complying with the future realities not only from the agricultural sector, but other sectors as well.

AGRICULTURAL PRIVATISATION, LAND REFORM AND FARM RESTRUCTURING IN CENTRAL AND EASTERN EUROPE

Johan F.M. Swinnen and Erik Mathijs *

I. Introduction

This paper presents a comparative analysis of agricultural privatisation and transformation policies, land reform, and resulting changes in farming structures in Central and Eastern European countries (CEECs). The paper summarises some of the insights and conclusions of two research projects, the results of which are published in greater detail in two edited volumes: Swinnen (1997a) and Swinnen, Buckwell, and Mathijs (1997).

II. Agricultural privatisation and land reform

a) Observations on agricultural privatisation and land reform

Restitution of farmland to former owners is the most important process of land reform (in terms of share of total agricultural land) in the CEECs (Table 1). Typically, the reform laws specify that former owners are restituted, if possible, the land within historical boundaries. Otherwise, they receive property rights to a plot of land of comparable size and quality. With the exception of Poland and Albania, an important share of farmland has been restituted to its former owners in all CEECs. In Albania, collective farmland property rights have been restituted to former owners in some mountainous regions.

In the Former Soviet Union (FSU) land is restituted to former owners in the Baltic countries only. Russia and Ukraine distribute land in two forms. The most important of the two is the distribution of collective and state farmland equally per capita among collective farm members or state farm employees in the form of paper shares or certificates. Outsiders who are not entitled to land shares can receive land for private farming from a special state reserve established for this purpose (15-20 per cent of TAL).

There is an important difference in land reform procedures between collective farmland and state farmland in CEECs, but not in the FSU countries. In the latter, the reforms treat collective and state farmland in the same way. In CEECs, collective farmland is generally restituted to its former owners. The main exceptions to restitution of collective farmland are found in Hungary and Albania. In Hungary, one third of collective farm land is auctioned for compensation bonds, and another third is distributed among farm workers. Albania distributes its collective farm land among rural households. In the majority of CEECs, state farmland is leased, pending sale of the land. For example, nationalised land in

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East Germany is managed by the Land Utilisation and Administration Company (BVVG) and leased to former owners who lost their ownership titles to legal entities. The main exceptions are the restitution of state farmland in Slovenia and the distribution to farm workers in Albania.

Whereas land has mostly been restituted in-kind, this has not been the general rule for other assets. Non-land assets have been restituted in some countries, but in many cases were privatised using vouchers that could be turned into capital shares in the new co-operative farm or used for purchasing non-land assets for private use. The distribution of those vouchers was the subject of much debate. In general, the principle was that members (or their heirs) who had contributed land, labour, or other assets to the co-operative over the forty-five years of its existence should receive some share of the remaining assets. To implement this policy, an inventory of the co-operative's assets, their value, and a formula to determine the shares of each contributor was required. Both aspects posed great difficulties.

b) Determinants of agricultural privatisation and land reform policies

Four historical-institutional factors are key determinants of the choice of the privatisation and land reform policies in CEECs: *(1)* the post-collectivisation asset ownership status, *(2)* the ethnicity of the pre-collectivisation asset ownership, *(3)* the equality of pre-collectivisation asset distribution, and *(4)* the length of Communist rule.

i) Legal asset ownership

All agricultural assets which were still legally privately owned in 1989 have been restituted in all CEECs. The principle that agricultural assets which were formally still privately owned are restituted to their formal owners explains the following observations.

- Differences between CEECs: where land is not restituted to former owners (such as Albania, FSU and Poland), the land was state owned.
- Differences within CEECs: where part of the land is restituted (e.g., Hungary), the difference is due to legal ownership.
- State farm land is often not restituted when collective farmland is (as state farmland was) mostly state-owned;
- In several CEECs, the base for land restitution is the ownership distribution after the land reform(s) implemented under Communist dominated governments after World War II.
- The difference between the treatment of land and non-land assets.

ii) Ethnicity

The privatisation policy choice affects the distribution of asset ownership between ethnic groups. A general observation is that agricultural assets are not restituted to former owners who are, or have become, foreigners. This factor is important in explaining the difference between the privatisation of state farm land in Poland (sales and leasing) and in Slovenia (restitution), with both countries having a very similar pre-1989 agricultural structure.

The choice of the privatisation process also affects the distribution of (agricultural) assets between ethnic groups within the country. Intuitively, one would expect that this motivation would lead to the choice of a privatisation policy which transfers property rights mostly to the ethnic majority for the same reason that foreigners do not receive land. However, this was not always the case because it depends on the influence of ethnic minorities on the political economic equilibrium. An example where the privatisation choice benefits ethnic minorities is found in Bulgaria where the allocation of a high

share of non-land assets to 'labour contributions' was partly to placate the Turkish ethnic minority, largely employed in agriculture and not eligible for much land, while being an important political force. An example of where the privatisation choice was used against ethnic minorities is found in the Baltics where the restitution of land allocated assets to native citizens in the presence of large ethnic minorities.

iii) Equality of pre-collectivisation asset ownership

Equality of pre-collectivisation asset ownership determines the potential conflict between the objectives of 'equity' and 'historical justice'. Theory suggests both positive and negative effects of an egalitarian pre-collectivisation land distribution on the likelihood that restitution will be chosen as privatisation policy. Empirical observations suggest that when social equity conflicts with historical justice, as was the case in Albania, equity (and, originally, efficiency) prevailed in the government's choice. With more than half of the Albanian population active in agriculture and a highly unequal pre-reform land distribution, land restitution would have transferred most of the fertile land into the hands of a small group of families, leaving the bulk of rural households without land. The government approved distribution of land to rural households instead of land restitution to former owners, because the prime importance of the land issue for the large number of rural voters was more important than the large vested interests and lower collective action costs of fewer former landlords.

iv) Length of communist rule

The most straightforward effect of the historical legacy of the land ownership is the lack of demand for land restitution in large parts of the FSU. Lerman (1997) states that nearly a century of communism has washed away all traces of former land ownership and that very little tradition of private land ownership remains in most of the FSU. Voices for restitution or some form of compensation to former owners were raised only in the Baltics, in Western Ukraine, Moldova and Western Belarus. In those areas collectivisation was imposed only after World War II. However, in the rest of the FSU there was little demand for restitution of land. Besides the impact on farm disruptions, this lack of a tradition of private ownership and demand for land restitution may have also contributed to the choice of share distribution, rather than distribution-in-kind of land in Russia and the Ukraine.

III. Privatisation, Land Reform and Effective Property Rights

Property rights of individuals over assets include the rights, or the powers, to consume, to obtain income from, and to alienate these assets. Legal rights, as a rule, enhance economic rights, but the former are neither necessary nor sufficient for the existence of the latter. Property rights are fully restored only if individuals obtain all rights (user, income, and alienation rights).

Privatisation does not necessarily lead to a full transfer of all property rights to new (private) owners. Some privatisation schemes are inherently imperfect in transferring property rights (e.g. usufruct allocation or restitution in comparable boundaries). In addition, the effective property rights distribution is also influenced *(a)* by technical factors and transaction costs in the reform implementation, *(b)* by the extent to which interest groups could influence the reform implementation, and *(c)* by detailed implementing regulations, in turn affected by political influence of interest groups and by political coalitions.

The most radical reform policies on paper may result in little effective change unless they are fully implemented. The reform implementation depends critically on the institutional design of the reforms and on transaction costs. While the government has control over the choice (the design) of the policy, it may have less control over the implementation of the design. There are several problems.

- Technical problems: trying to value assets, to assess the validity of land and asset claims, to assign land parcels to claimants or to develop voucher schemes and auctions has proven a very difficult process.

- Reform implementation requires shifting powers to the relevant local institutions, which may create principal-agent problems in the presence of imperfect information. Those institutions are often influenced by local preferences and biased towards management and interests of employees who are closely involved in the decision-making and the activities of the institutions. The potential for the existing management to manipulate the reform implementation and resulting property rights distribution depends strongly on the transaction costs for the various partners (legal owners, potential users) in a potential exchange of the assets.

- Timing and government credibility: the privatisation and transformation processes require much time, even when all parties support the reforms. Therefore, there exists a real chance that before the reforms are finished, or even well under way, the government is replaced by another which may be less supportive of the reforms. While the new government may not choose to change the privatisation process it may very well introduce a number of regulations and policies which have an important impact on the speed and the extent of the reform implementation. As a consequence, local administrations and executing institutions may feel less inclined to follow government regulations which they privately oppose, because enforcement procedures may not come into effect if the government might be replaced.

- Recent amendments to the privatisation and land reform laws limit the distribution of property rights on agricultural production factors towards new (former) owners. The most striking examples of such measures is the introduction of the 'good landlord' and 'co-ownership' rules in Slovenia which allocate part of the decision-making rights on the use of the agricultural land under restitution to the state farms which are currently using the land, as long as the state farms behave as 'good landlords'. Similar legal initiatives which allocate part of the effective property rights to the users of the land (the former state and collective farms) have also been introduced in other CEECs, e.g. in Bulgaria, often as a result of the return to power of ex-Communist parties.

IV. Farm Restructuring

a) Observations on farm restructuring

Following the enactment of the necessary legislation, state and collective farms have been transformed into a wide variety of farm organisations, such as producer co-operatives, joint stock companies, limited liability companies, partnerships and individual farms.

A wide variety of farm structures has emerged in many CEECs (Table 2, FSU countries are not included). Often it is not fully clear what the various names, such as 'joint stock companies' and 'private co-operatives' mean. Therefore, we distinguish between five production structures depending on ownership and use of assets:

- *Public or state farms* which are entirely owned by the state. They have not yet been privatised or will not be privatised, e.g. because, as in the West, they remain active in public research.
- *Co-operatives* are still large-scale farms ranging on average from 475 hectares in Romania to 1,461 hectares in Eastern Germany.
- *Companies* include all kinds of enterprise structures (limited liability companies, legal entities, etc.) owned by shareholders. They are characterised by some form of joint ownership and joint operation of the means of production. They are typically large-scale farms, their average ranging from 281 hectares in Bulgaria to 823 hectares in Eastern Germany.
- *Partnerships* are characterised by joint operation and ownership, but at a smaller scale than companies or co-operatives. Moreover, partners are often family members. They are medium-sized farms of 100 to 500 hectares.
- *Individual farms* are farms managed by a single individual or household. These farms typically include both family farms and household plots and are generally characterised by their small scale: from 1 to 50 hectares. In Eastern Germany, only the "single proprietorships" are classified as individual farms.

The data in Table 2 suggest that in 1994 large-scale farms still dominated in several CEECs. Co-operatives, partnerships and companies use 66 to 80 per cent of TAL in Eastern Germany, the Czech Republic, Slovakia, Hungary and Bulgaria. In the Czech Republic most restituted land was leased to transformed co-operatives or to state farms. Only 700 000 hectares, or 16.4 per cent of TAL, was physically withdrawn from these structures. As a result, individual farms cultivated 23 per cent of TAL. State farm land, representing 18 per cent of TAL, was leased to 'expected' owners. In Slovakia, only 123 988 former owners claimed their land to set up a new farm (about 8.5 per cent of TAL). Most 'new' land owners (44.1 per cent of TAL) decided to lease their land to a co-operative or a company. State farms had not yet been privatised and still had 15 per cent of TAL. In Hungary, 22.3 per cent of total land was cultivated by individual farms. In Bulgaria, organisations under liquidation still represented 18.1 per cent of arable land, but 43.9 per cent was reported to be farmed by individuals. In Eastern Germany, collectivised land has been restituted, but many who benefited leased their land to the new co-operatives. State farm land has been 'pre-privatised' by leasing it to private individuals with and without restitution claims. Individual farms cultivated one-fifth of TAL in 1994.

The main exceptions in Table 2 are Romania where individual farms occupy 61 per cent of TAL and Albania where virtually all the land (95 per cent) is used by small private farmers. In Slovenia, as in Poland, the large majority of land was used by individual farms already under the Communist period.

b) The emergence of individual farming

Table 2 shows that the break-up of large-scale agricultural production units into individually operated "family farms" differs considerably for the various CEECs. Table 3 presents our calculations of an individual farming index (IFI) -- based on the percentage of agricultural land used by individual farms but corrected for the initial situation -- for 18 CEECs. The IFI varies between 5 and 95 per cent. The IFI is low in countries where large-scale successor organisations to the former state and collective farms still dominate, such as Slovakia (5 per cent), Hungary (13 per cent), and the Czech Republic (20 per cent). The IFI is highest in Albania (95 per cent) and Latvia (80 per cent) where a massive break-up of the collective farms resulted in a domination of small-scale production units. Within the CEECs there also

exists wide variation in the importance of individual farming of different regions and agricultural subsectors.

c) Individual farms and fragmentation

While the break-up of state and collective farms into individual farms clearly causes fragmentation in some cases (e.g. Albania), this is not the case in general. In most of the CEECs we study, many individual farms cover 100 hectares and more. The Latvian case in particular shows that a high IFI (80 per cent) does not necessarily imply a high degree of fragmentation: only 23 per cent of TAL is cultivated by farms smaller than five hectares. Most of the land is farmed by farms between 5 and 100 hectares (see Table 4). In general, the Baltic states have more land used by larger individual farms than the other CEECs.

The data in Table 2 also indicate considerable differences in the average size of an individual farm. Individual farms are larger in Eastern Germany (48 ha) and the Czech Republic (14 ha). They are around one ha in Hungary, Bulgaria and Romania. This is partly a statistical reason: it is impossible from the available data to distinguish between household plots, part-time farms and full-time individual farms. Because of this, the data *underestimate* the average size of part-time and (even more) of full-time individual farms.

The most important factor explaining fragmentation is the size of the rural work force. A high share of agriculture in employment implies a strong demand for small household plots, thus contributing to the fragmentation of land. Chart 3 shows an almost perfect linear correlation (regression R^2=0.92) between the share in TAL of small farms as a measure for fragmentation and the share of agriculture in the economy. Additional factors have apparently stimulated the start-up of larger individual farms.

d) Factors affecting farm restructuring

The post-transition CEEC farm structure will depend on the pre-reform farm structure, on the design of the privatisation and transformation policies (itself influenced by political economy factors), on the implementation of the policies, and on a series of additional factors, including the economic environment, affecting the outcome of the reform process. While the available empirical evidence is imperfect, we draw the following (preliminary) hypotheses :

i) Transition-related risk and adverse terms of trade have negatively affected the creation of individual farms.

Agricultural terms of trade declined strongly in 1989-1991 in CEECs, and have stabilised since 1991. The variability in prices was extreme in 1989-1991, but has been considerably less since 1992. Even in a country such as Bulgaria, where inflation was never brought fully under control, price variability declined strongly after 1992. Therefore, as price variation has reduced substantially since 1992 and agricultural producers are generally getting a better understanding of the emerging market, economy overall production risk, especially “transition-related” risk, has reduced.

These observations offer an explanation why decollectivisation was especially low in the 1989-1992 period and has increased afterwards in many countries (as reflected in Chart 1). However, also other factors have most probably played a role in this, such as the fact that most privatisation and decollectivisation legislation was only passed in parliaments in 1991 and 1992 in most countries. Therefore, available evidence is in general consistent with the hypotheses that negative terms of trade

evolutions and high transition risk have reduced decollectivisation in the beginning of transition, but other factors may have contributed to this effect.

ii) The break-up of collective farms is strongest for the least productive farms and the most labour intensive farms.

Chart 2 shows how the IFI is negatively correlated with gross agricultural output (GAO) per farm worker in 1989 (as a proxy for average collective farm productivity) for six CEECs. Countries with low productivity on collective farms, such as Albania, have a significantly higher degree of decollectivisation than those where collective farm productivity was higher, such as Hungary. Furthermore, especially in those countries where productivity on collective farms is too low to provide for the basic needs of members, they will leave. The issue of relative productivity is thus related to consumption risk, or more generally, food security, reflected in the share of the budget spent on food. In countries characterised by a large share of the budget spent on food, food security is more critical. This factor appears to have been a key factor for countries such as Albania and Romania, where extremely low productivity of collective farms, in combination with government policy favouring state farms and taxing collective farms, caused very low incomes on the collective farms. In the case of Albania, where about 70 per cent of income is spent on food, the situation was so extreme that food shortages and hunger resulted, causing a massive break-up of the collective farms after 1991 (Cungu and Swinnen, 1997).

Also regional (within country) differences in decollectivisation are strongly correlated with productivity differences and scale economies in production. Decollectivisation is found to be significantly lower in plains where crop production with scale economies is the main activity than in other regions. For example, data from Hungary and Romanian show a strong negative correlation between the percentage of plains in the total area of a county and the share of individual farms in total agricultural land.

iii) The emergence of individual farms is reduced by the costs of leaving the co-operative farm.

These “exit costs” are affected by the procedures for withdrawing assets from the co-operative farms and the ownership of the assets. These factors, in turn, are influenced by the privatisation and transformation (or “decollectivisation”) regulations. The method of privatisation and land reform will in this way affect the emergence of individual farms. For example, in the case when many former owners are no longer active in agriculture, restitution of assets to former owners induces a conservation of the collective farm structure, in contrast to privatisation procedure that allocates assets to the collective farm members, such as distribution.

Further, transformation regulations can stimulate or hamper the break-up of collective farms. For example, governments, under political pressure from a collective coalition, have introduced amendments to the land law making it more difficult for individuals to withdraw their land. One such example is the introduction of co-ownership of land between private individuals and state farms in Slovenia. In Bulgaria, amendments to the original land law include the institution of an extended administrative procedure, the possibility or reviewing the restitution process, and several restrictions to sales of land. Another example is Hungary, where members can still leave their co-operative after its transformation, but cannot withdraw their land or non-land assets. They receive a compensation which is only a fraction of the real value of the assets. In Slovakia, co-operatives can issue vouchers instead of restituting assets to former owners, but these vouchers cannot be traded for seven years.

Governments in favour of decollectivisation want to reduce exit costs and also reduce the ability of collective farm members and managers to influence these costs. An example of this is from Bulgaria. The 1991 Land Law passed by the ex-Communist government did not include detailed specifications about how to implement the law. Much leeway was given to local government and collective farm management to increase exit costs. After the 1991 elections, the law was amended by the new reformist government. Liquidation councils were installed to oversee the liquidation of the collectives and keep managers from raising exit costs. Not surprisingly, the role and the composition of these institutions was changed when the ex-Communists came back to power (Swinnen, 1997b). The 1991 Sajudis government in Lithuania removed the existing management from its controlling positions and created new institutions, the Municipal Agrarian Reform Services, chaired by outsiders. Similarly to Bulgaria, the re-elected ex-Communist government changed the role and the composition of these institutions in 1993 (Rabinowicz, 1997).

Also in FSU countries, many obstructions to farm restructuring can be found. Private ownership of land has not been recognised in Kyrgyzstan and Uzbekistan, while in Belarus and Kazakhstan only private ownership of household plots is allowed. Nevertheless, user rights were made secure and marketable in Kazakhstan and Kyrgyzstan. In Georgia the buying and selling of land is only allowed since 1996; in Turkmenistan it is still not (Lerman, 1997).

Table 5 presents various indicators of land reform, privatisation and decollectivisation legislation in CEECs. Individual farms are more important where *a)* more of the land was distributed to farm workers instead of restitution to former owners, *b)* the share of agriculture in employment is high, and *c)* exit costs are low. It is remarkable to see how the two countries at the extremes of the spectrum are exactly opposite in these three factors. Albania, where decollectivisation is highest, distributed all the land to farm workers, has a high share of agriculture in employment, and low exit costs. Slovakia, where decollectivisation is lowest, restituted land to former owners, has a low share of agriculture in employment, and high exit costs.

Chart 4 shows the relationship between decollectivisation and the share of agriculture in total employment for CEECs. Central European countries with more than 15 per cent of active people employed in agriculture (Albania, Bulgaria, Latvia, Lithuania, and Romania) show a higher degree of decollectivisation compared with countries where agricultural employment is less than 10 per cent of the work force (Czech and Slovak Republics, Hungary).

Two factors can be the cause of this relationship. First, the share of agriculture in total employment is typically negatively correlated with the level of development and the use of technology in agriculture. A country with a high share of agriculture in employment is typically less developed and uses inferior technology compared to a country with a low share of agriculture where there was a substitution of labour by capital as a result of the technological progress. Second, the share of agriculture in employment also captures the number of outsiders versus insiders. A high share of agriculture in total employment is an indication that relatively few people have left agriculture and thus that the ratio of outsiders to insiders is relatively low. Consequently, a low share of agriculture in total employment means that relatively many farmers left agriculture, resulting in a high ratio of outsiders to insiders. Recent World Bank surveys suggest that the overwhelming majority of individual farmers are former co-operative members or employees of state farms (Csaki and Lerman, 1996). Since in general outsiders lack the appropriate skills to start up a private farm, the number of farm workers, i.e. insiders, is a good reflection of the number of people actually interested in individual farming.

The Chart indicates some additional regional biases: the Baltic countries all lie above the curve, while the southern Central European countries lie on or below the curve. This observation suggests that

additional factors have stimulated decollectivisation in the Baltic countries and especially in Latvia. Overall in the Baltics, becoming independent from Russia has been a key political strategy, also affecting their reform policies. Collective farms were partly seen as part of a system imposed on them by the Russian occupation. Decollectivisation was thus part of their independence strategy (Rabinowicz, 1997). These additional factors have apparently stimulated especially the start-up of larger individual farms. This can be derived from comparing Charts 3 and 4. There is an almost perfect linear correlation (regression R^2=0.92) between the IFI and the share of farms smaller than five hectares in total agricultural land. The comparison with Chart 4 suggests that farms larger than five hectares have emerged more strongly in the Baltics and especially in Latvia than in CEECs with a similar agricultural share in employment. One explanation is that land ownership in 1945 was less fragmented and more egalitarian than in many other countries. Another important reason is the active Latvian restitution and decollectivisation policy, which was inspired by nationalistic motivations. Restitution of land allocated land property rights exclusively to native Latvians in a country with a very high share (46 per cent) of ethnic non-Latvians in the population, most of whom were post-1945 Russian immigrants. Further, the Latvian reform regulations specify that individual farms are given the highest priority in land allocation. The lowest priority is given to reforming collective farms (quite unlike many other CEECs, where collective farms receive a preferential treatment).

Table 1: **Most important land reform procedures in CEECs (*)**

	Collective Farmland		State farmland[a]	
	Procedure	***% of TAL***	***Procedure***	***% of TAL***
Albania	Distribution (physical)	76	Distribution (physical)[b]	24
Bulgaria	Restitution	72	Miscellaneous[d]	9
Czech Republic	Restitution	61	Sale (leasing[c])	25
East Germany	Restitution	82	Sale (leasing[c])	7
Hungary	Restitution + distribution (phys.) + sale for compensation bonds [f]	70	Sale for compensation bonds + sale (leasing[c])	12
Latvia	Restitution	57	Restitution	38
Lithuania	Restitution	62	Restitution	30
Poland	-	4	Sale (leasing[c])	19
Romania	Restitution + distribution (phys.)	58	Undecided[e] + Restitution	28
Russia	Distribution in shares [g,h]	40	Distribution in shares [g]	58
Slovakia	Restitution	71	Sale (leasing[c])	15
Slovenia	-	0	Restitution	17
Ukraine	Distribution in shares [g]	n.a.	Distribution in shares [g]	n.a.

