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The Fifth Finnish-Baltic Seminar of Agricultural Economists, Helsinki, Finland, 1995

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Abstract. The fifth Finnish-Baltic seminar of agricultural economists was held on June 12-14, 1995, in Helsinki, Finland. The seminar was organised by the Finnish Agricultural Economics Research Institute. The report contains the articles presented in the seminar.

The theme of the seminar was "Trade Liberalisation and its Impact on Farm Economy." The topic is actual for all the participating countries. Finland is a new member in the European Union and her food sector including agriculture has faced new challenges. There is a big structural reform going on in agriculture in the three Baltic countries, and the agenda for the EU enlargement may eventuate that in some years the Baltic economies are fully integrated into the Common Market.

The seminar consisted of four sessions: (1) The role of agricultural economics research in the restructuring of agriculture, (2) Evolution of the agricultural trade liberalisation, (3) New challenges for agricultural policy, and (4) Trade liberalisation and food chain.

The papers dealt with the impacts of agricultural trade liberalisation both on the farm level and on the whole agricultural and food sector. The presentations on urgent problems in the agrarian reform aroused great interest. The three Baltic countries are facing a number of similar problems concerning the transition from the planned economy to the market economy. The EU membership would have large impacts on the agriculture and food sectors. A lot was discussed on the evolution of the Common Agricultural Policy with special emphasis on the possible accession of the countries of central and eastern Europe. The nuclear issue is whether the CAP should be changed drastically once again or should we think in terms of development on the basis of the principles set out by the 1992 reform. The key issue is the large agricultural potential of the CEEC.

The critical question concerning the agricultural sectors in the Baltic countries is, on the other hand, how food imports will be regulated and, on the other hand, how the Baltic suppliers manage in the export markets. At the moment the production costs are lower than in the EU countries but the costs are gradually increasing. A general feature is that the cost of production has gone up while, due to low purchasing power and relatively free imports, producer prices have remained at a low level.

Index words: agricultural policy, CAP, consumption, Estonia, EU, family farming, Finland, food chain, Latvia, Lithuania, trade liberalisation

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Welcome Address

JOUKO SIRÉN
Director, Agricultural Economics Research Institute
Helsinki, Finland

Mr. Minister, ladies and gentlemen,

I warmly welcome you all to participate in the 5th Finnish-Baltic seminar of agricultural economists.

The series of these seminars started in Helsinki 5 years ago. After that they have been held in Latvia, Lithuania and Estonia. The latest seminar was held in Saku, Estonia, 2 years ago.

Five years ago the problems concerning agriculture were quite different when compared to those of today. Transitional process of farming in the Baltic countries started at that time and the themes of seminars concentrated on the reform of agriculture, the economics of traditional family farm, the state role in controlling agricultural production, and on the development problems and possibilities of agriculture in the Baltic countries in the future.

Much has happened after that. In January 1, 1995, Finland became a member in the European Union and a new era started in her agricultural policy. Free-trade agreements have been negotiated between the Union and many Central and East-European countries including the Baltic countries. The scheme of EU enlargement can imply that within some years the Baltic countries join the Union.

As a result of this development the economic environment of agriculture and farming has changed radically. Trade barriers have been lifted and the international competition in agricultural markets has increased. That is why the topic of this seminar was chosen to be "Trade Liberalisation and its Impact on Farm Economy". During the following 3 days we will discuss economic questions arising from this development, which strongly affects farms and the whole agricultural sector.

I hope, that we can also discuss on the role of economic research in solving the problems arising from the trade liberalisation. My opinion is that economic research becomes more important all the time. Because of the lack of resources, cooperation and coordination between countries, research institutes and organisations, is needed.

Ladies and gentlemen, you all are welcome. This time we have representatives also from the Commission of the European Union.

Mr. García Azcárate and Mr. Strittmatter, I warmly welcome you to participate in this Finnish-Baltic seminar.

There are many reasons why we decided to stay the first day here in the Agricultural Economics Research Institute. For example, we are allowed to be almost in the countryside and the participants can see our institute and our personel, what we are doing and how we are doing. Our institute produces research results, publications, research reports but also researhers and staff for various organisations. Former researchers of our institute are working e.g. at the university, in banking, state and agricultural organisations and Farmers Union. Two of our people are or have been as the minister of agriculture and forestry. The present minister of agriculture and forestry, Dr. Kalevi Hemilä, is a former researcher of our Institute. I think, such backround cannot be a disadvantage for the minister who has the main response in adapting the Finnish agriculture into the EU.

Minister Hemilä, I have the honour to invite you to open the 5th Finnish-Baltic seminar of agricultural economists.

Opening Address
The State of the Finnish Agriculture: Need for Restructuring

KALEVI HEMILÄ
Minister of Agriculture and Forestry
Helsinki, Finland

Ladies and gentlemen,

The title of the seminar, "Trade Liberalisation and its Impact on Farm Economy," covers the big changes the participating countries have faced during the first half of the 1990s. Lithuania, Latvia, and Estonia have cut the economic ties with Russia and entered the western markets. Finland has joined the common market of the European Union. The evolution of the common market will sooner or later enter into the phase where the Baltic countries are full members of the European Union.

The most important issue in the discussion concerning the Finnish agriculture is the membership in the European Union. The border controls were abolished at the beginning of this year. A new era in agricultural policy was introduced. The transitional period 1995-2000 softens the decrease in producer prices by additional prices and direct income support. By taking the additional prices into account, in 1995 the producer prices of milk have decreased about 20 percent, whereas those of eggs and cereals have decreased more than 50 percent.

The year 1995 will be remembered as the year when the feelings of uncertainty described the decision-making in farms. The uncertainty set up by the new agricultural policy and new market rules was added by the delayed decisions concerning support programmes and rainy May which delayed spring sowing until June in many areas even in the most Southern Finland.

High production cost, caused for example by short growing season and the small farm size, is one of the major problems in Finnish agriculture. The need for rationalisation requires that Finnish agriculture will be going through a period of restructuring. At the end of the hard road, Finnish agriculture will probably consist of some 50,000 vital farms that are competent to produce at the prices which are valid in the European Union. The remaining farms will survive in the long run, partly because of the bigger size, partly because the support available will be divided by smaller amount of farmers. The necessary condition for the survival is, however, that the foreseen levels of support programmes will actualise.

What kind of farms will survive? Agricultural economists expect that milk producers will cope quite well, whereas meat, eggs, and cereal production will be doing much worse.

What will be the structure of agriculture in the future? It is evident that an increasing share of total output comes from existing large farms, and from today's medium-size farms that have been able to enlarge their size. However, big farms are

not always the most profitable ones in the beginning of the life-cycle. The farmers that run into economic trouble are typically young farmers who have invested heavily. In the beginning of the life-cycle a farmer must borrow a lot in order to buy the farm from the previous generation. The amount of borrowed capital generally increases as a farm increases its size. Thus, the price of capital related to the net returns is the central issue in the restructuring of agriculture.

Agricultural policy measures will be targeted on those farms who have long-term potentiality in remaining in business. During the transitional period, Finland has the possibility to speed up the restructuring measures without the restrictions that apply to the EU support in general. The period ought to be used as efficiently as possible, by agricultural-policy makers and by farmers as well. This will ensure that Finnish agriculture remains as a vital industry and source of income also in the future.

Farm-level production restrictions, that dominated Finnish agricultural policy for a long time, are now lifted in many respects. However, because of the strongly decreased producer prices, increased output does not solve farmer's income problem. More important than the size of the firm is the per-unit cost of production and the overall activity of the entrepreneur. Cost efficiency and multi-activity are the central terms in describing a successful farmer of the twenty-first century. The latter target is supported by measures to develop rural businesses in general.

Environmental concerns have to be taken into account at every level of food chain. Although environmental problems are not as extensive in Finland as in some other EU countries, environmental policies have been introduced also here in order to reduce the intensity of agricultural production. The support is paid on the basis of area to the farms that make an environmental management contract.

In the short run, the decrease in the intensity of production can cause a discrepancy between the environmental targets and farmers' economic targets, but in the long run the environmentally friendly production methods will be an advantage to the Finnish farmers. The consumers in Finland and abroad should be aware that the food produced in Finland is among the cleanest ones in the world, and production methods are environmentally friendly. These aspects give possibility to gain some premium price in the markets.

From farmers' point of view, the fact that the EU membership coincided with economic recession was unfavourable. The state budget cuts that hit everybody in Finland make Finnish farmers to face difficult times in the coming years.

Dear listeners, the food chain, that starts from a farm and ends in kitchen table, is under reconstruction. The agricultural sector is expected to face dramatic changes. The basis for the situation is of economic origin. Consequently, agricultural economists are the key persons in finding solutions to the problems. Professor Matias Torvela's activity has to be mentioned when talking about the Finnish-Baltic co-operation between agricultural economists. The practice initiated in 1990 has proved to be valuable for the participating institutes.

I am pleased to open the fifth Finnish -Baltic seminar of agricultural economists. I hope you will rise essential questions and find right answers.

The Evolution of the CAP in the European Union: Some Personal Reflections[1)]

TOMÁS GARCÍA AZCÁRATE
Deputy Head of Unit for Studies and
Overall Approach, European Commission
Directorate-General for Agriculture

1. The 1992 CAP reform

In this introduction, we will first underline what were the main characteristics of the agricultural situation in the European Union (EU) in 1992, which advocated a major reform of the Common Agricultural Policy (CAP). Secondly, we will present the main objectives pursued and instruments employed.

The needs for reform

There is a huge consensus in the academic world on the analysis of the consequences of the traditional CAP. These points have to be remembered today if we want to understand why the EU decided to reform its agricultural policy in the way it did in 1992. Some of the most relevant points seem to be:

- a simultaneous increase in EC budget expenditure on agricultural markets and decrease of the agricultural net value-added.
- a system which links support to agriculture to amounts produced stimulates production growth and thus encourages intensification of production techniques. This development, if unchecked, leads to negative results. Where intensive production takes place, nature is abused, water in polluted and the land empoverished. Where land is no longer cultivated because production is less dependent on surface areas, abandoned and wilderness result
- the prices and guarantees provided through intervention and production aids stimulate output and discourage demand, as it has been observed in the case of animal consumption of cereal.

The main objectives

The main objectives pursued with the 1992 CAP reform can be divided in two groups: The medium term and the short term.

[1)] The views expressed in this talk are those of the author, and do not necessarily represent the official views of the institution for which he works.

In the medium term,

- sufficient number of farmers must be kept on the land. There is no other way to preserve the natural environment, traditional landscape and a model of agriculture based on family farms as generally favoured by society. This requires an active development policy and this policy will not be created without farmers.
- to recognize that the farmers fulfils, or at least could and should fulfil two functions viz. firstly that of production and secondly of protecting the environment in the context of rural development.

In the short term,

- to *clean up* the EU cereal market, increasing consumption and decreasing the level of intervention stocks;
- to discriminate in favour of the extensive stockbreeders;
- to support farmers more directly, instead of supporting products.

The main instruments

The main instruments used in the 1992 CAP reform are:

- a 29 % decrease in intervention prices for cereals, on average;
- compulsory set-aside;
- per hectare (crops) and per head (animals) subsidies, based on historical references for yields, areas and herds, and
- accompanying measures to encourage extensification, early retirement and re-forestation.

2. A reform that works

The reform on the CAP was not unanimously welcomed in agricultural circles, or by agricultural economists. When we reread some of the criticisms published, we realise how flimsy were the grounds for the fears expressed, which stemmed from a basically pessimistic attitude to the prospect of considerable change (Pelletier, 1995).

However, the facts are stubborn. At the level of the European Union as a whole, we should mention the following.

- Demand for cereals has increased in the Community, mainly for animal feeding. TOEPFER International estimated the increase at 6.7 million tonnes in 1993/94, while demand remained steady in 1994/95; STATEGIE GRAINS calculated an

increase of 9.7 million tonnes in 1993/94 , and a slight decline, of 1.2 million tonnes, in 1994/95. In terms of the substitution effect, the main casualty of this increase in the consumption of cereals has been cassava (Couty, 1994).

- Output of cereals in the Union stood at 176 million tonnes in 1993/94, and about 173 million tonnes in 1994/95.
- Intervention stocks were around 10 million tonnes at the end of the 1994/95 marketing year, compared with 33 million tonnes at the beginning of 1993/94.
- Intervention stocks of beef were around 40 000 tonnes in February 1995, compared with 1.2 million tonnes at the beginning of 1993/94.

Many of the consequences of the reform cannot be quantified.

- Farmers' behaviour patterns are changing as they move towards "economic extensification" or "rational farming".
- Market prices are less and less under the influence of administrative prices, and much more dependent on supply and demand; they are also affected by producers' decisions (Fischler, 1995 (a)).
- Farmers are taking more interest in the quality of products, and in quality products, rather than in purely quantitative aspects.
- An agreement has been reached under the GATT conferring international recognition and stability on the CAP (Delorme, 1993). Without the reform, the GATT agreement – or the trade war that would have started if the agreement had been delayed – would have marked the beginning of the end of European agriculture (Cloos and Tung-Laï, 1994). With the reform, a sort of natural alliance has been formed between the United States and Europe, reflecting the similarities between the situation of their agricultural economies (Delorme, 1995).
- The European Union has availed itself of a new instrument: set-aside, to manage markets in the post-GATT situation, where it is not so easy to resort to the machinery of intervention stocks (Chol, 1994). For example, the market situation has made it possible to reduce compulsory set-aside land for recipients of aid introduced by the reform for arable crops.
- Area aid has acted as an agricultural insurance policy for crop damages, when belonging to a Community market permanently in surplus prevents prices from rising to offset the poor harvest. This is particularly important in countries as Finland, the Baltic States and Spain where yields varies significantly from one year to another.

These results are not exclusively due to the reform of the CAP. The tendencies promoted by the reform have been underpinned by other factors, such as weather conditions in Europe (Albisu *et al.*, 1994), floods in the United States, the drought in Australia Due to "El Niño" (Wuethrich, 1995), the devaluation of some European currencies (Sumpsi, 1994) or favourable development of the dollar. It is also true that

undesirable effects have been observed, such as "subsidy cropping" by farmers (Gámiz, 1994) and bureaucracy. Without going so far as Burrell (1992), who describes the reform as a "work of art", we should not let the adverse effects blind us to the fact that, on the whole, the reform achieved its objectives, and the general situation of the agricultural sector in Europe is better now than it was few years ago (Santer, 1995).

The Commission believes that multiannual agricultural price fixing was a positive measure which contributed to creating a climate of security and stability, thus encouraging investment and entrepreneurial decision-making. Consequently, prices and subsidies have been fixed not only for the transition period, but also from the 1995/96 marketing year. The Commission did not achieve its aim. It was widely believed, against the background of the uncertainty that affected much of the farming world following the reform, that aid could be phased out by the end of the 1995/96 crop year (Burrell, 1992). With the passage of time, feelings have calmed down and things have been put into perspective.

In brief, then, the reform works well on the whole, and there is no need to undertake major changes in the short term (Fischler, 1995 (b)).

Does this mean that there are no factors of change for the common agriculture policy in the medium to long term? By no means; but the European Union has plenty of time to analyse and prepare the changes needed.

3. The probable accession of the countries of central and eastern Europe

Mr. Steichen, former Member of the Commission, stated in his valedictory article that, as well as the institutional question, the basic issues to be resolved before any eastwards extension of the Community was how to safeguard common policies built up over forty years, among them the CAP. Should the CAP change drastically once again, to meet the challenge, or should we think in terms of development on the basis of the principles set out by the 1992 reform?

There have been numerous studies of the forthcoming enlargement, and estimates of its cost to the Community (anything from ECU 5,000 million to ECU 50,000 million).

A reasoned analysis of the situation, which is an indispensable prelude to the impact analysis (not to say the budgetary calculations) must take account, among other things, of the following factors.

- Since the reform of the CAP, Community prices have been fixed in current ecus. With the passage of time, this has meant that the reform includes arrangements for gradual decline in agricultural prices in real terms.

- The agreements of the Uruguay Round and, in particular, the decline in subsidised exports, will have a positive impact on world prices. The most recent report I have seen, the 1995 OECD report, stressless and quantifies this trend.
- The much-discussed gulf between Community prices, world market prices and prices in the countries of central and eastern Europe may well be considerably smaller than a simple statistical analysis implies (OECD, 1995).
- The right way to estimate the real productive potential of the countries of central and eastern Europe is certainly not to multiply the area under cultivation by the average Community yield (or by the French yield for cereals and the Dutch yield for milk)! In Spain we have suffered for years from criticism of our wine-producing potential, as calculated on the basis of our enormous areas of vineyards, and our capacity to bring our productivity into line with the Community average (overnight, no doubt). That such an objective is clearly ridiculous does not seem to be a consideration.
- There are factors hampering, if not actually blocking, economic development in general, and agricultural development in particular. They include, among other things, the deterioration in the internal market, the size on the structural changes needed in the productive sphere and the agri-industrial complex, the enormous financing requirement that is not matched by financing capacity (when capital exists, it is often channelled, not towards activities like farming, but to other more profitable sectors), political uncertainty, both locally and across the region (Balkan conflict, situation in the former Soviet Union, etc.).
- The Uruguay Round has affected the national agricultural policies of the countries of central and eastern Europe. Although most of them have some scope for keeping out imports, the limits on subsidised exports and internal support will be applicable.

Davidova and Buckwell (1994) correctly pose the problem: it involves identifying the minimum indispensable change to the CAP to enable enlargement to take place. It does not seem reasonable to promote drastic change, which always leads to radical social and political consequences, as a protection against a hypothetical conflict situation that might arise within ten years or so.

4. Some conclusions on some guidelines for a new CAP

A group of leading economists has provided an interesting study, commissioned by the DG for economic and financial affairs, on "EC agricultural policy for the 21st century" (Munch *et al.*, 1994). This study, which does not commit either DG II or the Commission, puts forward an alternative for radical change to the new CAP, summarised as follows.

- The role of the Commission should be merely to ensure the smooth functioning of the internal market and avoiding distortions of competition. To this end, its powers should be reinforced.
- Community prices should be aligned on world market prices, with total liberalisation of the market at the end of the transitional period: Community prices at world levels, disappearance of milk quotas and sugar quotas, etc.
- While income support is clearly necessary for social reasons, its cost should be borne entirely by the Member States.
- National aid would be authorised, if it were totally independent of output levels, and governed by social or environmental criteria.
- However, the Social and Structural Funds, and the Cohesion Fund, should be reinforced.

This suggestion raises a number of questions and, in particular, the following.

- What would happen in the Member States with budget problems, which could not afford to finance the national aid? The Commission's Director General for Agriculture, Guy Legras, has said that it would be "madness" to think that the present compensatory aid introduced by the 1992 reform could be charged to the Member States (Legras, 1995). The richest countries would give away large sums, with which the others could not compete. This aspect of the question in emphasised by Barato (1995) in a remarkable contribution.
- How far is this approach, which implies increased public expenditure, consistent with the achievement of the objectives of economic convergence set out in the Maastricht Treaty, especially for the Member States whose economic situation is less buoyant, and which will therefore find it more difficult to achieve the objectives?
- How far would the Commission be empowered to prevent the national aid from distorting free competition within the internal market, and from undermining not just the foundations of the common agricultural policy, but also those of Europe itself?
- How does this increase in the Commission's political power to supervise and control actions by the Member States fit in with the declared intention of developing the application of the principle of subsidiary?
- How are the environmental consequences of such a radical proposal taken into account? Two of the most influential ecology groups at European level, whose studies on the CAP and CAP reform are among the most reliable and valuable, the UK Royal Society for the Protection of Birds (RSPB, 1995), and the Netherlands Society for Nature and the Environment (NSNE, 1995), do not think that proper account has been taken of this aspect.

The worst attitude towards those who want to see the end of the specific features that have so far characterised the western countries' agricultural policies is total opposition, in the name of the basic principles laid down in the Treaties, to any proposals for change. Setting conditions for the forthcoming eastward enlargement, as the COPA did (1994), does not seem to be the best way of ensuring that due thought is given to the matter.

The following guidelines could inform reasonable change, which would help us to meet the challenges outlined above, while consolidating the essence of a modern agricultural policy.

- Traumatic proposals equating eastward enlargement with the destruction of western rural societies should be avoided.
- Environmental policy and agricultural policy should be better integrated. Aid from the reformed CAP could be at least partly conditional on meeting a set of environmental requirements. This would mean overcoming the practical problems of setting in motion cross-compliance on a large scale (see García Azcárate, 1993).

  A similar tendency is apparent in the United States. Although it seems unlikely that it will manage to influence the new Farm Bill, at present under discussion, an innovative coalition of ecology organizations, university economists and farmers' organizations is gathering strength (Debar, 1995).
- Agricultural policy should be better integrated with rural development policy. Many analysts have called for an integrated target in which, alongside specific or sectoral measures to promote given situations, other programmes or projects would be adopted with a real impact on local development, environmental protection and conservation, enhancement of local resources, and incentives for new sectors or branches of activity. In Andalucia, for example, CAP aid is the second most important source of foreign exchange, after tourism. It is logical and understandable that the regional authorities wish to maximise the efficiency of such public investment for the countryside.

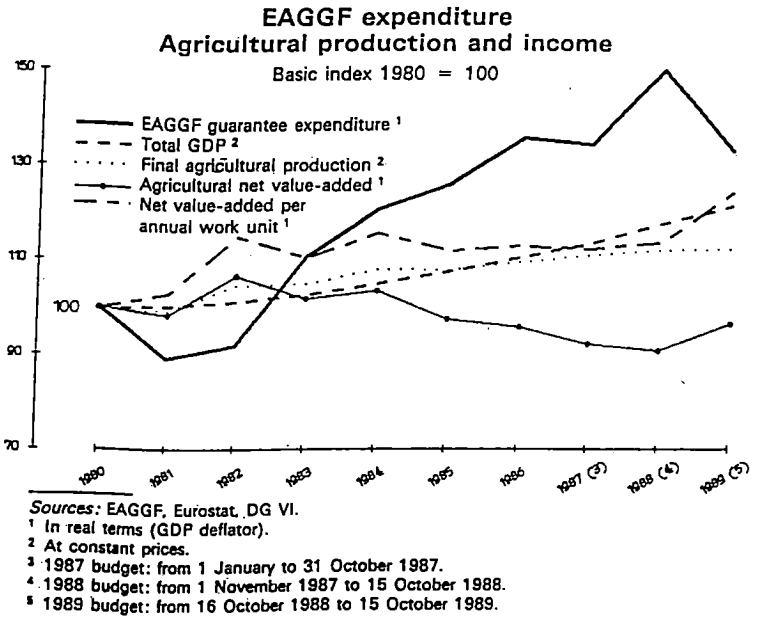

Figure 1. EAGGF expenditure. Agricultural production and income. Basic index 1980=100.

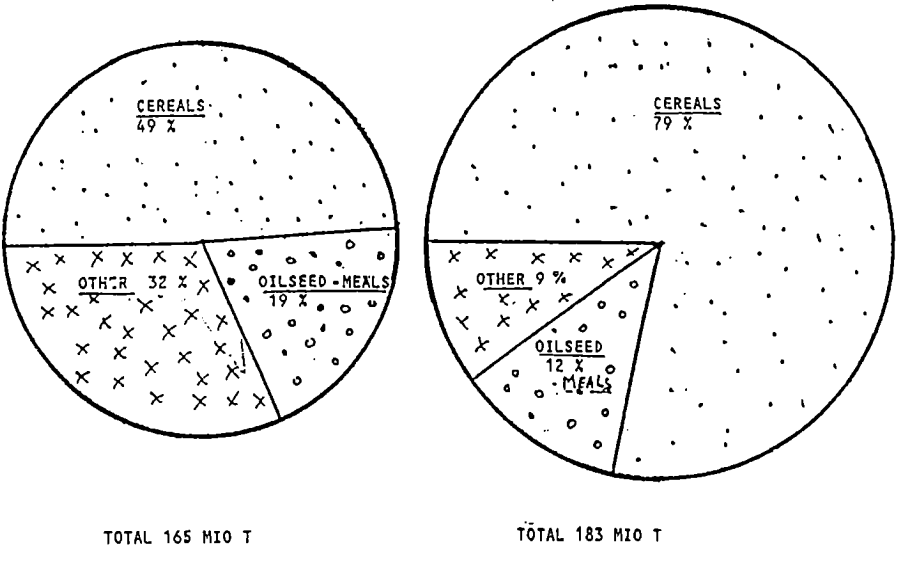

Figure 2. The proportions of cereals, oilseed meals and "other feeds" in concentrates in the EEC and USA (average 1986-1991).

The European Union and Central Europe

MARTIN STRITTMATTER
European Commission, Directorate-General for Agriculture

Helsinki is a good place for a seminar like this: Finland has become a member of the EU only recently and may have the role of a mediator between the EU and the neighbouring Baltic Republics who have just started the process of closer cooperation with the EU. As far as I know, the Finnish-Baltic seminar has already some tradition and I am sure, the exchange of views, which is an important element of seminars like that, will have a very positive impact on mutual understanding and will be helpful in the ongoing process of integration.

I want to talk first of all about the relationship between the EU and the PECO countries as it stands now and then have a look at the future perspectives and the work we are doing in this context at the moment.

Since the days of the foundation of the EU, the community was never seen as a restricted circle and enlargement was always part of the natural process of the development of the EU. It has therefore a certain logic that the European Council, two years ago at the summit in Copenhagen in June 1993, established an option for EU membership for the associated (PECO) countries. Of course, this option was given under certain conditions. First of all the associated countries have to express their wish to become members and, secondly, a number of economic and political conditions have to be fulfilled. At that time the circle of associated countries comprised the Visegrad countries, Bulgaria and Rumania. The Baltic Republics and Slovenia are just about to sign the association agreements.

Up to now all the countries concerned have expressed their wish to join the EU, some of them, Poland and Hungary, have already asked officially for membership some of the others will probably follow in 1996.

The Council in Essen in December 1994, has been a further important step towards integration. It established a basis for formalised relations between the EU and the PECO countries. The so called, "structured dialogue", which has been one of the results of the Essen summit, foresees regular contacts on ministers level, between the PECOs and their counterparts in the EU.

In addition the council adopted a first strategy for the "pre-accession time", setting a framework, of how the EU could help the associated countries to solve their problems of transition and to prepare for EU membership. Major part of this strategy is a closer economical and political cooperation, which later on will help to adopt the rules of the EU single market.

Only a few weeks ago, the Commission finished a "White Paper" which contains not only political guidelines for integration but also a long list of legal regulations which are crucial for the functioning of the EU single market. When the accession

is prepared, these regulations will have to be taken into account by the potential new members. The preparation of the White paper has been undertaken in close collaboration between the commission and the PECO countries. It showed that until full integration there is still a long way to go and a lot of work to be done. Taking these difficulties into account it is not astonishing, that a final time table for integration was not yet fixed in this white paper.

Looking at the political and economical situation we see major differences between the PECOs. These differences also make it difficult to fix a common time table for accession. It is therefore very probable that there will be several dates for integration rather than one common date for all the PECOs..

It is well know that agriculture plays an important role in all the PECOs and also for the Baltic Republics and certainly agriculture will be an important issue in the context of preparation for accession. Some statistical figures underline the importance of agriculture in the PECOs compared to the European Union. In the EU, Agriculture has a share of only 2.5% of GDP, and some 5.7% of the EU labour force is employed in agriculture. In the PECOs, agricultural contribution to the GDP reaches an average of approximately 7.8%. In the Baltic countries, except Estonia the agricultural share in GDP is still more than 10%. If we look at the labour force, we see that in the PECOs at an average 25% of the labour force is employed in agriculture. In some countries employment in agriculture has even increased, due to the fact that especially in rural areas other jobs are missing. In these cases agricultural production in household plots and small scale farms gives people at least an opportunity to grow food for their own needs and perhaps for some additional income. This development underlines the social buffer role, agriculture plays in the transition period.

It is also interesting to look at the agricultural potential of the PECOs. The agricultural surface of all the PECOs taken together equals about 40% of the correspondent surface in the EU. The arable land of the Eastern European countries reaches even more than 50% of the EU arable land. If we look at the development of production, we can state that an important part of the production potential, which is expressed in this figures is no used at present. Generally speaking, the decline in the livestock sector was more pronounced than the drop in the production of arable crops.

As far as the Baltic Republics are concerned, it is obvious that livestock production was by far the dominating sector based, to a good deal, on imported grain. Due to the fact, that the Baltic Republics were part of the Soviet Union and regained their independence only a few years ago, Estonia, Latvia and Lithuania did not only have to face "usual" problems of transition. As independent states they had first of all to establish their own economic, legislative and administrative structures, which certainly posed a number of additional problems. The total agricultural area of the three Baltic Republic taken together reaches about 7.4 Mio ha, which is about 5% of the comparable area in the EU. Livestock production and export of meat and dairy products were of enormous importance before independence but as we all know,

contracted tremendously over recent years, leading also to declining surplus production and reduced exports. Recent figures for production and consumption suggest, that the export potential has declined and for some commodities, such as pig meat, which used to be important export commodities, the Baltic countries presently are net-importers.

For the present economic and trade relations between the EU and the PECOs, the "Europe agreements" are the most important corner stone. In a first round, Europe agreements have been concluded, with the Visegrad countries, i.e. with Hungary, with Poland, with the Czech Republic, and with Slovakia. Later on Europe agreements were also concluded with Bulgaria and Rumania.

Negotiations for Europe agreements with the Baltic Republics and with Slovenia have started early this year and will be signed in the near future. Main objectives of the Europe agreements, are cooperation in the cultural and economic field, the conclusion of a free trade area, and last but not least the agreements open an option for EU membership.

The trade parts of the agreements entered into force on an interim basis even before the Europe agreements had officially been concluded. For the Baltic countries this was in January 1995. In principle all these treaties foresee reciprocity of mutual trade concessions, but a certain asymmetry has been intended in order to assure greater benefit for the PECO countries. The main concessions which have been accorded, for trade with agricultural and food products are tariff reductions for determined quotas of commodities. Within a five years period, these quotas are increased by 10% each year, while the customs duties which are applied are step by step reduced. For the Baltic Republics quotas for meat, butter and skimmed milk powder are the most important ones in quantitative terms. For some other commodities, such as soft fruit, tariff reductions are not connected with quotas but to enter the EU market, minimum prices have to be respected.

Only recently the commission was empowered to negotiate changes to the Europe agreements. Two main reasons made changes necessary. First, Austria, Finland and Sweden have become members of the EU and the bilateral concessions they had given to the Central and Eastern European countries were now to be integrated into the Europe agreements.

Second reason for renegotiations were the constraints of the GATT agreement, which will have to be implemented beginning July 1. Variable levies have to be transformed into fixed tariffs which step by step have to be reduced. This general reduction of import barriers would also lead to a reduction of the preferential margins of the associated countries, which would certainly has an effect, which is not in the sense of the Europe agreements. In order to maintain the same level of preferential margins for the PECOs, amendments had to be made to the association agreements.

As we could see in recent years, trade flows between the PECOs and the FSU deteriorated over recent years, whereas trade with the EU - in both directions - has become more and more important for many of the Eastern European countries, including the three Baltic Republics. For some of them, the EU and the EFTA have

become the most important single trading partner, for others however, Russia and the other FSU stayed the most important foreign markets.

The following figures underline the development of trade between the EU and the PECOs: Between 1988 and 1993 the EU increased the agricultural imports from the PECOs by 24%. In 1993 the total value of imports reached 2050 Mio ECU. In the same period, exports from the EU to the PECOs increased by 257 % i.e. from 700 Mio ECU in 1988 to 2500 Mio ECU in 1993. The just mentioned figures show, that trade flows stayed asymmetric but with a negative balance on the side of the PECOs, which is certainly not in the sense of the Europe agreements. For the time being the commission is carrying out a thorough analysis of trade flows in order to figure out the reasons for this trend and especially to find out why in some cases quotas of the association agreements were not fully used.

The EU will certainly remain an important market for PECO exports also in future, but it has to be kept in mind, that the EU market has only a limited capacity of absorption and for a number of commodities, mainly those which are also the main export commodities for the PECOs i. e. beef meat, pork, cereals and dairy products, the EU itself has to face a constant threat of over supply.

The trade agreements with the Baltic Republics entered into force only in January this year, so that it is still to early to judge on the real impact of the given quotas for the development of bilateral trade. In addition, access to the EU market presupposes that certain hygienical and quality standards are fulfilled, which in the nearer future will cause problems especially in the case of meat, so that market access to the EU is limited. Traditional markets in the FSU should therefore not be neglected, even if the economic situation in these traditional markets is for the moment rather difficult. They will probably play an important role also in the nearer future.

PHARE assistance is another important aspect of the bilateral relations between the EU and the countries in Central and Eastern Europe. Phare programmes are primarily targeted to accompany the process of transition, by providing the necessary help for the establishment of an economical and structural surroundings, which is appropriate to cope with the new challenges. The programmes should also help to prepare a basis for further integration, so that the PHARE assistance can also be seen as an important element of the pre-accession strategy. The total volume of the PHARE programme increased from 500 Mio ECU in 1990 to more than 1000 Mio ECU in 1993. Around 8% of this amount are earmarked for agricultural purposes.

Phare assistance for the Baltic Republics totalled about 25 Mio ECU in the period between 1990 and 1994. These funding were spent in the framework of "General Technical Assistance Facilities". Assistance was directed no only to the agricultural production, mainly in the form of credits, but also to the related sectors, taking into account, that agricultural production is dependent on functioning upstream and downstream sectors and on an appropriate infrastructure. Phare assistance therefore covered several fields. Among others assistance is provided for the privatisation of agro-industries, the development of rural financial services, the training of agricultural statistical services and for the land cadastration.

Apart from the trade part, which at present is quite important, the Europe agreements include an option for EU membership as an ending point. The strategy which will be followed in future will have to bear that in mind.

One of the most burning questions, which is asked at the moment is certainly the question on the possible impacts of Eastern enlargement on the common agricultural policy of the EU. At this stage it is certainly too early to give a final answer to the question and it evokes a couple of further questions that have to be answered before.

One of these questions would certainly be what Common agricultural policy will we have once it comes to accession? As Tomás García Azcárate already explained, the last major reform of the CAP has been made in 1992. The main result of the reform was a shift in the emphasis of support away from production oriented support to more direct support measures. The first two and a half years of implementation are just behind us and, as far as we can see for the moment, the reform seems to be quite successful. I could imagine, that changes to the CAP, in the foreseeable future will probably be more in the direction of evolutionary amendments and simplification of existing policies, than in the direction of fundamental changes in the direction of support.

At the present stage it is for example difficult to imagine, that market support will be completely phased out. The level of market price support might still change and for some products may be further reduced, but a certain stability of prices is a necessary precondition for all decision on investments also in agriculture. On the other hand, elements of direct support and support measures could be strengthened. That would take into account, that agriculture provides a number of environmental, social and structural functions, which go beyond mere production of food.

I am not able to predict future political decisions. But looking at discussions on agricultural policy, which are going on at the moment, we see that the focus is on questions like the environmental impact of agriculture, the maintaining of the landscape and the importance of agriculture for the social and economic structure of rural areas as a whole. I could imagine that agricultural policy in the future will have to give more comprehensive answers to questions like this.

The date which will be chosen for enlargement will also be important for the immediate impact of accession on EU agricultural markets. A development takes place not only in the levels of agricultural production, but also in the upstream and downstream industry and in the whole economic surroundings, both, within the EU and within the PECOs.

It will also make a difference if we talk about accession, - to go to the extremes, of all 10 PECOs at the same time or if we talk about an accession one by one and certainly we should not forget, that joining the EU has not only an impact on the EU, but also on consumers, markets and the economies of the countries who are joining. It may well be, that at least for some of the joining countries a longer period of preparation or transition will be desirable in order to allow their economies to prepare for the competition in the single market.

Ladies and gentlemen, at the present stage questions like this are intensively discussed within the EU but it is certainly to early too give definitive answers to all these questions and I do not want to loose myself in speculations.

A number of studies have already been carried out in this context. Let me just have a short look at the main results of some of them: Early this year, the studies of 4 university professors were published. They had been ordered by DG I, our Directorate General for foreign relations. After a more or less general analysis of the situation of agriculture in the PECOs, the studies came to the conclusion that accession of the Central and Eastern European countries would only be possible if institutional prices in the EU would further be reduced. The studies stated, if support prices in the PECOs were aligned to the level applied in the EU, this would not only increase budgetary spending for the agricultural sector, but in addition it would burden consumers with higher food prices. It is certainly true, that (too) high price levels for food hamper the economic development and it is also true, that the consumers in the PECOs already pay a high share of their available salary on food. The GATT commitments that have been signed by most of the PECOs represent a further constraint for a price support policies. They set limits not only to internal support, but also to the level of border protection.

It can not be doubted that studies, like the just mentioned, help to point out a number of problems. Nevertheless all strategy needs a solid and more detailed country by country analysis of the agricultural sector, which up to now was still missing.

The first step of the work we are carrying out in DG VI, the Directorate General for agriculture, is therefore a series of studies on the agricultural sector for each of the PECOs. If I speak of the agricultural sector, I have to add that the processing industry, the rural economy as a whole and the macro-economic situation are also included in our analysis.

We think that only such a comprehensive analysis can give us the necessary basis to judge on the possible future development, as we see it now. The studies will also help us to measure, country by country, the challenges that the agricultural sector faces. It would certainly not have been the best idea to prepare these studies from the green table in Brussels. We tried therefore to get into contact with leading experts in place. These contacts proved to be most useful and we got not only information on latest development but also well funded expertise, based on many years of experience, which helped us to get a far better understanding of the current situation and developments.

For the time being, we are just about to finish our country studies and certainly we cannot stop at that point. Our next steps will be, to reflect on the conclusions we have drawn from the per country studies and to think about consequences which have to be taken into account when it comes to the discussion of the further strategy. We think, that by the end of the year we will be able to present a strategy, giving more detailed answers on the impact of enlargement and on the further steps to be taken.

Agricultural Trade Liberalisation: Expectations and Reality

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1. Theory and practise

Trade liberalisation for agricultural products is one of the hottest topics in the world economy. The rapid development of new technologies in farm and low income elasticity of food demand influence the market prices and significantly increase the financial and economic costs of agricultural price support policies.

By the Law of Comparative Advantage the benefits from trade are:

- Greater overall efficiency of resource users (more output for the same inputs).
- Greater overall world output (consumers gain)
- Increased competition and lower prices (consumers gain)
- More choice (consumers gain)
- Trade is the engine that drives economic growth. Increased demand for a country's products injects cash into the economy creating jobs. This increases as money circulates round the economy (the multiplier effect)
- Political, social and cultural advantages from fostering trade links

Here is a question: whence protectionism - whence the roots of protectionism? Arne Jon Isachen, Carl B. Hamilton and Thorvaldur Gylfason [1] have mentioned two main reasons.

The first explanation has to do with the uneven distribution of the gains and costs of government protection. The owners of a firm threatened by import competition obviously gain from protection of the firm. The same also is true concerning the workers in the firm, at least in the short run. The two groups of beneficiaries are concentrated, visible, and easy to identify. The firm's owners and workers will have a strong incentive to expend both effort and resources in order to ensure protection for themselves. In a society with active media and ongoing competition among political parties the firm's precarious situation will be a public issue. Pressure will be brought to bear on public authorities to do something about the situation.

Political decision makers can indeed do a few things - but protection against healthy competition is not the right answer.

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[1] Arne Jon Isachsen, Carl B. Hamilton, Thorvaldur Gylfason.
Basic Economics, From Plan to Market,Tallinn 1994. p. 287

Many decision makers actually seem to be unaware that protection imposes a burden on consumers and other firms, sometime partly because it can be difficult for them to obtain accurate estimates of the costs of protection. Such loss estimates are more abstract arguments in political life than the potential suffering of a vocal, visible, and relatively small group of people.

But are there none to defend free trade and point out the overall gain to the society from free trade? Who protects the public from protectionists? The answer is: a precious few, for two main reasons.

First consumers who stand to lose most from protection are typically an ill-organised, amorphous mass of people. Each of them has many other things to worry about than just the price of a particular commodity or group of commodities. So the consumers' incentive to organise a pro-free-import-lobby is much weaker than that of producers (i.e. owners plus workers).

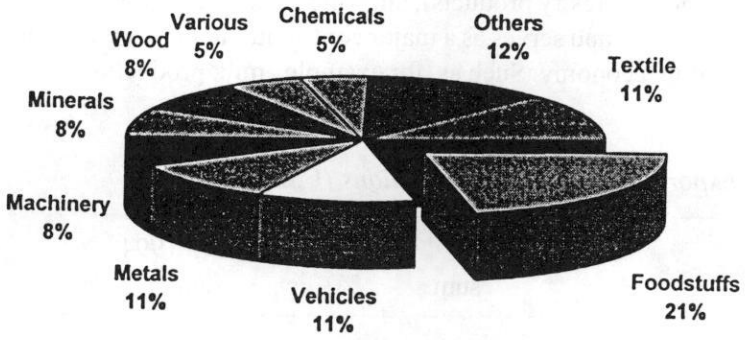
Second, the cost of protection is generally rather low to each consumer, especially when considering one commodity at a time. But when consumers' costs are added up the implicit transfer from consumers to the workers of the protected industry frequently turns out to be very high. For various countries and commodities these costs have been estimated. It has been found that the cost of saving a job in the textile, clothing, steel and car industries often amounts to some 50.000 to 100.000 USD per worker in year .One reason why the cost often is very high is that the protection does not raise only the price on the import quantity, but the price rises also spread to domestically produced substitutes. In fact, the latter price rises are the source of the benefits to some domestic producers at the consumers' expense.

2. Estonian background

Estonian trade policy is one of the most liberalised in the world at present. Government have negotiations about an Association Agreement with EC and other countries. Republic has signed an agreement on trade and economic co-operation with the EC. This agreement provides for the removal of specific quantitative restrictions on import and the mutual granting of Most Favoured Nation status in trade with EC member countries. Latvia and Estonia initialled a free trade agreement in April 1993 and the Baltic Free Trade Area agreements is awaiting signature. Unfortunately agricultural products have been excluded from these arrangements.