(*) Special procedures for marginal amounts of land are not included in the table.

[a] Excluding research farms which are nowhere privatised.

[b] Farm workers received vouchers in newly established joint ventures. However, as most of these joint ventures failed, farm workers received first user rights and eventually full property rights.

[c] Land is leased to individuals or entities pending sale.

[d] In Bulgaria, the distinction between state and collective farms is more complicated than in other CEECs because the creation and later abolishment of the so-called Agro-Industrial Complexes. Part of the land classified under "state farmland" is restituted, because it was initially collective farmland and has a similar status; another part will not be privatised, and another part is the land on which large pig and poultry enterprises are built and which will be privatised separately.

[e] The Romanian government has not decided how to privatise the state farms, including the land, on two-thirds of the state farmland.

[f] Each of the land reform procedures applies to approximately one-third of the collective farmland.

[g] Distribution of collective and state farmland equally per capita among collective farm members or state farm employees in the form of paper shares or certificates. Outsiders who are not entitled to land shares can receive land for private farming from a special state reserve established for this purpose (15-20 per cent of TAL).

[h] Private ownership is prohibited in ten ethnic republics of the Russian Federation.

Table 2. **Farm structures in Central Europe in 1994 based on agricultural land**

	Albania	Bulgaria[a]	Czech Republic	East Germany	Hungary	Romania	Slovakia	Slovenia
State farms								
area in '000 ha	n.a.	328,085	199,022	-	[b]	2,051,000	443,977	84,800
number	13	1,009	239	-	36	550	262	n.a.
average size in ha	150-200	325	498	-	n.a.	3,729	1,695	n.a.
% of total area	n.a.	7.0	2.8	-	[b]	15.5	20.3	10.9
Co-operatives								
area in '000 ha	-	2,260,356[d]	2,043,470	1,952,100	2,306,000	1,779,569	1,531,147	-
number	-	2,373	1,468	1,336	2,048	3,970	961	-
average size in ha	-	953	1,392	1,461	1,126	446	1,563	-
% of total area	-	48.2	47.7	35.9	37.7	13.4	69.9	-
Companies								
area in '000 ha	-	39,946	876,600	1,286,200	1,163,600[b]	-	100,522	-
number	-	142	1,461	1,563	3,311	-	219	-
average size in ha	-	281	600	823	n.a.	-	459	-
% of total area	-	0.9	20.5	23.7	19.0[b]	-	4.6	-
Partnerships								
area in '000 ha	-	-	14,570	1,116,400	[b]	1,536,532	-	-
number	-	-	47	2,379	2,369	13,741	-	-
average size in ha	-	-	310	469	n.a.	112	-	-
% of total area	-	-	0.3	20.5	[b]	11.6	-	-
Individual farms								
area in '000 ha	n.a.	2,058,545	871,669	1,081,700	2,652,400[c]	7,905,372	115,331	696,500
number	490,000	2,010,961	60,666	22,505	1,203,000	3,579,234	7,759	n.a.
average size in ha	1.05	1.0	14	48	n.a.	2.21	15	n.a.
% of total area	n.a.	43.9	20.4	19.9	43.3[c]	59.6	5.3	89.1

[a] Arable land. [b] 'State farms' and 'partnerships' are included in 'companies'. [c] 'Other' is included in 'individual farms'.
[d] Including organisations under liquidation.

Source: Country studies in Swinnen, Buckwell and Mathijs (1997)

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Table 3. **Individual farming index (IFI) 1995**[a]

	IFI		*IFI*
Albania	94.2	Georgia	21.2
Armenia	81.8	Hungary	17.3
Latvia[b]	80.2	Belarus	15.2
Lithuania[b]	60.4	Ukraine	14.1
Romania	55.2	Uzbekistan	13.1
Bulgaria	45.4	Russia	12.1
Estonia[b]	37.5	Turkmenistan	7.1
Kyrgyzstan	23.2	Slovakia[b]	3.1
Czech Republic	22.1	Kazakhstan	0.0

[a] The IFI is calculated by dividing the difference between the share of individual farms in total agricultural land in 1995 (IND95) and in 1989 (IND89) by 100 minus the share of individual farms in total agricultural land in 1989: IFI=(IND95-IND89)/(100-IND89)×100. For all FSU countries except the Baltic countries, an initial share of individual farms equal to 1 per cent is assumed.

[b] 1994.

Source: Mathijs and Swinnen (1998)

Table 4. **Degree of fragmentation of agricultural production based on land use data**[a]

Country	**Share of individual farms in TAL**[b]	**Share of farms smaller than 5 ha in TAL**	**Share of farms larger than 5 ha in TAL**
Albania	94	95	-
Latvia	81	23	58
Lithuania	64	33	31
Romania	61	45	16
Bulgaria	44	30	14
Estonia	40	25	19
Hungary	22	12	10
Czech Republic	20	1	na
East Germany	20	na	15
Slovak Republic	5	2	3

[a] Total agricultural land, 1994.

[b] Own estimate based on the 1994 survey of small farmers.

Source: Swinnen, Buckwell and Mathijs (1997) and OECD (1996)

Table 5. **Various indicators of land reform and transformation regulations**

	Share of total agricultural land (in %)			Share of agriculture in total employment (1994)	Man/land ratio (workers/10 ha)	Exit costs due to government regulations*
	Privatised land by		State-owned land 1994			
	restitution	distribution				
Albania	-	93	3	53	6.8	1
Latvia	64	30	2	17	0.9	1
Lithuania	96	21	1	23	1.1	2
Romania	43-58	15-30	13	36	2.4	2
Estonia	74	22	-	8	0.6	2
Bulgaria	81	-	7	22	1.1	2
Czech Republic	79	-	13	5	0.6	2
Hungary	62	19	5	9	0.6	3
East Germany	82	-	8	n.a.	n.a.	2
Slovakia	74	-	20	7	0.7	3

* Own estimate of exit costs induced by farm transformation regulations (1=Low, 2=Medium, 3=High)

Source: Mathijs and Swinnen (1998)

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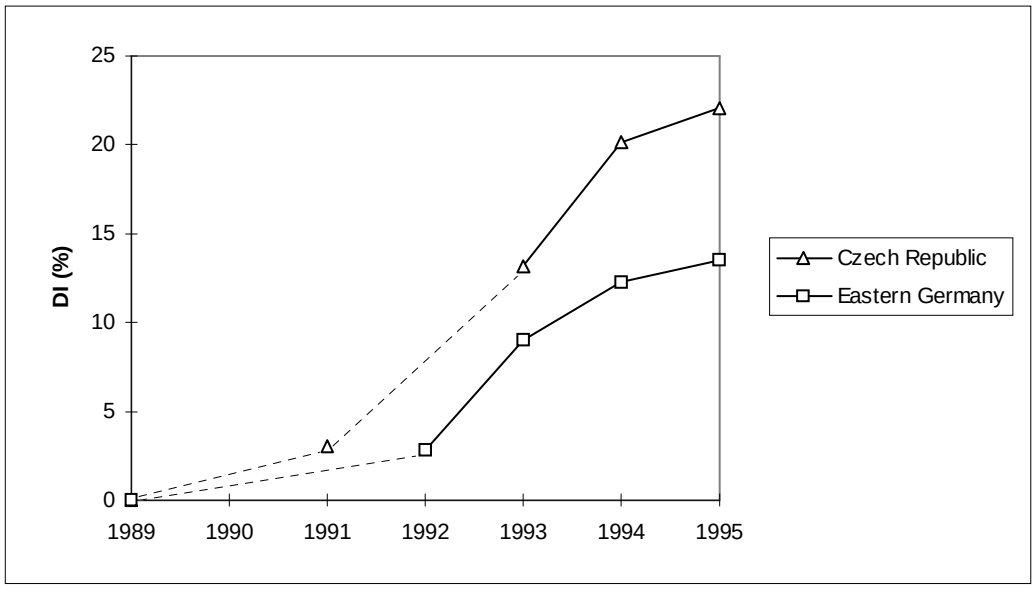
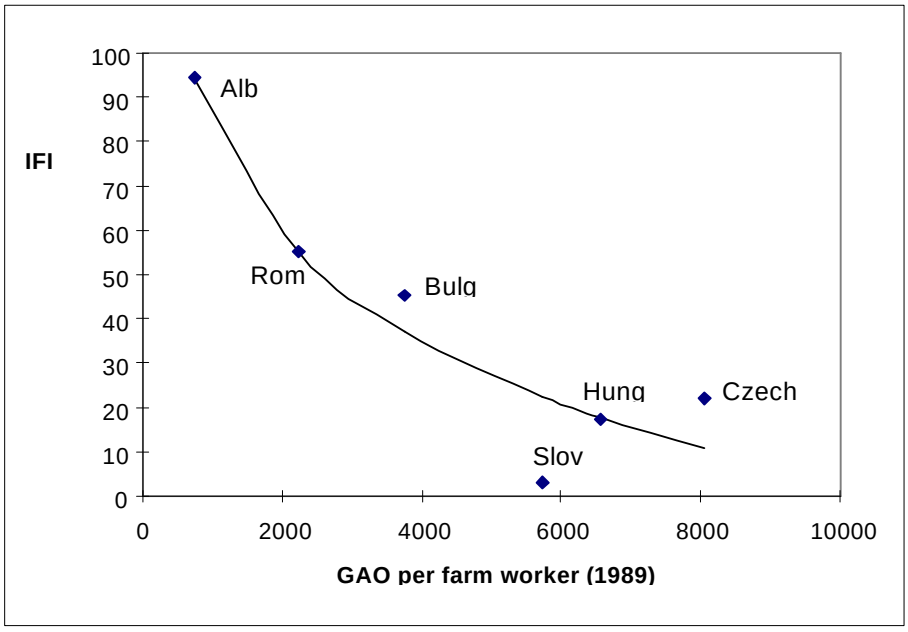
Chart 1 **Decollectivisation index for Eastern Germany and the Czech Republic, 1989-1995**



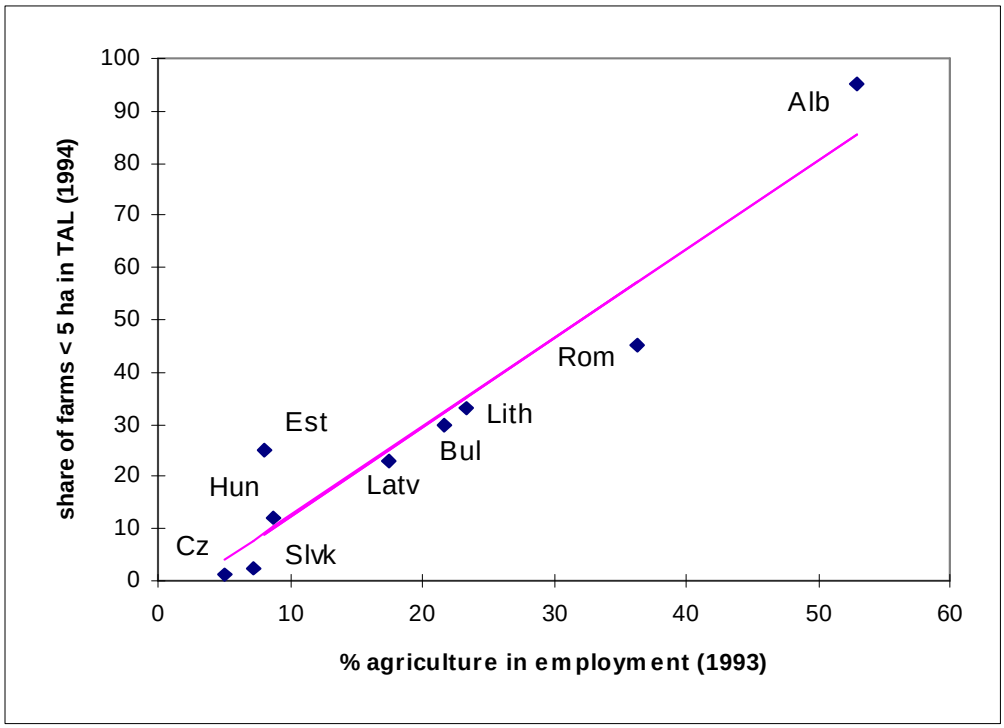
Source: Mathijs and Swinnen (1998)

Chart 2. **Relationship between IFI in 1995 and initial collective farm productivity in 1989 for six CEECs**



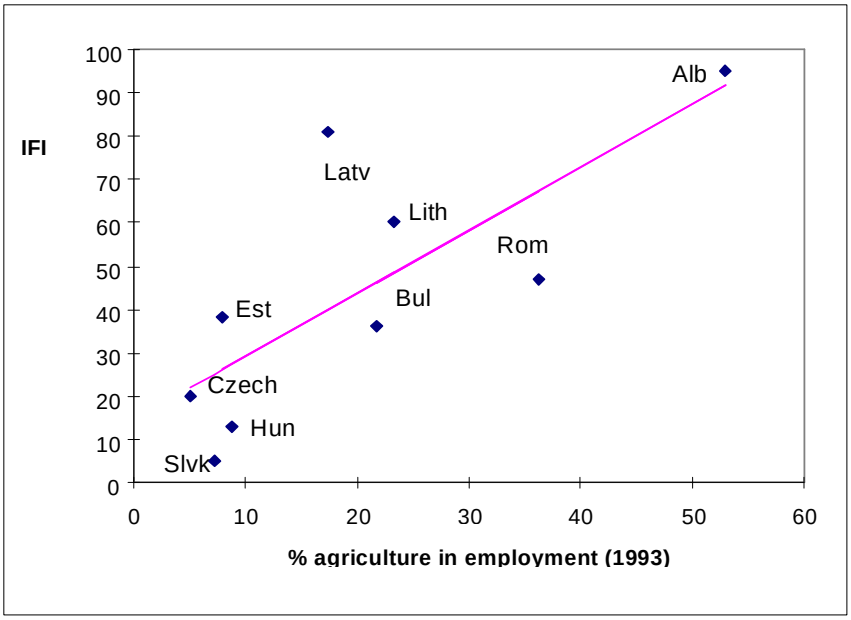
Source:Mathijs and Swinnen (1998)

Chart 3. **Relationship between land fragmentation in 1994 and the share of agriculture in total employment in 1993**



* The curve on the graph is based on a least squares regression.
Source: Mathijs and Swinnen (1998)

Chart 4. **Relationship between the Individual Farming Index in 1994 and the share of agriculture in total employment in 1993**



* The curve on the graph is based on a least squares regression.
Source: Mathijs and Swinnen (1998)

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MARKET REGULATIONS AND PRICE SUPPORT POLICIES IN THE ESTONIA

Toomas Kevvai *

The level of subsidies given to the agricultural sector during the Soviet era was relatively high and more or less uniform for all Baltic states. (The PSE has been calculated at approximately 70 per cent). However, since independence, Estonia, Latvia and Lithuania have developed separate and distinct agricultural policies. This paper will seek to give a brief overview of the agricultural and market support policies undertaken by the Estonian government in recent years.

As is apparent from the figures in Chart 1, the agricultural budget (divided into three main components: direct payments, reduction of input costs and general services) has been reorganised with the introduction of many changes in government support policies reflecting the liberalisation of the Estonian economy, including the agricultural sector. These changes, including a sharp increase in the use of direct payments, were introduced so as to force the economy to adjust to the new economic reality and thereby encourage the development of those sectors best able to compete in a free trade environment. Structural changes were also introduced particularly through land reform and the privatisation of agriculture. In the following sections, more detailed information on the different policy tools used in Estonia will be presented.

I. Financing of agriculture

The main source of credit to agriculture continues to be the Agriculture and Rural Life Credit Fund with a budget of 400 million Estonian Crowns equally divided between short and long term credit (up to five years) and disbursed by commercial banks. As of October 1997 most of the fund had been disbursed.

One of the new tools introduced to support the financing of agriculture, and the rural economy in general, is the Rural Life Credit Guarantee Fund which seeks to provide additional guarantees to rural enterprises when they borrow a sum greater than the amount their collateral would normally allow them to borrow. The fund is valued today at 50 million Estonian Crowns and it can guarantee up to 60 per cent of the total loan. The total amount which may be given as a guarantee is legally set at 120 million Estonian Crowns.

II. State programmes

State programmes in Estonia are directed towards the more important branches of production so as to maintain increases in profitability, improvements in quality and sustainability of production. They are implemented by the Ministry of Agriculture primarily through appropriate development schemes and

* Ministry of Agriculture, Estonia.

programmes. These can be divided into two groups: product oriented programmes and the so-called interdisciplinary programmes.

High priority production groups and related governmental programmes are as follows:

- Milk "Milk" and feed production development scheme.
- Grain Grain economy development scheme.
- Potatoes Potato cultivation and processing development scheme.
- Oil Oil plant programme.
- Flax Flax cultivation programme.

As of 1998 a special development scheme for horticulture will also be launched.

The main measures envisaged in the programme and development schemes are as follows:

- development of plant and animal breeding, and seed production systems;
- applied scientific work to improve information quality and availability for the advisory and extension services;
- resolution of possible "bottlenecks" occurring in the branch of production (logistical and other problems);
- developing quality control mechanisms.

These do not involve any direct production subsidies.

Finally, a "reference enterprises programme" was also created. Its objective is the development of a network of reference enterprises so as to guarantee the availability of objective information on the economic position of different companies and production processes.

III. Support services

a) Advisory service programme

In order to build a solid basis for the development of a free market it was necessary to provide consultation and information services. This programme enables advisors to offer these services in a competitive environment. Several support programmes were also launched for developing rural infrastructure (local roads, electrical and telephone networks, etc.) and up to 50 million Estonian crowns have been allocated on a yearly basis to this end during the last three years.

Phytosanitary and veterinary inspection services are nearly 100 per cent paid for by the State.

b) Direct payments

Since 1996 compensation has been granted to offset increases on excise tax on fuel. This support is paid per hectare and in 1996 amounted to approximately 35 million Estonian Crowns, and in 1997 to nearly 60 million Estonian Crowns.

In 1997, a Capital Grant Scheme was set up to encourage investments in agriculture and rural societies. The main principle of this scheme is to support selected investments with up to 25 per cent of the total investment amount. Even if the funds for this purpose are relatively low -- 20 million Estonian Crowns -- it is a radically new tool compared with the usual forms of indirect payments offered by the State. In the 1998 draft State budget the allocation for this scheme is to be increased nearly threefold.

As a result of negotiations held between representatives of agricultural producers and of the government, the Estonian government will begin in 1998 to make direct payments for milking cows as well as for grain production. The main requirement for farmers to receive this aid is an average milk yield higher than 4000 Kg/year as well as the inclusion of their herds in a milk recording scheme. In so far as grain production is concerned, it is expected that grainfields be well maintained and a field book be kept up-to-date. On the government side, the primary goal is to obtain precise information for establishing the land parcels register. Ninety million Estonian crowns are allocated in the draft state budget for this purpose.

c) Market policy

Chart 3 shows the changes in the world market as well as indicating the close relationship between world and Estonian market prices. From this comparison we can say that there is very minor market price support, if any in Estonia. The main problem in applying such a policy is that world market prices fluctuate strongly, which has an undesirable impact on agricultural structural change.

As can also be seen in Chart 3, pig meat at the production level was relatively profitable in 1994 and 1995, but it changed together with the increase in grain prices in 1996. With rapidly changing market prices, it is very difficult to find one's comparative advantage.

As has already been stressed in earlier papers, it is very important to react from the state side to structural changes in the countryside because of the loss of a high number of jobs. So the Estonian government has launched several so-called regional programmes.

VI. Regional policy

Six regional programmes have been implemented since 1996, which concern the hinterland, monofunctional settlements, Ida-Virumaa, islands, population movement and border villages. In addition, regional-political entrepreneurship loans and regional subsidies have been extended. In 1996, EEK 40.6 million were allocated for funding all of the above mentioned packages.