In spite of the fact that agricultural production is decreasing the share of farm products in total export remains rather considerable (21 % 1993; Figure 1). The value of total agricultural food imports in 1993 (USD 103,5 million) was nearly three times the 1992 level. Export doubled to USD 150,7 million, leaving a surplus USD 47 million. Substantial re-orientation of export to Western markets has occurred (2/3 of export went to Western market and EFTA countries in 1992). Imports from New Independent Countries are still significant at 1/3 of total imports in 1992.

Export
(percentage, 1993)



Imports

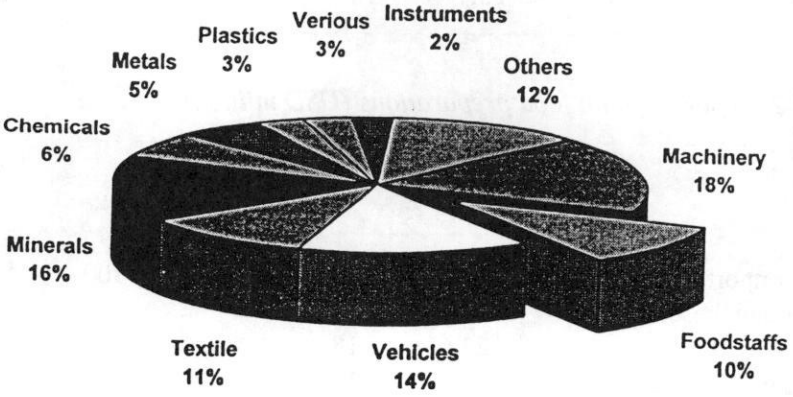


Figure 1. Foreign trade by brands in Estonia.

In 1994, gross export value of food was 291 million USD (Table 1) and import value 275 million USD (Table 2).

One of the most important factors from which depends the present and the future of our agriculture is farm income policy. In case of efficient production the costs will be compensated.

A productive rural sector which has specialised in areas of comparative advance (eggs, dairy, pork, forestry products), but which also develops broadly - establishs rural income option and serves as a major contributor to the growth of an open and vigorous trading economy. Such as, for example, milk production.

Table 1. Export of main food preparations (USD million).

Products	1993		1994		94/93
	sum	%	sum	%	%
All food export	192	100	291	100	152
among these					
Dairy products	60,9	32	59,7	21	98
Fish and fish products	41,7	22	89,3	31	214
Meat	15	8	13,4	5	89
Sugar, confectionery	35,3	18	49,2	17	139
Beverages	7,3	4	18	6	247
Fats and oils	6,1	3	6,4	2	105
Others	25,7	13	55	18	214

Table 2. Import of main food preparations (USD million).

Products	1993		1994		94/93
	sum	%	sum	%	%
Gross import	136	100	275	100	202
among these					
Sugar	24,6	18	33,8	12	137
Cocoa preparations	16,7	12	31,4	11	188
Beverages	10,7	8	33,3	12	311
Fats and oils	10,2	8	20,4	7	200
Meat	3,4	3	11,8	4	347
Milk products	3,8	3	9,9	4	261
Cereals	3,1	2	3	1	97
Others	63,5	46	131,4	49	207

According to the studies implemented in Iowa State University the producer price of milk in Estonia is quite competitive compared with other developed countries (Figure 2).

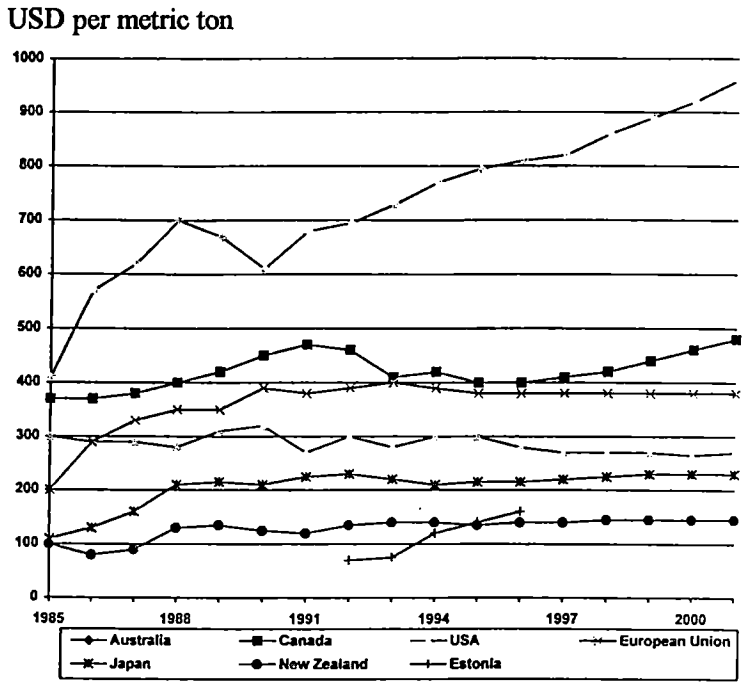


Figure 2. Forecast of milk producer prices.

Income models of private farm were prepared to compare use of arable land and natural grassland for dairy cattle. Model presents four scenarios (Figure 3).

Scenario A

An existing private farm of 25 hectares with the land use on the level of present average farm, but oriented towards cattle production with an existing herd of 13 heads including 5 cows.

Scenario B

The same 25 hectares farm unit assuming a change in land use with crop rotation extended to nine years including three years of cultivation and six years of

pasture, improved pasture management, improved feed conservation and an increase of the cattle size to 21 heads including 10 cows.

Scenario C

A hypothetical 50 hectares farm of having the same land use and crop pattern as proposed for B, and a herd of 45 heads including 20 cows.

Scenario D

A hypothetical 100 hectares farm as for C, with a heard of 88 heads including 40 cows.

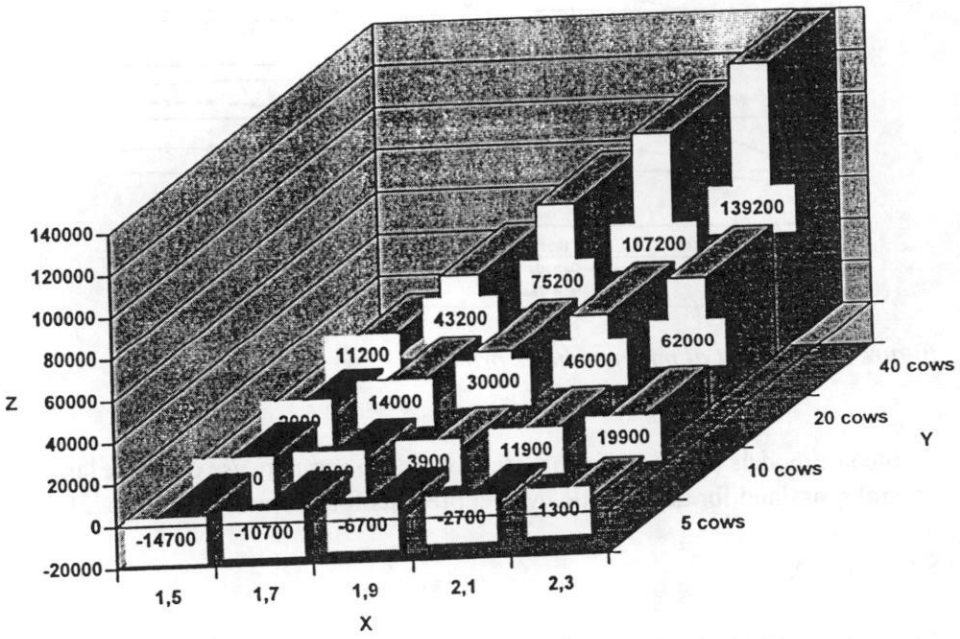


Figure 3. Farm size and profit (milk production).

X : producer price (crown per kilo)
Y : number of cows
Z : calculated loss or profit (crown)

3. Agricultural trade policy

Still, despite of the attempts to gradually liberate the international trade the protectionist tendencies remain firmly ingrained in Western market economies. Various existing government - imposed trade barriers like tariffs and import quotas remain. Therefore, Estonian agricultural trade policy needs its own approach. Moderate border protection (MBP) of the domestic market can shelter agriculture from the excessive variability of world market prices. But, what is MBP for Estonia?

Used mainly as a stabilisation device, this protection should be limited and vary according to short-term international price levels and currency fluctuations. Uniform, low, and predictable tariffs are preferable to the complicated antidumping law. In the same time we must take into consideration three general principles of WTO:

- reciprocity : regards market opening as a concession requiring concessions in return
- non - discrimination : if one country opens a market to another it is then required to open it to all members of WTO
- transparency : replace non-tariff barriers with tariffs.

The general non-tariff barriers include: 1) exchange controls, 2) technical and administrative protection, 3) government procurement policies, and 4) quotas, also known as voluntary restraint agreements and voluntary export restraints

Movements towards a more market - oriented agricultural policies should therefore reduce administered prices in proportion to the existing level of price support for each commodity computed on the basis of long term price trends. This process of trade liberalisation is better implemented gradually, according to the ease of adjustment.

Trade and Trade Policy Development in Lithuania

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In less than four years since Lithuanian independence, trade and trade policy have changed rapidly and longer run tendencies in policies and trade patterns are beginning to emerge. The paper reviews key stages in policy development, like the major trade patterns and arrangements and prospects for the future.

1. Stages in policy development

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

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

From 1994 to the present, more consistent trade policies emerged that began to harmonise the trade regime with domestic and world market conditions and constraints. External pressures to establish consistent and transparent trade policies led to elimination of non-tariff barriers and a switch for using only ad valorem tariffs. Bilateral and multilateral agreements were signed, which influenced this process.

Among the most influential agreements were the IMF Memorandum in September 1994, the EU Free Trade Aggreement in January 1995 and the Memorandum on Foreign Trade Policy provided to the WTO in late 1994. On April 1, 1995, a Government resolution came into force to establish a differentiated tariff system, which includes MFN (conventional), preferential (under free trade agreements), and autonomous (sanctional) tariffs.

Under the laws passed to establish agricultural and trade regimes, tariff rates are set by government resolution and other legal acts not requiring legislation. Preferential tariffs are established in bilateral or multilateral agreements. External constraints on trade policy decisions include IMF and World Bank Memoranda and the need for keeping policies consistent with WTO stantards in anticipation of WTO accession. The trade policy is planned to be liberalised further by commitments for IMF. The commitments include: no increases in the tariff rates, no quantitative border restrictions and gradual reductions of the average tariff of the main products in the consumer food basket.

2. Trade patterns and arrangements

The trade balance of agricultural and food products was positive in the last two years (Table 1), but it declined from $135.9 million 1993 to $38.9 million in 1994. Although exports declined by 7 %, the main reason for the lower trade balance was a 41.8 % increase in imports. The trade balance improved with only two regions, Baltic countries (+$10 million) and CIS countries (+$3.7 million). From 1993 to 1994 Lithuania switched from a net export to a net import position with the European Union, Asia, Africa, and Australia but retained its net export status with the Baltic, CEFTA countries, and the CIS.

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

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

The main export products in 1994 were milk products, live animals, and meat products, accounting for 44 % of total exports (Table 2). Other product groups accounted for less than 10 % of the total. On the import side, only fruits and

vegetables stand out as a major group, accounting for 18 % of the total. Most of imports, in fact, were scattered among a large number of products that together made 41 % of the total.

Trade with the EU was regulated by MFN tariffs until January 1995, when the prerefential trade agreement came into effect. Lithuanian agricultural and food exports to the EU include a significant but unspecified quantity that is reexported to other countries outside the EU. The trade agreement provides 20 %, 40 %, and 60 % reductions in tariffs for specified quantities of Lithuanian products. However, time will be needed for reducing obstacles associated with certification, lower product quality, packaging deficiencies, and othger marketing infrastructure problems. Lithuanian tariff reductions are not large and are also subject to quotas for sensitive products. A quota administration system has been established but still needs time to operate effectively. As a consequence, imports of EU products are likely to exceed quota levels for some time.

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

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

The CIS region was formely a traditional market for Lithuanian products, but this exchange of goods under the Soviet system was not really a trade but a delivery system not driven by competitiveness and market forces. Over the recent years trade with this region has been hampered by declining demand, lower market prices, payment problems, high transactions costs, competition from former COMECON

countries, and competition with subsidies, export credits, and food aid provided by the EU and the US. Trade policies have also been very erratic. Russia only applied MFN tariffs to Lithuania beginning in January 1995, after a period when sanctional tariffs of two times MFN were applied. Lithuanian now has trade agreeements with Ukraine, Belarus, Russia, Kazakhstan, and Tajikistan. Negotianions are currently in progress with Moldova, Turkmenistan, and Azerbaijan.

3. Prospects for the future

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

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

The CEFTA countries have been the second largest trading partner in Europe after the EU. Poland accounts for more than 70 % of this trade both for imports and exports. Lithuania and Poland are now negotiating a free trade agreement that may later lead to membership in CEFTA. However, agricultural and food products are not currently included in CEFTA and will likely have only limited participation any future agreement.

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

Table 1. Pattern of agricultural and food exports and imports in 1993 and 1994 (Lt thousand t).

Regions	1993		1994	
	Exports	Imports	Export	Imports
Europe	616 665	379 711	576 160	673 648
EU	369 622	240 770	314 403	367 876
CEFTA	160 445	64 720	136 988	115 564
Baltics	40 363	27 363	89 078	37 000
Other	46 235	46 859	35 690	153 208
CIS	612 367	275 716	573 657	222 080
Asia	11 044	7 710	9 015	13 143
Africa	4 983	213	1 238	10 462
Americas	13 991	52 282	10 351	94 991
USA	2 331	38 523	2 134	80 323
Australia	194	74	113	707
Total	1 259 245	715 705	1 170 533	1 015 031

Table 2. Composition of Lithuanian product trade 1994 (%).

Product	Export	Import
Milk and Milk Pdts	24	2
Live An.& Meat Pdts	20	5
Fruit & Veg.	9	18
Grain and Pdts	9	5
Beverages	6	8
Chocolate Pdts	5	1
Fish and Pdts	4	8
Sugar Pdts	3	2
Tobacco Pdts	3	8
Other	17	41

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

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

Lithuanian Agriculture During Transition: Problem Solutions

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During 1990-1993, Lithuanian economy was driven into a deep economic crisis that is still proceeding. The present decrease of production is not a unique phenomenon, similar tendencies are observed in other post-communist countries that are in transition from a centralised command to market economy. Lithuania had been incorporated in USSR for quite a long period. Nevertheless, some negative tendencies have been slowed down recently. Alongside with the economic reform Lithuania has been transforming its economy into independent state's economy. Therefore structural changes were inevitable. From the point of view of national economic stability, agriculture is an important sector and the overall economic situation depends greatly on the situation in agriculture. The policy of reforms conducted in Lithuania resulted in abandoning directive price regulation, centralised command management, centralised planning and product distribution.

The dependence of Lithuanian economy on the former Soviet republics, especially on Russia has somewhat decreased. In 1993 one fourth of total export went to western countries. Inflation goes hand in hand with major economic reforms. In 1991 inflation amounted to 383 %, in 1992 it reached 1 163 %, in 1993 it was 189 % and in 1994 it was 45.1 %.

However, mistakes were not avoided in conducting economic reform, that is speeding up the overall economic decline and bringing about a deep social crisis.

The economic situation may be characterised by production dynamics. During 1990-1992 the gross domestic product decreased by 49 %, in 1993 it was 27 % lower than in the previous year. In 1994, however, it increased by 2-3 %. The economic crisis, production decrease and decline in efficiency influenced negatively population's living standard. The "consumerism" tendencies in using gross domestic product remained.

The reasons for this critical economic situation in Lithuania were both objective and subjective.

The main reasons for the price leap and inflation were increase of input prices (fuel, energetic resources and raw materials), disrupted economic relations with former USSR enterprises and a deep overall crisis of the region. The worsening social and economic situation was influenced not only by external economic conditions but also by failure to create and implement a true market economy mechanism, mistakes of the economic reform and essential mistakes of the agrarian reform.

Although market relations have been reinstalled in Lithuania, market institutions are weak and the Government has to intervene into economic processes.

The former USSR republics used to provide basic inputs as well as market for the products. In pursuance of the centralised plan of deliveries, Lithuania used to sell in former Soviet republics 30-40 % of meat and milk products produced. Besides, Lithuania exported blood-stock horses, eggs, potatoes and vegetable seeds. Trade transactions were conducted in accordance with set plans at fixed prices, irrespective of the demand and supply situation. State procurement prices depended on product quality, bonuses were paid for exceeding the delivery plan as well as for higher deliveries compared to the previous year.

State procurement prices for farm products including all price bonuses used to be much higher than retail prices. The difference used to be covered from the state budget. Subsidies were usually high, e.g. the average procurement price and price bonuses per 1 kg of pork (bacon), live weight, was 3.60 Rb and the retail price for 1 kg of pork was 2.20 Rb.

Lithuanian producers did not know the true prices for machinery, fertilizers, fuel and other inputs, as state subsidies used to be allotted for their purchase.

The economic reform included gradual refusal of the state price regulation. In 1991 and early 1992 price control for most products was lifted. Food prices were successively liberalised. Fruits and vegetables were the first products to be left uncontrolled, potatoes and other crops followed. In autumn, 1991 prices for eggs and poultry were liberalised. The next year beef and pork prices were and later milk price. On the whole, agricultural product prices were liberalised in November. In 1992 food prices increased by 14 times and the increment of average wages made only 4 times. By the end of the year expenditure on food amounted to 60-70 % in total expenditure and was by 6 points lower than in 1993.

The "price scissors" formed in 1992 have remained until now. Prices for energetic resources coming from the East nearly reached world prices. Agriculture was in the least favourable situation. In 1992 agricultural input prices increased by 17 times and the output prices did not cover production costs. In 1993 the gap between input and output prices showed no tendencies of increasing though the differences settled down in 1992 failed to the balanced.

In 1993, the government tended to regulate procurement prices for grain, sugar beets and flax. Minimal procurement prices were set as well as quotas for food grain. However, enterprises had no own capital to procure and bank loans were only available at high interest rates regulated by the market. Processing enterprises raised prices for their products because of high interest credits.

The law on the Regulation of Economic Relations in Agriculture adopted in 1994 introduced procurement quotas and minimal marginal prices for basic agricultural products. Special attention was payed to price and competition in agriculture. Restrictions on retail margin for food products had been enacted earlier and depended

on the marketing area. These restrictions additionally impeded product movement within the domestic market and allowed monopolistic dictate in local markets. In 1995, seeking to protect consumers as well as producers trade margin restrictions for food and compound feed, livestock and poultry were lifted. As a result, food prices went up slightly. As the above trade margin restrictions did not apply to imported food products, Lithuanian food items were discriminated. In future trade margin issues will settle down without government's intervention.

Since introduction of market relations agricultural production has decreased considerably. The reform period was accompanied by draughts in 1992 and 1994 that aggravated the situation furthermore. Basic reasons for it were both external (trade with the former USSR republics declined and, as it was mentioned already, input prices reached the world level) and internal rising from transition difficulties.

In 1992 total agricultural production fell by 39 % compared to 1989. It increased by 8 % in 1993 but did not reach the previous year level (crop production went up by 22 % and livestock production dropped by 21 %); in 1994 production decreased by 22 % (crop production fell by 25 % and livestock production by 20 %).

In 1994, against 1993 grain production decreased by 22 %; the yield of potatoes and vegetables curtailed by one third and that of sugar beets by half. In 1994 losses because of the draught made 6 % for cereals, 7 % for sugar beet and 11 % for potatoes and vegetables. The draught was especially ruinous to meadows and pastures with perennials. Losses in crop production alone amounted to 800 Lt mio (USD 200 mio).

Implementation of agrarian legislation was given much care as well as rural economic, financial and other problems. New decrees and amendments were adopted by the Government regulating land restitution, buying, selling and leasing, setting land use purpose, registration of land plots and land transactions. A number of former land owners requested compensations for land. Nearly 50 % of applications for land have been accepted.

Basic measures to be implemented in 1995-1996 are strengthening the normative basis of land reform, speeding up the agrarian reform, setting up land data system, development of cereal seed and pedigree livestock breeding, restructuring of the food sector, co-operative development etc.

To solve rural employment problems small business is being promoted in rural areas. Direct and indirect financial support to agriculture from the Government does not solve all the problems, joint efforts will be necessary.

As a result of reduced population's purchasing power, the volume of food products marketed domestically curtailed. Nevertheless, there are shortages of some products in domestic market. Aiming to retain the narrowing foreign markets the main task is to reduce production costs.

In the past most trade partners came from the East. Lately the trade balance with the East and West has shifted. In 1994 export to non-CIS countries amounted to 53.3 %, while the CIS countries accounted for 46.7 %. The share of import from non-CIS

countries was 49.8 % and from CIS - 50.5 %. Processed food products, non-alcoholic and alcoholic beverages, vinegar made 11.9 % in the export structure, live animals and livestock products - 8.9 %. Skimmed milk powder was an important export item.

On the whole, the last year's trade balance was negative. Import of energetic resources from Russia at world prices was the main reason for it.

As trade with Western countries has been increasing, forecasts of further export development to the West are being made. Inter-state free trade agreements are signed. Lithuania already has free trade agreements with Switzerland, Norway and the EU. Similar agreements, already sigred but not in force yet, have been concluded with Ukraine and Kazachstan. Negotiations are in progress with Poland, Iceland and Uzbekistan.

Beside free trade agreements, Lithuania has agreements with 11 countries enacting the most favoured nation's status. Negotiations on joining The General Agreement on Tariffs and Trade (GATT) are under way.

Export of agricultural and food products has been liberalised, export quotas and licences refused. Protection of domestic market is very important for Lithuania. So far this protection was executed through systematic analysis of the process and through relevant regulation of import tariffs. Other measures that would prevent the domestic market from the flood of smuggling products are also being implemented. In view of the changing agricultural situation the government has been adjusting import taxes periodically. Import taxes on farm and food products have been raised. At the beginning of this year the more strict procedure of food product import to the Republic of Lithuania was adopted. The prospective tariff policy until 2000 is targeted to the more efficient production by farmers and increased competitiveness. The gradual way to market will form prerequisites for operating in market and competition conditions.

Adaptation Possibilities for Latvian Farmers under Conditions of Trade Liberalisation

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1. Background

Latvia, like other Baltic states, is in a process of transition from a socialist society with a centrally planned economy to a democratic society with a market economy. The privatisation process in agriculture is close to the end and the first market economy mechanisms have been developed. Now the first results can be observed.

Agricultural output in Latvia has decreased significantly during 1992-1994 (Figure 1). It is not only as result of changed farm structure, but also of development of market environment.

Not only privatisation and restructuring of agricultural production can be observed during this period. Most of other's fields of farm economy were reorganised also, including marketing structures and mechanisms.

It concerned price determination system, setting of domestic production volumes and the role of Latvian agriculture within international trade turnover as well as. For many inputs and some commodities prices are approaching world market levels. The analysis of the domestic market and foreign trade policy in future serve as a basis to determine possible production volumes and prices.

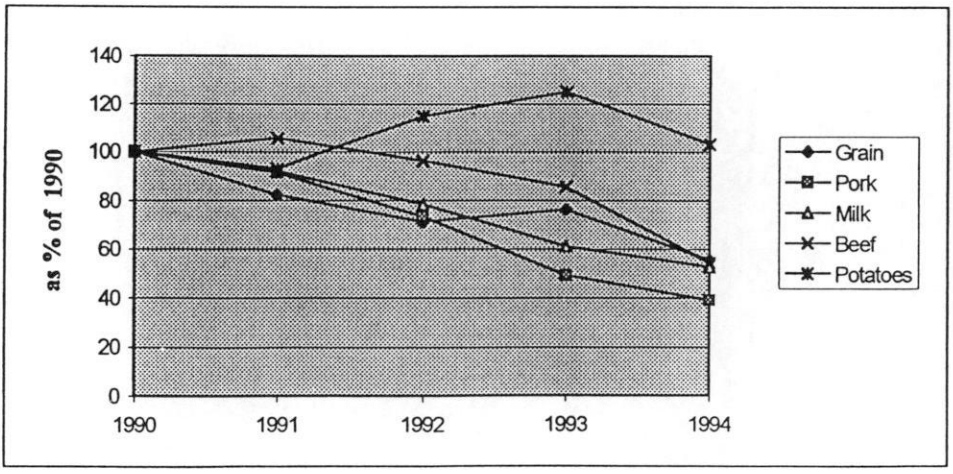

Figure 1. Production dynamics of main agricultural activities.

Liberalisation of Latvian agricultural market had serious impact on agricultural output and total farmers' income due to:

- changes in demand structure in domestic market, which were influenced by the sharp decreasing of personnel income and new products into food market.
- changes in environment for international trade - legal and economical.

2. Domestic market

2.1. Price liberalisation

In December 1991, The government of Latvia decontrolled agricultural procurement prices and retail food prices. However, indicative prices were established for cereals, sugar beets, flax, meat, milk, and poultry to serve as a basis for price negotiation between farmers and procurement agencies. These indicative prices were based on average production costs plus a profit margin. The rationale for the introduction of indicative prices was to protect farmers in a time of high inflation and uncertainty about prices. They served to perpetuate old habits of "cost-plus" pricing and to inhibit the development of cost-reducing management decisions at the enterprise level. Under high inflation, the "cost-plus" method usually did not revalue inputs for their cost at the time of the end product sale, nor does it encompass other costs of inflation, particularly delayed payments. By the mid - 1992, farmgate prices exceeded the support (indicative) price levels. Evidently processors and procurement enterprises do not have the market power to fully impose the low indicative price levels on farmers.

2.2. Food consumption

At the same time sharp decrease in purchasing power of Latvian population could be observed, which led to changes in structure of food consumption. Consumption of main food products has decreased significantly during 1991-1994 (Table 1). There is strong relationship between dynamics of food consumption and purchasing power of population. It is illustrated on Figure 2. The substitution of more expensive products with less expensive has happen. Consumption of potatoes and cereals per capita has increased, while consumption of milk and meat went down.

Table 1. Consumption of food products per capita (kg per annum).

Product	1991	1992	1993	1994
Cereal products (bread and macaroni, converted into flour, flour, groats, pulses)	105	110	111	112
Potatoes	115	116	119	120
Vegetables and cucurbitaceous plants	69	75	71	73
Fruit and berries	37	34	50	52
Vegetable oil	3.8	3.9	6.7	7.3
Sugar	40.5	32.8	36.0	36.0
Fish and fish products	18.0	13.0	12.0	13
Meat and meat products converted into meat, excluding fats and edible offals	69	54	50	48
Milk and dairy products, converted into milk	420	370	355	345

Sources: State Statistical Committee.

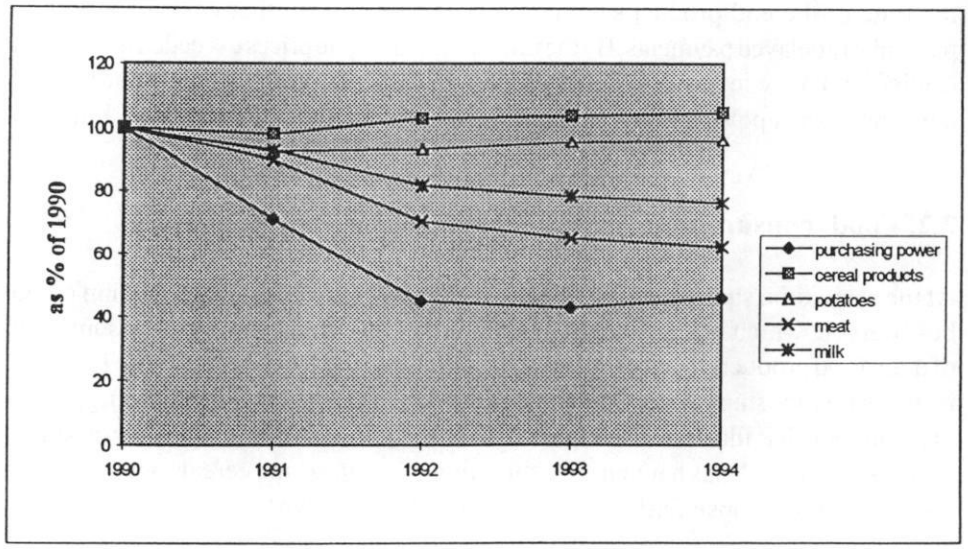

Figure 2. Relationship between purchasing power and food consumption.

It also should be pointed, that number of population has decreased in some extent during this period. It has led to decrease in total consumption of main food products, produced by Latvian farmers (Table 2).

Table 2. Human consumption (in thousand tons).

Product	1991	1992	1993	1994
Grain	280	289.5	287.1	285.3
Meat	198.7	165.8	150	148
Milk	1123.6	973.8	727.1	892.2

Sources: State Statistic Committee.

3. Foreign trade relations

3.1. Trends

In the past, Latvia has been an important source of meat and dairy products for Russia and other CIS countries. In 1989, over 550000 tonnes of dairy products and 62000 tonnes of meat were delivered to other republics of USSR ("exported"). Agricultural and food exports accounted for over 25 % of total exports. In 1993, Latvia exported only 29 000 tonnes of meat and about 300000 tonnes of dairy products, but in 1994 it became as net importer of meat products already. In the short run, a further decline of agricultural exports can be expected due to the large decline in livestock numbers.

Towards the end of 1993 and during the first half of 1994, Latvia experienced a fundamental change in terms of the composition of imports. Official estimates indicate that Latvia imported about 3700 tonnes of meat products and over 4400 tonnes of milk products. In 1994 level of imports of meat and dairy products exceeded the total level of imports in 1993.

3.2. Tariff barriers

Latvia had very liberal trade policy until the middle of 1994. Customs tariffs were introduced in 1993, but they remained low, and it led to dramatic increase in imports of grain, meat and milk products, which caused also decrease in domestic demand. For that reason tariffs were changed not only once, as illustrated in Table 3. The basis to calculate custom duty was the main problem until the middle of 1994, while reference prices on the world market prices were introduced. Now it is set by law, that value of goods will be calculated in world prices used in EU, in case they will not be set, in Latvian wholesale prices. Tariffs are set and can be changed only by the Parliament, and it is a long process.

Table 3. Development of customs tariffs to agricultural imports in Latvia.

Commodity	Until 01.03.94 $/kg	Until 01.12.94 Ls/kg	Since 01.12.94 generally Ls/kg.	to FTA[1)] with EU Ls/kg	FTA[1)] with EU in 2000 Ls/kg
Live animals	15 %	15 %	40 %	30 %	24 %
Meat (beef)	0.3	15 %	40 %	30 %	24 %
Butter and cheese	0.7	30 % or 0.3	55 %	45 %	36 %
Skimmed milk Powder	0.3	15 % or 0.1	40 %	30 %	24 %
Grain	0.3	30 % or 0.075	0.075	0.075	0.067
Sugar	0.2	0.12	0.12	0.12	0.1
Feed	15 %	30 % or 0.075	0.075	0.075	0.067

[1)] Free Trade Agreement

Exchange rate: 01.03.94 1US$ = 0.572Ls
01.12.94 1US$ = 0,549Ls

3.3. Agreements

Foreign trade, instead of former centrally planned export and import, is based on various bilateral and multilateral agreements.

Latvia has expanded its bilateral trade links by signing free trade agreements with the Scandinavian countries. As in the case of Lithuania and Estonia, the most important development has been the Free Trade Agreement with the EU signed on the 18th of July 1994. The Agreement came into force on the 1st of January 1995. Latvia, along with Lithuania and Estonia have a six year transition period to adjust their industries to competition in the western European environment. In the case of agriculture and food products, the Agreement provides for reciprocal concessions in trade. In addition, Latvia is currently negotiating possible early membership of GATT and as such would bound by the disciplines of the Uruguay Round, relating to market access, domestic support and export subsidisation.

In 1994, import tariffs on food products ranged from 0.5 % to 30 %. More specifically, the tariff on meat and meat products varied from 15 % to 30 %, milk products 15 % and 30 % on butter and coarse grains.

4. Analysis of some agricultural production activities

4.1. Agricultural income

There are not clear and official calculations on income, received by farmers from agriculture, its level and dynamics. In indirect way it can be characterised through analysis of value added in different branches of national economy. It is done in Table 4.

Table 4. Gross value added by industries.

		1990	1991	1992	1993	1994
Value added, gross	at current prices, Lvl million	60.2	139.0	938.6	1 331.8	1 471.0
Agriculture, hunting, forestry	at current prices, Lvl million	12.2	30.5	161.6	155.5	149.0
Share of agriculture in VA, gross	%	21.1	22	17.2	11.7	10.1
Value added, gross	at constant prices, Lvl million	2 701.0	2401.4	1 554.3	1 331.8	1 303.1
Agriculture, huntin, forestry	at constant prices, Lvl million	277.5	271.9	192.9	155.5	111.5
Share of agriculture in VA, gross	%	10.3	11.3	12.4	11.7	8.6

Data shows that, there is a sharp decrease in the role of agriculture in national economy in generally, and even in current prices agricultural income is decreasing since 1993. If we will take into account, there are around 210 thousand persons working in agriculture, there was 709 Lvl value added per person in agriculture in 1994.

4.2. Grain production

Grain production is one of the main branches of arable production and is planted on about 489 thousand ha or 29% of arable land. Total grain production declined in 1994 by almost one half, if compared to the peak years 1989-90. The same is true to the total consumption, but existing grain production volume supplies present consumption on level of about 85%. One of the main problems is low opportunity costs for grain production if compare with potatoes and sugar beets with almost unchangeable production. The comparison of various crop production activities is reflected in Table 5.

Table 5. Gross margins for crop production activities in 1994. (Ls, per 1 ha arable land).

Production activity	Rye	Wheat	Barley	Oats	Sugar beets	Potatoes	Flax	Fodder crops
Gross margin	36	65	46	30	380	374	-40	557

Source: Results of farm economic analysis in Latvia. Latvian Agricultural advisory centre, 1995.

There was attempt to look at possible development of grain prices and its impact on farmers' income. Some assumptions were made.

Total consumption in 1995 and structure of grain supply is forecasted on the level of 1994 (Figure 3). At the level of total grain production, 1000 thousand tons, from which about 700 thousand tons could be used for human consumption, about 60 thousand tons of food grain could be imported as high quality wheat. High quality wheat price is assumed to be at the level 140 USD per ton. The import threshold price is about 300 USD per ton in this case (with import tariff 150 USD per ton). Despite on the law, allowing this level of import tariff, it can not be used, due to various possibilities of grain consumption and possible substitution by other products. Latvia already has experience of too high grain prices from 1992. Only 25-30 % of the grain, produced by Latvian farmers, is being used for human consumption. The rest is fodder grain mainly. Level of this price is set by prices on livestock production and it is therefore lower.

Grains, produced by Latvian farmers, have high costs, specially if the use of fertilisers and plant protection supplies necessary conditions for crop cultivation. The survey data from Latvian Agricultural advisory service shows that use of fertilisers in 1994 has decreased about a half if comparing with 1993. But if the level of fertilisers used would be near to recommended the real income from grain production can be negative. Real costs in grain production, calculated by farmers in 1994 were 70 USD per ton, and are expected to reach the level of 110 USD per ton

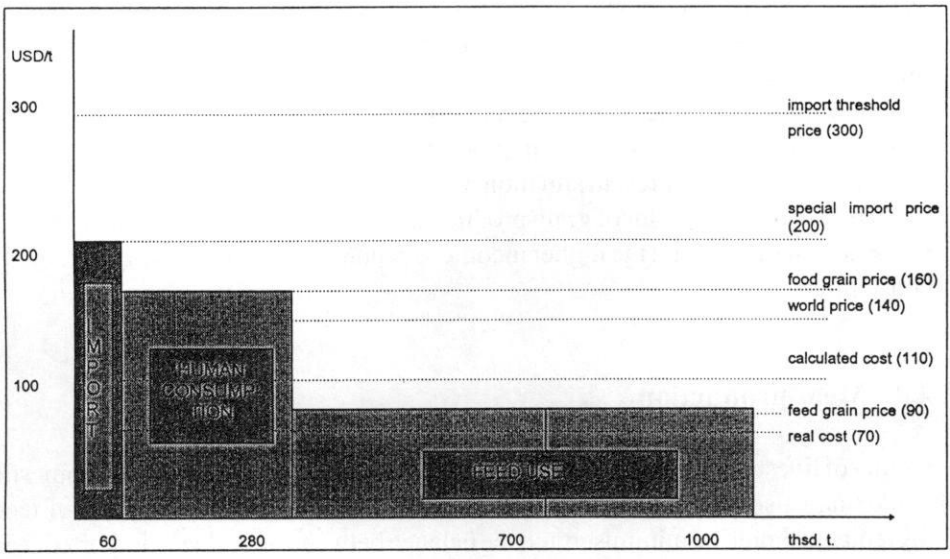

Figure 3. Development of grain price in Latvia.

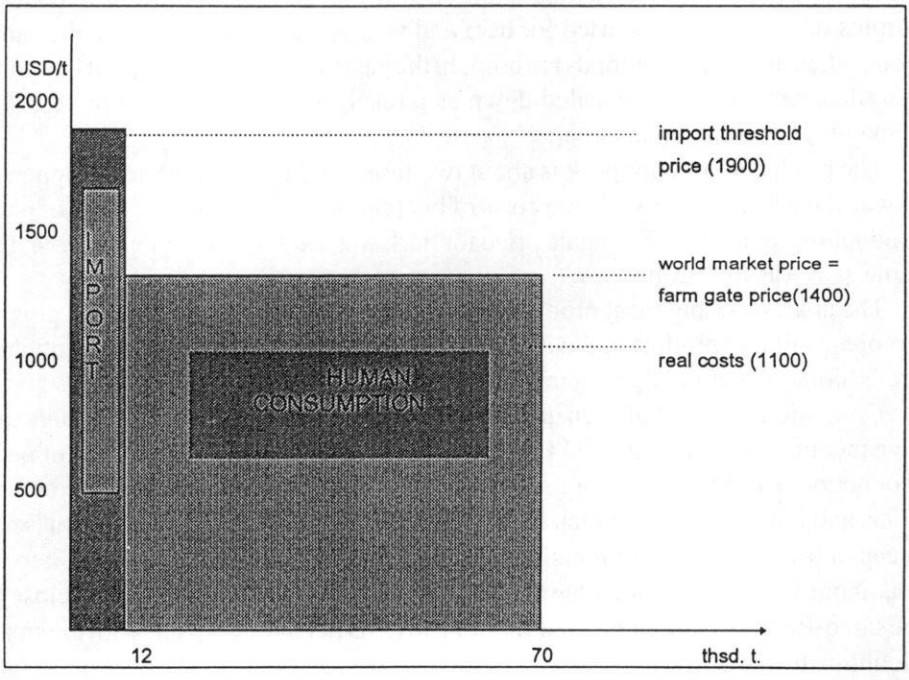

Figure 4. Development of pigmeat price in Latvia.

during next years and from 80-90 USD in 1995. Some negative impact on Latvian farmers' income has grain import also. It means the loss of income in 3000 USD million at least.

But from another side grain prices are restricted by prices on livestock products, where is not so big reserve to reach import threshold price.

It means, under the present situation in market regulation within couple of years it can be expected that a lot of grain producers will leave the grain branch, but more successive will stay with the higher income to produce grain almost only for human consumption.

4.3. Meat production

Output of livestock products has decreased close to the level needed on the domestic market and also it has an influence on the feed consumption. The imports of feed ingredients should be minimised and the balance between the value of imported feed and food products and exported food and agricultural products could be.

An index of pork production (Figure 1) decreases more rapidly, than beef production. Pigs are more dependent on concentrated feed, needed to be imported, compared to cattle, which are more dependent on domestically produced forage and feed. There are no specialised beef animals in Latvia. All cows are milked, and surplus of young cattle, is used for beef and veal production, usually on the same farm, where the surplus animals are born. In the past years pig breeding and fattening activities have drastically scaled down as a result of increasing feed prices, low demands and reduction in export.

The producer price for pork is about two times higher than for beef in opposite to world market prices, while the costs of beef production exceed the costs of pork production about 10%. Farmgate price for pork was 1400 USD per ton in 1994, the same as it was in Europe.

The analysis of pig meat production is given below (Figure 4). It shows pigs as a more profitable product and which has more stable domestic market as Latvians prefer pork to beef in large extent.

Estimations show, that even under present level of prices production of pigs can give income for agriculture 174 USD million per year. In 1994 the volume of pork production was 54 thousand tons. Export was of little importance because of low price, and Latvia produces much fatter pigs with lowest protein content, what is not acceptable for foreign customers. According to the statistical data total pork import was about 12 thousand tons. One can expect that the import volume will be close to the same. Real costs are calculated about 1100 USD per thousand tons with the small inclintion to reduction.

Pig breeding and fattening could be rather stable source of income for large scale producers, if feed prices will not increase too much. But there is some basis for such kind of increase to equalise income within different lines of Agricultural production.

Recent Changes in Lithuanian Agriculture

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Recent Lithuanian agricultural development has been following the path set out in the National Programme for Agricultural Development approved in autumn 1993 by the national government. After decades of high agricultural export levels present Lithuanian agricultural production is oriented mainly to domestic demand. As a result of changes in the national economy population's purchasing power has decreased, domestic market for farm products narrowed and consumption levels dropped. For such a country as Lithuania with few natural resources self-produced food products are somewhat like a guarantee of independence.

The grain, meat and milk programmes supplementing the national programme for agricultural development provide evidence that Lithuanian agriculture has sufficient capacity to supply the domestic market with traditional livestock and crop products. Although there are some problems with hard wheat production for pasta and confectionery industries, they bear interim character and are hoped to be solved in the short run through higher differentiation of grain prices.