Chart 1. **Distribution of budgetary expenditure to agriculture**

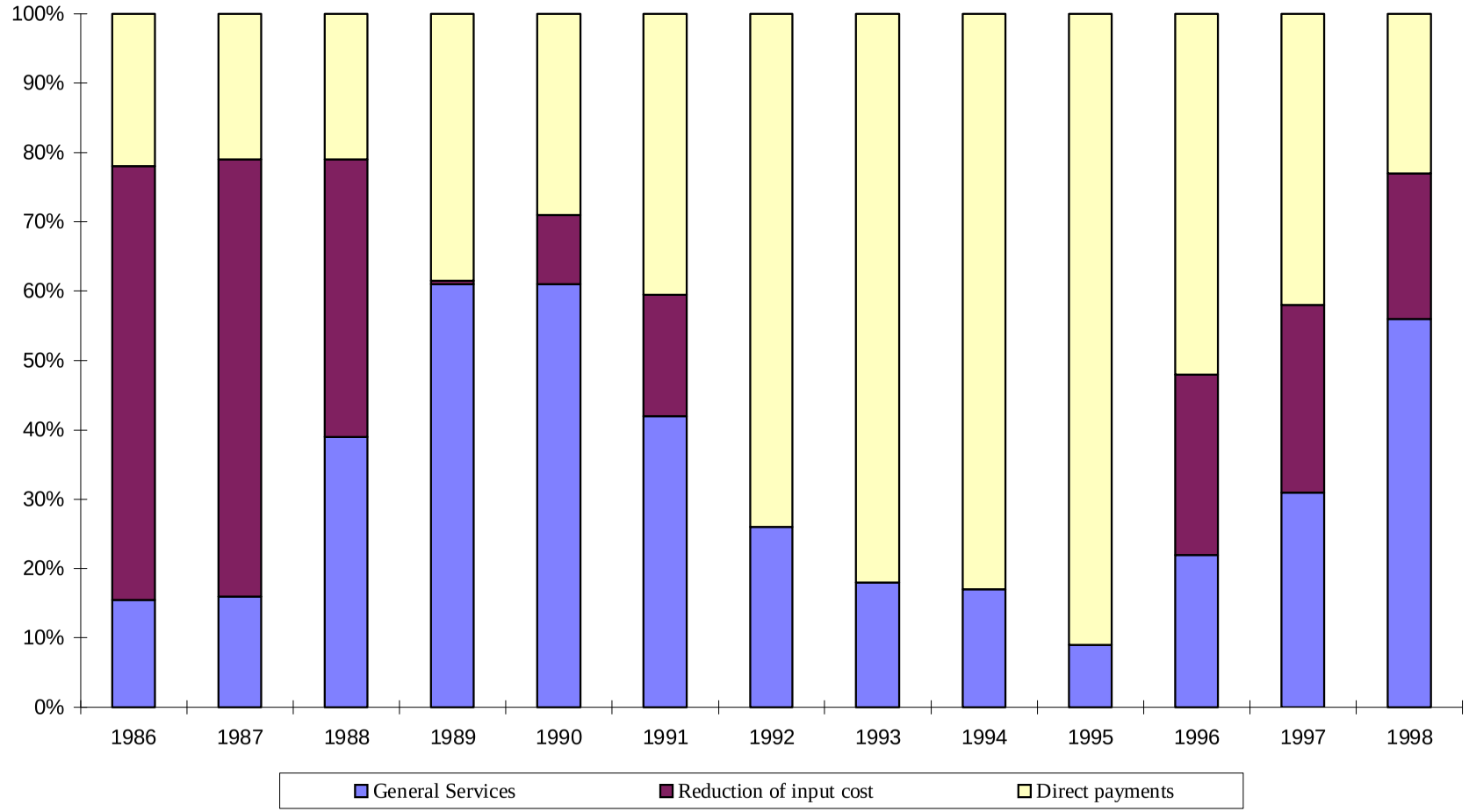


Chart 2. **Farm gate price vs production costs**

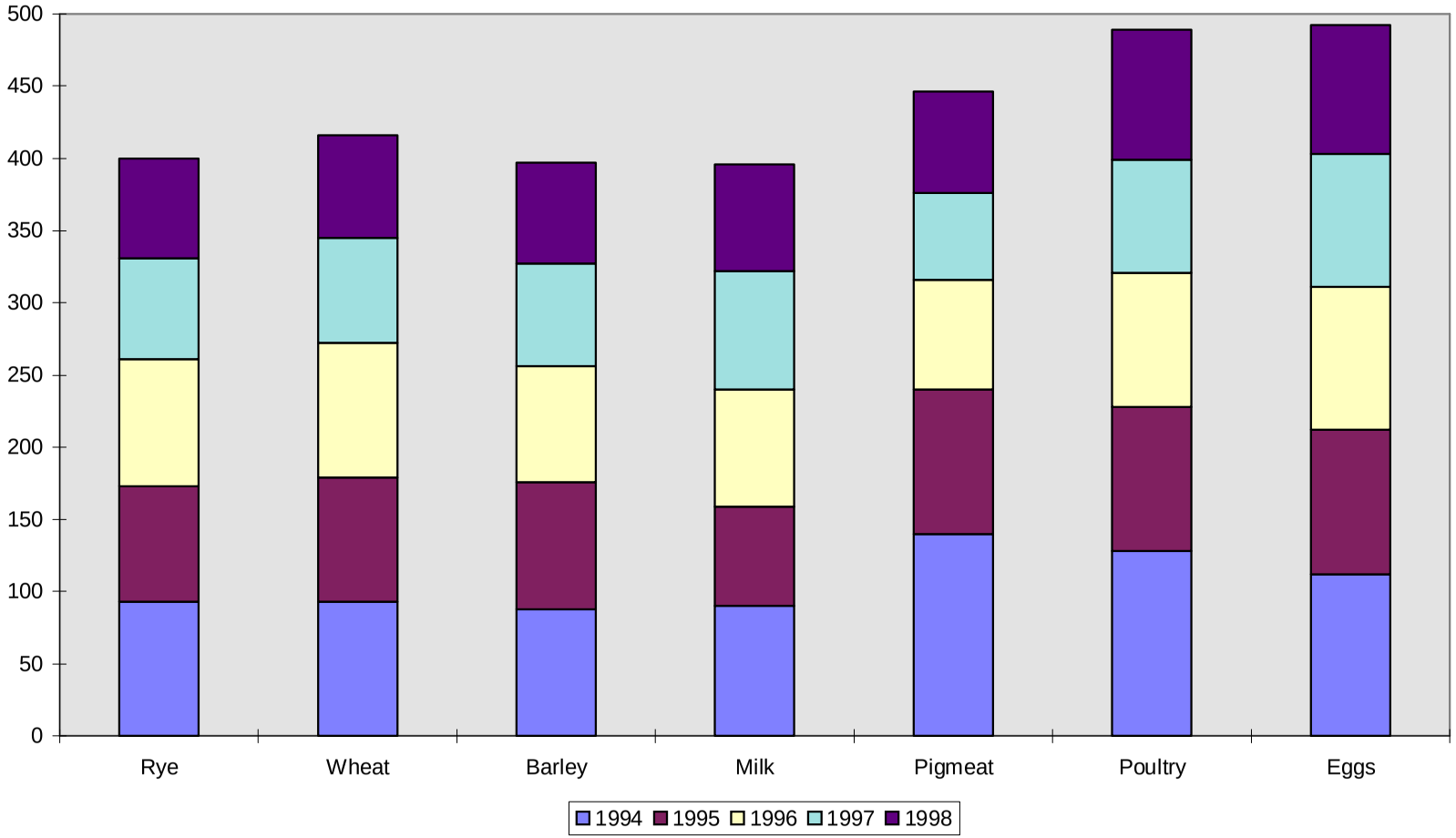
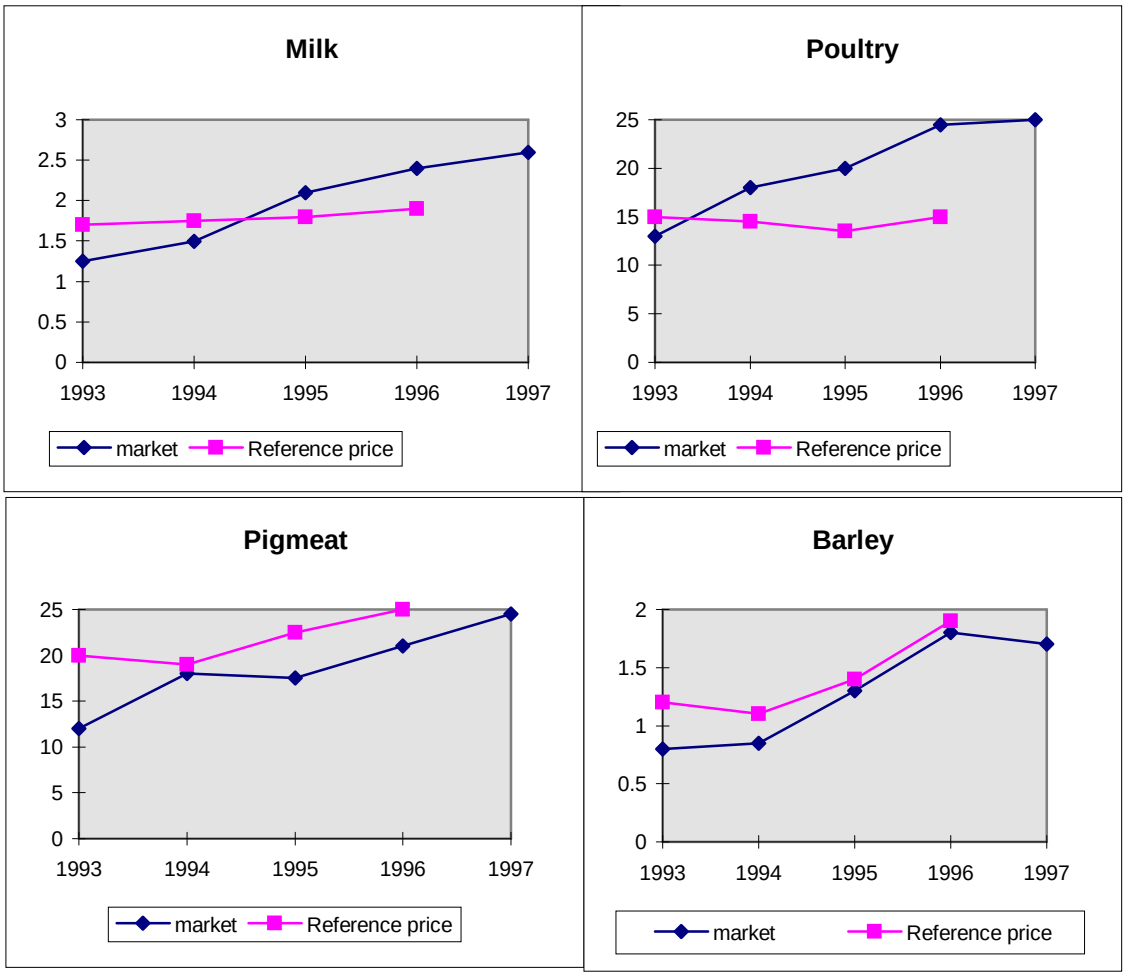


Chart 3. **Dynamics of Estonian market international (OECD) reference price**



MARKET REGULATIONS AND PRICE SUPPORT POLICIES IN LATVIA

Margers Krams *

Agricultural policy in Latvia has developed in response to both internal and external events. Among the external factors relevant to Latvian policy are those tied to commitments made in negotiating accession to the WTO, including trade measures relating to import restrictions as well as to national subsidy programmes. Since mid-1997, there have been no measures protecting the internal market other than ordinary import duties. Quantitative restrictions on the import of grain as well as the import ban on sugar have been abolished and the import licensing system has been modified to meet the requirements of the WTO's Agreement on Import Licensing Procedure. Given recent budget restrictions, no agricultural subsidies are expected. On the contrary, the harmonisation of Latvian legislation with the principles of the European Common Market Policy has guided Latvian policy towards a competitive system with relatively high internal market prices ensured by State interventions and reinforced by export refunds.

The second stage of reforms has consisted of three parts: restitution of land (with approximately 95 per cent of arable land farmed by individual farmers and 4 per cent by private companies), privatisation of industry (completed in 1996 for both upstream and downstream industries), and finally, administrative reforms (from a centrally planned economy to the establishment of a free market). There are significant obstacles, however, still to be overcome and which have slowed down developments in the agricultural sector. These include: soil degradation due to acidation; the small size of private farms which restricts their potential; outdated technology; low investment in agriculture; and the lack of professional management methods by people engaged in agriculture.

Discussions pertaining to agricultural policy cover a broad spectrum. It is clear from both the experience of developed countries and reports from local scientists that problems pertaining to the agricultural sector cannot be solved purely through subsidisation. For this reason, it is important to differentiate agricultural policies from other policies that also target rural development. These policies have been classified as either agricultural policy or rural policy. Analysis of the rural structure and those employed in agriculture has revealed differences between these two groups. This, in turn, has led to the following broad classification:

- the most successful farmers, and those who are the most efficient and who have targeted their expansion based on improving efficiency;
- those who remained active in the agricultural sector but were less efficient sought jobs in other sectors of the economy;
- finally, there were those living in rural areas but unable to find work in the agricultural sector due to lack of skills in that domain.

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* State Secretary, Ministry of Agriculture, Latvia.

The same policy measures cannot respond to the needs of these three groups, especially as they relate to agricultural production. They can certainly help the first group, but in so far as the second group is concerned, it is important to develop diversified policies. The only means of supporting the third group would be through socially-based schemes.

It is apparent that clear objectives must be set for agricultural production. In formulating these objectives, the Government has concluded that measures taken must be efficient so that goods can be competitive in the domestic market, the Baltic free trade area and the EC. It is equally understood that in order to be competitive, one must deal with the costs of production, i.e. that agriculture be efficient and produce quality goods. How then does one obtain efficiency in agricultural production? Two basic governmental instruments have been developed (though these do not cover general services): measures supporting market price (MPS) and direct payments. There is little possibility (mostly due to external factors) to introduce typical MPS measures, i.e. intervention or similar type measures. Such interventions could lead to an imbalance in the Latvian agricultural market and to the regulation of the supply of goods, to restriction of production, to an inefficient utilisation of the main resources (by freezing development), as well as to high administrative costs. It is recognised that direct payments made from the State budget could be more efficient if they were better targeted and, basically, had a less distortive effect on the market. Here again, preference is given to horizontal measures rather than to the commodity approach. In a sense this could be classified as an input subsidy or a reduction of input costs.

Support programmes are designed on the principles of a systematic targeting of the objective, transparency and on co-financing. A degree of self responsibility on the producer side is also expected. The horizontal approach has been chosen to increase capital involvement so as to improve efficiency *via* facilitating the access to credit resources. This leaves the farmer in the position of making the decision when to invest (for example, purchasing new technology, constructing new buildings or enlarging the farm) as well as to improve land conditions (fertility, acidity, water regime, etc.). These horizontal issues are given credit support in order to lower the cost of credit, and to offer a partial guarantee for loans undertaken. An increase in efficiency is also expected through improved agricultural education and training. A summary of the support measures provided by the government to the agricultural sector and the reorientation of support schemes is provided in the tables below.

Table 1. **Support for agriculture in Latvia (arable crops)**
(thsd.LVL)

	Flax	Cereals	Barley	Seed material	Potatoes	Protein crops	Sugar beets	Payments for areas treated
1994	139.0	269.5	0.0	2137.5	0.0	0.0	0.0	653.3
1995	296.7	500.0	0.0	1743.0	0.0	0.0	165.9	3559.0
1996	270.0	750.0	0.0	1350.0	0.0	0.0	374.8	0.0
1997	270.0	500.0	165.0	1695.6	120.0	0.0	400.0	0.0
1998	270.0	0.0	190.0	1950.0	120.0	220.0	400.0	0.0

Table 2. **Support for agriculture in Latvia (livestock)**
(thsd.LVL)

	Cattle	Milk	Sheep	Pigs	Semen material
1994	12.7	0.0	0.0	0.0	290.4
1995	1326.2	0.0	0.7	0.0	610.5
1996	234.0	0.0	0.0	0.0	100.0
1997	662.0	0.0	0.0	0.0	207.0
1998	810.0	2374.0	0.0	230.0	0.0

Table 3 : **Support for agriculture in Latvia (horizontal measures)**
(thsd.LVL)

	Credit interest rate subsidy	Credit subsidy	Credit guaranty fund	Soil improvement
1994	0.0	0.0	0.0	0.0
1995	0.0	0.0	0.0	0.0
1996	264.5	0.0	0.0	0.0
1997	931.1	0.0	500.0	0.0
1998	0.0	8000.0	999.9	4300.0

AGRICULTURAL SUPPORT POLICIES IN LITHUANIA

Ramute Naujokiene *

Agriculture plays an important role in Lithuania's economy. It is important not only from an economic point of view, but it also has a social importance related to employment in the countryside. Lithuania, with approximately 3.7 million inhabitants, of which 1.19 million live in the countryside, employs 24 per cent of the population in the agricultural sector, with agricultural products making up about 18 per cent of exports. In 1996, GDP was estimated at 31.115 billion Lt., with the agricultural sector accounting for 11.4 per cent of the total.

The Law on State Agricultural Economic Relations Regulations serves as the basis for agricultural support policy legislation in Lithuania. Although the state budget allocates up to 10 per cent of its expenditure on this sector, the total is usually less in practice because of the need to support social programmes. Most of the resources received in the agriculture sector are directed through the National Agricultural Development programme.

Policy direction and instruments of support are changing in Lithuania. Prior to 1997, the majority of expenditures were allocated through a system of "soft credits". Commercial banks, however, did not have sufficient credit resources to support this system and, in addition, these credits were expensive and often inaccessible to agricultural enterprises. In order to create a more favourable situation, the Agricultural Support Fund was established to allow for the granting of short-term credits to agricultural enterprises, the allocation of price subsidies, and subsidies for good quality production, seeds and breeding animals. The remainder of the budget was directed towards the farmer's support fund providing finance for infrastructure developments and long-term credit.

With the significant changes in agricultural support policies that occurred in 1997, Lithuania's commercial banks have since had adequate financial resources (including a US$30 million World Bank credit line) and credit unions have become more active. As a consequence, the state budget no longer needs to provide credit to the agricultural sector, and the new resources are now directed to support other priority investment projects. Nevertheless, programmes of the former subsidy system still remain, and state finances continue to support the income of agricultural producers as well as the improvement of the quality of agricultural products.

All agricultural financing is concentrated in the Rural Support Fund. The government has approved its disbursement rules and the Ministry of Agriculture and Forestry has approved certain areas for the use of such disbursements. The resources of the Rural Support Fund can be used in the following areas:

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* Ministry of Agriculture and Forestry, Lithuania.

- to implement agricultural market regulations, to provide farmers and agricultural enterprises income support, to subsidise the purchase of agricultural products according to stated quotas, to subsidise the purchase of high quality genetic material, to promote agricultural exports, to support the purchase of agricultural products through the use of minimal (marginal) prices, and to partly cover interest rates and financial support in case of an accident;

- to participate in the implementation of priority investment programmes, farmers settlement, co-operation and agro-service, new machinery and technologies, seed-growing and pure strain stock breeding, ecological farming, to change farming practices in environmentally sensitive areas and to develop agricultural quality certification systems;

- agricultural research activities, consulting and education, and the creation of agricultural information systems; and

- to improve agricultural infrastructures, to take part when forming agricultural loan guarantee fund, which would allow to draw Lithuania's and foreign banks' credit resources for the implementation of agricultural investment programs .

The state supports seven key investment programmes: farmers settlement, co-operation and agro-service, new machinery and technologies, seed-growing and pure strain stock breeding, ecological farming, the restructuring of activities in low efficiency soils, and the development of agricultural products in quality certification systems.

Resources from the Rural Support Fund cannot be allocated to credit resources, which explains why farmers and agricultural enterprises are granted privileges from this fund to cover part of their investment expenses. The use of public resources for investment programmes are transparent and all agricultural producers can participate in state supported investment programmes provided they are chosen as the most effective investment projects after tender procedures.

In addition, other direct support measures are used. For example, farmers do not have to pay the Land Tax, agricultural enterprises' income taxes are lower than others, there are privileges towards the Road Tax, and rural inhabitants pay less for electricity.

Further steps are expected to be taken to improve the agricultural support system, with a general change in policy from agricultural support to the provision of more support for rural areas. This is particularly important in Lithuania where farming conditions vary greatly between regions.

Table 1. **Rural support fund 1997, 397 million Lt.**

Targeted programs	**Million Lt**	**Per cent share**
Income support measures to agricultural enterprises	246	62
Priority investment programs	108	27
Research, training, advisory service	23	6
Agricultural credit guarantee fund	20	5

Table 2. **Main trends of utilisation of the resources of the Rural Support Fund**

1. Economic regulation of agricultural market; Farmers' income support

Subsidies are paid for the purchasing of cattle, milk, wheat, ray, rape seed, protein crops, buckwheat;
Subsidies/grants for breeding stocks;
Subsidies/grants for seeds and seedlings;
Aid to farmers in the event of accidents;
Export promotion.

2. Participation in agriculture credit guarantee fund

3. Participation in priority investment programs

Farm setting-up;
Co-operation and agroservice;
New machinery and technologies;
Environmentally friendly farming;
Restructuring of agricultural activiti es in the low-productivity soil areas;
Development of quality laboratory system;
Agricultural research extension service, training and development of agricultural infosystem;
Rural social infrastructure.

Table 3. **Main objectives of the Rural Support Fund**

- Sole financial source
- No direct financing and soft credits
- Investment support to targeted priority programs
- Transparent and well defined application procedures
- Public competition
- Activities supported: rural infrastructure - advanced technology - quality improvement

MARKET REGULATION AND PRICE STABILISATION IN THE CEE'S AN OVERVIEW

Nancy Cochrane *

I. Market Regulation and Price Stabilisation in the CEE's: an overview

Since 1992 there has been an tendency amongst most of the CEE governments towards greater government intervention in agricultural markets. In part, this is a result of political pressure from farmers dismayed at the real income declines they have experienced. Farmers, who still make up 20 or even 30 per cent of the population, are a powerful lobby in all these countries. Another motivation is the desire of all CEE's for membership in the EU. In preparation for eventual membership, policy makers see a need to align their policies more with the Common Agricultural Policy (CAP). A third motivation, in the case of Bulgaria and Romania, is a deep concern for food security. Policies in these two countries are aimed primarily at maintaining adequate supplies of reasonably priced food for the population.

All CEE's have introduced various market regulation schemes which fall into two general categories. First, there are the market regulation agencies that have been introduced in the visegrad four. These include the Agency for Agricultural Markets (ARR) in Poland, the Market Regulation Funds in the Czech and Slovak Republics, and the Agricultural Market Regulations Bureau in Hungary. Neither Bulgaria nor Romania have agencies analogous to those in the northern tier; however, these two countries, with different mechanisms, have intervened in their markets much more pervasively. The key difference between these two patterns of intervention is that policies pursued in the northern countries have resulted in prices at or slightly above world levels, while intervention pursued in Bulgaria and Romania has resulted in prices well below world levels.

The market regulation schemes that have emerged in the CEE's are quite distinct from one another and represent different levels of intervention. Hungary, which relies most on agricultural exports has wholeheartedly embraced instruments such as export subsidies. The Czech and Slovak Republics also use export subsidies, but are mainly concerned with maintaining a proper "balance" on their domestic markets. The role of Poland's ARR was initially limited to price stabilisation, carrying out intervention purchasing to maintain a floor under prices. Since then it has implemented guaranteed minimum prices but has not engaged in export subsidies. Until recently, Romania and Bulgaria pursued some of the most interventionist policies, relying to a large extent on quantitative controls on exports and controls on profit margins in the processing sector in an attempt to keep retail food prices low.

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II. Poland

The ARR was established in the spring of 1990 with the mission to stabilise prices through intervention purchasing. Its primary function at the time was to stabilise commodity markets through intervention purchasing -- buying up stocks when prices were falling and releasing them back onto the market when supplies were tight. Its role expanded in 1992 when it was given authority to set guaranteed minimum prices for wheat, rye and dairy products, which it supported through intervention purchasing. Since 1992 its role has expanded still further, and it is now involved in the management of the strategic reserve as well as providing preferential credit to grain producers and warehouses.

Currently, the ARR intervenes in grain markets in the following ways:

- Direct intervention purchasing using funds provided by the state budget. This accounted for 31 per cent of all intervention purchases in 1995/96.

- Procurement through a network of authorised warehouses. The warehouse agrees to purchase wheat at the intervention price and in return ARR provides guarantees for preferential credit to the warehouses. At the end of a three month period the ARR will purchase the grain at the intervention price plus storage, interest and handling grain if he can get a higher price. This accounted for 51 per cent of all intervention purchases in 1995/96.

- Advance payment to selected producers. Wheat producers who are willing to store at least 100 kilograms of wheat can receive an advance payment of 45 per cent of the intervention prices. The producer is obliged to leave his grain in storage for three months. At the end of that period, he can either repay the advance plus interest in cash, or he can forfeit 45 per cent of the grain to the Agency and take back the remaining 55 per cent, which he can either use on farm or sell on the open market. This accounted for 18 per cent of all intervention purchases in 1995/96.

The ARR also sets and administers minimum prices for dairy products and carries out intervention purchasing of pork and sugar. It is also periodically engaged in the import and export of these commodities; some of the exports have been subsidised. It does not directly engage in trade, but contracts with commercial companies to carry out the transactions on its behalf. In its first years of existence, the ARR's share in foreign trade of certain commodities was quite substantial and, although in recent years its share in foreign trade has been lower, it still has the authority to carry out foreign trade directly.

III. Hungary

Agricultural policies in Hungary place a higher priority on protecting the income of this sector, as well as promoting agricultural exports. Hungarian policies include extensive use of export subsidies, in addition to intervention purchasing, investment subsides, and variable import levies.

The Hungarian Government passed a law on market regulation in February 1993. This law established an Agricultural Market Regulations Bureau within the Ministry of Agriculture which is responsible for export/import licensing, setting production, processing and export subsidies, trade quotas, and price intervention levels. The bureau includes a number of Product Councils made up of representatives from producer, processor, trading and consumer groups. These Product Councils are

intended to have a significant role in the market regulation process, although there is some disagreement as to how important they are in the policy making process.