Reality, however, belies forecasts. In 1994, for example, grain yield was only 2.14 million tons (i.e., 2/3 of the yield in most favourable years) as a result of unfavourable climatic conditions. The grain procurement quota set by the government was only half-fulfilled because of unavailable funds to procure grain and unsatisfactory price level. Meanwhile, grain export was above 110 thousand tons. In spring 1995 grain import commenced but purchasing prices were much higher than those received from selling grain abroad. To procure all food grain amount determined by quota for 1995 and to accomplish timely payments, processing enterprises will have to accumulate large funds before harvest time that is rather unlikely as enterprises have financial difficulties.

Like in previous years feed protein problem poses great difficulties. The protein level in feed is well bellow satisfactory and the farmers are reluctant to grow feed. Feed will have to be imported. Lately interest in rape seed production has been growing in Lithuania. This interest has been encouraged by foreign companies purchasing rape seed and providing producers with seeds and chemicals in advance. The newly built rape seed processing enterprise lacks raw material and consumers have no domestic rape seed oil and protein rich meals for feed.

Unlike in other sectors of economy, transformations in Lithuanian agriculture started before the agrarian reform. They were begun by increasing personal smallholdings of rural population to 2-3 ha. In autumn 1989, family farms started to set up in accordance with the Law on Peasant Farms. Consequently, there were

5 thousand family farms already before the agrarian reform was initiated. Currently both the smallholders and the farmers set up in 1989 situated on somebody else's land cause dissatisfaction on the side of farmer land owners. Most of family farms and agricultural companies established within the agrarian reform framework have been operating for less than three years. Most of them have been unable to compete with the western agricultural structures so far.

In spite of unfavourable market conditions there were 134.6 thousand family farms by early 1995. The average farm size of former land owners and farms set up in accordance with the Peasant Law has been further curtailing and is 8.5 ha. Only a little more than 1/4 applications to restore land ownership have been satisfied. Different reasons contribute to the fact that this process tends to slow down. Thus, it will take long to implement the land reform. The largest share of agricultural land (34.2 %) is already owned by family farms, while agricultural companies and other enterprises have 32.8 %, and population's personal smallholdings account for 25.2 % (Figure 1).

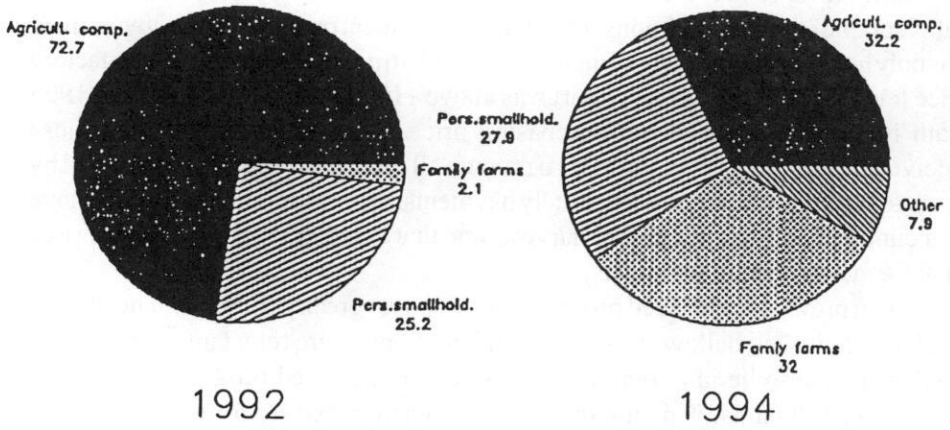

Figure 1. Agricultural land by users, % in 1992 and 1994.

It was only at the end of last year that local governments started registering family farms. In accordance with their registries the family farm number is 55.4 thousand and the land owned by them accounts only for 18 % of total land acreage. The difference in data may be attributed to underdeveloped farm registering system. The average size of these registered farms is over 11 ha. Farms less than 10 ha account for 60 % and farms above 30 ha account for 4.8 %. One farm has on average 4.4 ha area under crops, 1.5 cows, and 1.9 pigs. Nevertheless, in 1994 family farms produced 39.2 % of total grain, 26.7 % potatoes, 37.4 % sugar beets, 40.9 % flax fibre, 16.7 % meat and 17.9 % milk. Crop yield differences in family farms and agricultural companies were insignificant, while the yield of potatoes and vegetables was 1/3 higher and milk yield per cow 45 % higher than in family farms.

Table 1. Agricultural production in family farms (% of total production).

Product	1990	1991	1992	1993	1994
Grain	0.8	2.6	16.2	34.7	39.2
Potatoes	0.9	4.2	15.4	27.6	26.7
Vegetables	0.9	5.7	11.3	32.7	29.8
Sugar beet	0.1	2.2	14.7	31.5	37.4
Flax fibre	0.9	2.3	31.6	17.7	40.9
Meat	0.7	1.8	11.1	11.5	16.7
Milk	0.4	1.0	6.3	13.8	17.9

The number of agricultural companies and other entities of joint labour have been dropping. During the second half of 1993 this number decreased by 100 and in 1994 the reduction made 600 already, or nearly 18 %. Farm products produced in agricultural companies still account for a considerable share in total agricultural production (38.7 % in 1994).

Beside the mistakes of the reform there are other reasons contributing to the agricultural company liquidation process, namely, inability to adjust to market and lack of competent managers. Most managers, while assessing the economic situation of their farm are inclined to blame external factors rather than look for internal reserves. They are reluctant to change the production structure and introduce flexible production. The attitude of company members towards work and assets has barely changed so far.

Along with the decrease of number of agricultural companys the acreage of land in their possession and number of workers also curtail. The average agricultural land plot leased by a company has been decreasing more rapidly than the average annual number of workers.

In 1994, 48 % of agricultural companies were unprofitable. Greatest losses were experienced by companies that used to have the largest share of income coming from livestock production. Milk and cattle production brought highest losses, and grain production was profitable.

Financial results of family farms and agricultural companies are related to production costs of basic products (grain, milk, and meat). The cost price varies from company to company by 3-5 times. Thus, the annual results depend greatly on local efforts. Low crop yields increase consumption of inputs in feed production. This exercises a direct effect on livestock production costs. The lowered productivity of agricultural land was caused by insufficient fertilising and plant protection. In 1994 the consumption of fertilisers was by 13 times and that of pesticides by almost 10 times lower compared to 1989. In agricultural companies depreciation of basic assets is very high, the average age of machinery making 15-20 years. Family farmers have approximately 63 % of necessary buildings and 57 % of machinery. The agricultural production capacity is used only 40-60 %.

The food market was being liberalised gradually but it failed to bring positive effects either on producers or consumers. Domestic consumption is low because of low living standards and external trade of food products is rather incidental. Throughout 5 years of independence production conditions for certain farm products have changed several times. With the increase of grain prices feed prices went up, causing drops in pork and poultry production. Pork production curtailed to such level that it was not enough for sausage production. In 1994 pork and poultry import was commenced and in 1995 pig production recovered and currently producers have marketing problems. As a result of very low milk and beef prices cow numbers were reduced considerably. Contrary to producers, agricultural processors are associated and can dictate such prices that do not guarantee the income level for producers and cause their dissatisfaction.

Market conditions discouraged producers to extend production of certain products, set up new family farms, some former land owners are reluctant to take their land and start farm business.

Unfavourable financial situation of agricultural producers and narrowed domestic market brought about the decision of the government on agricultural export liberalisation starting in the middle of 1993. In the absence of permanent trade relations it did not change the situation much and the export volume is still curtailing. However, export distribution between the East and the West has been changing: export to the East is decreasing while export to the West is higher. New market partners and differences in production costs and marketing price will have crucial influence on export volumes. Lithuania received proposals to export some products but the suggested price does not cover production costs. Should the suggestions from the producers side to subsidise export be implemented agricultural situation would improve. Such decisions, however, should be given careful consideration because of the overall economic situation.

Table 2a. Agricultural Production (kg per capita).

	1990	1991	1992	1993	1994
Grain and grain products	876	891	592	723	575
Potatoes	422	402	287	473	295
Vegetables	79	106	69	100	76
Meat and meat products	142	120	111	74	60
Milk and milk products	847	776	644	552	510
Eggs, units	342	329	234	163	192

Table 2b. Agricultural Consumption (kg per capita).

	1990	1991	1992	1993	1994
Grain and grain products	109	138	142	122	96
Potatoes	146	128	95	122	80
Vegetables	79	83	65	69	55
Meat and meat products	89	66	65	56	50
Milk and milk products	476	315	334	319	267
Eggs, units	304	293	209	143	165

Import of cheaper farm products that can be produced domestically has a negative the influence on agriculture. With decreasing of agricultural production decreases also the employment in this sector. A lot of employees are not working full hours and are loosing jobs. The only source of income remaining from their personal smallholding (2-3 ha). Uncultivated land plots are increasing. In some less-productive areas such land makes 8 000 ha.

As long as the western countries are subsidising their producers, and Lithuanian farmers have not gained enough strength the policy of "open boarders" suggested by the western experts is unacceptable. Lithuania makes efforts to protect its food market from foreign products. In 1994 regulation of farm and food products was adjusted several times by means of tariffs. On the demand from producers side customs duties for imported products were raised considerably, although they had to be co-ordinated with the International Monetary Fund. The average customs tariff rate is 35 % and is going to be lowered gradually.

One cannot expect rapid changes in the market. Lithuania will not reach the previous food consumption levels soon. Domestic possibilities to sell will not increase abruptly and entering saturated foreign markets will take much time and efforts. The ones producing cheaper will have better chances. In the situation where production exceeds consumption there is competition between producers.

To stand this competition farmers should get associated and to defend their interests in market conditions jointly. Associations or co-operatives could set quotas for selling products, search market for the products exceeding quotas, as state institutions are unable to do this timely.

The government of Lithuania views agriculture as the priority branch of economy as its economic, social, environmental and ethnocultural functions are essential in strengthening economic and political independence and achieving market ability. Allocations to agriculture amount to 10 % in the state budget. The Parliament has adopted the law on the regulation of economic relations in agriculture. The regulatory measures will guarantee minimal marginal procurement prices of agricultural products and ensure minimal support to agricultural entities.

Farming conditions differ throughout Lithuania. The government supports farmers on low-productivity land and stimulates restructuring of their farming activities into non-traditional agricultural performance or businesses that are in good demand so that in future they can survive without government's support.

The well-being of many rural people will depend not only on income from agriculture but also from other activities. A small plot of land would not provide for the living of farmers family. The consolidation of farms is inevitable, some farmers will have to change type of activity. Rural development should be based on regional policy conducted jointly by different ministries, not only the Ministry of Agriculture.

Estonian Agricultural Policy and European Integration

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In the year 1995 it seems that most of the Estonian people support Estonia joining the EU. Actually, Estonia has no other reasonable option. If so small country as Estonia would like to try to be independent between two large economic unions - EU and Russia, then Estonia has to pay custom tariffs on export to west and east which would be rather expensive. So from the economic point of view it is reasonable to be in one of economic unions. In the eastern union Estonia has already been for fifty years.

From the point of view of Estonian agricultural producers, in joining the EU there are a lot of problems. In the EU, overproduction of food products exists and GDP of agricultural producers is 42 - 90 % compared with average level of GDP per worker (Table 1).

Table 1. Agricultural economic figures.

Country	Contribution to civilian employment	Gross value added % of GDP	Gross value added % of the country's average or worker
Australia	5.3	3.0	57
Denmark	5.7	3.5	61
Finland	8.6	4.4	51
France	5.2	2.8	54
Germany	3.1	1.3	42
Greece	22.2	12.7	57
Italy	8.2	3.1	38
Netherlands	4.0	3.6	90
New Zealand	10.8	7.3	68
Sweden	3.3	2.1	64
United Kingdom	2.2	1.5	68
USA	2.9	2.0	69

Source: OECD in figures, 1994.

In Estonia, GDP statistics has not yet fully solved the problems of accounting household plots and family farmers production and numbers of workers. Approximately 10 % of workers are employed in agriculture. We have quite satisfactory data about the wages in agricultural enterprises. In the third quarter of 1994 by the sample research of 73 agricultural enterprises average wages were 1170 EEK or 68 % of the average level of Estonian enterprises, in the fourth quarter 1117 EEK or 53 % (Eesti Statistika 11, 1994). In addition, workers of agricultural enterprises have additional incomes from household plots but we have no exact statistic data about it. But we can make the conclusion that the workers, who still have employment in agricultural enterprises, have the same level of incomes compared with other jobs as in other European countries. Of course, one should have in mind that now 42000 workers are working in the agricultural enterprises, while four years ago the number was threefold. Which are the incomes of laid-off workers is hard to tell. And of course, enterprises have used old production reserves for financing their production and indebtedness of enterprises has increased enormously. It is a new economic situation in the countryside. In the Soviet times the average wages of agricultural workers were equal to average level of wages in the whole economy. It is the main explanation why the previous government coalition had clear defeat on parliament elections on March 5, 1995, on rural areas and lost the majority in the parliament.

Important question is, when Estonia may really become a full member of the EU. Some Estonian politicians have expressed the hopes that it will happen very soon, but it seems more realistic that it will take about ten years. Estonia, like other Baltic countries has a free trade agreement with the EU from January 1, 1995, and the so called "European agreement" is in the process of adoption.

After introducing own currency, kroon (DEM 1 = EEK 8), in June 1992, Estonia has had very liberal agricultural policy with no price and income support. The only protection for agriculture has been the strongly overdevaluated currency but gradually Estonian agriculture is losing this protection as a result of internal inflation. After the introduce of own currency consumer prices have increased 2.9 times and wages 2.8 times. Liberal economic policy has got a lot of compliments from the World Bank and IMF.

Medium-term outlook of Estonian economy depends on how our industry will manage on the export markets. In the west it is important to find new markets and solve the problem of free trade. In the east, it is important to restore the previous markets if the economic situation in Russia will improve and political conflicts are avoided.

From the point of view of adjusting to the market conditions, agriculture is an exception to the rest of Estonian economy. The main reason is that in the previous years, the Soviet Union bought large quantities of fodder grain from the world market with the oil dollars, which in the Estonian agriculture made 40 % of the total fodder. Produced milk and meat products were sold mainly to Leningrad. With the present

world market prices it is now not profitable to buy grain and produce milk and meat. Thus, we have had to cut the output of these products. Compared with the year 1988, total output was in 1993 67 %, 53 % in livestock and 99 % in plant production.

In the former Soviet Union, the state regulated retail prices of food constituted approximately half of the real costs. In the beginning of 1992, state regulation of food prices was abolished in Estonia. Consequently, there was a sharp rise in prices and therefore a reduction in the domestic demand. An additional factor influencing food demand was a sharp rise in energy prices, a good example of cross-elasticity influence on food demand.

From the point of view of the European integration, the most important question is the competitiveness of Estonian agriculture. Of course, the main products of Estonian agriculture could be produced on competitive quality level but the problem is the level of production costs.

For Estonia bookkeeping results for large-scale farms and GDP calculations of Statistical Office for the whole agriculture are available. To analyse competitiveness, the data of OECD of production costs were used.

Production costs (intermediate consumption; the third column) from the value of production in the world market prices is calculated by dividing the second column by 100 minus the first column.

Table 2. Produce subsidy equivalent (1992) and intermediate consumption in agriculture (1991).

	Produce subsidy equivalent, % of value of production	Intermediate consumption, % of value of final output	
		in domestic prices	in world market prices
Australia	12	50.0	57
Norway	77	56.2	244
Sweden	57	61.9	144
Finland	68	49.6	155
USA	28	52.2	72
New Zealand	3	44.4	46
EU	47	42.6	80
OECD	44	...	...
Estonia (1993)	0	54.0	38

Estonian closest neighbours Finland and Sweden have production costs which are 1.5 times higher than value of production in the world market prices. The EU production costs were 80 % from the value of production in the world market prices. We have no reason to wait that in the future production costs in Estonia will be lower than in the EU because natural conditions for the agricultural production are worse. The negative influence is partly possible to compensate if we will have more large-scale production in Estonia.

According to the bookkeeping data of 1016 agricultural enterprises in Estonia the production costs were 54 % of the value of sold production. But in the year 1993 the producer prices were lower the than world market prices. One can estimate that the world market level was achieved in the middle of 1994. It is quite sure for meat, because at that time import of meat products to Estonia started. Compared with July 1993, in July 1994 the price index of industrial production of meat and meat products was 160; for milk products the index was 124. As the share of meat and milk products is almost equal, we could take for account average price index 142. Dividing production costs 54 % to this index we get for production costs 38 % from the value of production in the world market prices. Of course, this level of costs is not possible to maintain for a long time. Agricultural enterprises are using fertilisers and pesticides on the minimum level, repairment works are on minimum level, too. Prices of services and goods produced in Estonia are yet cheaper than the world market prices. This account has been made by official bookkeeping, by which the production costs are not indexed by inflation. During the year 1993, inflation by the consumer price index was 38 %. Due to this reason the actual production costs are higher. In 1993, the value of stocks increased from 278 EEK million to 648 EEK million (Ettevõtete finantsnäitajad 1993. Riigi statistikaamet. Tallinn 1994). At the same time the short-time and long-time debts increased 514 EEK million by which the increase of value of stocks was financed. As the production in enterprises decreased, we can assume, that there was no real increase of stocks, and all increase of value of stocks was unaccounted costs. If we take this into account, production costs will be 53 % from the value of production in the world market prices.

We can make the conclusion that at the moment the production costs in Estonia are lower than in our neighbour countries and the EU, but they are gradually increasing. With a rational production organisation, Estonian agriculture could manage on the level of EU production costs but, this level of costs is too high to be competitive with the world market prices.

If Estonia will continue food policy with no state regulation, Estonian agriculture will be liquidated. The main argument of supporters of this policy is that we will get cheap food. But if Estonia will join the EU, we will have the EU prices, which are high enough in Estonian agriculture to manage. So we will have cheap food only during the transitional period to EU, but in this case the Estonian agriculture will be liquidated and we have to make large investments for settling rural people into towns

and creating new jobs for them and also for workers of upstream and downstream industries.

By the level of production and regulation costs, three options can be discussed:

1) The production level of agriculture should be maintained on the existing level, which means considerable amounts of food export.
2) The production level of agriculture should be in the balance with the domestic demand of food products, traditionally produced in Estonia.
3) In order to create larger choice of food products for consumers, some amount of import should be allowed for all food products.

Agricultural producers will naturally support the first option in order to maintain the existing production level. But if the EU like import regulation measures would be introduced, for those products, which are exported from Estonia, export subsidies are necessary. At the moment, 20 % of pork consumption is imported, beef production and domestic demand are in balance, but about half of the milk products are exported mainly to Russia. As the transition to the market economy develops in Russia, probably there will be the same type of import regulation as in the EU. In this case, the subsidies will be needed for Estonian milk products export, but taking into account the large quantities, it may be difficult for the state budget to finance it.

Amount of export subsidies will depend on the difference of prices of Estonian producers and export market prices. Of course, to maintain the level of milk production, political decisions will have to be made to regulate milk producers' incomes. Which will be the producer prices for milk more exactly, is quite hard to forecast, but this problem could be solved by increasing support step by step. Another factor, influencing need for milk export subsidies, is Russian agricultural and trade policy. If Russian protection measures will be stronger, Estonian milk export needs more support and will be more expensive for the state budget and the probability of accepting this option by Estonian parliament will be lower.

Of course, the option that production quotas with higher prices will be introduced and the amounts exceeding quotas should be exported with world market prices, should be kept in mind. In this case, the budget financing is not needed and individual producers, who have possibilities for efficient production, can freely choose their amounts of production.

In the case of the option that export will not be subsidised, the main problem should be the protection measures against import. Of course, the preferable choice will be the EU-type measures. From the political and agricultural producers point of view, in this case the main difficulty will be the too large number of cows. For the Estonian domestic market only half of the existing number of cows is needed. If the milk yield per cow increases, maybe only one third of the existing number of cows is needed. In 1994 63 % of the total number 226700 of cows were in enterprises, 27

% in household plots, 10 % in family farms. The experience of previous years has shown that the decrease of number of cows in enterprises continues. The most stable will be the number of cows on household plots, where the milk production is often an additional income for pensioners. However, the new milk quality requirements, introduced at the beginning of 1995, are the most difficult for the household plots and may put them out of competition.

Supposing that some amount of import of food products is allowed to create larger choice for consumers, there always remains the question why we do not produce these products in Estonia. It seems that in addition to the northern natural conditions, a small market is another important factor reducing comparative advantage. Many of the contemporary food processing plants have such large capacity, that there is not enough market in Estonia and export is not profitable because the markets of neighbour countries are closed by the protectionistic measures. At the same time Estonian consumers would be interested in these products and as these products have been used during the liberal trade policy, in some way import of these products should be allowed. Good examples are cheese, ice-cream, yoghurt, and sausages. One option is to create better conditions for food trade in the Baltic countries, but too liberal trade policy of Estonia has been the main obstacle on this way. The advantage of Baltic trade will be that the processed food products with high-value added would be cheaper compared with other import possibilities because wage costs would be lower.

As about the future forecasts up to the year 2000, it seems that the most probable option is that some amount of import will be allowed (the bet is, say, 60 %). Less probable is that the existing level of production is maintained (10 %), or that the domestic production and demand are in balance (30 %). Thus, at the time Estonia is joining the EU, the export problem of food will not be acute anymore.

Creation of Legal and Conceptual Base for Latvian Agricultural Policy

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1. The development of agricultural policy

Since 1990 when Latvia had renewed its independence, the government started to set up the Latvian agricultural (rural) policy. The first task of the government in this field was structural and ownership reforms. First, it includes the farming sector: restitution of land and other real property, land privatisation, and privatisation of the non-land assets of the collective and state farms. Approximately at the same time the second and very important task was agricultural output price liberalisation (the main step in that has been done in December 1991).

When the process of structural and ownership changes in the farming sector showed that private farming became the main form of production unit and the main rural lifestyle structure as well, the next step of the reforms was the restructuring and privatisation of up- and downstream industries (started with dairies in September 1992).

During all these steps the privatisation of food retail structures has been continued. It was a good pre-condition to create successful market relationships in the food and agricultural products market.

However, during the first years of reforms in agriculture, the activities of the government in order to create stabile farmer's income-support policy and the regulation in the food and agriculture products market were weak. Development of the reforms and policy measures are showed in Figure 1.

On January 1, 1995, as legal heirs of former collective and state farms, 192 statutory companies were operating (in 1991 there were 610 such enterprises) with much less assets than the same enterprises in 1991. All the rest of the former socialist-type agricultural enterprises are liquidated or they are in the process of liquidation. The Central Statistics Committee has collected data on the dynamics of privatisation. The results show that at the beginning of 1994, 69 % of all former collective and state farms assets were already privatised.

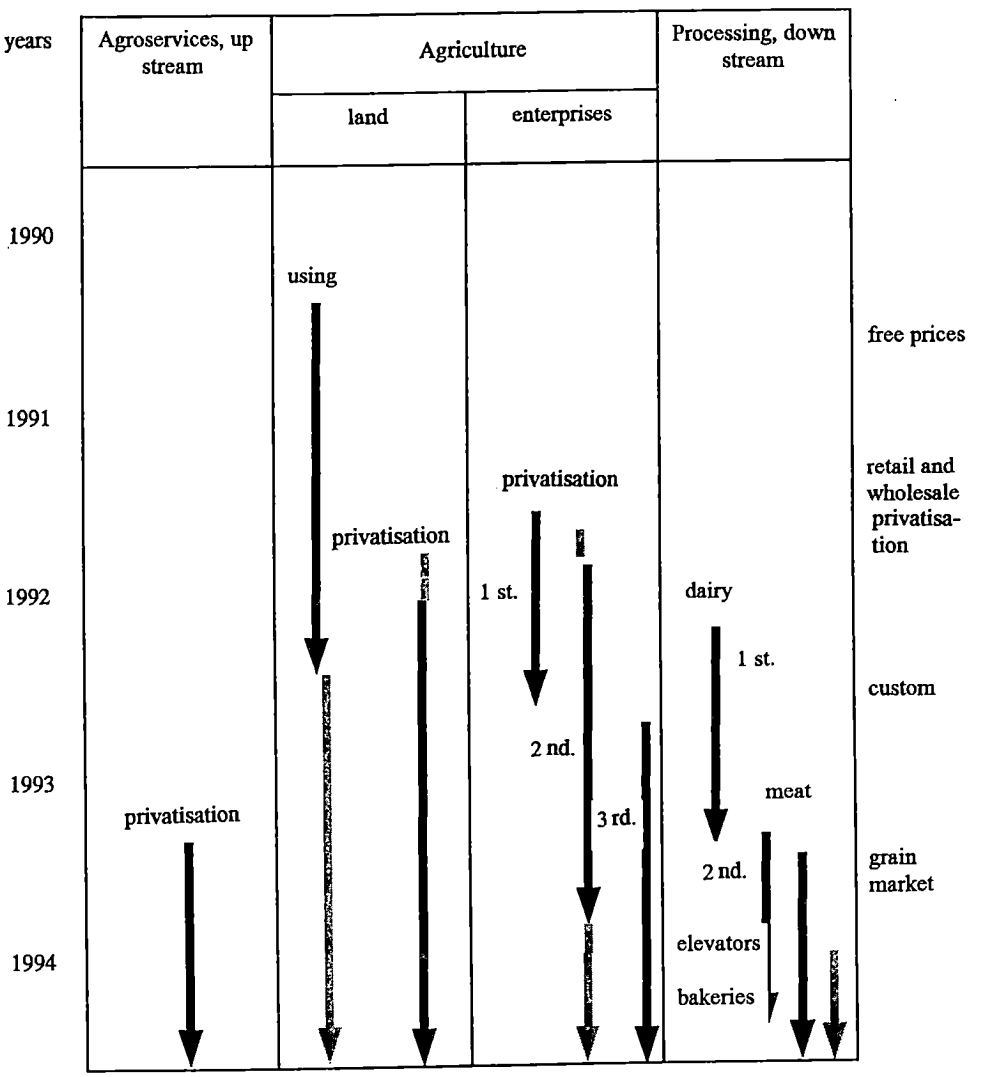

Figure 1. Development of the reform in Latvian agriculture and rural industries.

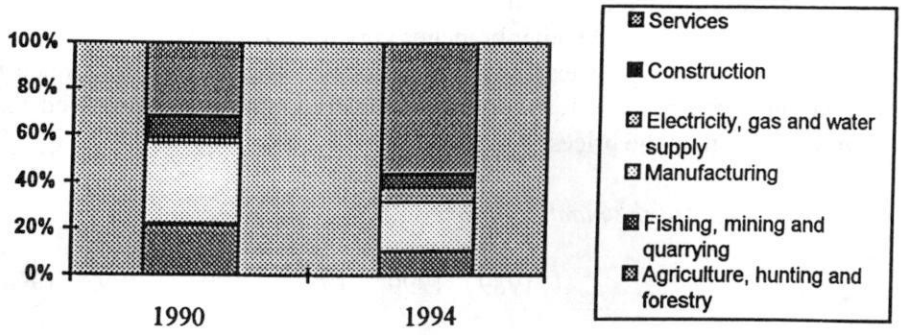

Figure 2. GDP structure by sectors.

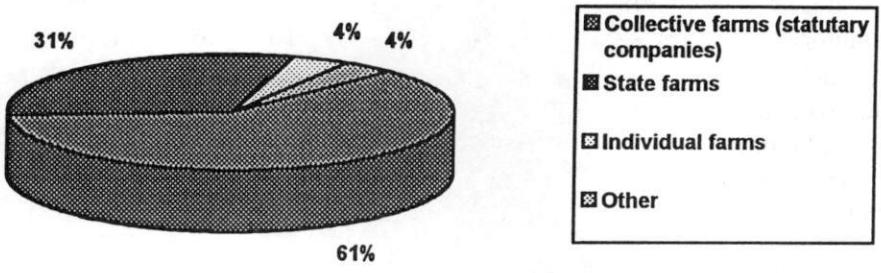

Figure 3. Agricultural land by users, 1.11.1990.

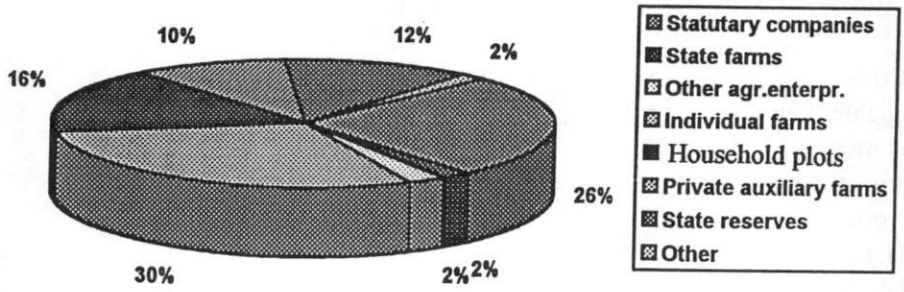

Figure 4. Agricultural land by users, 1.1.1994.

Up- and downstream industries are privatised according to different laws, which is the main reason why the level of privatised and restructured enterprises in few branches is high and in some other branches very low (Table 2).

The sector continues to experience a serious price-cost squeeze. Since the deregulation of prices in 1991, the prices of industrial inputs have increased about five times faster than the prices of agricultural products.

Table 1. Dynamics of the number of farms.

	1989	1990	1991	1992	1993	1994
Collective farms	363	413	401	-	-	-
State farms	238	210	208	92	103	-
Agrofirms	16	2	-	-	-	-
Private farms	3 931	7 518	17 538	52 279	58 311	64 264
Household plots and private subsidiary farms	-	-		105 745	113 100	
Statutory companies of which:	-	-	16	673	1 101	
-Joint-stock companies	-	3	*	10	10	*
-Share holdings				458	440	
-LTD companies				1 913	88	
-Other				14	263	

Table 2. Level of privatisation within branches of up- and downstream industries.

Groups of enterprises	Number	1.1.1994 Privatised	1.1.1994 Started privatisation	1.1.1995 Privatised	1.1.1995 Started privatisation
Dairies	15	1	14	15	-
Slaughterhouses	14	1	-	9	5
Bakeries	14	1	-	9	4
Grain processing factories	17	-	1	4	11
Sugar plants	3	-	-	-	2
Technical service enterprises	122	-	121	15	107
Other enterprises	134	3	12	27	29
Total	319	6	148	79	158

The role of agriculture in the international trade has changed. The sector does not fulfil the role of main exporter as it was before the reforms. In some branches Latvia is already a net importer.

2. Conception for development of agriculture - necessity or mirage?

When the present government at the end of 1994 started work on legal and conceptual base of the development of agriculture, the conception was prepared firstly. Initially it included a very precisely formulated tasks of agricultural development by commodities, at the same time without any serious analyses of comparative advantages. According to the public opinion it seems to be necessary to create politically stabile conception which will not be changed by new government or even by the Parliament. It has been concluded in the scientists' discussion that there is no opportunity to create such a detail long term document because of political democracy and because difficulties in forecasting of integration processes with EU and WTO. It is difficult to create a politically accepted long-term conception. Each government has to formulate its conception in the medium run (3-5 years), which would be the base of its policy and would be the skeleton of the Report on Agriculture or Agricultural Annual Law.

3. Law on agriculture - legal instrument for agricultural and rural policy

During the creation of the draft of the law, the working group[1] had information about similar legislation in Germany, Austria, Finland, Norway and drafts of laws in Lithuania and Estonia. At the same time the draft of Latvian Law on Agriculture has been created on the basis of economic and political analyses. The main development of this draft of law could be characterised as follows:

- from detail to more common rules;
- from strictly formulated restriction to flexibility;
- from short-run to long-run goals and tasks;
- from eclectic compination of rules about agriculture to the most important agricultural and rural long term regulations.

Finally the draft of the Law on Agriculture has been prepared as the constitution of legislation concerning agriculture and rural development, where formulated are three main functions of agriculture: production, social aspects, and environmental aspects. The draft of the law includes following the objectives and tasks[2]:

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[1] A. Miglavs and R. Zile are members of this five persons team.

[2] Unofficial translation.

4. Objectives and tasks

The objectives of the law are to maintain the participation of agriculture in the development of the national economy. This is done through the formulation of stabile agricultural policy and through creating the main mechanism on agricultural policy implementations.

The main tasks of the agricultural policy are:

- to support the development of the rational agricultural enterprises, which produce compatible, quality products for reasonable prices;
- to develop economically stabile, ecologically and socially oriented firms in rural environment, at the same time taking in account the different social, ecological and regional conditions;
- to compensate natural and economical disadvantages in agriculture, giving equal social and economic opportunities for those persons, who work in agriculture and forestry;
- to secure land, soil, water, and other natural resources, which maintain natural base for agriculture and landscape.

5. Contents of the Law on Agriculture (version on 20.5.1995)

The contents are as follows:

- objectives
- tasks
- competence of the Law
- agricultural branches programmes
- responsibility of the Government for the implementation of the Law
- the Annual report on Agriculture
- the Agricultural Annual law
- the requirements for Information
- Food and Agriculture Board
- methods of income regulation in agriculture
- the main conditions for market promotion and regulation
- institutions and instruments of market regulations
- import regulation
- state reserves and exports
- the Rural Development Fund
- credit policy
- state investments

- budget outlays
- Organisations of Agricultural Producers
- protection of the entrepreneurs
- promotion of agricultural products' procurement
- responsibility on non payments
- land transformation
- planning of measures for improvement and securing of agricultural land

6. Report on agriculture (Agriculture Year Law)

One of the most important results of the Law on Agriculture would be the annual report on agriculture. This report would be the government's main document concerning agricultural policy, basing on the analyses of situation and the plan of medium-term measures.

The plan of measures could also be formulated as the annual Agriculture Law, that would be accepted by the parliament. This would create an opportunity for the quantitative control over agricultural policy and could cause some political and legal problems among the ministries of Agriculture and Finance, the government and agricultural producers etc.

Reliable information on farms seems to be the most serious problem in preparing the first Report on Agriculture (September 1995). Currently the only source is the bookkeeping data on about 500 farmers (totally there are about 64 000 farmers) in Farmers Extension Service. Since July 1995, the Ministry of Agriculture in co-operation with the State Committee for Statistics is going to collect information on 2500 farmers. Those respondents are volunteers from different regions of Latvia.

During preparation of the Report's contents the working group took into account the development of Report on Agriculture in Germany and partly the first Reports in Czech Republic and Slovakia.

The contents of the first Report on Agriculture will obviously be flexible, and the contents will be as follows:

The Situation in Agriculture

1. Agricultural production
    1.1. Methodology
        1.1.1. Sources of information
        1.1.2. Classification of enterprises
    1.2. Sector level
        1.2.1. Structure of enterprises (number, acreage etc.)
        1.2.2. Production resources (land structure, labour, livestock, machinery etc.)
        1.2.3. Structural changes (privatisation and restitution)
        1.2.4. Production
        1.2.5. Consumption
        1.2.6. Prices
        1.2.7. Subventions
        1.2.8. Gross value add
        1.2.9. Main macroeconomics parameters and role of agriculture in economy
        1.2.10. Commodity balance
    1.3. Enterprise level[1]
        1.3.1. Costs
        1.3.2. Revenues
        1.3.3. Income/profit
        1.3.4. Ratio of Equity
        1.3.5. Comparison of functional and household incomes
2. Downstream industry[2]
    2.1. Production
    2.2. Revenues
    2.3. Costs structure
        2.3.1. Agricultural raw material
        2.3.2. Other expenditures.
    2.4. Structural changes (privatisation, restructuring etc.)
3. Forestry
4. Foreign trade

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[1] The subjects of analyses are enterprises from different type of farms, varieties of specialised farms etc.

[2] Subjects of analyses: branches of processing (milk, meat, grain etc.).

Agricultural and rural goals and measures program

1. Goals structure
2. Measures:
    2.1. Harmonisation of the Latvian Agriculture policy with the Common Agriculture Policy (CAP) and conditions of WTO
    2.2. Market and price policy
    2.3. Privatisation and structural policy
    2.4. Credit policy
    2.5. Regional and social policy
    2.6. Environmental policy
    2.7. Land transformation
    2.8. Taxation
    2.9. Food quality, certification
    2.10. Research and education

The most disputable methodological problem concerning the analyses and also subject of agriculture policy is the classification of farms (enterprises). The authors suggested an approach, where the criteria are not the amount of hectares managed by the enterprise (farms, household plots, subsidiary plots, statutory companies), but labour force and income, which are added with interim criteria: value of revenues per household or person. There are five types of enterprises (Table 3).

7. Conclusions

Currently the main attention in the agricultural research is focused on the formulation of agricultural income and trade policy. Researchers have prepared drafts of three documents on this topic:

1) The Law on Agriculture;
2) The conception of strategy in agriculture;
3) Structure of the first Agriculture Annual Report.

The main goal of these documents is to make precondition for the creation of regular agriculture policy, which has to be aimed at:

- gradual implementation of farmer's income support policy in the framework of international agreements and treaties;
- improving of the competitiveness of Latvian agricultural products;
- improving of social, regional and environmental situation in rural areas.

Table 3. Possible classification of farms and agricultural enterprises.

Type of enterprise	Criteria 1	Criteria 2	Interim criteria
1. Farms (family farms):			
1.1. Full-time farms	> 1 manpower per year	> 75 % of total household income from agriculture	sales net income > one minimum salary per one family member
1.2. Part-time farms	>0.5 manpower per year	50 - 75 % of total household income from agriculture	sales net income and self-consumption > one minimum salary per one family member
1.3. Additional (interim, hobby)-time farmers	< 0.5 manpower per year	< 50 % of total household income from agriculture	sales net income and self-consumption < one minimum salary per one family member
2. Companies:			
2.1. Statutory companies (state farms) - legal heirs of former state and collective farms	> 50 full time workers	> 50 % from total income from agriculture	> 50 % from assets before privatisation
2.2. Companies and other legal entities which has been established on the base of privatised and alienated property or/and on the base of joining the capital	> 1 manpower per year	> 50 % from total income from agriculture	

Possibilities of the Formation of Protectionism Policies in Estonia Considering its Joining the International Structures

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Agricultural production in Estonia has decreased remarkably during the past few years. The main reasons for that are: a) the lost of the stable market, b) the adjustment with the requirements of new markets, c) the fall in the domestic demand, d) unfavourable price conditions for producers, e) producers are uncertain to produce, f) obsolete means of production, g) agricultural services' market does not function properly, h) farmers cannot get/take enough credit and i) the lack of the advisory service. However, although the production has decreased, it can still meet the needs of the domestic demand for a number of products and even to export. But the export of the main domestic agricultural products: meat, milk and milk products, has decreased.

At the same time, the import of the agricultural produce has increased, which, on the one hand has created the wide option and offered the healthy competition, but, on the other hand, due to dumped prices for many products, have occupied the market to a relatively great extent for some products being harmful to the domestic producers. It is very difficult to compete with dumped prices by Estonian agricultural producers in case of the intense import of the agricultural products. With the increase in domestic prices, import pressure has increased as well. If our prices will rise to the level of the world market prices, the sharp increase in the subsidised products by rich countries can be expected.

In considering the possibilities of the application of protectionism policies in Estonia and, at the same time, joining the international structures, both the WTO and the EU, we should consider these opportunities, which is offered by the current international policy. It should be insisted that the adoption of a liberal economic philosophy and the advocacy of a liberal international economic order, which is supported by some influential political parties in Estonia, are different from the philosophy of complete laissez-faire (see Willett, 1979). The liberal economic order is an American inspired post-Second World War system of freer trade, of low, non-discriminatory tariffs (absence of quantitative restrictions, and of currencies convertible into each other in the exchange market- the system symbolised and institutionalised by the GATT) (Haberler, 1979).

According to Ratso (1995), Estonia is clearly the country with the lowest tariffs in the Central and East European countries (CEECs), where the weighted average import tariff is 1.4%, while in other CEECs of more liberal trade policy, in Czech, Slovakia, Slovenia and in Macedonia, it is between 4.7% and 5.7%. The OECD average is 6.3%.

According to Article 19 of the GATT, the contracting parties are allowed to temporarily suspend, withdraw or modify obligations they have entered, including tariff concessions, if domestic industries suffer, or threaten to suffer, serious injury from an unforeseen increase in imports (see Grossman, 1994). In contrast to Article 19, which is concerned with the protection of domestic industries against superior foreign competition, Article 6 is directed against supposedly unfair trade practices by foreign enterprises and governments. It grants the contracting parties the right to impose anti-dumping or countervailing duties if an existing branch of the domestic economy is injured by, or threatened with injury from dumping or subsidies or if the establishment of a domestic branch is considerably delayed for the same reason (Grossman, 1994).

These above-mentioned conditions are valid in Estonia, which means that the imposition of tariffs and anti-dumping duties are relevant to under the concessions of the GATT rules. McKinnon (1992) holds that temporary tariff protection, which increases the internal cash flows of protected enterprises, is fully consistent with the principle of self-finance as the main financial mode for liberalised enterprises in a transitional socialist economy.

An important point in the application of protection is to find and use such measures, which are the least distorting. The specify rule says that it is more efficient to use those policy tools that are closest to the source of the distortion. The theoretical literature has successfully criticised the fiscal efficiency of using restrictions on foreign trade to compensate for which are essentially domestic distortions. Subsidies should be used to offset distortions directly in the market where they appear. At most, tariffs on competing imports can only be a next-best policy, while quota restrictions on foreign trade must be a worst-possible solution to the problem of overcoming domestic distortions. Export subsidies are considered very distorting in the global context, but they are costly to a national budget, as well. Product subsidies are widespread protection instruments in the majority of developed countries in the world, except in the EU and Japan, where respectively export subsidies and import restrictions are more important.

However, considering the conditions in developing and newly emerging countries, an import tariff can still be justified. In those nations, tariff as a source of revenue may be beneficial and even better than any alternative protective policy. For a newly independent nation, the most serious domestic distortions may be related to the government's inability to provide an adequate supply of public goods. In such nations import tariff becomes a crucial source, not so much of a protection of some industry, but of public revenue.