Until 1997, the regulation scheme provided for guaranteed prices for wheat, corn, milk, pork and beef. Quotas were set for the quantities which are purchased at the guaranteed prices. For livestock products the system of guaranteed prices has been replaced by one of target prices. A target price is set for EU, and R grades of hogs delivered to those plants which apply European standards. If the market price is under that target price by ten forints or less, that deficiency is paid to producers. If the market price exceeds the target by up to ten forints, a premium is paid to the processor.

The bulk of support provided to Hungarian producers is in the form of export subsidies. In 1996, the Hungarian government paid out a total of nearly 40 billion forints in export subsidies. The budget for 1997 earmarked 42.3 billion for various types of market support, including about 25 billion for export subsidies.

In compliance with WTO restrictions, Hungary does not maintain any quantitative controls on imports. It does, however, maintain such controls on exports. Exports of grains and other strategic products are subject to licensing, which is not automatic. With the periodic shortfalls that have occurred in Hungary's grain output, the Government has more than once suspended licensing of exports, thereby restricting the outflow and keeping grain in the country for the benefit of livestock producers. It can be said that Hungarian policies tend to tax grain producers in order to subsidise livestock production.

IV. Czech and Slovak Republics

The Czech and Slovak State Funds for Market Regulation (SFMR) were created along similar objectives as the ARR -- the stabilisation of prices and maintaining producer income. Both funds operate on similar principles. They regulate the market for key commodities through intervention purchasing or subsidised exports. Neither engages directly in either domestic purchasing or foreign trade, but contract with commercial companies to act on their behalf. These companies are selected through tenders.

Both Funds have their origin in the Federal Fund for Market Regulation of the former CSFR. The key functions of this Federal Fund were:

- Market regulation through intervention purchase and export subsidies
- Sale of products obtained through intervention domestically and abroad
- Determine licensing policies for agricultural exports
- Implementation of targets associated with intervention purchases and sales
- Propose lists of products for which compensatory rates are settled at import and the level of compensatory rates.

Its resources came from allocations from the state budget, sales of products, compensatory rates on imports, contributions from producers and processors. With these funds it financed intervention purchases, costs of processing, storage and sale or export of products, subsidies on imports, instalments on credits and interest.

With the separation of the two republics, each republic has a Fund for Market Regulation, each operating along the same basic principles as the former Federal Fund. The Slovak Fund supports the major grains -- food and feed wheat, corn, rye, feed and malting barley -- and milk and milk products. The former Federal Fund purchased only what could be exported. Both Republic Funds purchase both for

export and for domestic processing. The Funds also handle a large share of grain imports, although they do not have a strict monopoly on imports. Their large role most likely results from the limited resources of alternative trading companies.

There is a complicated system for allocation of quotas for intervention purchasing. Only a certain amount can be purchased in each region, no more than 20 per cent can come from a single farm in any one region. Within those guidelines, however, the criteria for purchasing from one farm or another are not clear.

V. Bulgaria

The Bulgarian government engages in a variety of market regulation activities which have changed over the year, but the fundamental objective behind these policies is food security. The market regulation schemes in the northern tier countries were a response to reduced agricultural income resulting from large surpluses in 1990 and 1991. Bulgaria's policies were inspired by the perceived need to maintain stable food supplies at reasonable prices.

Support to producers is administered through Fund Agriculture, which is responsible for providing low interest credit to producers and administering guaranteed minimum prices. It is authorised to grant export subsidies as well, although this has never been done. On paper its functions and responsibilities are very similar to the Polish ARR, but its impact on producer income has been quite the opposite. Until the summer of 1997 guaranteed prices were deliberately set below the world level. Farmers who received credit were required to sign contracts pledging to sell a given volume per hectare to the Fund at the minimum price. This became a serious problem for producers during 1996-97, when yields were particularly low and the minimum price was eroded by rapid inflation.

For the 1997 harvest, the Government raised the minimum price for bread wheat to US$134 per ton. Initially it was quite unclear how the Government intended to enforce this minimum price. Recently, however, the Ministry announced that state purchasing firms would be required to pay this price and will receive subsidised credit and loan guarantees to carry out these purchases. It is still the case that much of the purchasing, processing and foreign trade of grains is carried out by companies which are still majority state-owned; these companies continue to receive benefits from the state which are not available to private companies. After the 1997 harvest, the Agricultural Ministry made available about 260 billion leva (US$146 million) for low interest loans targeted at purchasing about 1,100,000 MT of wheat at the new minimum price. But only state enterprises where the state share is over 50 per cent will have the right to apply for these credits. These include 27 state mills; the largest, Zarneni Chrani, had the highest purchasing quota at 843,000 MT, which gave it a significant share of the market. Private mills must apply to the banks and pay the market interest rates. Zarneni Chrani also carries out the normal functions of a commercial firm, with the result that there is considerable conflict of interest among its various activities.

Controls on profit margins of processing companies are used to prevent excessive price increases for consumers. The Government has promulgated a set of normative profit margins for each stage of processing for bread and livestock products. The normative margin is calculated as a percentage of production costs, so as long as an industry was relatively monopolised, the system could have the effect of pushing up consumer prices. Recently, however, increased competition in the flour milling sector has forced millers to cut their margins below the normative levels. As competition increases in other sectors, the system of normative margins will become increasingly irrelevant and could be abolished with little ill effect.

Bulgaria has made liberal use of quantitative controls on imports and exports, and these measures change frequently in response to changing perceptions of supply and demand on the domestic market. Quantitative restrictions on imports have ceased with Bulgaria's accession to WTO. Export controls continue, however. Currently, exports of grain and certain other products are subject to an export tax, but they have also been subject to periodic bans. Such changes in the regime are announced with little warning and often in response to inaccurate information on the supply and demand situation in the country. The net effect of such intervention has been to exacerbate the current "grain shortage".

VI. Romania

Romania likewise does not have an agency specifically responsible for market regulation. But its policies until recently have been among the most highly interventionist of the CEE's. The fundamental objective of Romanian policy is to provide a given basket of foods, still heavily dominated by meat, at prices considered reasonable to the urban population. Even more than in Bulgaria, maintaining stable farm income is a secondary goal. Policy instruments include state control of producer prices, limits on processing margins, and quantitative controls on exports (imports are regulated almost entirely through tariffs).

Until recently, there were state controls on producer prices covering wheat, corn, oilseeds, sugar beets, potatoes, milk and a few other commodities. These applied only to state owned purchasing companies, and there simultaneously existed a free market on which substantially higher prices tended to be paid. State prices were calculated according to a rigid cost-plus formula which does not take into account spatial or temporal variations in production costs.

Low producer prices are partially offset by input subsidies. Other *ad hoc* stimulative measures are put in place when officials fear a production shortfall. For example, last year the Ministry of Agriculture anticipated a shortfall in sugar beet production and implemented a variety of stimulative measures such as providing seeds and chemicals free of charge and giving farmers 50 kilograms of sugar for each ton of beets sold to state procurement agencies.

Until 1995 the former Romcereal had a virtual strangle hold on the procurement of wheat. Almost all marketed wheat was purchased by Romcereal at prices that were barely half the world level. Romcereal had the responsibility for distributing subsidies to producers, channelling inputs to producers, managing government-owned storage, distribution of imported grains, and maintaining the state grain reserve. While it had ceased to be the only purchaser of grain, it managed to retain a substantial amount of market power. Where banks refused to extend credit to the loosely organised "family" associations, Romcereal provided credit against delivery of the crop. The credit was often in the form of essential inputs and services. Many associations had no other means to acquire needed inputs. Romcereal did not engage directly in foreign trade, but controlled most storage and the supply and prices charged to potential exporters.

In June 1995, Romcereal was dismantled. Part of it was reorganised as the National Agency for Agricultural Products (ANPA); the remainder was split into several commercial companies. These companies are eventually to be privatised, but at the moment most are majority state-owned. Furthermore, the functions of ANPA are rather broadly defined, to include purchasing, storage, and reserve management. In the year since the reorganisation, there does not appear to have been any increase in competition among purchasers of wheat. Monthly wheat prices a year ago showed almost no seasonality, and there was very little regional variation in wheat prices. This situation has not changed; there is still very little seasonal or spatial variation.

Exports are subject to quotas and outright bans for the explicit purpose of holding down domestic prices. Livestock products are currently subject to strict quotas; during the 1996/97 marketing year wheat exports were banned in response to a particularly bad harvest. Exports are also inhibited by the overvalued leu. Until this year imports, particularly of livestock products were restricted by extremely high tariffs. In 1995 Romania imposed tariffs of 143 per cent on poultry meat, 169 per cent on beef and veal, and 236 per cent on pork meat.

However, the recently elected non-communist government is committed to liberalising trade on both the domestic and international markets. In May 1997, the Romanian Government substantially lowered many of its tariffs: the tariff on poultry meat is now 60 per cent. In addition, the tariff on sunflower seed was lowered from 138 per cent to 30, while tariffs on both soy and sunflower seed meal were lowered from 25 per cent to zero. The new government has abolished all remaining controls on producer prices and is moving aggressively to privatise the daughter companies of the former Romcereal. However, the impacts of this price liberalisation are not yet evident.

VII. Impact on markets

On the surface, the impact of such market support policies on CEE commodity markets seems simple to analyse. In Romania and Bulgaria one can argue that flawed policies have kept domestic producer prices well below world levels. As for the northern countries, it might appear on the surface that the market regimes in place do not substantially distort production or trade. Producer prices of most commodities are very close to world prices; wheat prices in Poland have tended to drift above world levels recently, but are not much above.

The impact is more complicated than that. It is not sufficient merely to look at the gap between domestic and world prices. Instead, let us look back to some projections done by ERS in 1990, just as the CEE's were beginning the process of economic reform. At that time ERS did some projections of the medium term (seven or so years) impacts of reform on demand, supply and trade of major commodities. The predictions, seven years later are only partially born out. The region was forecast to be a net exporter of five million tons of grains, a major exporter of pork and a net importer of beef. Poultry trade was projected to be almost negligible. While the region has been a net grain exporter in most years since 1990, net exports have not exceeded two million tons. But where the situation diverges the most from the forecast is in the development of the livestock sector. The decline in livestock inventories has been much greater than projected, and the recovery is only now beginning.

A major reason these forecasts did not come true was that two of the most important assumptions underlying it did not prove correct. These were:

- the removal of all producer and consumer subsidies, such that both producers and consumers face world prices;
- an outward shift of the supply curve to reflect productivity gains that would take place as a result of market reform. It was assumed that the gap between CEE and EU yields would be closed by half.

We will look at the first assumption. According to OECD PSE and CSE calculations, support to producers and consumers is substantially less now than it was during the Communist period. While the net PSE may be rather low, support to producers is still significant in several of the CEE's and has had an impact on production decisions.

As a case in point, consider Hungary. According to our forecast Hungary was to become a net exporter of wheat and corn, a net importer of pork and beef, and a small exporter of poultry. Seven years later Hungary is indeed a net grain exporter, but grain exports are only half the forecast level, and Hungary has become a net exporter of all livestock products. Our results from 1990 suggested that Hungary's comparative advantage lies in grain production. Yet, Hungary's livestock sector has turned around, while grain yields still lag behind those of the EU. This is a direct result of an agricultural policy that is aggressively promoting livestock production and exports and taxing grain producers.

Yet, Hungarian policy does appear to be achieving its objective to promote livestock production and exports. Hungary's livestock sector has definitely bottomed out and is well on the road to recovery. Moreover Hungary has succeeded in reorienting its agricultural exports away from the Former Soviet market to a far more demanding EU market.

Intervention in the other CEE's has not so successfully met the objectives of their policy makers

- Romanian policies seem to be aimed both at food security and at promoting its livestock sector. One can say the food security objective has been achieved, since food supplies are plentiful. However, the livestock sector has failed to respond to all the incentives given to producers. For example, 1997 poultry production was only 150 000 tons, down from 450 000 in 1989, despite almost total protection from imports.

- Bulgarian policies, implemented in the name of food security, have led to a disastrous situation on the domestic market -- domestic supplies of both bread and meat are extremely tight, and there are said to be a large number of people who are truly not able to meet their daily nutritional requirements.

- Poland remains a net grain importer in most years, and grain yields remain well below pre-transition levels. In its livestock sector, only poultry has realised a significant recovery. There has been significant improvement in feeding efficiency in the hog sector, and there have been significant quality improvements as well. Hog numbers, however, continue to be subject to a widely gyrating hog cycle, responding strongly to changes in grain prices. Cattle numbers are still going down.

This brings us to the second assumption underlying our 1990 forecasts: productivity increases. We assumed that the gap between CEE and EU grain yields would be closed by half during the forecast period. Instead, the gap has widened: in 1989 CEE wheat yields were 91 per cent of the average EU yield; in 1997 this ratio was just 64 per cent. Productivity gains have been realised in certain segments of the livestock sectors in Poland and Hungary. But the livestock sectors in Bulgaria and Romania continue to be dominated by inefficient loss making state enterprises on one hand and two or three-hog private farms on the other. Feeding is still sub-optimal, and inventories of all animals are still declining in these two countries.

One of the key assumptions in our 1990 forecast was that with the dismantling of the institutional barriers that prevented the transmission of world prices to producers during Communism, producers would respond rapidly to world prices, would quickly identify their comparative advantage and invest in those areas where that advantage lay.

This, to a large extent, has not happened and there continues to exist a formidable array of obstacles that prevent the full transmission of world prices to producers. These include a lack of well defined property relations, bottlenecks in the distribution system, incomplete market information, and in

many cases an investment climate that still discourages foreign investment. One can argue that the market support mechanisms that have been put in place to some extent have slowed down reforms in these areas.

a) Farm Structure Remains Fragmented

The privatisation of agricultural land is nearly complete in all the CEE's, but the result in many cases has been an overly fragmented farm structure. Many private farms in Romania, for example, are less than 2 hectares. Moreover, many of the institutions that are needed to support the new private farmers are not yet in place. In Bulgaria and Romania many farmers still lack permanent title to their land, which prevents them from selling the land and makes it difficult for them to get credit. Credit institutions are undeveloped everywhere, and none of the CEE's have a functioning land market. Only Poland has a well developed extension system to provide advice to new farmers.

Poland does have clearly defined property rights, but the land market remains undeveloped there too. While Poland has realised some degree of farm consolidation, the average farm size is still only 6 hectares, and several farms consist of several non-contiguous plots. Livestock production remains dispersed: 63 per cent of its livestock operations have less than 20 hogs and account for 14 per cent of total numbers. Cattle are even more dispersed. There are 1.37 million cattle farms, and only two per cent have more than 20 head; these two per cent account for 21 per cent of cattle. Nearly 80 per cent of poultry producers are "one chicken house". The resulting high production costs make it difficult for most farmers to compete on world markets without subsidies. The vast number of small producers led to strong political pressure for protection, but this very protection is slowing down the consolidation that market forces would dictate.

b) Bottlenecks in the Distribution Sector

In some CEE's, most notably Hungary, the processing and distribution sector is entirely privatised. In other countries, such as Bulgaria and Romania, the purchasing and distribution of agricultural products remains dominated by state owned firms. These firms have been restructured and are no longer strictly monopolies. However, these state firms tend to enjoy benefits such as low cost credit which are not so easily available to private firms, with the result that the state firms still have considerable market power. They tend to use that market power to depress prices paid to producers. Even in Poland, there are complaints that the remaining state-owned firms have an unfair advantage in the marketplace.

c) Need for accurate economic information and forecasts

The successful operation of a price support programme requires accurate information on domestic and foreign market conditions. Officials must be able to make reasonably accurate projections of the budgetary impact of any given support price. In setting a support price, the responsible agency must be able to anticipate the supply response to the announced price and must have a reasonably accurate projection of demand. There is a tendency to set the minimum price on the basis of the cost structure characteristic under Communism, not realising that producers have made adjustments in their use of inputs. This leads to overestimation of production costs and could cause officials to set minimum prices too high. Many officials still tend to project demand according to per capita consumption norms left over from the old regime, not taking into account the full impact of real income declines. For a commodity such as bread wheat, which is highly inelastic, policy makers can count on relatively stable demand: there was a one time drop in consumption in 1991, but since then consumption has changed little. Demand for commodities such as meat or sugar are much more volatile, however, and overestimating demand could be quite costly.

Policies based on inaccurate information can be more destabilising to the market than no policy at all. The extreme case is Bulgaria where constant intervention in markets combined with miscalculations of supply and demand have resulted in extreme price instability. It can also be argued that Poland's intervention activities during 1996 and 1997 actually increased volatility of grain prices. Polish grain prices have lagged trends in world prices by about six months. In a delayed response to the sudden surge in world grain prices in 1995/96, Polish grain prices continued to rise well into 1996, as world prices fell. Finally, in belated recognition that Polish prices had risen above world levels and that this was causing problems for livestock producers, the Government decided to lower import tariffs for grains. For many livestock producers, however, this was too late.

VIII. Conclusion

There are important structural problems in CEE agriculture that still need to be addressed. Major institutional changes are needed to deal with these problems. These institutional reforms are being realised, but much work remains to be done. Further privatisation in the downstream sector, completion of land redistribution, better market information, and a more effective extension system are essential if producers are to thrive in a free market system. To the extent that these changes have not been completed, producers cannot adjust their production and marketing decisions rapidly to changing world market conditions. Without more rapid reform in these areas, the CEE's will be poorly prepared for accession to the European Union. Current efforts to support inefficient producers through price supports and import barriers will only slow down that process.

AGRICULTURAL POLICY REFORM
THE NEW ZEALAND EXPERIENCE

Neil Fraser *

I am very pleased to have been asked to make this short presentation on New Zealand's successful experience of moving from a heavily assisted agriculture sector to the position we now have of an agriculture sector that is fully market-oriented, receiving low levels of support. As a small country with a population of 3.7 million and an agricultural sector that is an important part of its economy, New Zealand has some strong similarities with the three Baltic countries under study.

New Zealand's agricultural sector, including farming and processing, involves around 16 per cent of the workforce and accounts for approximately 14.6 per cent of Gross Domestic Product. There is, therefore, a relatively limited scope for subsidisation of agriculture by the industrial sector. One factor that contributed to the problems New Zealand experienced was its historical dependence on a limited number of markets. The country's past agricultural prosperity was based not on "the market" but on a system of managed market arrangements, primarily with the United Kingdom. This network of arrangements covering dairy products and sheep meat appeared to work reasonably well in the 1940s, 1950s and 1960s, but began to break down when the UK moved towards the European Union. These arrangements meant there was little incentive for New Zealand farmers and exporters to develop new products or markets, and were the primary cause of the worsening of agricultural prospects in the early 1970s. The greatest incentive to improve and diversify agricultural production in New Zealand came from our need to participate in open markets after Britain joined the EU. The managed market approach prior to this had:

- stifled product quality and variety;
- slowed the development of marketing skills and the broadening of our export profile; and
- postponed the development of production and processing efficiencies.

In the 1970s, persistent balance of payments deficits led the Government to a drive for increased export earnings, and the Government saw agriculture as the sector that would lead this recovery. It began to increase its assistance to agriculture in a variety of ways, including concessionary loans for land development, livestock incentives and input subsidies.

To underpin this drive for increased production, the Government introduced a "Supplementary Minimum Price" (SMP) Scheme in 1978. This was intended to be a temporary expedient, but the international market did not improve as quickly or as sharply as was hoped. Supplementary payments to the dairy industry were negligible but payments to sheep farmers rapidly increased. There were also some payments on beef and on wool. (The pig and poultry industries were not part of the scheme and were consequently less affected by later policy reform.) New Zealand also had a system of industry protection

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(import controls and tariffs) that had the effect of adding to farmers' costs. Also, government kept the exchange rate at a level that overvalued the New Zealand dollar, thus disadvantaging the agricultural export industry.

The effect of these assistance measures to agriculture, and other interventions in the economy, led to a distortion of market signals to farmers. They resulted in changes to our pattern of livestock production, our farmland prices, and our production costs. They led to severe misallocations and waste of the country's productive resources. In particular, the emphasis given to sheep farming, especially lamb production, resulted in unsaleable surpluses. At the peak, New Zealand produced 39 million lambs for export to markets that could profitably sustain 32 to 34 million at the time. This increase of sheep production was at the expense of beef cattle, the number of which declined.

In 1982, 1983 and 1984 livestock subsidies, concessional loans and other forms of support amounted to more than two per cent of New Zealand's GDP. The percentage PSE for sheep meat in these years averaged more than 84 per cent. With a fiscal deficit rising to nine per cent of GDP in mid-1984, this level of support was obviously unsustainable and reform was urgently needed.

Following the change of government in 1984, the reform process began in earnest -- both in agriculture and in the economy generally:

- *Finance sector:* interest rate controls abolished; freely floating exchange rate.
- *Public sector:* corporatisation of state owned enterprises; sale of government businesses.
- *Industry Assistance:* tariff reductions; import quotas abolished.
- *Macroeconomic Policy:* fiscal and monetary policy; inflation reduced.
- *Agriculture:* elimination of supplementary minimum prices, export subsidies and input subsidies; concessionary loans phased out; producer board loans discontinued; 'user pays' principle for government services.
- *Labour:* abolition of compulsory union membership; more freedom to negotiate terms and conditions of employment.

What has been the effect of reform on the agricultural sector? During the assistance period sheep numbers rose to 70 million from their late 1960s level of around 60 million, with much of the expansion occurring at the expense of beef cattle numbers. Since 1984, numbers have dropped back to around 47 million. Dairy cow numbers have shown a slow but variable increase. The pig and poultry industries, which never received significant government assistance, have been relatively little affected.

Farm incomes declined initially, but have since recovered, as farmers adjusted to the new policy environment. Land values fell dramatically when the reforms began, but recovered in the early 1990s.

While there were hundreds of farms (out of about 80 000) thought to be non-viable, the reforms actually led to very few (measured in dozens) foreclosures. Rather, farmers and their creditors undertook debt-restructuring exercises. The farm-servicing and processing sectors have been rationalised and so became more efficient, with positive effects on farmers' incomes.

The reforms have stimulated greater efficiency, as well as the development of new products and production patterns. There has been diversification in production, products and markets and more attention has been paid to quality.

The reforms have generally been beneficial for the environment as marginal, easily erodible land has been taken out of production. There is less specialisation of production, creating a more attractive landscape in some areas.

It is important to note that the reform process was not confined to agriculture but implemented across the whole economy. While the reforms caused pain to many farmers, farming leaders took the responsible view that they were necessary and would eventually lead to a sustainable and stronger agriculture sector. Farmers had previously come in for criticism because of the level of support they were receiving. Now, farmers have regained public appreciation and also the self-respect that accompanies independence from government handouts. The sector is now more adaptable, more efficient and more responsive to market opportunities.

New Zealand farmers' highest priority now is a fairer, more open, world agricultural trading environment. They look overseas, and see heavily supported agricultural sectors, border protection, quotas, export subsidies and the like and can see that, following internal reform in New Zealand, there is an urgent need for more international reform. The Uruguay Round was a vital first step along the road to a fairer, more open, international agricultural trading system. But there is still a long way to go. The OECD calculates that total transfers from consumers and taxpayers to agriculture in its member countries totalled a staggering US$297 billion in 1996. These countries' agricultural trade barriers, export subsidies and other support measures impose considerable costs not only on their own consumers and taxpayers, but on farmers and exporters in the rest of the world, many of them in less developed countries.