We have to consider that tariffs have to be linked with a fixed rate. If we, in joining the WTO, link our tariffs with the current rate of the agricultural protection (almost nil), it will be almost impossible to raise them later. For that, it must be achieved an agreement of all member states of the WTO. As we know, the main principle of the GATT has been that after the joining the agreement, the higher import restrictions cannot be used. Linking of the tariff rate does not mean that we should have to apply tariffs instantly. This, at least, gives us an opportunity to introduce them if Estonian economic situation requires it.

It is established in the general rules of the Free Trade Agreement between the EU and Estonia that since tariffs are not in effect on agricultural products in the last country, it has a right to impose tariffs on the agricultural products originating from the EU member states. Estonia has such a right within two years starting from the date the Agreement came into force. When needed, the two-year period can be extended by one year in virtue of the decision of the Joint Committee (Vabakaubandust ja kaubandust puudutavaid küsimusi..., 1995). The general rules contain also anti-dumping measures, which can be applied in accordance with the GATT rules (op.cit.). Considering the volume of the mutual trade in the agricultural production, the sensitivity of these products, the Common Agricultural Policy, the principles of the Estonian agricultural policy, the importance of the agricultural sector in the Estonian economy, Estonia and the EU commit themselves regularly to offer the further preferences to selected products (Article 13). If, considering the sensitivity of agricultural products, the import of one party causes injurious effects on the markets of the second party, the parties immediately must begin to negotiate for finding out the appropriate solution, regardless of the rules of the current agreement. Until the solution has been found out, the injured party can apply the measures, it considers necessary (Article 14). At the same time, according to the Agreement, the parties are obliged to mutually liberalise trade on the ground of the GATT principles (op.cit.).

In case of full accession into the European Union, Estonia will enter the composition of the Customs Union. Resulting from that the following course of events will appear:

1) Estonia will be obliged to equalise its tariffs with those of the EU (the countries who belong to the Customs Union, have to apply common tariffs with respect to third countries);
2) Estonia will be obliged to nullify its tariffs with respect to the EU Member States.

Estonia must take over the complicated system of protection of the EU, which is differentiated by sectors.

In the imposition of tariffs it should be kept in view that they should not lead the economy to the state, where they will extensively retain inefficient enterprises. Such a situation could aggravate Estonian export potential. Also, the high level of tariffs could become burdensome for taxpayers and consumers and, if needed, it could be extremely complicated, both economically and politically, to lower them. At the same time, the majority of protection instruments increase the respective domestic prices. Then, it is much easier for import products to compete, which causes the more severe import pressure. It is important that the protection measures (tariffs) will be modest and will not increase the domestic price level by themselves considerably. Protection can be in question for the products, which either (a) have the medium- or long-run comparative advantage, (b) production has decreased remarkably or (c) the most compete with the dumped import products. For these imported products, which Estonia cannot produce sufficiently by itself and, which widen the choice of our consumers, as well as for the products, which offer the improving competition to Estonian enterprises, the application of protection is not expedient. So much more, if an import product without (tariff) protection is more expensive than a domestic product and if the quality of the domestic product is worse than that of the imported product. But, if the price of an imported product drops below the level of the price of a domestic product (especially the case of dumping), whereby the difference in quality is not considerable and if, due to the low price the raise in import demand will inhibit the development of the domestic enterprises, we can start to discuss the application of protection.

One possible way of protecting the domestic market is the establishment of minimum prices. The meaning of this is that it is restricted to import the products with the price lower than the established minimum prices. Otherwise, countervailing duties must be paid as a difference of the prices. Article 6 of the GATT grants the right to impose countervailing duties, if an existing branch of the domestic economy is injured by dumping or subsidies, or if the establishment of a domestic branch is considerably delayed for the same reason.

Quality requirements can also be effective protection measures. These enable to protect the importation of the products, which do not correspond to the requirements. First of all, consumers can benefit from this policy. But it could also have a positive influence on the domestic production as well, since the general level of the quality of the imported products should raise, which should make higher demands to the domestic producers, therefore, fostering the increase in their competitiveness.

Some studies (Abedeij, 1983; ECA, 1986) have demonstrated, that in case of internal economic distortions, protection does not necessarily play the major role in economic growth. Above all, the economic policy and strategy oriented to the utilisation of internal factor inputs and to the development of highly qualified and motivated labour, are more important. In the economic development point of view, the priority should be given to the enhancement of economic competitiveness. The development strategy oriented to the achievement of complete self-sufficiency (in

foodstuffs) together with the extensive market protection can be harmful to the competitiveness of the agricultural sector. Therefore, market protection can have only a contributory, but not a decisive role in economic growth.

Thus, on the one hand, agricultural protection, considering the respective conditions in Estonia, is allowed by the GATT principles and, on the other hand, it will be inevitable if Estonia will fully enter the EU and its Customs Union, establishing the common tariff with respect to third countries. But considering the negative effects linked to many protection measures, we carefully have to ponder on the need and the extent of protection both by protection instruments and by commodities.

Analysing the need for and the extent of the protection of the agricultural sector in Estonia, we also have to consider that due to the economic development, the share of the agricultural sector in the economy in general is changing. The agricultural comparative advantage is changing, too. As industrial capital accumulates or is imported, the comparative advantage can move gradually towards the services and industrial sector. But again, the productivity of labour in the different sectors matters, and that can be influenced by institutional arrangements affecting individual incentives. Thus, as comparative advantage of agriculture in Estonia declines, protection can only achieve its objectives if it is increased over time. If Estonia joins the WTO, the further raising of the protection levels could be extremely difficult. This could also be an increasing burden on our state budget for a medium-term period. In the longer run, when the share of agriculture in the domestic economy has decreased, it will be somewhat cheaper (relatively) to protect it. At the same time, we have to realise that it could be a very difficult task, both politically and economically, to reverse the protection, if it is already established. Thus, the extent of the protection depends on the dynamics of the restructuring of different sectors in Estonia and how the agricultural comparative advantage will change.

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State Regulation of Economic Relations in Agriculture and its Impact on Financial Situation

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1. The economic situation in Lithuanian agriculture

The post-reform agriculture faces both internal and external market economy problems that are closely interrelated. One of them is disrupted relations with the former republics of the Soviet Union which reduced demand and consequently, production. Another problem is growing competition with agricultural import countries for markets. Besides, the sector development is impeded by uncertain rights of the farmers, unsatisfactory supply, of inputs unavailability of credits.

The above reasons influence negatively the income level of agricultural producers. The reduction was especially painful after July, 1993, when the Government liberalised prices and ceased to regulate agricultural product prices.

For example, at the end of 1994 agricultural enterprises while marketing their products could hardly cover production costs. Profitability by different farm products was as follows: cattle - 11 %, pigs - 12 %, milk - 5 %, grain - 38 %.

Therefore, seeking to speed up the recovery of farm economy the Parliament of the Lithuanian Republic adopted the Law on State Regulation of Economic relations in Agriculture.

2. Law on State Regulation of Economic Relations in Agriculture

The main objective of the law is to form such environment for implementing state agrarian policy that would stabilise economic situation in agriculture and maintain market equilibrium. The law envisages the following basic regulatory measures for agricultural economic entities and state institutions:

1) guaranteeing the procurement of agricultural produce according to the quotas;
2) supplementing or selling the part of state food product reserves;
3) supporting agricultural investments;
4) regulating the import and export of agricultural produce and food products;
5) product quality control;

6) restricting the activities of agricultural entities which dominate on the market;
7) promoting or limiting the production of certain agricultural products;
8) protecting the interests of agriculture by international agreements.

3. Income regulation

The above listed measures are aimed at the redistribution of income. In 1994 procurement quotas for milk, food grain and cattle were set although prices for quoted products were not guaranteed because of the strained budget as well as reduced population's purchasing power.The law envisages procurement of agricultural products in accordance with quotas at guaranteed prices (Table 1).

Minimal marginal prices are set by Product Procurement and Regulation Board of the Ministry of Agriculture in view of the supply and demand situation, input prices and boarder prices.

For several agricultural products (rye, cattle, and milk) these prices are coupled by subsidies that are of interim character and are supposed to improve the present economic situation.

Table 1. Minimal marginal prices for quoted farm products.

Product	Price, Lt/t
Young cattle peak-condition weight:	2800
over 450 kg	2500
421-450 kg	2400
401-420 kg	2200
standard weight	2100
Adult cattle peak-condition weight	2100
Milk:	
highest grade	500
1st grade	450
2nd grade	400
Food wheat:	
over 23 % gluten	500
18-23 % gluten	450
Rye	350
Barley groats	350
Barley malt, I c.	400
Barley malt, I c.	375

However, practical implementation of these prices does not seem very realistic as neither the budget situation nor the purchasing power are likely to change. The situation is extremely bad in the cattle sector. For example, the average guaranteed price for cattle since February 15 was 2800 Lt/t (including subsidy). In practice, however, in April, 1995 producers received 26 per cent less (i.e. 2084 Lt/t).

The fixed procurement price fails to guarantee minimal income (earnings for marketed agricultural products, which compensate labour and input costs, taxes and interest and guarantee minimal profit) to most producers, especially agricultural companies. For example, in 1994 average actual cost price for cattle was 3997 Lt/t. Increasing price in order to cover production costs would hardly be feasible as supply exceeds demand. Therefore the best way to raise cattle production efficiency would be economising and increasing quality that would make product competitive both in domestic and external markets.

Seeking to regulate income flow targeted funding for agricultural entities in low-productivity lands has been introduced. This funding is intended to be used to restructure economic activities and reduce differences in economic environment. Low-productivity land is agricultural land with soil bonitet lower than the national average by one fourth.

Long research shows that profit received by farms on low-productivity lands is twice as low as national average. Thus, under present conditions that do not oblige farmers to deliver products to procurement system and they are free to choose what to produce and to sell farmers situated in less-favourable areas should have main income source from activities other than agricultural production. Therefore, while compensating for differences in economic conditions the Government is not going to guarantee minimal income to such farmers. Introduction of income tax might help to solve this problem. Not only positive but also negative tax rates would be an efficient measure to regulate income in agriculture.

Success in this area is highly related with introduction of proper account and reporting system in all agricultural entities. All agricultural producers should have to make detailed records of all production expenditure and income from different sources, suitable for tax paying purposes. Unfortunately, these items have been included neither in the law on state regulation of economic relations in agriculture nor in other legislative documents.

Beside support to commercial farm producers the Government will fund the following activities:

- production of ecologic farm products and elimination of concentrated pollution centres;
- development of co-operatives and agroservice;
- implementation of family farm establishment and infrastructure development programmes;
- reduced income from agricultural production resulting from governmental restrictions;

- agricultural research, advisory services and training;
- productive plants, pedigree livestock and poultry;
- land reclamation and liming of acid soils.

4. Credits

Preferential crediting occupies an important place in the law. Soft credit is defined as the loan to agricultural entities and agricultural market partners providing services to them at the interest rate not exceeding 50 % of the average annual market interest rate or where the state refunds at least 50 % of interest on credits.

The law foresees that the Government allots interest-free loans from its financial resources for co-operative crediting system creation. The co-operative members will also enjoy tax advantages.

In this respect several disputable questions arise: isn't administration too heavy; are preferential credits likely to cause deformations in market interest rates, and disbalance agricultural procurement versus the supply/demand situation. Should this system be feasible the problem of soft credit distribution will come into being, as credit resources are not sufficient. We maintain that the law should have set priorities of soft credit distribution.

5. Agricultural export and import

There are no restrictions on agricultural export. Import, however, is regulated through quotas and tariffs. The following annual quotas apply to Lithuania: 1000 t pork, 500 t poultry, 1000-1200 t butter, 1400 t cheese, 3000-3500 t milk powder, 100 t tomatoes, 100 t garlic and 1000 t apples. Some quotas are common to the three Baltic countries: 3500 t cattle and 1500 t beef.

A customs duty of 30 % is imposed on the imported farm and food products. In the nearest future the national economy should be restructured in a way that would allow tariff-free trade. At the moment, however, tariffs protect our domestic market from cheaper Western food products and other commodities. On its way to Europe Lithuania would have to adjust its customs and tariff policy.

There are few optimists in Lithuania who believe that we will not only reach the level of EU member countries within 6 year period but also be able to support our agriculture to the extent that is common in EU countries. As the EU membership perspective is not very remote, up to 2000, the laws under way at the present moment in Lithuania should be more Europe-oriented and be in compliance with the EU agricultural policy.

Estonian Family Farming in the Conditions of Unregulated Domestic Market and Limited Export

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The free-market economy and the lacking state regulation and support has resulted in a steep decline in the Estonian agricultural production, reduction of the number of people engaged in agriculture, high unemployment among rural population, and foreign trade deficit. The once cheap resources made it possible to continue producing for some time, but now they have been depleted. Producing is going to perish gradually, if nothing is done about the sluggish pace of the agrarian reform, if the low prices or agricultural products remain like that, and if the it farmers are not granted favourable long-term credits.

Table 1 showsthe decrease in the number of workers engaged in agriculture and shows their low wage level in comparison with other sectors. Moreover, the present critical situation results in the decrease in the number of those willing to restore farms. The restoration process is further hampered by the bureaucratic paper-work and complicated land-surveying.

This tendency is demonstrated by the following figures (growth rate of farms in 1990-1995):

- Prior to the adoption of the Farm Law, by November 1st, 1989, there were 828 farms in Estonia, with total territory 21 100 ha.
- On January 1st, 1991, these, figures were, 2339 farms and 62 100 ha.
- On January 1st, 1992, 7163 farms and 183 500 ha.
- On January 1st, 1993, 8412 farms and 213 900 ha.
- On January 1st, 1994, 10153 farms and 252 300 ha.
- On January 1st, 1995, 13543 farms and 311 900 ha.

We observe major growth in 1991 (4824 farms), but in 1992 the establishment of family farms was practically stopped, no decisions were able to made, because the land value and compensation rates were not clear and the reform commissions had not finished their work. But this delay resulted in an uncontrolled growth of expenditures and in a hyperinflation of rouble. Thus, the right moment for establishing family farms was missed and now the establishing costs, especially for new starters, are tens and hundreds times higher.

Table 1. Number of workers, average wage and per capita net value added in several sectors.

No	Sector	Annual average number of workers			Average wage per capita EEK/ per month			Net value added per worker EEK/ per month		
		1992	1993	1994	1992	1993	1994	1992	1993	1994
1.	Farming and hunting	85229	42368	32490	388	641	1015	741	855	1196
2.	Processing industry total	-	127264	113804	-	1036	1789	-	1415	2007
3.	Including food, beverages, tobacco manufacturing	23682	23682	22452	662	1232	2334	2181	2560	2728
4.	Fishing	14578	8737	4764	540	1228	1723	728	1341	1426
5.	Wood processing and manufacturing	7580	7071	4957	491	901	1627	889	415	721
6.	Forestry	7476	7401	7119	473	908	1584	778	907	1535
7.	Construction	37551	33197	31433	647	1264	2049	1232	1503	2433
	Total in Estonia	601753	516519	477385	549	1066	1743	802	1473	1988

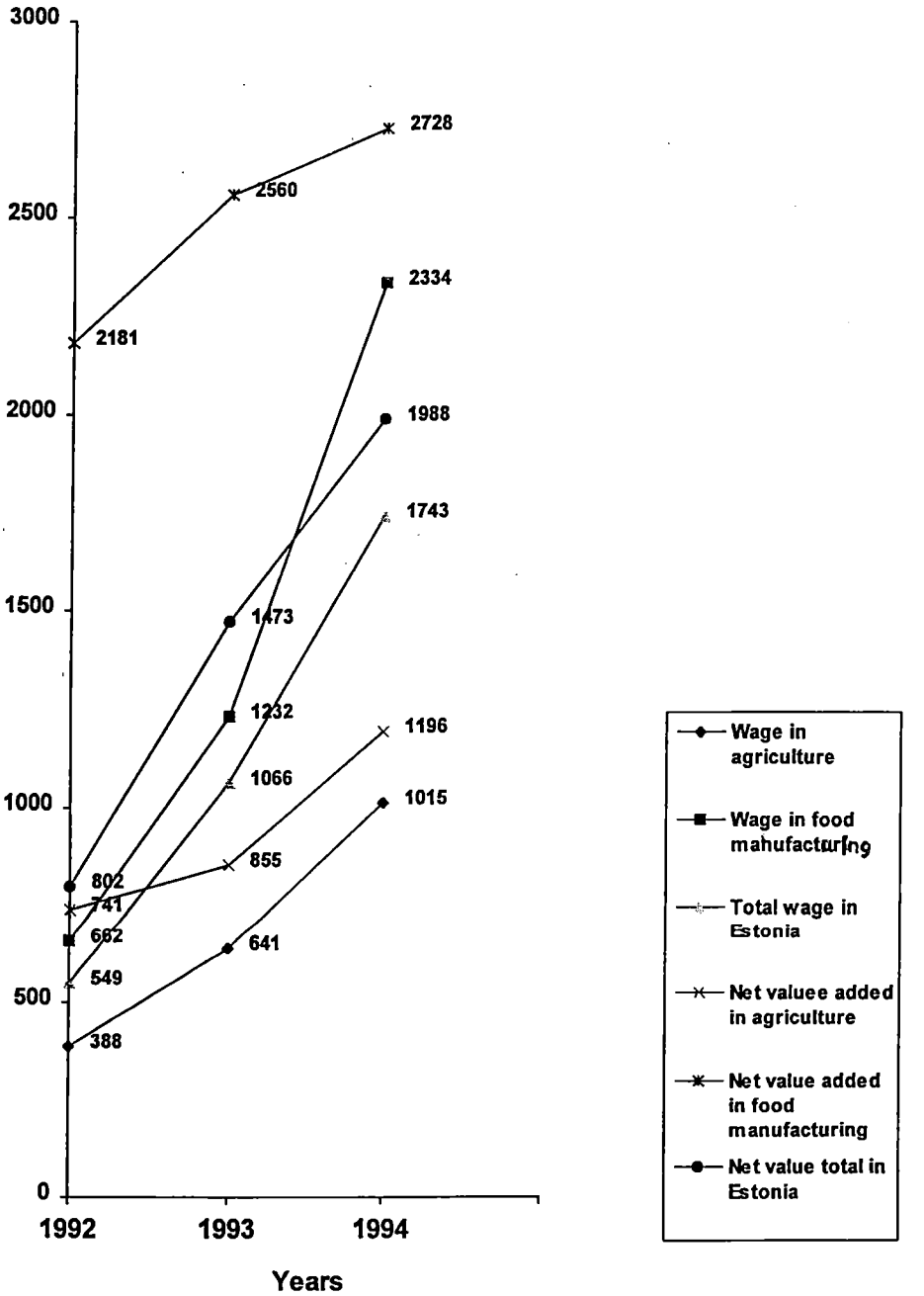

Figure. Average wage and net value added per worker EEK/per month.

Cost of agricultural production have gone up while sales prices have remained at a low level. This is due due to the small purchasing power and unlimited import of foodstuff at artificially low prices.

Calculatory producer price and needed net value added in agriculture are shown in Table 2. Table 3 gives the deficit of the net value added in agriculture, taking into account actual sales prices in the 2nd quarter of 1994. According to the calculations the deficit of the net value added in agriculture will amount to 1,251 billion kroons in 1995. The two-year-old negotiations between producers and the Government have produced no results.The following steps should be taken to improve the present situation:

- A special market analysis unit should be established under the Ministry of Agriculture to work out the strategy and policy for seeking and penetrating to new markets.
- The market regulation system of the EU should be adopted to increase production, quarantee agricultural labourers average living standard, stabilize the market and provide population with foodstuffs at reasonable consumer prices.
- Negotiated producer prices should be introduced and quotas for producers set (amount of production purchased at producer price per 1 ha arable land), while converting different kinds of production into cereals to get them comparable.
- A taxation policy should be implemented, which takes into account specific features of rural life and agriculture, contributes to the effective land and property use, and enables agriculture to get on its feet.

Table 2. Calculatory needed producer price and net value added in 1995.

Product	Necessary producer price EEK/1 t	Necessary net value added EEK/1 t	Amount needed to feed the population of the country (t)	Necessary net value added mill. EEK
1 Cereals (rye,wheat)	1900	550	150000	82.5
2 Potatoes	1100	375	150000	56.3
3 Vegetables	2500	550	150000	82.5
4 Milk	2600	600	600000	360.0
5 Beef (live weight)	13500	2400	50000	120.0
6 Pork (live weight)	12800	1700	62000	105.4
7 Poultry (live weight)	12200	1000	8000	8.0
8 Eggs (1000)	850	250	300000	75.0
Total				889.7

Table 3. Deficit of the necessary net value added according to the actual sales price in the 2nd quarter of 1994.