Following are the conclusions that can be drawn from the New Zealand experience:

- heavy levels of assistance to agriculture are not sustainable for countries with relatively large agricultural sectors -- they create distortions and dependence;
- assistance becomes capitalised into land values, which encourages intensive farming and restricts new entrants;
- farmers will benefit from the efficiencies made in other sectors (transport, processing, shipping) as a result of reform in those sectors;
- agriculture should not be treated in isolation but as part of general economic policy;
- a consistent, credible and neutral policy framework should be provided for all sectors;
- agricultural output should be "market led" and not "production driven"; and
- unilateral agricultural liberalisation does work.

TRADE POLICY IN ESTONIA

Andres Oopkaup *

Agricultural products, including fish and fish products, play an important role in Estonian foreign trade. During the period 1992-1996, the share of these products in total trade rose from 15.8 per cent to 23.5 per cent and exports of agricultural products have risen fourfold, with imports increasing by 11.6 times.

When Estonia regained its independence in 1991, it introduced liberal principles in its trade policy while avoiding the application of measures regulating its domestic market. The Government's intention was to apply certain economic measures, such as *openness, free trade, and liberalisation*, so as to attract foreign partners. The approach to radical reform was based on strong monetary and liberal trade policies, a balanced budget, a generally transparent taxation system, and privatisation of state-owned enterprises. It became clear, however, that this kind of policy, particularly as applied to foreign trade policy, was not always in harmony with policies applied by other countries, and that for a small economy such as Estonia the risk of being upset by external events was an important one. Nevertheless, the Estonian economy has, in general, benefited from these policies enjoying a low inflation rate, an influx of foreign investments, and the introduction of new technology.

There has been a parallel development in the services sector, while the shares of the production and processing industries have decreased. On the basis of 1995 data, the share of the services sector was 63.7 per cent and the production sector (agriculture, industry, construction) was 36.3 per cent. In Latvia, comparable figures were 57.2 per cent and 42.8 per cent and in Lithuania, they were 48.5 per cent and 51.5 per cent, respectively

Since 1992, Estonia has signed fourteen free trade agreements, and although several have since expired, nine continue to remain valid (those with the European Union, EFTA countries, Baltic States, Ukraine, Czech Republic, Slovak Republic, Slovenia, Turkey, and Hungary). These agreements have led to improved trade relations, although growth in trade volume was relatively higher with EFTA, Baltic FTA countries and with Ukraine. The free trade agreement with the EU, signed on 1 January 1995, provided for preferential quotas to some Estonian imports as well as an opportunity to implement custom tariffs for a number of products originating from the EU (valid until the end of 1997). These quotas are, nevertheless, difficult to implement due to domestic market constraints. The agreement with Ukraine came into force on 14 March 1996 and provides full access to that country's markets. The Baltic Free Trade Agreement on agricultural products, which came into force on 1 January 1997, is a full free trade agreement providing free access to all Baltic markets. Acute problems in the agricultural sector have emerged as a result of the highly competitive environment created by these agreements, but it is believed that the long term benefits will provide for greater trade opportunities.

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It is clear to Estonian observers, however, that the goal of providing the population with affordable food purchased on the world market, and thereby alleviating internal agricultural costs by cutting down on subsidies, is unrealistic. Although recognising the importance of remaining competitive, there is a potential social risk in following certain policies in this regard. In Estonia, despite the relatively high proportion of income spent on foodstuffs (approximately 32 per cent), families are in general undernourished by international standards. At the same time, food prices have increased more slowly than the general consumer price index. Compared to 1993, the consumer price index in July 1997 was 262.9 per cent and, of this, food made up for 193.6 per cent. Producer output prices have grown more slowly than prices of production inputs. The prices of agricultural products have remained low for several reasons, including the slow growth of the population's purchasing power and the importation of some subsidised products.

	EXPORT	**IMPORT**	**+/-**
1992 Total	5548.6	5127.65	+420.95
of which:			
agricultural products (HS 1-24)	973.5	517.2	
share in total (per cent)	17.5	10.1	+456.3
1993 Total	10636.2	11831.0	-1194.8
of which:			
agricultural products (HS 1-24)	2498.6	1741.0	
share in total (per cent)	23.5	14.7	+757.6
1994 Total	16924.4	21509.3	-4584.9
of which:			
agricultural products (HS 1-24)	3748.1	3429.9	+318.2
share in total (per cent)	22.1	15.9	
1995 Total	21048.8	29111.9	-8063.1
of which:			
agricultural products (HS 1-24)	3452.7	4136.7	-684
share in total (per cent)	16.4	14.2	
1996 Total	24988.3	38552.6	-13564.3
of which:			
agricultural products (HS 1-24)	3936.8	6014.4	-2077.6
share in total (per cent)	15.8	15.6	
1997 January-June Total	17495.3	26602	-9106.7
of which:			
agricultural products (HS 1-24)	2530.5	4471.7	-1941.2
share in total (per cent)	14.5	16.8	

The importance of market regulations (implementation of custom tariffs, reference price system, minimum price) have been on the national agenda since 1992, and yet statistics show a negative foreign trade balance in foodstuffs and a rapidly increasing deficit since the first quarter of 1995. Estonia imports

many food products that it could produce itself and yet it has allowed domestic production capacity to fall to a level that does not cover the needs of the domestic market. The situation is also poor in the meat sector where in 1996 the self-sufficiency level for beef was 85 per cent, for pork 82 per cent, and for poultry only 34 per cent. Finally, the protection once offered by a highly devalued Estonian kroon, put into circulation during the 1992 monetary reform, has vanished as a result of price increases in the domestic market, which in turn has lead to a structural crisis requiring state intervention.

One of the primary objectives of the Parliamentary decision of 23 February 1994 was to ensure that the population would be fed with foodstuffs originating primarily from Estonia. The present trade policy measures, however, conflict with that objective. There has been a constant income deficit (approximately 1 billion kroons per year) in the agricultural production sector due to a shortage of finance for investment. There is, in fact, the possibility that agricultural production could completely shut down. According to the data for 1995 provided by the Statistical Office of Estonia (ESA), investments in agriculture totalled 3 per cent of the total value of investments. At the same time, the role of retail and wholesale trade was 14 per cent, and the role of transport, stock economy and communication was 21 per cent. Producers and traders try to increase their income by keeping producer prices as low as possible. The application of tariffs could enable producers to raise their prices, as well as add income to the State budget. For example, according to the data for 1996, approximately 600 million kroons per year could have been added to the State budget by the application of a 10 per cent tariff. Should this have been the case, the new resources could have been used to cover the agricultural deficit.

There is actually no legislative base for the application of tariffs in Estonia. This legal barrier will certainly disappear soon and the application and level of market regulation in the form of tariffs will depend on political decisions. In this context, it is appropriate to remember that although EU accession would entail the application of EU policies by Estonia, there are still differences to be resolved concerning the choice of measures that should be taken (market management, level of protectionism, etc.).

The expected results, if tariffs were applied, would be the following:

- producer price increases would directly increase the profitability of production;
- extra money would come into the State budget which could be used to support agriculture programmes and/or offset increased cost of living for the poorer members of the population;
- the Estonian market would become less attractive to imports and more attractive to investors, and the competitive conditions for local producers and processors would improve;
- the deficit on the foreign trade balance would decrease as a result of import limitations.

SUMMARY OF THE REPORT "AGRICULTURE TRADING POLICY IN LATVIA"

Aiga Smiltâne *

There are presently two concurrent lines of direction in Latvia's trading policy. The first relates to the harmonisation of the country's laws and regulations and the control of the domestic market as a result of requests made by the World Trade Organisation and the European Union. Secondly, Latvia is also developing a more open and liberal policy towards foreign trade.

I. Accomplished tasks related to the accession of Latvia to the WTO (1996 - 1997)

Today, Latvian trade policy is characterised by the following :

- uniform commodity prices are annulled and adapted to new tax rates with regards to imported products. In accordance with the new Customs Code, there is a fixed base for contract prices. The above regulation came into force on 1 September 1997.
- the harmonisation of laws in conformity with the provisions of the WTO; quantitative trade restrictions on sugar, cereals and cereal based products were annulled. Licensing is maintained only for the purpose of gathering statistics and for the possibility it offers to follow domestic market developments. Licences are issued automatically.
- customs tariff rates for agricultural and processed products are gradually being decreased in accordance with requests made by the World Bank and the International Monetary Fund, and following initiatives taken by the Ministry of Agriculture, producers and bilateral concessions as provided for by Free Trade Agreements.
- elaboration of safeguard measures with respect to the domestic market in conformity with the relevant WTO provisions.

II. Free trade agreements

The following free trade agreements have been negotiated by the Latvian government :

- FTA between Latvia and the European Union -- the first to be negotiated -- was concluded just after Latvia's independence and can be considered as the first step towards integration into the European Union;
- FTA between Latvia and EFTA countries. These were joint agreements relating to trade in processed agricultural products. Bilateral agreements related to trade in agricultural products were negotiated individually;

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- FTA between Latvia and Czech/Slovak Republics, and Slovenia is characterised by the principle of equality with respect to trade in agricultural and processed products;
- The Baltic states trilateral FTA allows for the possibility for producers to test their competitiveness according to free trade conditions, although Latvia tends to have more active trading with Estonia and Lithuania. Nevertheless, there is a common tendency in increasing reciprocal trade volumes as was forecasted before the FTA entered into force.

III. Trade balance analyses

The total imports of agricultural products in 1996 reached Ls 171 mn, and exports, Ls 134 mn. In analysing the import- export data, it is clear, however, that for the period 1 January - 1 July 1997, the trade balance with respect to agricultural and processed products did not change and still continues to be negative -- Ls 39,2 mn.

Trade balance is also negative with the EU countries and for the period 1 January - 1 July 1997 it constituted Ls 49,4 mn. When comparing the above data with those of the same period in 1996, it is clear that trade volume has increased with Belgium, Great Britain and Netherlands. Trade balance with the countries of the former Soviet Union is positive and constitutes Ls 43.5 mn for the period 1 January - 1 July 1997. In comparison to 1996, the increase in trade of agricultural and processed products was LS 8.2 mn.

Within the scope of the Baltic states, trilateral trade balance was negative -- Ls 6.3 mn and in comparison to the period of 1 January to 1 July 1996 increased by Ls 4.9 mn(LS 1.4 mn at the same period in 1996). Nevertheless, export volume to Estonia and Lithuania increased in comparison to 1 January- 1 July 1996 by Ls 678.5thous and Ls 2.1 mn, respectively.

As far as imports of agricultural and food products is concerned, the member states of the European Union are the largest trade partners to Latvia.

The main recipients of Latvian agricultural exports are the former Soviet union countries, including Russia, Belarus, and Ukraine. The major export items are milk products, fish and fish products, and confectionery and the export volume of mineral water, juices and alcoholic beverages are gradually increasing. In the future, exports of specific food products, for example, potato starch, ketchup, mayonnaise, beer, and yeast, is expected.

IV. Perspectives of foreign trade

Negotiation of free trade agreements have begun with Poland and Turkey, and the Government plans to negotiate these same types of agreements with Ukraine, Hungary and Bulgaria. It is also expected to further develop and improve its trade with Russia. Finally, the Government intends to begin accession procedures to the WTO.

LITHUANIA'S FOREIGN TRADE POLICY IN AGRICULTURAL PRODUCTS

Antanas Poviliunas *

I. Introduction

The agricultural sectors of the former Soviet Baltic countries and Belarus specialised in dairy and meat production for the Soviet Union market, supplying it with 13.8 per cent of its commodity meat and 15.7 per cent of its dairy products between 1986 and 1990. Today, the primary objective of Lithuanian agriculture has been to satisfy national demand. Agricultural production in Latvia is superior to imported goods because the product is cheap, delivered fresh, is relatively free of chemicals, and residents are familiar with the produce. The quality and appearance of these goods also comply with international norms thereby strengthening its competitive edge.

The capacity of the national agricultural sector to produce goods in excess of market demands allows for the prospect of increasing exports. In 1995, the export of agricultural products amounted to US$ 487.6 mn or, 13.4 per cent of the total import, whereas in 1996 it amounted to US$577 mn, or 13 per cent of total imports. The foreign trade balance in 1995 was thus positive (US$+8.1 mn), but in 1996 it was already negative (US$21.6 mn). When analysing Lithuania's trade with foreign partners, however, one finds a positive foreign trade balance with the Baltic and CIS countries only. It was negative with other countries.

II. Lithuania in internal market of the Baltic countries

The free trade agreement between Lithuania, Latvia and Estonia came into force in 1994. It did not include agricultural products, however, given the obstacles posed by the agricultural subsidy policies of each of these countries. Estonia did not have any import duties, and duties imposed by Latvia and Lithuania fluctuated between 20 per cent and 60 per cent.

To maintain market prices, Estonia allocated US$1.3 mn in 1995 and US$20.5 mn in 1996 from the State budget, Latvia allocated US$7.7 mn and US$14.4 mn, and Lithuania allocated US$10.8 mn and US$123.3 mn. Other measures towards agricultural support made up US$14.4 mn in 1995 and US$6.3 mn in 1996 in Estonia, respectively US$19.2 mn and US$16.3 mn in Latvia, and US$57.9 mn and US$84.3 mn in Lithuania.

As a result of the differences in support programmes, it was only in June 1996 that a free trade agreement covering all products complying with the original requirements was signed. It came into force on 1 January 1997, becoming the first foreign trade agreement signed by the Republic of Lithuania. Even without a Customs Union it is possible to trade freely in agricultural products produced in the Baltic countries and although this market is not large (there are only 7.9 mn residents), there is a real possibility

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for agricultural and processing industry enterprises to learn about competition and to participate in a broader market.

It is not surprising that agricultural specialisation in these three countries is similar. They belong to the same zone of the former USSR which developed pig breeding and cattle breeding. The agricultural production circulating in these Republics is also similar. Lithuania is responsible for the largest part of goods (Table 1).

There were no essential changes in 1996. Lithuania tried to bulk-buy more local grain, and limited its exports to Latvia. The objective was to provide the local market solely with nationally-produced grain in order to maintain low grain prices. Meat products did not have this same restriction. Nevertheless, with the free-flow of agricultural products within the Baltic countries, it is expected that this situation will largely change in 1997. In addition, it is also expected that the Baltic FTA will lead to lower consumer prices.

The next step is to balance state regulations with the agrarian policies of the EU. It would seem appropriate that the three countries agree on and prepare a common programme on expansion of their agricultural sector (this could be done following the example of the national agricultural development programme in Lithuania). Lithuanian foreign trade balance in agricultural products with Latvia and Estonia was positive in 1995 and 1996 ; the export of these products was higher than imports (Table 2).

In generalising the steps taken by the Baltic countries towards the development of an internal market, and taking into consideration the initial results, it is possible to conclude that:

- the variety of agricultural products offered on the market is increasing and that marketing is improving;
- it is possible to increase exports of Lithuanian grain;
- flows of meat and dairy products will remain the same;
- difference in prices will gradually decrease between the three countries;
- specialisation of farms will improve as they adapt to market demand;
- new inter-republican unions of enterprises will be created.

Table 1. **The flow of selected goods between Lithuania, Latvia and Estonia, 1995 (thousand US$)**

Goods	Lithuania	Direction	Latvia	Estonia
Livestock	558.4	-------->	420.7	137.7
	2.4	<--------	2.1	0.3
Meat	2 165.7	-------->	1 658.6	507.1
	22.5	<--------	-	22.5
of which: beef	907.0	-------->	478.9	428.1
pork	74.4	-------->	74.4	-
poultry	1 173.4	-------->	1 094.4	79.0
Fish	835.7	-------->	745.5	90.2
	1 109.5	<--------	397.6	711.9
Dairy products	8 777.2	-------->	2 750.8	6 026.4
of which: butter	2 824.1	-------->	2 081.7	742.4
cheese and	1 739.1	-------->	1 563.1	176.0
cottage cheese	13.9	<--------	13.9	-
Eggs	1 688.1	-------->	1 563.2	124.9
	7.1	<--------	-	7.1
Potatoes	2.9	-------->	2.9	-
	6.4	<--------	-	6.4
Vegetables	233.3	-------->	167.5	65.8
	172.9	<--------	172.1	0.8
Fruits	856.8	-------->	769.4	87.3
Grain	719.8	-------->	483.9	235.9
	332.0	<--------	4.9	327.1
Products of the milling	1 033.3	-------->	358.6	674.7
industry	295.4	<--------	2.6	292.8
Other plant products	582.9	-------->	508.8	74.1
	293.5	<--------	288.9	4.6
Fat and cooking oil	42.1	-------->	35.0	7.1
	238.7	<--------	211.5	27.2
Sugar and confectionery	1 216.5	-------->	591.2	625.3
	210.4	<--------	106.8	103.6
Pastry	376.7	-------->	162.6	214.1
	723.0	<--------	699.2	23.8
Fruit and vegetable	166.8	-------->	97.7	23.8
products	299.4	<--------	57.4	242.0
Other food products	882.4	-------->	346.3	536.1
	249.8	<--------	43.3	206.4
Soft drinks	200.4	-------->	52.6	147.8
	2 198.2	<--------	17.4	2 180.8

Nota: The arrows indicate the direction of the flow of production: to the right from Lithuania to Latvia and Estonia, to the left - *vice versa*.

Table 2. **The balance of Lithuania's foreign trade in agricultural products with Latvia and Estonia (thousand US$)**

		Export	Import	Difference
Latvia	1995	23 850	4 400	19 450
	1996	32 609	6 378	26 231
Estonia	1995	15 950	7 450	8 500
	1996	25 316	10 776	14 540

III. The development of Lithuania's trade relations with CEFTA countries

Trade policy in Lithuania also differs from that of Latvia and Estonia by the free trade agreements signed with the CEFTA countries. Lithuania seeks to become a member of the CEFTA once it is admitted to the WTO.

Trade agreements with Poland and Slovenia have been signed and negotiations are continuing with the Czech Republic, Slovak and Hungary. To date, Lithuania's foreign trade balance with these countries has been negative, with imports twice as high as exports (Table 3).

Table 3. **Lithuania's foreign trade balance in agricultural products with CEFTA countries, 1995-1996 (thousand US$)**

CEFTA	**Export**		**Import**		**Difference**	
countries	**1995**	**1996**	**1995**	**1996**	**1995**	**1996**
Poland	5 540	5 185	10 661	28 662	-5 121	-23 477
Hungary	4 305	2 842	6 899	19 740	-2 594	-16 898
Czech Republic	1 081	482	3 761	7 793	-2 680	-7 311
Slovak	104	-	228	493	-124	-493
Total	**11 030**	**8 509**	**21 549**	**56 688**	**-10 519**	**-48 179**

The flow of goods is favourable for Lithuania. CEFTA countries buy livestock, meat and dairy products. Lithuania's imports of these same goods are insignificant, although it does import more pork, poultry, and eggs. The main imports are: vegetables, berries, fruits, grain and sunflower seeds, sugar, and confectionery as well as pastry products.

Some imports, however, reflect inadequacies within Lithuanian agriculture. The export of live-stock is due to the fact that the equipment capacity of meat processing enterprises is not fully utilised. Among imported vegetables, including potatoes, the prevailing species are ones that grow well in Lithuania. The volume of grain exported has been large even though this kind of fodder grain is needed in Lithuania. There many pastry and confectionery products imported while the capacity of the confectioneries is not fully used. Table 4 provides an example of some of these product flows with CEFTA countries.

Table 4. **The flows of some goods between Lithuania and CEFTA countries, in 1995 (thousand US$)**

			of which			
Goods	**Lithuania**	**CEFTA**	**Poland**	**Hungary**	**Czech Republic**	**Slovak**
Livestock	1 047.6	------>	1 026.4	-	21.2	-
	<------	0.9	0.7	-	0.2	-
Meat	2 097.5	------>	38.0	1 368.2	590.7	100.6
	<------	897.8	668.4	219.0	-	10.4
of which: beef	1 931.2	------>	11.3	1 228.6	590.7	100.6
pork	<------	638.4	638.4	-	-	-
poultry	<------	14.8	-	14.8	-	-
Dairy products	3 411.0	------>	600.6	2 810.4	-	-
	<------	23.5	10.1	12.2	1.2	
of which: butter	22.2	------>	22.2	-	-	-
cheese	2 917.9	------>	125.6	2 792.2	-	-
canned milk	456.8	------>	452.8	4.0	-	-
Eggs	<------	332.7	253.5	57.4	21.8	
Potatoes	<------	12.9	9.1	3.8	-	-
Vegetables	20.4	------>	4.9	15.6	-	-
	<------	530.1	358.2	157.9	6.2	0.9
Fruits and berries	5.2	------>	-	5.2	-	-
	<------	272.3	269.7	2.6	-	-
Grain	1 056.2	------>	1 056.2	-	-	-
	<------	2 415.5	614.6	1 401.7	395.7	3.6
Sunflower seeds	125.5	------>	125.5	-	-	-
	<------	1 253.8	1702	1 222.0	6.2	8.3
Products of the milling industry	254.0	------>	254.0	-	-	-
Sugar and	30.6	------>	30.6	-	-	-
confectionery	<------	512.4	427.7	38.6	42.4	3.8
Pastry	<------	1 257.8	188.1	419.0	637.0	-
Juice	<------	921.2	444.9	467.4	3.8	5.2
Soft drinks	<------	805.4	587.4	85.4	130.5	2.2

Nota: The arrows indicate the direction of the flow of production: to the right, from Lithuania to CEFTA, to the left, *vice versa*.

The data for 1996 reflect the same picture and it is doubtful the situation will change in the near future. Joining the CEFTA could help solve an important problem concerning fodder and maintain a greater import/export balance. It is necessary that the agrarian policy decrease costs of production rather than increase prices. In addition, free trade agreements with neighbouring republics and joining inter-republic unions will hasten membership in the EU.

IV. Conclusions

Now that the Lithuanian market is no longer tied solely to the former USSR market, it is necessary for it to specialise in products that meet local needs as well as to expand in areas that would create a profitable foreign market. It is clear that exports are limited due to geographical and internal structural reasons, yet it is important that a positive trade balance with export markets be established. Therefore, the internal market of the Baltic countries is important as it would enable the expansion of sales

of agricultural products. This, in turn, could expand into a broader market towards northern European countries, particularly those that share the Baltic sea coastline.

Attempts by Lithuania to join the CEFTA should be directed in such a way that would help the country develop its rural areas, to expand businesses that are not of agricultural origin, as well as to strengthen the competitiveness of agricultural enterprises. It is imperative to give greater importance to more productive co-operation within the marketing infrastructure, to increasing state investment in the development of wholesale markets, commodity exchanges, systems of categories and standards, programmes of export promotion, and systems of market formation.

AGRICULTURAL TRADE POLICIES AND TRADE RELATIONS IN TRANSITION ECONOMIES

Angela Bergschmidt and Monika Hartmann *

I. Introduction

The break-up of the Council for Mutual Economic Assistance (CMEA) resulted in a rapid and substantial reorientation of trade towards the West. In general, a reintegration of the East European countries into the international market has taken place. This is reflected in considerable changes in the transition countries' trade policies, but also in the fact that most of these countries have become or have applied to become members of the General Agreement on Tariffs and Trade (GATT). In addition, a number of new trade agreements have been signed in the last five years, with the European Union (EU) and other Western Countries, and also among East European Countries. Among the most important agreements are the Europe Agreements, as examples of the former, and the Central European Free Trade Agreement (CEFTA) and the Baltic Free Trade Agreement (BFTA), as examples of the latter.

The EU Commission has recently proposed to start negotiations for accession with the Czech Republic, Estonia, Hungary, Poland and Slovenia. This would have pronounced trade effects on the EU-15, the New Member Countries (New MCs), and third countries, especially those Central and Eastern Associates (CEAs) who will not be invited to join the EU in this first round.

Given this background, the aim of the paper is to provide an overview and a first evaluation of the economic consequences some of the most important developments in the CEAs' national and multinational trade policies (Section II) and trade relations (Section III) during the last years will have. The possible future trade impact of the first accession on those five association countries that will remain outside the EU will be analysed in Section IV. The findings from the previous sections are summarised in the final section.

II. Agricultural Trade Policies

a) Trade Policies at the National Level

Trade policies in agriculture and the food market differ somewhat between the various Central and Eastern European Countries (CEECs). It would go beyond the scope of this paper to provide a detailed account of the policies each individual country has pursued. At this point only a summary of some common trends can be presented, although this bears the risk of oversimplification[1]. The main trade measures applied in CEAs agriculture are presented in Table 1.

At the beginning of the transition process, most CEAs liberalised their agricultural price and trade policies to a large extent[2]. In the meantime, however, policy interventions on agricultural and food

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markets have again gained in importance [3]. Agricultural trade intervention in the CEAs ranges from discriminating against the agricultural sector, as is the case on some product markets in Bulgaria and Romania, to considerably protecting agriculture, as happens in Poland and Slovenia. This very much reflects the fact that the political importance of food prices, and thus a more consumer-oriented policy approach, increases as the average level of income decreases (EU Commission, 1997, p. 16).

However, there are not only pronounced differences in the way the CEAs influence their agricultural product markets, but also many common features. Thus the CEAs have generally introduced measures to stabilise their domestic markets and to reduce imports. The latter has been achieved mainly by raising import tariffs, an instrument that has been especially popular because of its ability to raise funds for the public budget (EU Commission, 1997, p. 15). In addition, export subsidies are also used on some markets for some products. Of all policy interventions in the agricultural sector in Hungary, export subsidies have created the highest budgetary burden. In 1995, Hungary exceeded the maximum level of export subsidies allowed under GATT by more than 100 per cent[4].

Especially on the grain markets, some countries have pursued a policy of export restrictions. Export taxes, export quotas, and in some cases also export bans have been implemented not only in Bulgaria and Romania, but also in Lithuania and the Czech Republic[5]. The main aim of these measures was to prevent food shortages for domestic consumers.

As the exposition has so far shown, trade interventions in agricultural markets are prevalent in all CEAs except Estonia, inducing the well-known welfare losses. The distribution effects of the policies depend on the direction of policy intervention. However, from a welfare point of view it is not only the kind of trade policy that matters, but also its stability. Especially the beginning of the transition process was marked by *ad hoc* interventions, mainly aimed at solving short-term problems. Although in most countries governmental policies have gained in stability, this does not hold for all CEAs; e.g. in Bulgaria trade measures which had been approved and implemented have been changed several times in the course of one year (EU Commission, 1997, p. 117). This has induced severe risks for the economic agents, thereby hampering the development of the agricultural and food sector. The lack of information on policy changes has often further aggravated the negative implications of these *ad hoc* policy measures. Thus it should be stressed that not only the type of trade policy applied, but also its stability and predictability are crucial for the development of the agricultural and food sector in the CEAs (OECD, 1997, p. 151).

b) Multinational Trade Policies - GATT/WTO

Integration into the global trading system has become an important feature of trade policies in the transition economies. The Czech Republic, Hungary, Poland, Slovenia, Romania[6] and the Slovak Republic, all signatories to the GATT, participated in the Uruguay Round (UR) negotiations and acceded to the World Trade Organisation (WTO) by accepting the related commitments. Bulgaria completed negotiations in 1996, while the Baltic states are currently at different stages of negotiation for accession [7].

i) Provisions and Implementation of the GATT/WTO

The Agreement on Agriculture of the UR and the product-specific commitments laid down in country-specific schedules give the juridical background to the rules on agricultural trade. The provisions, which are briefly described in Annex 1, can be grouped into three main areas: market access, domestic support and export subsidies.

Market Access

Market access provisions in the WTO comprise tarification procedures and minimum access commitments[8]. The reference period for the binding of tariffs was generally set to be 1986-88, a period which was clearly not suitable for the countries of Central and Eastern Europe. They therefore chose to make use of the so-called "national offers" which propose the possibility of setting tariffs freely, and to present them to the GATT signatories at the UR (Twesten, 1997). On the basis of their tariff bindings, the CEAs can be grouped into four categories of protection potential: relatively low (Czech and Slovak Republics), average (Hungary and Slovenia), high (Poland and Bulgaria) and very high (Romania). While Bulgaria and Poland generally targeted their bindings at EU level, most countries stayed considerably below it. Because of its developing country status, Romania was able to negotiate very high tariffs with a weighted average (*ad valorem* equivalent) of 161.5 per cent (OECD, 1997).

The tarification procedure resulted in a general increase in tariff protection in the aftermath of the negotiations[9]. Tariffs nevertheless remained below the bindings in most of the CEAs. Currently, Hungary, the Czech Republic and the Slovak Republic are operating at the limit of their WTO commitments[10], while most other countries still have some potential to increase protection.

Domestic Support

Regarding the Aggregate Measures of Support (AMS), the CEAs have to follow the general rules, which provide for a binding of the AMS at the nominal average prices of the base period (1986-88) and a 20 per cent reduction until 2001. Some countries seem to have been confused by the procedures laid down for the calculation of the AMS ceiling. In the case of the Czech Republic, "green box" measures were included, while existing market support measures were left out. Poland and Hungary included market support measures, but Poland deducted its negative market support (in some cases administrative prices were below world market prices) -6 a procedure not foreseen in the Agreement on Agriculture. While Poland expressed its AMS in US dollars, Bulgaria and Slovenia used the ECU. The Czech and Slovak Republics and Hungary expressed their AMS in local currencies[11], while Romania does not have an explicit AMS, having been allowed to spend 10 per cent of the value of agricultural output on non-exempt support measures. Compared to the EU, which has a base AMS of 57 per cent of its output value, most CEAs have rather low bindings; with 52 per cent, Poland is one exception.

The implementation of the AMS is difficult to assess, as most countries have not yet declared their 1995 domestic support measures to the WTO. While the OECD has come to the conclusion that the AMS "does not appear to be a binding policy constraint" (1997, p. 152), Twesten (1997) concludes in his study on the Visegrad countries that Hungary, the Czech and the Slovak Republics have already reached their AMS ceilings, whereas Poland still has considerable room for manoeuvre.

Export Subsidies

All CEAs that have WTO commitments, with the exception of Slovenia, have included export subsidies in their schedules (OECD, 1997). Again, confusion or a lack of information about the regulatory framework has led to a number of irregularities in the process of laying down the commitments. In some cases, products were allocated to several product groups[12], offering the possibility of achieving a higher overall binding. On the other hand, Hungary did not declare export subsidies for some products for which export subsidies had been paid in the base period, and "overlooked" the export subsidies in trade with the CMEA countries. As in the case of AMS, most countries expressed their budgetary outlays with respect to exports in local currencies, only Poland (US$) and Bulgaria (ECU) chose foreign currencies. The consequence of the local currency choice is much more serious in this case, because WTO rules do not

provide for an option to re-negotiate export subsidy commitments should they be eroded by excessive inflation.

Among the CEAs that are members of the WTO, so far only Hungary has experienced serious constraints from its export subsidy commitments. In 1995 its aggregated budget constraint was exceeded by 114 per cent (Twesten, 1997) and the case was put to the WTO arbitration committee. The settlement agreed upon provided for a new base year (1995), but maintained the final level to which the subsidies will have to be reduced by the year 2002 as laid down in the schedule.

Consequences of the integration of the CEAs into the world trading system arise not only directly from obligations of the Central European WTO members as described above. The effect of the UR Agreement on international markets also has repercussions on the trade environment for the CEAs. The possible gains and losses of these effects will be discussed in the following section.

ii) Effects of the GATT/WTO on the CEAs

The agricultural provisions of the UR are expected to lead to a slight reduction in agricultural protection, very probably causing a rise in the level and the stability of world market prices. This price rise is primarily owed to the obligation to reduce subsidised exports[13]. It will be further advanced by liberalisation in other areas, generating world-wide gains in real income. Estimates using computable general equilibrium models to establish the world income effects of the UR agreements predict GDP increases ranging from US$60 to 477 billion[14]. Depending on the income elasticity of demand for agricultural products, this will produce a stronger increase in international agricultural prices. The world market price rise will favour those countries previously unable to compete in the escalating subsidisation due to financial constraints, but who are now able to compete on the basis of comparative advantages (Inotai and Kiss, 1996). Leaving aside domestic policies, the agricultural net exporters in the CEAs are the potential winners of this agreement. Both real income and net export receipts will increase as a result of the changes in world market prices. CEAs that are originally importers, but which become net exporters in view of the rise in world market prices and the resulting technical advances, may also achieve welfare gains; beyond this they will experience a clear improvement in their foreign exchange balance. On the other hand, countries that continue to be net importers after the implementation of the Uruguay Round provisions may suffer losses on two fronts; in addition to a fall in real income, they will suffer a deterioration in their foreign exchange balances if import demand elasticity in the agricultural markets is less than unity. Since the restructuring process has not yet been completed in most CEAs, it remains to be seen which countries will in the long run be able to compete with respect to agriculture.

The picture is further complicated by the existence of domestic agricultural policies and macroeconomic distortions in CEAs[15]. Especially if the relatively high, and in some cases still not fully utilised, tariff bindings encourage the CEAs to increase their own protection, this will certainly be detrimental from a welfare point of view.

Furthermore, the EU and other industrial countries have concluded a series of agreements with the CEAs (see section IV.a) under which they have granted trade concessions. As the GATT agreement will tend to result in a lowering of protection and a rise in world market prices, this will lead to an erosion of preferences for favoured nations. Neglecting this aspect will therefore lead to an overestimation (underestimation) of the possible welfare gains (losses) in the CEAs[16].

In addition, attention must be paid to the price stability aspect when analysing the effects of the agreement on the CEAs. This effect is the result of the tarification, which no longer permits countries to completely isolate their domestic markets from the world market by means of variable import levies,

export subsidies or import quotas[17]. The expected modest reduction in price instability on the world agricultural market will reduce uncertainty for importing and exporting nations alike, thereby raising the efficiency of resource allocation[18]. Even more important in this respect are the WTO commitments of the CEAs themselves if they do represent a serious constraint on *ad hoc* protective measures. More stable agricultural world markets and national prices could therefore generate considerable welfare gains in CEAs.

For the CEAs, quantitative estimates of potential gains through their WTO membership or the conclusion of the UR have not yet been undertaken. However, in total the liberalisation of agricultural trade is estimated to lead to an increase in world GDP of US$53 billion, of which 14.3 billion are expected to be realised in the developing and transition economies (Yüksel, 1996, p. 54).

III. Treaties and Agreements among the CEAs

After a period of disintegration in the former socialist bloc, efforts have been made to find new forms of integration since the beginning of 1992. In addition to a large number of bilateral trade agreements (see also Table 2)[19], two major multilateral trade agreements were signed in the CEAs, namely the CEFTA and the BFTA.

a) Main Characteristics of BFTA and CEFTA

The CEFTA was founded by the Czech Republic, Hungary, Poland and the Slovak Republic and came into force in March 1993. Slovenia joined in January 1996 and Romania in July 1997. The countries interested in future membership are Bulgaria, which holds observer status, the Baltic states, Croatia, Macedonia, Ukraine and Russia (East Europe 4/97, 9/97). Baldwin´s Domino Theory (Baldwin, 1994) comes to mind as a relevant framework for attempting to explain the increasing interest of transition countries in becoming members of CEFTA. According to Baldwin, the establishment of a Free Trade Agreement (FTA) might induce in third countries the fear of losing export markets to member countries as a result of such an agreement. This results in pressure on non-member countries to join the FTA. When they do eventually join, thereby expanding the FTA, this increases pressure on those countries that are still left out (Valdés, 1997, p. 4). In general, the adverse consequences for a non-member country, and thus the importance of the domino effect, depend on the relevance of FTA members for the specific country and on the kind of policies implemented by the trading blocks. Thus Bulgaria's interest in joining CEFTA might very well be due to the fact that about 15 per cent of its exports go to the CEAs. Remaining outside the CEFTA might lead to a loss in export markets.

The CEFTA is a symmetrical treaty, with all participating countries committing themselves to simultaneously reducing customs tariffs and trade barriers on the products listed in the agreement. The focus is on industrial products, while trade in agricultural commodities is covered in separate protocols (OECD, 1996).

The original protocols on agricultural trade covered only one quarter of the CEFTA countries' trade in agricultural products, and the tariff and quota concessions were modest. Trade in most agricultural and food products continued to be governed by bilateral agreements. Some additional but equally moderate tariff reductions were made in 1994 (OECD, 1996, p. 14).

In 1995 the four founding member countries signed an agreement on the reduction of agricultural duties by about 50 per cent on average, with effect from January 1996, agreeing to completely eliminate them by January 1998[20]. Under this agreement, agricultural commodities have been classified into three groups:

- products not generally produced in the CEFTA, for which duties will be totally eliminated;
- products for which a uniform duty of 14 per cent will on average be applied;
- sensitive products, for which member countries will sign bilateral agreements on duties and quotas.

While the first group accounts for 14 per cent of the total value of mutual trade, the second and third encompass 31 per cent and 55 per cent respectively (OECD 1996, p. 14; Internet, Hungarian Economy 1995: www.iqsoft.hu/economy/page95_4/cefta.html). The original objective to introduce free trade as early as 1998 has been abandoned by all CEFTA countries, with a majority of member states advocating the year 1999. Slovenia[21] is arguing for a total removal of tariffs not before 2001 (East Europe 7/97).

As already mentioned above, a second multilateral trade arrangement has been established in the CEAs. This is the Baltic Free Trade Agreement, which was signed by the Baltic countries Estonia, Latvia and Lithuania in 1993 and took effect in April 1994. Initially, it dealt exclusively with trade in industrial products and was formulated with the long-term aim of forming a customs union. After long and difficult negotiations, the agreement on trade for agricultural products came into force in January 1997. It is unique in that it provides for a complete liberalisation of the trade in domestically produced agricultural and food products in the Baltics.[22]

As the border policies of the participating countries do not necessarily have to be harmonised, regionally traded products must comply with rules of origin similar to those of the EU. These rules generally require a considerable part of the value to have originated in a member country[23]. The BFTA also provides for a safeguard clause, a standard instrument in trade agreements allowing member states to introduce temporary domestic market protection measures.

b) Theoretical Background to Regional Integration

The CEAs' efforts to reintegrate raise the question what effects these Free Trade Agreements might induce. Theoretical analysis of the welfare effects of FTAs has been undertaken from different perspectives: with a focus on an individual member country, concentrating on the members of an FTA as a group, from the viewpoint of the rest of the world, or considering the whole world. Besides, recent research studies have differentiated between "traditional" and "non-traditional" (or external) effects of trade agreements (Fernández, 1997); the former include trade creation and trade diversion, competition and investment effects, while the latter concentrate on credibility, bargaining power and induced liberalisation effects.

The "traditional" Vinerian customs union theory reveals two effects that emerge as a result of establishing an FTA: the trade creation and the trade diversion effects. The former is due to a replacement of high-cost domestic production by more efficiently produced imports from partner countries, which leads to an increase in welfare. The latter is the result of substituting imports from member countries for those of non-member countries, thus reducing welfare from a global welfare point of view (Langhammer and Hiemenz, 1990, p. 4).

Trade creation is very likely to dominate trade diversion if:

- the FTA is successful in completely removing intra-regional barriers to trade;
- the FTA forms a large market;
- each country's goods are in high demand in the partner country/countries[24];
- the pre-FTA tariff is very high (possibly prohibitive).

In these cases, world welfare and the welfare of the FTA are also likely to improve[25]. Besides the more static effects of trade creation and trade diversion, the dynamic effects of FTAs are significant as well. In this respect, trade creation and overall welfare in the world and the FTA will be fostered more if the enlarged market increasingly induces:

- an improvement of the efficiency of domestic firms resulting from increased competition;
- a realisation of economies of scale and thus an increase in comparative advantage. (see De Melee, Montenegro, and Panagariya, 1992, p. 31; Lang and Stange, 1994, p. 148).

Moreover, the dynamic effects represent an incentive for investment including foreign direct investments. This also holds among other things for the "non-traditional" or external effects of the inter-regional agreements, which are increasingly acknowledged as being of crucial importance in the decision to create or become a member of an FTA (Fernández, 1997, p. 7). These "non-traditional" gains from FTA membership are due to:

- the prevention of time inconsistency in policies[26]; e.g. a country that pursues time inconsistent policies either runs the risk of being excluded from the agreement, or faces sanctions from the other members;
- the signalling effect of joining an FTA; e.g. a country signals to foreign investors that it can be competitive in a common market;
- the insurance effect of an FTA against undesirable and possible future events, such as a trade war with its neighbours, or the frequent application of safeguard measures [27];
- the increase in bargaining power and the creation of a co-ordination device; e.g. the negotiating power of a "union" is clearly greater than that of a single country;
- the co-ordination function of an FTA for general trade liberalisation; e.g. free trade areas can play an important role in overall trade liberalisation (Josling, 1993).

c) Potential Effects of BFTA and CEFTA

Given these theoretical considerations, it seems worthwhile investigating what kind of agricultural trade effects can be observed in or expected from the multilateral arrangements between the CEAs. Since, however, a more extensive liberalisation of agricultural trade in the CEFTA has only been in force since January 1996, and the agricultural agreement in the BFTA only since January 1997, the trade and welfare effects cannot yet be analysed on a quantitative basis. Thus the following exposition will have to be confined to a qualitative analysis.

A positive impetus to the intensification of agricultural trade and the increase in welfare in the BFTA compared to the CEFTA is that the former group has liberalised its agricultural trade through a complete removal of intra-regional barriers, while the success in removing agricultural trade barriers has so far only been partial in the CEFTA. Nevertheless, potential growth in intra-regional trade can be expected to be far more pronounced in the CEFTA than in the BFTA. There are several reasons for this. Firstly, CEFTA encompasses a much larger market. While the three Baltic countries together have less than eight million consumers, the population of the CEFTA amounts to almost 90 million and is thus more than ten times larger. Secondly, to a much greater extent than the CEFTA members, the individual Baltic countries seem to have similar production structures and thus similar comparative advantages[28]. As a consequence, export structures are competitive rather than complementary, which is a further problem for the expansion of intra-regional trade. This holds especially since the Baltic states are characterised by a low income level. Poor countries' trade, however, is generally dominated by inter-industry trade, and the existence of a competitive advantage in the same areas seems to present particular difficulties. With Poland, Romania and Slovenia, the CEFTA encompasses countries which have a "high" pre-FTA tariff,

while the Baltics have comparably low protection. Thus the trade- and welfare-enhancing effects induced by a high pre-FTA tariff are also very likely to be greater in the CEFTA than in the BFTA.

Improved efficiency due to increased competition and the realisation of economies of scale are often said to increase trade and improve welfare inside and outside the FTA[29]. Whether a small FTA is able to capture the benefits of economies of scale very much depends on the characteristics of the subsector considered. A decrease of the average cost curve at relatively lower levels (higher levels) of production might lead to higher (lower) benefits for the member countries in the case of a small FTA.

No general assessment can thus be made as to whether CEFTA or BFTA is in a better position to profit from the FTA-generated realisation of economies of scale. In general these effects are certainly of much higher relevance in the agricultural downstream and upstream sectors than in agriculture itself. With respect to most subsectors of the food industry, the assumption of a more continuous decrease in average costs seems to be more plausible. Thus there are good reasons to assume that most subsectors of the food industry in the BFTA countries will also benefit, due to the better utilisation of economies of scale.

The FTAs of the CEAs have often been considered as a "front garden" to the EU; this also implies that the effects discussed so far might not be the CEAs' only reasons for creating or becoming members of an FTA. Assuming that an important reason is seen in the EU membership they aspire to[30], it is necessary to take a closer look at the "non-traditional" or external effects of membership in BFTA or CEFTA with respect to this issue[31].

For a country like Estonia, which, in the past years, has shown its eagerness to pursue a very liberal trade regime, credibility and time consistency might not be a problem. Romania on the other hand, which has shown a high degree of volatility in its policies, will find it more difficult to convince the European Commission or potential investors that its recent liberalisation and reform commitments are of a permanent nature. When it became a member of the CEFTA, Romania had to lower its tariffs considerably, and this action is expected to be more time consistent than previous declarations of intent because of its incorporation into the framework of the FTA.

CEFTA and BFTA membership might make it easier to join an EU integration scheme, since it reveals these countries' integration capability. They have signalled that their agro-food sectors can survive under competition, and that their institutions are capable of dealing with the issues arising in the context of an FTA. The EU has itself been very much in favour of regional integration schemes within the CEAs, and can be expected to use the signals of regional integration as a "preliminary test" for their eventual integration into the Union.

FTAs do add stability to the trading environment by reducing the danger of individual trading partners' *ad hoc* protective measures. This insurance aspect is of crucial importance for all CEAs and can thus be regarded as a further benefit of the CEFTA and BFTA to its member countries.

Although a phrase expressing the mutual support of all CEFTA member countries during the EU integration process was omitted from the final text of the 1997 summit communiqué (East Europe 9/1997), the membership in a Central European FTA could be a tool for the co-ordination of accession strategies and improve the bargaining power of CEAs. As there is a competition for EU funds, especially between the association countries and the poorer member countries, it is important that the CEAs do not act as rivals. Until now co-ordination between the CEAs with respect to EU accession has generally been limited, and the FTAs do not seem to be sufficiently utilised as a tool for co-ordination by their member states. One major impediment in this respect could be the lack of permanent institutions (a CEFTA

secretariat has not been established), while another important drawback is the existence of at least two groups of countries with different timetables for their potential accession.

There is broad consensus in the literature[32] that, even though an FTA principally allows each member country to pursue its own trade and domestic policies, the impact of these policies is often undermined. A general exception are policies which are decoupled, such as direct income support, i.e. measures which have been attributed to the "green box" in the UR negotiations. It is therefore essential to harmonise policies in an FTA; this is very likely to lead to a more liberal policy framework, given the GATT/WTO constraints[33].

With respect to the "traditional" as well as the "non-traditional" trade and welfare effects of creating or becoming a member of CEFTA or BFTA, a generally positive impact can be expected. In a comparison of both FTAs, the CEFTA countries can be expected not only to gain more from trade creation, but also to have more impact than the BFTA with respect to the external effects. This is mainly due to CEFTA's size.

The positive effects could certainly be enhanced if the two FTAs were to merge. Especially the BFTA could gain considerably from such a fusion, particularly if the CEFTA had by then provided for a total liberalisation of agricultural trade. First steps in the direction of one large FTA can be seen in the bilateral agreements each of the Baltics has signed with members of the CEFTA.

IV. Integration of the CEAs into the EU

The CEAs' integration efforts have, however, not been limited to agreements with each other. In fact all CEAs have expressed their strong desire to become members of the EU. The conclusion of trade agreements between the EU and the CEAs can be regarded as a first step towards an enlarged Union.

a) The Association Agreements

Different forms of trade agreements have been concluded between the CEAs and the EU in the past years: Trade and Economic Cooperation Agreements, Interim Agreements, Agreements on Free Trade and Trade-related Matters and finally, the last step of integration before becoming a member of the EU, the Europe Agreements. The Europe Agreements are in effect for Hungary, Poland, Romania, Bulgaria, the Czech and Slovak Republics, while the three Baltic states and Slovenia are still awaiting ratification by the EU member state parliaments[34].

The Europe Agreements cover five main areas: political dialogue, economic co-operation, financial assistance, adoption of EU legislation and trade liberalisation. Trade and co-operation provisions in the Europe Agreements call for MFN treatment and a gradual elimination of quantitative restrictions over a ten year period. Agriculture and other sensitive sectors such as textiles are covered by separate protocols.

The protocols for agriculture are similar for all CEAs. For imports from the EU to the CEAs, tariffs are lowered either once by 10 per cent when the Agreement comes into effect, or gradually, by one percent each year. For exports from CEAs to the EU, there are different regulations which depend on the commodity traded:

- without quantitative restriction and without tariffs (i.e. horses for slaughter, fat livers of geese, horse radish);

- without quantitative restrictions, but with *ad hoc* reduced tariffs (including a wide range of fruit and berries);
- fixed quotas with consecutively lowered tariffs and levies (i.e. cheese, tomatoes, garlic);
- annually extended quotas with *ad hoc* reduced tariffs and levies by 50-60 per cent (i.e. milk powder, butter, live pigs, pig meat, poultry);
- annually extended quotas with tariffs and levies successively reduced by 20 per cent, 40 per cent, 60 per cent (i.e. onions, cabbage, salad, frozen vegetables, apple juice)
- groups of countries (i.e. Poland, the Czech Republic, Slovak Republic and Hungary) share a common quota for cattle which can be activated if the EU imports less cattle than the amount fixed in the Agreement. In this case levies for the specific quantity are reduced by 75 per cent.

The Europe Agreements were structured in an asymmetrical way to promote CEA exports to the EU. Up to now, however, they have not fulfilled the CEAs' expectations. While the EU's agricultural exports to these countries rose substantially in the period 1992 to 1996, the CEAs' exports to the EU only increased slightly, making most of those countries net importers of agro-food products from the EU (see Table 3). In addition, the CEAs fully utilised their EU preference quotas for only a few products throughout 1993, 1994 and 1995. At first glance, one could conclude that, instead of promoting agricultural exports from the CEAs to the EU, the agreement might have had the opposite effect. However, in addition to structural flaws in the Association Agreements, other external and internal factors might have led to the poor export performance of the CEAs in recent years (see Frohberg and Hartmann, 1997). Internal factors that have induced this development are:

- restrictions on the production levels of the countries considered, e.g. transition-induced, but also serious droughts in some of these countries in 1992 and 1993;
- lack of quality and insufficient standards (i.e. no Baltic slaughterhouse satisfies the hygiene standards of the EU);
- inefficiencies in the food industry that hamper the competitiveness of the primary sector;
- instability of agricultural policies (see also section II.a).

The full utilisation of the preference quota has also been prevented due to external factors such as:

- the allocation of the quotas to EU importers and not to CEA exporters [35];
- a lack of information on the allocation of quotas by the EU Commission;
- a lack of familiarity with EU procedures;
- the EU's quarterly administration of preferential quotas[36].

In addition, both the agreement reached in the UR of Multilateral Trade Negotiations, and the EU north enlargement have affected, and will continue to affect, the agricultural concessions granted in the Europe Agreements (Frohberg and Hartmann, 1997). To compensate for the erosion of preferences, amendments were made to the Association Agreements, which take the form of "Additional Protocols" to the initial Agreements. Their effects are listed below.

- The reduction of the applicable duty in percent of the MFN tariff was in many cases extended from 50-60 per cent to 80 per cent.
- For most products, the tariff quotas were extended.

In addition, the European Commission seems to have realised that some changes in quota management are needed to ensure quotas are used more in the future, although a change in the general

procedure for issuing licenses will most probably not take place (see Frohberg and Hartmann, 1997). Ultimately, changes in the Association Agreements might also be in the EU's interest. While the Union may initially appreciate the positive balance in agricultural and food trade with the CEAs, this may eventually lead to stagnation in the CEAs' agriculture. Inefficient and non-competitive agricultural sectors in the CEAs will cause a permanent dependency on budgetary subsidies in the agriculture of these countries, a burden which would upon integration be borne by EU taxpayers.

b) Implications of an EU East Enlargement for the Non-Member CEAs

The EU Commission has recently announced which countries it proposes to start negotiations for an accession with; they are the Czech Republic, Estonia, Hungary, Poland and Slovenia. A decision, however, will not be made until December 1997, when the EU Council of Ministers will meet. Nevertheless, there is good reason to believe that the proposal of the EU Commission will be confirmed by the Council of Ministers.

The discussion about an EU east enlargement very often focuses on the effects this might have on the Union. Particularly the fact that an accession of the CEECs to the EU will enlarge the farming sector in the EU has given rise to some concern[37]. There has also been some discussion on the possible impact an accession might have on the countries concerned[38]. However, little attention has so far been paid to the possible repercussions the first east enlargement will have on those CEAs that will not be invited to join the EU in the first round. Table 4 clearly shows that the EU is an important trading partner in agriculture for all countries, accounting for 55 per cent of the CEAs' agro-food imports and for 38 per cent of their exports. As discussed in Section III.b, enlargement of a trading block theoretically gives rise to two effects: trade creation and trade diversion. The latter could induce negative repercussions for those countries that will be left outside in the first round of east enlargement. This is likely to occur if the NewMCs export the same type of commodities to the EU-15 as the CEAs remaining outside the Union (NonMCs), and if trade barriers for exports of those products to the EU exist at the time of east enlargement. Where exports are not similar or European import tariffs are close to zero, there is little scope for trade diversion.

The level of protection given in the EU agricultural policy certainly varies considerably for different products. This aspect will be neglected here; the possibility that the first east accession may divert trade away from the NonMCs will be assessed exclusively on the basis of the degree of similarity between exports from the NewMCs and the NonMCs to the EU respectively. For this purpose two different indices are calculated: the Export Similarity Index of Finger and Kreinin (S_{ij}, see formula 1) and the Relative Revealed Export Indicator (RXA, see formula 2)[39].

The Export Similarity Index reveals the proportion of exports from a NonMC (i) to the EU that is equal to the exports from a NewMC (j).

$$(1)\quad S_{ij} = \left\{ \sum_{P} Min\left(M_{i,P}, M_{j,P}\right) \right\} * 100$$

with $M_{i,P}$ being the share of product P in total EU imports from country i, and $M_{j,P}$ being the share of product P in total EU imports from country j. The index ranges between 0 and 100. It will take the value of 100, if the structures of exports from countries i and j to the EU are identical; in a case where export patterns are completely dissimilar, it will equal 0. The main results are summarised in Table 5.

The figures in Table 5 suggest that all NonMCs are strongly influenced by the first east enlargement. Table 5 reveals especially high figures for the Slovak Republic. Exports from the Slovak Republic to the EU have not only a 58 per cent overlap with exports from the Czech Republic, but also a

high degree of similarity with exports from Hungary and Poland. For Bulgaria and Romania the accession of Hungary to the EU will pose the biggest problem, since about 40 per cent of their exports to the EU match with Hungarian exports to the EU. Latvia is most affected by the accession of Poland and Estonia.

To analyse in which product areas the repercussions of an EU east enlargement will be greatest for the NonMCs, the similarity index was also calculated for four different groups of agricultural and food products: raw products, little processed products, semi-processed products and highly processed products. The results for the years 1994 and 1995 are also summarised in Table 5.

Table 5 reveals that Romania, about 30 per cent of whose exports to the EU consist of raw products, is especially affected in this product group. The high similarity in export structures between Romania on the one hand and the NewMCs Poland and the Czech Republic on the other is due mainly to live bovine animals, which account for about 40 per cent of total Romanian exports. The high similarity index for the Slovak Republic when compared to Poland and the Czech Republic is also due mainly to exports of bovine animals, while the similarity in the export structures of Bulgaria and Hungary arises from exports of live sheep and goats.

In the second product group which encompasses those commodities characterised by very little processing, the overlap between the export structures of the NonMCs and the NewMCs is less pronounced for Romania and the Slovak Republic, while it is of relevance for Bulgaria, Latvia and Lithuania. The high degree of similarity in the export structures of Latvia and Estonia is, however, not due to agricultural products, but can be almost exclusively related to exports of fish.

The high similarity in the export structures of Bulgaria and Hungary for the third product category is due mainly to semi-processed fruit, vegetables and nuts, while the high index figures resulting for the Czech and the Slovak Republics are mainly due to oil cake, malt and dried legume exports from these countries to the EU.

Finally, in the group of highly processed agricultural products, it is mainly the export of fruit juices that leads to the high similarity index between Latvia and Poland, as well as between Lithuania and Poland.

As already mentioned above, one possibility to identify the countries remaining outside the union that are likely to be affected most severely by the new east enlargement is to assess those products for which there appears to be competition between countries exporting to the EU. It seems reasonable to assume that trade diversion is more likely to occur if a NewMC and a NonMC are competitors for the same kind of products. This can be measured with the Relative Revealed Export Advantage Indicator:

$$(2)\quad RXA_{ij} = \left(X_{ij} \Big/ \sum_{l,l\neq j} X_{il}\right) \Big/ \left(\sum_{k,k\neq i} X_{kj} \Big/ \sum_{k,k\neq i}\sum_{l,l\neq j} X_{kl}\right)$$

In formula 2, X refers to exports to the EU and the subscripts i and k denote the product categories, while j and l denote the country categories. The numerator is equal to a country's exports of a specific product category to the EU relative to exports of this product from all other countries to the EU. The denominator reveals the exports of all products but the considered commodity from the respective country to the EU as a percentage of all other countries' exports of all other products to the EU. Counting countries or products twice is thus prevented in this indicator. This is especially important if the country considered is a fairly important agent in the EU market, and/or the commodity/commodity group considered is important in EU imports. The level of this indicator shows the degree of competitiveness.

Values for RXA which are above one suggest that the country has a comparative advantage in the considered product category, values below one point out comparative disadvantages.

The RXA was calculated at a four-digit level of the CN-Code for each of the ten CEAs. The share of exports to the EU in which the NonMC and the NewMCs have a relative revealed comparative advantage was calculated for each NonMC.

As can be seen in Table 6, an overlap in competitive advantage could be recorded for each of the NonMCs with at least one of the NewMCs in 60 per cent of its trade with the EU in 1994 and 1995. The only exception is Latvia, where the highest trade share amounted to only 54 per cent in 1994. Thus more than 60 per cent of exports from the NonMCs to the EU may be generally exposed to increased competition from the respective NewMC. The strongest competitor for Bulgaria and Romania is Hungary, for Latvia and Lithuania it is Poland, and for the Slovak Republic it is the Czech Republic. These results support the outcome of the analysis based on the similarity index (see Table 5).

Thus, while all NonMCs seem to have cause for concern, the product categories where repercussions are most likely to occur vary, as does the extent to which this applies. Tables 5 and 6 suggest that Slovak agricultural trade with the EU might be affected most by the east enlargement. This is mainly due to the high similarity between the Slovak and Czech exports to the EU. However, this does not imply that the Slovak Republic has to be affected most by the first east enlargement. Indeed, taking into account in addition to the similarity of exports also the importance of the EU as an export market for the respective NonMC (see Table 4), Romania seems to be the country most affected by the first accession, while the results suggest that Latvia is hit the least. The latter is due to the fact that there is not much similarity between exports from Latvia and those from the NewMC, and that Latvia's export share to the EU is also rather small. At this point it should, however, be noted that the analysis so far can only give a first indication with respect to the possible repercussions of the first east enlargement on the NonMCs. Further studies also need to consider the post-accession level of EU protection expected on those markets where a high degree of similarity has been detected between NewMCs and the respective NonMC, since trade divergence will take place only on markets with a high level of EU protection.

V. Conclusion

This article has examined the consequences of current developments in agricultural trade policies and trade agreements for the CEAs. Its findings are summarised below.

- National agricultural trade policies have been extended in recent years, and increasingly oriented towards higher protectionism in most CEAs, thus resulting in a rise in market distortions in the considered countries.
- As a result of the agricultural reforms under GATT/WTO, agricultural protectionism is expected to be somewhat lowered, and world market price instability to be marginally reduced. While the latter effect will be beneficial for all countries, the assessment of the former effect from the point of view of CEA welfare depends on the agricultural trade position of the respective country, the possible erosion of granted preferences by third countries, and the scale of domestic distortions in the initial situation. However, for the overall welfare impact it is crucial whether the GATT bindings force a CEA to reduce its agricultural protection, or whether they even encourage an increase in protection, thus aggravating welfare losses.
- Integration efforts among the CEAs open up the prospect of more rapid developments for the countries involved. The benefits of the CEFTA seem to outweigh those of the BFTA. The merging of these two free trade areas would probably benefit all participating countries.

- The Association Agreements between the EU and the CEAs are aimed at promoting CEA exports to the EU. Internal factors such as insufficient sanitary and phytosanitary standards in the CEAs, as well as external factors such as structural flaws in the Europe Agreements have, however, led to a deterioration of the trade balance of most CEAs for trade with the EU.
- A first EU enlargement is very likely to cause trade diversion effects that will result in welfare losses for those CEAs who are not joining in the first round. These negative repercussions are due to the relatively high share of NonMC exports in total exports to the EU, the considerable similarity between NonMC and NewMC exports to the EU, and the generally high level of EU protection. Romania seems to be affected the most.

Current developments in CEA agricultural policies and trade agreements carry a number of risks, but they also hold opportunities for the economies in transition. While it is difficult for the CEAs to influence policies outside their borders, the best strategy for these countries is to ensure optimum use of their own resources. This does not only involve a reduction of existing internal trade distortions and ad hoc policy intervention, but also the provision of an adequate framework for economic agents, such as sanitary and phytosanitary standards, as well as of functioning market and price information systems. Closer co-operation among the CEAs might not only help to overcome the small market constraint; it could also help to increase their bargaining power versus the EU, and in international trade discussions.

NOTES

1. A more detailed description can be found in EU Commission, 1997 and OECD, 1996.

2. This also includes the abolishment of state monopolies on foreign trade in those CEAs where such institutions were still prevalent.

3. The Common Agricultural Policy system seems to have inspired policy design in many CEAs.

4. Hungary's commitment to keep its GATT obligations has led to a reduction in market price support in 1996, while the country has increased subsidies for inputs and credits at the same time (cf. OECD, 1996a and 1997).

5. In the Czech Republic no export licenses were issued at the end of 1995 to prevent exports.

6. Romania is the only country among the CEAs which has developing country status (OECD, 199 6b).

7. As is the case for other post-Uruguay Round applicants, the Baltic states are being asked to accept stricter disciplines than those negotiated with the old GATT signatories. Estonia is facing especially difficult negotiations, as it has been asked to bind tariffs for some products at zero (OECD, 1997).

8. In the case of minimum market access commitments in the form of tariff quotas, the CEAs have to follow the same rules as the other WTO members.

9. Among all CEAs, the highest increase was observed in Romania, where tariff protection increased from 25 per cent weighted average to 60 per cent (OECD, 1997).

10. See also Twetsen, 1997.

11. The Agreement on Agriculture gives the option of re-negotiating the AMS in the case of high inflation.

12. The Czech Republic for example placed milk powder in a separate product group, as well as including it in the category of "milk products" (Twetsen, 1997).

13. The effects of the tarification process are not clear. Inotai and Kiss (1996) predict that the transformation of non-tariff measures into tariffs induces high initial Most Favoured Nation (MFN) tariffs in all WTO member states. Even though these bound rates have to be reduced by an unweighted average of 36 per cent, effective tariff rates will in some cases be higher in the year 2000 than they were in 1994.

14. For a detailed assessment see Schott, 1996.

15. Even net importers (exporters) among the CEAs may be among the winners (losers) of the Uruguay Agreement if they discriminate against (protect) their agricultural sector by providing import subsidies (export subsidies).

16. In the case of the EU Association Agreements, some compensation measures have been decided on (see also section IV.a).

17. However, the potential stabilisation effect of tarification will be greatly restricted by the possible levying of additional duties under safeguard clauses.

18. In view of the relatively low levels of income and high spending on food compared to total expenditure, especially in the Baltics and the Balkan countries, fluctuating agricultural prices endanger the livelihood of producers and consumers in those countries. This explains why poor people in particular are extremely risk-averse, and why the danger of resource misallocation as a result of price instability in the agricultural sector in these countries is high.

19. The most important one is the customs union between the Czech and Slovak Republics created on 1 January 1993 (OECD, 1996b).

20. Slovenia, which joined in January 1996, was granted an adaptation and negotiation period until July 1996, prior to which the existing bilateral agreements remained in force.

21. Slovenia seems to have a controversial approach to the CEFTA, having failed to meet its commitments concerning the protocol on the reduction of import tariffs for farm goods since joining the agreement (East Europe 4/97).

22. In 1996 intra-regional exports in the BFTA accounted for around 14 per cent of total exports, and intra-regional imports for around 6 per cent of total imports. In the case of agricultural products, about 12 per cent of all agricultural exports and about 6 per cent of all agricultural imports were traded between the Baltic countries in 1994, i.e. before the creation of a free trade area for agricultural products (Kazlauskiene and Meyers, 1997).

23. Josling (1993) is sceptic whether rules of origin are a useful instrument for preventing the leakage of third country products from the lowest-price country to a high-price country. Even if the rules of origin were enforced, the lowest-price country in an FTA could export all its production to the high-price country and cover its consumption needs through imports from the world markets.

24. For rich countries, complementarity of demand is more likely when the countries are similar with respect to, for example, consumer preferences and production structures. This is because at high levels of income, differentiated products are in greater demand, and similarity offers gain from intra-industry specialisation. By contrast, in poor countries, complementarity is generally greater the less similar the countries are, since countries at this stage of development primarily engage in inter-industry trade (de Melo and Panagariya, 1992, pp.3-4).

25. For a detailed theoretical analysis on the potential effects of FTA on individual countries see Schiff, 1997.

26. Policies that are time inconsistent will be reversed in the future due to predictable developments over time. In contrast, time consistent policies will be sustained as circumstances change over time, although they may not be optimal at the point in time at which they are pursued.

27. It has been argued that, for example, the free trade agreement between Canada and the US had as a background Canada's wish to insure itself against the frequent application of safeguard measures by the US.

28. See also Kazlauskiene and Meyers 1997, p. 7; Kopsidis 1997, p. 12.

29. There are conflicting opinions about the latter in the case of small FTAs: while Kopsidis (1997) argues that economies of scale cannot be expected in the Baltic countries due to the small size of the BFTA,

Fernández (1997) supports the thesis that small countries draw relatively greater benefit from expanded markets in terms of increased competition and economies of scale, because they start at a lower base.

30. This is also revealed by the fact that only countries who have signed association agreements with the EU can become members of CEFTA.

31. One of the important "non-traditional" benefits is the higher credibility of a nation encouraging FDI. This aspect is also of great importance for the capital-scarce CEAs.

32. See for example Josling, 1993.

33. The fact that Slovenia, being the most protectionist member of CEFTA, has so far succeeded in slowing down the internal agricultural liberalisation process does not contradict this opinion. Slovenia might even be able to slow down CEFTA's external liberalisation, but, given the GATT/WTO constraints, it will not succeed in harmonising external protection at a higher average level in CEFTA. The same constraints are very likely to prevent the BFTA from succeeding in harmonising protection at a higher external level. All three Baltics are eager to become members of the WTO. This, however, limits them in their policy choices.

34; All of the above-mentioned countries have agreements on free trade and trade-related matters, which are very similar to the Europe Agreements where trade regulations are concerned. These agreements are therefore also referred to as Europe Agreements below.

35. Overberg and Tangerman, 1997, p.127.

36. See also Economic Research Service/USDA, 1997, p. 25.

37 See e.g. Anderson and Tyers, 1993; Baldwin, 1994; Brenton and Gros, 1993; LEI, 1996; MAFF, 1994; Matthews, 1994; Tangermann, 1994; Tarditi, 1994.

38. See e.g. Banse and Münch, 1997, Frohberg et al. forthcoming.

39. For a discussion and the application of these methods, see also Finger and Kreinin, 1979; Brenton, Tourdyeva and Whalley, 1997.

Table 1. **Trade Policies in the CEAs**

	Export Subsidies	Import subsidies	Export Tariffs	Import tariffs	Import quotas	Licences and special arrangements
Bulgaria	not applied [5]	not available	fixed tariffs on wheat and flour [3]	*ad valorum* and specific mostly for dairy products, 15-40% cereal 25% ; meat 20-70%; dairy 15-25%; sugar 40% [5]	applied [3]	non-automatic licensing on imports of tobacco [5]
Czech Republic	for some products exported by State fund for Market Regulation; dairy products [5]	not available	not available	escalatory tariffs, average 9% for primary , 19% for semi-processed and 23% for fully processed goods, general average 19%, extremes: 233% some processed meat, 155 some potatoes [4]	tariff quotas [4]	non-automatic licensing with quantity limits for exports, automatic licensing of imports [5]
Estonia	not applied [5]	not applied [5]	not applied [5]	zero tariffs countervailing duties against imports below world market price [5]	not applied [5]	government support up to 50% of costs of exporters for market research and advertising [5]
Hungary	fixed rate export subsidies for wheat, poultry, pork, maize, etc. [2] (50% of agri. budget)	not available	not available	average tariff of 46% [3] weighted average 23% [5]	not available	licences e.g. for wheat exports [3]
Latvia	periodically in 1995 [6] for dairy products [5]	not applied [6]	not applied [6]	average tariff 40% *ad valorem* [1] live animals and meat 40%; dairy 55%; fruit and vegetables 30-40% [1]	until 3/97 for sugar still for grain and cereals	licences for import and export of grain [1] since 3/97 for sugar [é]
Lithuania	for dairy and meat products [5]	not applied [6]	up to 60% [1]	10-30% [1] 87% for grain, 35% for refined sugar, 5% olive oil [2] 28% for a basket of food products [5]	import tariff quotas [6]	8% VAT on domestic products, 18% on imports [5]
Poland	tax reductions [4] occasionally sugar, butter, skimmed milk powder, pork, potato starch [3] pork to NIS [5]	exemption on customs duites on e.g. raw flax, oilseed cake, skins [4]	not available	weighted average tariff 23% (1996) [3, 5]	tariff quotas [3]	licencing [2]
Romania	not applied [4]	not available	not applied [4]	anti-dumping duties [4] 80% weighted average [5]	tariff quotas [4]	licences: raw hides/skins, wood, special arrangements, advance payment for export of live animals, meat, milk and dairy, grains [4]
Slovak Republic	e.g. skimmed milk powder, malt, honey (1995) [3]	potatoes, sugar (1995) [3]	not available	cereals 24%; sunflower seeds 46%; beef 39-43%, poultry 50%; butter 78%; beet sugar 67% [5]	not available	licences, e.g. for export of bread wheat [3]; import deposits from 5/97 on [7]
Slovenia	not applied [5]	not available	not available	tariffs in accordance with GATT 20-70% *ad valorem* (life cattle 80%) [3]	tariff quotas, e.g. for wheat, maize [3]	state monopoly on imports of e.g. wheat, sugar, oilseeds [3]

Sources:

1. Internet USDA International Agriculture and Trade 5/97 (NIS & and The Baltics
2. Agenda 2000, 1997: Commission's Opinion on the Associated Countries' Application for Membership
3. OECD 1996: Agricultural Policies Markets and Trade in Transition Economies
4. Internet 1996 EU - Sectoral and Trade Barriers Database
5. OECD/CCET 1996: Trade Policies and the Transition Process
6. N. Kazlauskiene, W.H. Meyers 1997: BFTA in Agriculture
7. East Europe 4/97; 5/97

Table 2: **Main Trade Agreements of the CEAs**

Country	Agreements with the European Union	CEFTA	BFTA	WTO	Bilateral Trade Agreements
Bulgaria	Interim Agreement on Trade 12/93 Europe Agreement 2/95	obs.[1]		M[3]	Czech Republic Slovak Republic
Czech Republic	Interim Agreement on Trade 3/92 Europe Agreement 2/95	3/93		M	Slovak Republic (customs union) Bulgaria Romania Slovenia Latvia Estonia
Estonia	Trade & Economic Cooperation Agreement 2/93 Agreement on Free Trade and Trade-related Matters 1/95	obs.	(4/94)[2] 1/97	N[4]	Ukraine Czech Republic Norway Switzerland
Hungary	Interim Agreement on Trade 3/93 Europe Agreement 2/94	3/93		M	
Latvia	Trade & Economic Cooperation Agreement 2/93 Agreement on Free Trade and Trade-related Matters 1/95	obs.	(4/94) 1/97	N	Czech Republic Norway Switzerland
Lithuania	Trade & Economic Cooperation Agreement 2/93 Agreement on Free Trade and Trade-related Matters 1/95	obs.	(4/94) 1/97	N	Norway Switzerland Poland
Poland	Interim Agreement on Trade 3/92 Europe Agreement 2/94	3/93		M	Lithuania Israel
Romania	Interim Agreement on Trade 12/93 Europe Agreement 2/95	7/97		M	Czech Republic Slovak Republic Slovenia
Slovak Republic	Interim Agreement on Trade 3/92 Europe Agreement 2/95	3/93		M	Czech Republic (customs union) Bulgaria Romania
Slovenia	Trade and Economic Cooperation Agreements 9/93 Europe Agreement 6/95	1/96		M	Macedonia Czech Republic

1) observer status 2) BFTA for industrial products 3) member 4) negotiation

Sources: Agenda 2000, 1997: Commission's Opinion on the Associated Countries' Application for Membership
OECD/CCET 1996: Trade Policies and the Transition Process

Table 3. **Value of CEA Trade in Agricultural and Food Products with the EU (in Mio ECU)**

Countries	Exports to EU-15						Imports from EU-15						Net Trade with the EU				
	1992	1993	1994	1995	1996	change (1996/1992)	1992	1993	1994	1995	1996	change (1996/1992)	1992	1993	1994	1995	1996
Bulgaria	172	165	189	217	198	**16%**	122	209	218	222	145	**19%**	49	-45	-29	-4	53
Czech Rep.[1]	267	219	250	280	269	**23%**	408	414	543	743	832	**104%**	-140	-195	-293	-463	-563
Estonia	8	10	18	27	38	**376%**	64	80	84	178	219	**241%**	-56	-71	-66	-151	-181
Hungary	754	670	741	872	935	**24%**	224	332	424	424	363	**62%**	530	337	317	447	573
Latvia	5	11	9	13	18	**296%**	68	91	124	194	215	**215%**	-64	-80	-115	-182	-197
Lithuania	22	36	31	46	61	**181%**	114	157	171	164	209	**84%**	-92	-120	-140	-118	-147
Poland	859	729	791	877	858	**0%**	898	1.059	1.060	1.226	1.467	**63%**	-39	-330	-269	-349	-609
Romania	74	79	100	121	130	**76%**	316	312	174	278	293	**-7%**	-242	-233	-74	-157	-163
Slovak Rep.[1]	267	37	48	60	62	**67%**	408	108	125	197	213	**-48%**	-140	-71	-77	-137	-150
CEA-10	46	69	68	58	65	**41%**	68	205	263	359	363	**434%**	-22	-136	-195	-301	-298
CEA-10	2.474	2.025	2.245	2.570	2.635	**7%**	2.689	2.969	3.187	3.985	4.318	**61%**	-216	-943	-942	-1.415	-1.682

1) Between 1993 and 1996 for the Czech Republic and the Slovak Republic

Source: Own calculations based on data from EUROSTAT.

Table 4. **Destination and Origin of CEA Agricultural Trade**
Share of Country Groups in Total Value

		EU		Other OECD		CEAs[1]		NIS		Other	
		Exports	**Imports**	**Exports**	**Imports**	**Exports**	**Imports**	**Exports**	**Imports**	**Exports**	**Imports**
Bulgaria	1993	22	44	13	19	12	7	28	4	25	26
	1996	22	21	1	15	25	8	40	9	12	47
Czech Republic	1993	33	37	9	11	40	26	11	0	7	26
	1996	38	57	3	6	38	16	15	0	6	20
Estonia	1993	18	49	9	28	20	5	44	9	9	9
	1996	20	64	3	8	15	12	59	10	2	6
Hungary	1993	45	42	16	16	10	7	20	3	9	32
	1996	47	43	6	8	17	5	20	1	10	43
Latvia	1993	9	36	5	12	20	17	65	25	1	10
	1996	15	51	0	0	12	27	72	12	1	11
Lithuania	1993	16		4		12		66		2	
	1996	18	45	4	3	12	17	63	21	4	14
Poland	1993	57	57	14	22	3	3	19	4	7	14
	1996	49	70	2	5	6	10	36	6	7	9
Romania	1993	29	45	20	23	8	8	18	1	25	23
	1996	22	40	13	15	10	6	18	5	37	35
Slovak Republic	1993	16	24	8	10	57	51	13	1	6	14
	1996	17	36	2	4	56	43	19	1	7	17
Slovenia	1993	36	32	6	19	3	11	6	2	49	36
	1996	32	47	4	9	3	14	5	2	57	29
CEA-10[2]	**1993**	**39**	**44**	**13**	**18**	**15**	**13**	**21**	**3**	**12**	**22**
	1996	**38**	**55**	**4**	**7**	**16**	**14**	**29**	**5**	**12**	**20**

1) Includes Poland, Hungary and Czech Republic which became members of OECD in 1996.
2) Weighted with the share of each CEA in total CEA exports and imports. No data for Lithuania were available for 1993. However, since in 1993 the share of Lithuania in total CEA exports (imports) was only 2% (1%), the exclusion of Lithuania has hardly any effect on the overall results.

Source: Own calculations based on data from OECD (1997).

Table 5: **Similarity between NonMC and NewMC Exports to the** [1]

All Products

	Czech Rep.		Estonia		Hungary		Poland		Slovenia	
	1994	1995	1994	1995	1994	1995	1994	1995	1994	1995
Bulgaria	0.14	0.13	0.08	0.17	0.46	0.41	0.28	0.22	0.19	0.20
Latvia	0.14	0.17	0.26	0.37	0.13	0.09	0.26	0.34	0.09	0.18
Lithuania	0.20	0.23	0.34	0.30	0.17	0.19	0.43	0.44	0.21	0.24
Romania	0.29	0.31	0.07	0.11	0.39	0.35	0.36	0.32	0.21	0.27
Slovak Rep.	0.58	0.58	0.16	0.16	0.29	0.29	0.31	0.32	0.20	0.22

Group 1: Agricultural Raw

	Czech Rep.		Estonia		Hungary		Poland		Slovenia	
	1994	1995	1994	1995	1994	1995	1994	1995	1994	1995
Bulgaria	0.16	0.17	0.07	0.06	0.44	0.49	0.26	0.23	0.18	0.11
Latvia	0.06	0.07	0.57	0.29	0.06	0.07	0.25	0.14	0.04	0.05
Lithuania	0.07	0.22	0.20	0.51	0.06	0.13	0.25	0.34	0.05	0.42
Romania	0.51	0.67	0.03	0.14	0.57	0.52	0.71	0.73	0.08	0.17
Slovak Rep.	0.64	0.60	0.04	0.05	0.46	0.53	0.69	0.62	0.09	0.13

Group 2: Agricultural Products With Very Little

	Czech Rep.		Estonia		Hungary		Poland		Slovenia	
	1994	1995	1994	1995	1994	1995	1994	1995	1994	1995
Bulgaria	0.22	0.19	0.09	0.25	0.68	0.46	0.45	0.32	0.14	0.19
Latvia	0.22	0.11	0.38	0.48	0.12	0.09	0.38	0.21	0.06	0.18
Lithuania	0.24	0.29	0.23	0.23	0.19	0.21	0.34	0.43	0.30	0.21
Romania	0.29	0.20	0.13	0.15	0.35	0.25	0.34	0.23	0.15	0.22
Slovak Rep.	0.55	0.54	0.11	0.21	0.24	0.27	0.28	0.47	0.28	0.28

Group 3: Semi-processed Agricultural and Food

	Czech Rep.		Estonia		Hungary		Poland		Slovenia	
	1994	1995	1994	1995	1994	1995	1994	1995	1994	1995
Bulgaria	0.19	0.22	0.20	0.20	0.61	0.59	0.38	0.39	0.38	0.35
Latvia	0.21	0.34	0.37	0.61	0.27	0.07	0.46	0.38	0.09	0.11
Lithuania	0.28	0.33	0.59	0.36	0.32	0.26	0.38	0.31	0.21	0.27
Romania	0.23	0.28	0.15	0.17	0.40	0.36	0.33	0.35	0.20	0.28
Slovak Rep.	0.72	0.75	0.32	0.16	0.30	0.28	0.28	0.24	0.30	0.26

Group 4: Highly Processed Agricultural and Food

	Czech Rep.		Estonia		Hungary		Poland		Slovenia	
	1994	1995	1994	1995	1994	1995	1994	1995	1994	1995
Bulgaria	0.09	0.08	0.11	0.10	0.32	0.31	0.19	0.15	0.16	0.18
Latvia	0.22	0.22	0.12	0.22	0.15	0.16	0.46	0.61	0.15	0.25
Lithuania	0.16	0.19	0.20	0.28	0.14	0.14	0.64	0.61	0.10	0.24
Romania	0.16	0.15	0.11	0.11	0.42	0.40	0.28	0.27	0.40	0.36
Slovak Rep.	0.33	0.36	0.10	0.15	0.33	0.13	0.28	0.20	0.42	0.45

1. Measured with the Finger-Kreinin Export Similarity Index

Source: Own Calculations

Table 6: **Share of NonMC Exports to the EU in which the NonMCs and the NewMCs have a Relative Revealed Comparative Advantage**[1]

	New Member Countries (NewMC)									
NonMC	**Czech Rep.**		**Estonia**		**Hungary**		**Poland**		**Slovenia**	
	1994	1995	1994	1995	1994	1995	1994	1995	1994	1995
Bulgaria	0.28	0.22	0.12	0.20	0.66	0.74	0.40	0.29	0.47	0.49
Latvia	0.40	0.36	0.25	0.41	0.27	0.21	0.54	0.60	0.12	0.38
Lithuania	0.47	0.44	0.38	0.39	0.30	0.28	0.63	0.62	0.33	0.64
Romania	0.32	0.36	0.06	0.14	0.73	0.66	0.60	0.47	0.31	0.43
Slovak Rep.	0.75	0.74	0.18	0.18	0.49	0.45	0.67	0.56	0.26	0.26

1. Measured with the Relative Revealed Comparative Advantage Index
Source: Own Calculations

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Annex

GENERAL OUTLINE OF THE URUGUAY ROUND AGREEMENT ON AGRICULTURE

I. Market Access

a) Tarification

One of the substantial achievements of the UR is seen in the transformation of non-tariff trade barriers, such as quantitative restrictions, voluntary export restraints, licenses and variable levies, into bound tariffs*. Countries have to convert all existing non-tariff measures into tariffs, which are then combined with existing tariffs. This fusion of tariff equivalents and original tariffs is bound and cut by an unweighted average of 36 per cent over six years from their 1986-1988 levels. Countries are flexible in structuring the cuts for individual products, cutting tariffs for some products by much more than average and by much less for others, as long as each tariff is reduced by at least 15 per cent over the implementation period.

b) Minimal Access Commitments

Imports of at least three per cent of the home consumption at the start, and at least five per cent at the end of the six-year period have to be granted. This generally means that tariff rate quotas are established for specific products, with the in-quota tariff set at "low or minimal" rate, allowing competition between imported products and high-cost domestic products (Schott, 1994).

II. Export Subsidies

There has been agreement to reduce export subsidies in value by 36 per cent, and in volume by 21 per cent in equal annual instalments from 1986-1990 levels. In addition, a prohibition to subsidise exports of products which have not been subject to export subsidies in the base period has been introduced.

III. Domestic Support

The agreement establishes a ceiling for the total domestic support calculated as the AMS. The AMS has to be reduced by 20 per cent over six years from the average level of the base period (1986-1988). "Green box" and "blue box" measures such as the EU structural funds or the US deficiency payments are excluded from this regulation.

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* For a comprehensive description of the benefits of tariffs compared to non-tariff trade barriers see also OECD 1996a.

POLICY AND PROGRAMME FAILURES IN TRANSITION ECONOMIES

Stefan Bojnec *

This report refers to the FAO experience with agricultural policies in the Central and Eastern European (CEEs) transition economies.[1] The following topics relating to policy and programme failures were of particular relevance for the agricultural development in CEEs countries in transition:

I. Mis-specified policy goals

a) Food security vs. Food-self-sufficiency.

Food security is usually defined as an availability of food in quantitative, nutritional and qualitative terms or as an access of households to inexpensive quality food. Hence, food security is an income related issue which involves different types of households and which may differ considerably at the national versus the household level. Although food security is an important policy objective for most of the countries in transition, in practice it has often been reduced to a concept of food-self sufficiency. The latter refers to a notion defined by governments as a ratio of domestically produced food to total food demand. Obviously, food self-sufficiency close to 100 per cent does not necessarily imply food security (neither at the national nor at the household level), especially when accompanied with a drastic drop in real incomes and a drop in nutritional intake within low income groups (a common situation at the beginning of a transition period in a majority of CEEs countries). Moreover, it should be noted that a strategic meaning of food security would also imply a security of supply of agricultural inputs such as energy, fertiliser, seed and other means necessary for agricultural production (of which the great majority of CEEs countries are currently net importers!). Although food self-sufficiency is often considered to be a substitute for food security, maintaining a high food self-sufficiency level usually incurs unnecessary economic costs due to isolation of domestic markets from international trade, higher domestic prices, and export subsidies to enable trade of a domestic production surplus.

b) Copying of CAP-like policies

The copying of CAP-like policies (e.g. introducing intervention prices, levies, high tariffs, export subsidies, quotas, etc.) has been a common policy measure undertaken in many of the economies in transition. As in the EU, market price support would have a lot of negative consequences by increasing both the inflationary pressure caused by higher agricultural and food prices, as well as raising the budgetary costs of agricultural policy, due to unavoidable state interventions on agricultural markets and export subsidies. Moreover, in some of the transition countries, such policies could create problems with the negotiated GATT/WTO commitments. They will also uphold a huge and costly administration because supply management and control measures such as quotas for milk and sugar beet would be necessary. Finally, it is expected that similar policy actions will only postpone the necessary process of

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the restructuring of agriculture due to lack of incentives for producers to diminish their costs and improve efficiency.

The transition economies differ substantially among themselves and hence different paths of adjustment of agricultural price and trade policies between the individual countries in transition to the European Union (EU) can be expected. It is more likely that the pre-accession policies will have to be financed primarily from their own national resources with external technical assistance to support only the necessary restructuring and adjustments. As accession to the EU is likely to take place on a gradual basis, it is advisable for the countries in transition to concentrate more on measures for improving efficiency and international competitiveness in order to be ready to compete on both international markets and on the more developed EU markets at the time of full accession.

i) An overstated role of agriculture in rural development

An overstated role of agriculture in rural development has occurred as a result of a misunderstanding of the role of agriculture in sustainable rural development. Agriculture has been regarded as only a sector in rural areas and as an isolated object of policies. However, economic development demonstrates that agriculture is becoming less important not only in the overall economic structure, but also in the economic structure of rural areas. Hence, a lack of coherent policies across the entire food chain (agriculture, processing, marketing, market infrastructure, etc.) was an important policy failure in transition economies. As productivity in agriculture is usually lower than in the rest of the economy, new employment and job creation policies in non-agricultural activities in rural areas will contribute to both increased productivity in agriculture and to the overall growth of the economy through the transfer of labour from agriculture to more productive non-agricultural and service activities. Yet, several countries in transition lack the rural services and experience to set-up and manage such institutions. Needless to say, the development of rural areas is closely interlinked to the dilemma between equity (redistribution of resources from more developed to less developed areas) and efficiency (investments of scarce resources in areas where the highest return from investment is expected). Moreover, strong overall economic growth has proven to be the most important determinant contributing to the improvement of the infrastructure and development of services as well as creating new demand for products produced in rural areas.

ii) Isolation of agricultural policies from macro-economic policies

Isolation of agricultural policies from macro-economic policies has been an important factor resulting in the lack of consistency in economic policy. Changing price and trade policies, and the removal of state subsidies have resulted in a decline in production, consumption and trade. In some countries, governments have tried to increase economic incentives for producers through price increases and introduction of new pro-export trade policy measures. However, due to changes in exchange rate policies followed by a real exchange rate appreciation, producers were still taxed. Consequently, the changed exchange rate policies caused prices of imported goods to become cheaper by the real exchange rate appreciation of their currencies vis-à-vis Western currencies, but at the same time, *ceteris paribus*, they reduced export competitiveness and farmers incomes.

iii) The maintaining of a strong position by the state in the food chain

The maintenance of a strong State position in the food chain is one of the characteristics inherited from the past, and which has been further maintained in some transition countries by a tendency to overstate the direct role of the state through state monopoly storage enterprises, state marketing

channels, state regulation of foreign trade and state regulation of prices. The budgetary costs of such a policy were high due to the huge administrative costs of monitoring state monopolies and their low efficiency. Additionally, the dead weight losses were occurring when substituting private enterprises and well functioning markets. The dominant position of the state monopolistic structures is also the main reason for the asymmetric information problem existing in the transition economies. A lack of comprehensive market information and market infrastructure (e.g. private storage facilities) are reported to restrict the decision making process of private agents, limiting potential gains from market liberalisation. The private sector development has also been limited by a lack of alternative marketing channels, and non-existing or badly organised private associations and agencies.

iv) Lack of progress in land reform

Land reform has been carried out through land restitution, land compensation, and land distribution, but rarely through the sale of land. Severe restrictions have been imposed on the land market and land tenure. Several countries have set limits on the size of farms, as well as moratoriums or limits on the selling of land. Non-transparent property rights on land have been identified as one of the major technical constraints for the development of the land market and land tenure. The problem of land registration, titling and mapping of land has been substantially increased due to political and legal factors, and the lack of experience in monitoring these activities.

v) Privatisation without abolishing market imperfections

Privatisation without the abolishment of market imperfections has been one of the major failures in the agricultural policy programme. There is clear evidence that privatisation *per se* is not enough to increase efficiency in an economic environment characterised by a substantial lack of market institutions developed towards the needs of private agents. Different approaches were chosen among the countries as far as the privatisation of non-land farm assets is concerned. In some countries a lack of progress in the privatisation of the food processing industry and in the up-stream sectors has been observed as well. As a result, the food industry performance has not changed substantially as company management remains mostly unchanged. The inflow of fresh capital and, in particular, foreign direct investment to food processing companies were modest because some indirect restrictions which made the country less attractive for foreign investors were imposed. Competition distortions have been created by new oligopolies, sometimes aided by government policy.

vi*) Social policy by using agricultural policy instruments*

The use of agricultural policy instruments for social policy reasons has been used in some countries aiming at protecting consumers. These include the setting of prices for the main agricultural products below world market prices so as to stabilise maximum prices at a certain level, controlling prices and profit margins in food processing and trade, direct and indirect subsidies on the main food products, and export bans and export taxes for the main food products.

vii) Ad hoc policy measures vs. stable and continuation policy approach.

Consistent policy measures have not been applied in some transition countries. Government policy has continuously imposed shocks to the economy by unclear and confused policy measures which

are often changing on a daily basis, and thus producing much uncertainty and risk for agricultural producers.

viii) Direct vs. indirect state programmes

Problems often occurred in the implementation of agricultural policies in the transition economies due to both the lack of experience with a market economy and because of some market distorted practices observed in Western Europe, i.e. CAP. As direct state programmes create distortions and are costly for the budget, different measures aimed at market deregulation should be preferable from the policy makers' point of view. However, there is also room for indirect state programmes to create favourable conditions for private sector development, i.e. support provided for setting-up of market institutions, support to the development of market infrastructure such as storage facilities and market information systems, support for R&D and its application, support for the establishment of extension services, and control of food quality, and to harmonise quality standards according to international standards.

However, the policy objectives of CEEs transition countries differ substantially.[2] For many CEEs transition economies, the main priority is to create human and institutional capacities, and to formulate strategies and policies which will facilitate membership in the EU. Some CEE transition countries still face additional obstacles, such as delays in price liberalisation and restructuring which have severe macroeconomic distortions, which inhibit their readiness to join the EU. Some CEE transition economies are also facing deep structural problems and there is a lack of policy perception with regard to the medium- and long-term strategy for food and agriculture. Moreover, there are some CEEs which are recovering from poverty and food insecurity caused by wars and natural disasters, and for which poverty alleviation and food security are high on their priority list.

As far as the Baltic states are concerned, the FAO-TCP project on the Long-term Strategy for Sustainable Development of Agricultural Sector for Estonia is in its final stage. It focuses on conditions for improving efficiency in the agricultural and food sectors consistent with sustainable economic and environmental development, the regionalisation and globalisation of the economy, and the preparation of the country for possible EU membership. The experience of this project may be of use to other CEEs transition economies.

NOTES

1. It was originally prepared as a discussion paper for the Round Table Meeting on National Strategy for the Development of the Bulgarian Agriculture, Hissar, from 28 to 29 June 1997.

2. Food and Agricultural Organisation of the United Nations - Sub-regional Office for Central and Eastern Europe (1997) *Agricultural Reforms in the Transition Economies of Central and Eastern Europe*, Rome, 192 pp. (Report of the Meeting of Experts on Experience of Reforms, Integration of European Agriculture and Priorities for FAO's Assistance in Central and Eastern Europe (CEE) and the Commonwealth of Independent States (CIS) Economies in Transition, Warsaw, 6-9 March 1997).

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