Product	Sales price 2nd quarter 1994 EEK/1 t	Necessary producer price EEK/1 t	Deficit per 1 ton EEK	Deficit concidering the amount needed to feed the population of the country mill. EEK
1 Cereals	1013	1900	887	-133.0
2 Potatoes	945	1100	155	-23.3
3 Vegetables	2358	2500	142	-21.3
4 Milk	1623	2600	977	-586.2
5 Beef (live weight)	7003	13500	6497	-324.9
6 Pork (live weight)	11961	12800	839	-52.0
7 Poultry (live weight)	10000	12200	2200	-17.6
8 Eggs (1000)	540	850	310	-93.0
Total				-1251.3

Stuctures and Interrelationships in the Food Chain: The Case of Finnish Market

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1. Introduction

The membership in the European Union and the internationalisation of the food business means a great change for the Finnish food system. The new competitive environment affects all stages of the food chain. Agriculture has been a regulated and subsidies sector. About 60 % of the food processing industry has belonged to the closed, protected sector of the economy with hardly any export competition. The firms have formulated their strategies under the assumption of market stability. During the past years food processing industry has been strongly rationalised, resulting in the concentration of market structure. The concentration ratio, however, varies greatly among subindustries. The bakery and meat processing industries, for example, are fragmented, whereas the sugar and dairy industries are characterised by monopolistic and oligopolistic competition, respectively. Farmer-owned cooperatives have the market shares of about 90% in dairy and 70% in meat processing.

On one hand, lack of export competition may allow monopoly profits for leading food manufacturing firms. On the other hand, it may lead to overcapitalisation, lower operating efficiency due to organisational bureaucracy, and a reduced ability to generate product and/or process innovations (Russo 1992). To a large extent, the ability of firms to increase their international competitiveness is affected by 'good domestic competitors' (Porter 1980). An industry therefore requires a rich variety of firms, which constantly seek innovations, in order to maintain its long-term health (Nelson & Winter 1982). Food processors can no longer launch a broadside of standardised products at a mass market and be assured of marketing success. Due to the changing lifestyles and consumption patterns of consumers, there is a growing need for finding market niches (Drabenstott 1994). The fragmentation of consumer segments also changes structures and strategies in food retailing. In the Finnish food chain, the retailing sector is highly concentrated. The two co-ops and the two quasi-integrated chains account for 95% of all food sales. Theory suggests that buyer concentration, inter alia, restricts alternatives open to sellers, and weakens the dynamics of competition throughout the whole food chain (Tirole 1988).

The changing consumption patterns, stronger processors and concentrating retailing sector are bringing changes to the agriculture. First, to satisfy consumer

demand, processors want more specific farm products. There is a need for closer relationship between the farmers and processors (Shaw, 1994). A great part of the agricultural productions nowadays takes place through production contracts between farmers and industry. Second, from farmers' point of view increasing concentration in processing and retailing means monopsony or oligopsony on the buyer side. Theory suggests that monopsony/oligopsony may produce large farm-retail price spreads (Rogers and Sexton, 1994).

The opening and internationalisation of the food markets have stressed the importance to examine the relationships in the entire food chain as a source of competitiveness. Our study aims at analysing cluster structures, interrelationhips and the competitive strategies of firms in the food chain. The structure and interrelationships are described at the industry level. Based on survey data collected from food manufacturing firms, we examine competitive advantages, bargaining power and organisational performance in the intermediate sector of the food chain. The field study might be characterised as firm level analysis rather than industry level analysis.

2. Theoretical background

2.1. Porter's diamond as a determinant of industry competitiveness

Traditionally the concept of competitiveness has been seen as price or cost competitiveness. As the product differentiation has become common the importance of technology and firm's ability to innovate rapidly has become an important element of the competitiveness. Porter (1980, 1990) sees the industry as the appropriate unit when analysing competitiveness. Seeking to explain competitiveness only at the national level or at the firm level is too narrow viewpoint. Porter explains the dynamics of competitiveness using the concept of value chain, the five forces of competition (the nature of competition) and the diamond model. The diamond model tries to give a holistic framework for the analysis of the determinants of the competitive advantage in the context of national settings. Porter's approach emphasises the meso level analysis. It also stresses the interrelationships between the industry, inputs sectors like agriculture, and services.

The diamond is Porter's answer to the question what are the attributes that shape the environment which influence company's ability to create and sustain competitive advantage. The diamond is made up of four determinants, i.e. factor conditions, demand conditions, related and supporting industries, and firm strategy, structure and rivalry. In addition there are two 'outside' forces: government and chance. At their best these elements of the diamond form a mutually reinforcing system. The interlinkages and the interaction between the determinants promotes industrial clustering i.e. the formation of several competitive industries which are related and mutually supporting.

In an industrial cluster there are several firms that are linked via commercial networks. Porter's (1990) cluster chart is a good tool to describe the interlinkages of the industry.

According to Porter (1980,1990) the nature of competition is embodied in five forces 1) the threat of new entrants, 2) the threat of substitute products, 3) the bargaining power of suppliers, 4) bargaining power of buyers, 5) the rivalry among the existing competitors. The firms influence and respond to the industry structure. They also have to choose their position within the industry. At the heart of positioning is competitive advantage.

2.2. Competitive advantage

Much of competitive strategy research draws on Porter's (1980) generic strategy typology, examining under what conditions cost leadership, differentiation and a focused strategy generates positional advantages. Competitive advantage is ascribed to industry structural characteristics and competitive forces rather than to internal firm-specific resources (Caswell 1992; Conner 1991). In an examination of strategies and performance at the level of the firm, the generic strategy typology may lose its explanatory power (see e.g. Dess & Davies 1984; Hill 1988). By integrating concepts from economic theory and organisational behavior, the resource-based view on competitive advantage looks inside the firm and its resources in exploiting market opportunities (Barney 1991; Conner 1991; Penrose 1959; Snow & Hrebiniak 1980; Wernerfelt 1984). Wernerfelt (1984) broadly defines a resource as "anything which could be thought of as strength or weakness of a given firm" (p.172). By nature, these internal strengths can be managerial skills, competences as well as tangible and intangible resources (Day & Wensley 1988). These terms have often used interchangeably. Resources refer more to "having" while skills and competences characterise more "doing" (Barney 1991). For the purposes of the study at hand, tangible and intangible resources as the fundamental sources of competitive advantage are more relevant.

Transforming inputs into outputs requires the deployment of tangible resources such as working capital, highly automated production equipment, advertising and product development expenditures, and a broad distribution coverage. For example, technological superiority and marketing resources provide a firm with the capability to generate new processes/products faster than competitors. On the other hand, intangible resources can be illustrated by a variety of characteristics such as reputation, brand images, the relationships to suppliers and buyers, and a good knowledge of customer needs (Yao 1988). These intangible resources can cumulate over time (provided that the environment remains relatively stable), which can then make the current rate of spending more effective (Porter 1991). In many industries, successful differentiation is therefore based on intangible "hidden" resources. It should be noted that competitive advantage does not arise from better resources per se, but from a firm's ability to reconfigurate different resources in specific ways

(Penrose 1959). Valuable, rare, non-imitable, and non-substitutable resources are strategically the most important (Barney 1991). In the study, competitive advantage is described in terms of resource-based activities aimed to create customer value, and that the firm performs particularly well or differently relative to rival firms within a similar product-market domain.

2.3. Bargaining power

Two important forces that affect competitive advantage are the bargaining power of suppliers and buyers (Porter 1980). In the distribution channels context, the conventional analysis of bargaining power is based on power-dependence theories (Gaski 1984). In both views, an important origin of power may stem from increased dependency due to the concentration of purchases/sales on one or a few trading partners. The importance of a business partner and the associated switching costs, the degree of product substitutability, and the threat of vertical integration may also be the origins of bargaining power. For example, an important supplier can exert power over its buyer(s) by threatening to raise prices or reduce the quality of raw materials. And if the output market of a firm is dominated by a small number of distributors, flexibility to choose alternative trading partners decreases. In the vertical chain, powerful firms can squeeze the profitability of downstream or upstream firms (Tirole 1988). Bargaining power refers here to the perceived ability of a firm or a group of firms to influence other firms' decisions and actions in the vertical chain concerning what is traded, where, in what quantities, at what prices, and on what terms.

2.4. Organisational performance

Performance is a multidimensional concept and may be characterised in a number of ways, including profitability, efficiency and effectiveness. Most prior studies on strategy have described performance in terms of profitability, either alone or together with other performance indicators (Venkatraman & Ramanujam 1986). However, the empirical verification of financial measures (that are influenced by actions taken in many previous time frames) shows that these may not be adequate to predict "excellence" (Chakravarty 1986), and may actually undermine current and future strategic advantages (Bhargava et al 1994; Day & Wensley 1988). Access to accounting data on privately-held firms can also be severely restricted. Thus, performance measurement in strategy research is a very thorny issue. In this study, organisational performance is described in terms of subjective and self-reported objective measures that reflect profitability, efficiency, and effectiveness criteria (Dess & Robinson 1984). Efficiency indicates input-output ratios internal to the firm while effectiveness reflects 'how well an organisation relates to its environment", for instance by successfully expanding its product-market scope.

3. Cluster structure, strategic behavior and interrelationships in the Finnish food chain

3.1. The Finnish food cluster

3.1.1. Research methods

Porter's (1990) approach uses as a primary tool a cluster chart. In his study industries appearing in the chart were chosen according to the success in exports. Industries are grouped into primary goods, machinery used in making them, and specialised inputs that are associated with the goods and their production. Successful industries are grouped into subcategories most closely related by end use in order to expose the nature of clustering.

Porter's model can, in spite of its wide usage, be criticised especially when it is applied to regulated industries. The framework was chosen as a starting point, but the method has been adjusted for our purposes. Porter's original method to select competitive industries is based on export shares. This has been criticised by many authors (see Bellack and Weiss, 1993, Rugman and D'Cruz, 1993, Cartwright, 1993). In our study Porter's method to select internationally competitive industries has modified in several respects.

Porter's method focuses on the industry level and lacks quantitative measures. It can also been criticised because it attempts to generalise from a few particular cases (see Yetton et al. 1992 or Bellak and Weiss, 1993). Because of the lack of quantitative measures the method is in many respects subjective and descriptive. We try to increase the accurateness of the description of interrelationships by the aid of input-output-calculations. When studying the competitive advantage and bargaining power resource-based view is used.

3.1.2. The structure of the food cluster

In order to describe the food system as a whole we first formed a cluster chart involving a broad category of products. The share of exports of total production is only 9 % and many of the export products are subsidised commodities. Therefore, Porter's principle to choose only internationally competitive primary products was abandoned and all food products were considered as primary goods. The products were classified into established, potential and latent according to their success in export (Figure 1). The share of unregulated products of total foreign trade has been about one third until last years. Due to the rapidly increased exports to Russia the share of unregulated products of total exports was in 1993 45 %. Therefore, subjective evaluation has been used when classifying products into the potential export products and domestic products.

Some case studies have been made concerning every group. Established export goods are products where exports are greater than imports. Potential products are such that their imports are greater than exports but the exports have increased considerably during the last years. Latent goods are exported only in small quantities.

SPECIALTY GOODS	PRIMARY GOODS	BUYERS
Agricultural inputs	*Established*	*Domestic whole*
Ensymes	*export products*	*salers and retailers*
-chocolate,		
-sugar confectionery		
MACHINERY	-crispbread and biscuits	*Domestic Industry*
-baby food	*for intermediate usage*	
Equipment for low	-vodka	
temperature transport	-sucrochemical products	
Blenders		
Cooking machinery		
Conveyers equipment	*Potential export products:*	*OECD countries*
Industrial washing	-liqueurs	
equipment etc.	-beer	
-ice-cream		
-cheese	*Russia and*	
-malt	*Baltic Countries*	
BY-PRODUCTION	-juices	
-berry products		
-pet food industry		
-paper industry	*Latent export products:*	RELATED SERVICES
(starch)	-fish products	Storage and low-
-chemicals	-bread, cakes	temperature
(sizing)	-pasta	transport
-pharmaceutical industry	- soft drinks	Consulting
-packaging industry		Process automation
-process automation	*Products for domestic sale*	Academic research
-butter and milk	Biotechnological R&D	
-fodder industry	-vegetables	Catering
-sugar		
-meet		
-egg products		
-ready made meals		

Figure 1. The food cluster.

Due to the regulation of foreign trade there are only few industries which have been successful in export markets. Sugar confectionery and chocolate, crispbread, vodka, baby food and sucrochemical products are examples of successful product groups. Due to the free trade agreements between Finland and the EFTA and EC areas exports of these goods have increased considerably. However, also imports have increased. Exports of basic commodities like meat and dairy products has been regulated. Only few dairy products (ice cream, flavored yogurts) have been on the list of free trade products.

When defining specialty inputs, machinery or services Porter's original method relies on export shares. We have first tried to find the functional links and then examine whether there is export success. Supporting industries are not very strong and there are only few export products.

3.1.3. Interrelationships within the cluster

The links within the cluster are measured with the help of value added in different parts of the cluster (Figure 2[1]) and with input flows in the cluster (Appendix). The advantage of using calculations based on input-output studies is that they eliminate double counting and provide data within a consistent accounting framework.

A considerably part, 46 %, of the value added is created in the agriculture and the other input-sectors (Figure 2). The share of agriculture is steadily diminishing. In 1985 23 % of the value added in the whole food system was created in the agriculture and in 1989 19 %, respectively. The share of food processing, restaurant and other input sectors has increased, respectively. The share of whole sale and retail trade has been constant, about 17 %. The increasing share of input sectors can be explained by specialisation. Food processing companies buy services like transportation or cleaning from other companies instead of doing it within the company.

Input flows do not go only from input sectors to agriculture and from the agriculture to the processing industry, but also from input sectors direct to the processing industry and restaurants. The strongest links are, however, between the agriculture and the processing industry.

Because of the regulation the dependence on domestic inputs is great. About 93 % of inputs used by the processing industry are domestic (see Appendix). The share of imported inputs is small also in other parts of the cluster. Due to the tax system subsidies obtained by the industry are considerable.

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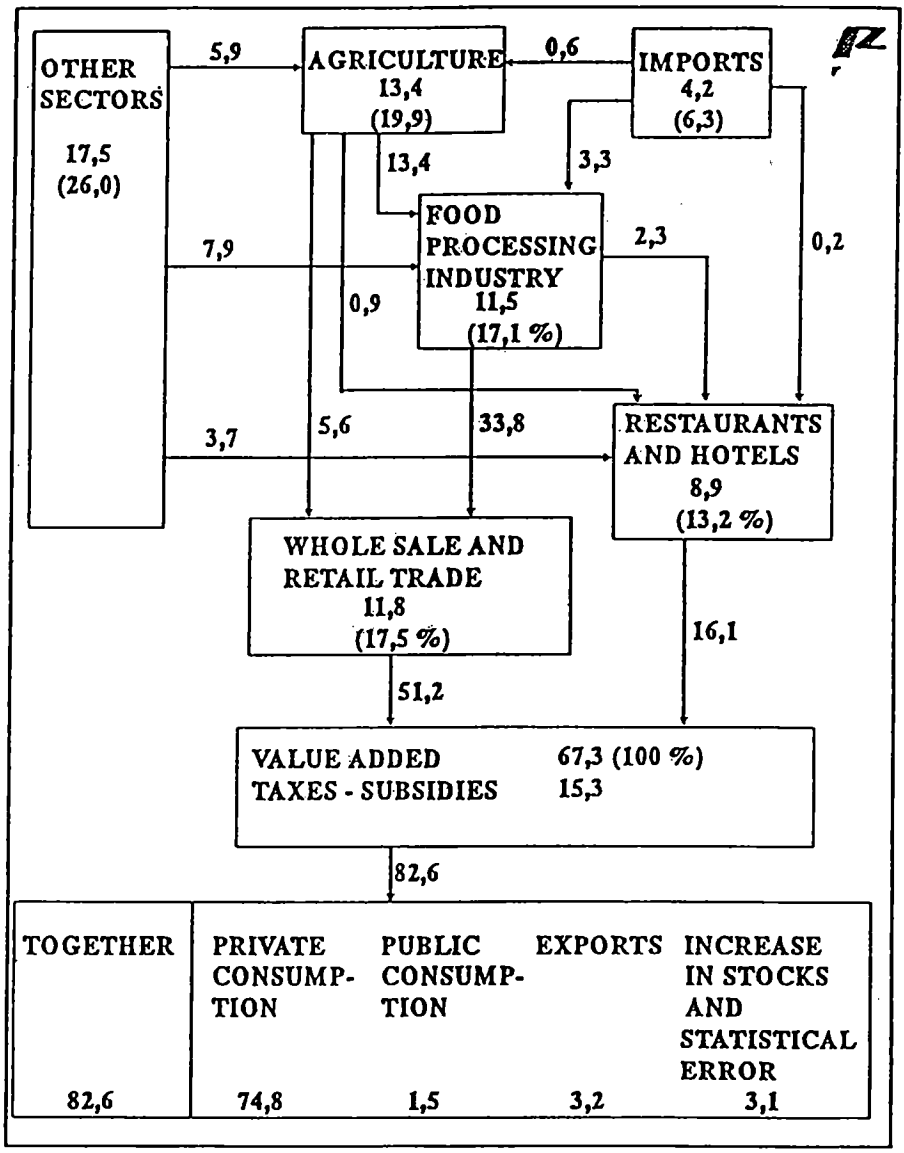
[1] There are several limitations to calculate input-output flows in the whole food chain. Figure 2 is calculated combining data from input-output-studies and from unpublished background information of the national accounts.



Source: Input-output models national accounts.

Figure 2. Value added within the food cluster 1989, 1000 millions FIM[1)].

[1)] The figures in the boxes describe the value added created in the respective sector and the figures between the boxes the net input flows between the sectors. There are minor differences between Figure 2 and Appendix, because in the figure 2 drink and tobacco sector is included in the food processing industry and in the appendix in other sectors.

The relationships between farming and the other input supplying sectors are of special importance. Fertiliser industry and some agricultural machinery industry are suppliers of the agriculture. Thus, agriculture has close connections to the chemical industry. Food processing industry also utilises different related services i. e. there are links to the storage and the transport and to the paper industry through packaging (Appendix). The output of the food system is used mainly for domestic consumption. Only a small part is exported.

Input-output calculations give an impression about the monetary flows between the different parts of the food sector. They don't, however, tell much about the nature of the relationships behind these flows. In order to understand the nature of competion we should understand the key driving forces of the environment. On the other hand, to understand how individual firms do develope competitive advantage we have made a field study.

3.2. Competitive advantages in the food industry

3.2.1. Field study and measures

In this part the strategic behavior of Finnish food manufacturing firms is analysed. For the empirical study, firms operating in the meat processing, soft drink, and milk processing industries were selected as the most appropriate data source. The total value-added contributed by these three subindustries is about 45%, suggesting that they are relevant sectors in our food industry. The initial list of companies was drawn from those listed in the published statistics of the Ministry of Agriculture (18.6.1991) and the Association of the Finnish Food Industry (1991). In total, 88 operating firms were identified, and all of them were selected for empirical exploration. This setting permits the examination of relevant questions applicable to diverse firms while controlling for circumstances that might otherwise vary greatly across industries. There are firms of differing sizes that operate in different market segments. This should ensure enough variability to study strategic behavior.

A semistructured questionnaire was mailed either to the chief executive officer (CEO), chief marketing executive (CME), or to the owner of the company. The two mailings and personal contacts resulted in a sample of 65 usable questionnaires, a response rate of 73.4% (65/88). A comparison of early responding firms and late responding firms showed that these groups do not differ in terms of years of business, number of employees, or firm performance. Concerning the industry categories of firms, 58 producers represented the meat-processing industry, four firms operated in the soft drink industry, and three firms represented the ice cream industry. The firms averaged 204 employees and 32 years in operation. Small firms employing less than 10 persons accounted for one third of the sample. A total of eight firms had operated less than four years.

The questionnaire was developed according to the general approach recommended by Nunnally (1978). Several iterations of the research instrument were made prior to an actual field test. The relevance of the items was ascertained through the use of extensive interviews in 12 firms, which led to several improvements in both the wording and the composition of lists of variables.

To provide a general profile of *competitive advantages*, production, purchasing, marketing, distribution, and finance variables are all represented in the strategy scale that consists of 19 items (Table 1). Respondents were asked to indicate the degree to which their firm emphasised each of the listed "success" factors or methods of competing. Seven-point scales with values ranging from one (not at all important) to seven (extremely important) were used. The instructions to the respondents also stressed that they should use their major competitors as a frame of reference, and that they should selectively emphasise particular competitive methods.

Three measures were developed for *bargaining power*. The manufacturer's power in input markets (i.e., the primary and secondary suppliers of raw materials) was measured with two items. The response scale ranged from one (extremely low) to seven (extremely high). Because Cronbach's alpha coefficient, which reflects the unidimensionality or internal consistency of a scale (Nunnally 1978), did not meet the critical value of .70 for a narrow construct, the item measuring power relative to the secondary suppliers was deleted. Hence, the final scale consists of one item (POW-S). Using an identical seven-point scale, the manufacturing firm's power relative to its distributors was measured with seven items altogether, reflecting different channel types. One five-item scale showed the manufacturer's bargaining power relative to the four leading wholesalers and the customer retailers. Cronbach's alpha for the scale was .79, showing adequate internal consistency. The five items were then combined into a summated scale (POW-W-R). Another two-item scale measured the manufacturing firm's power in relation to its industrial and catering customers. Coefficient alpha for the scale was .71. As earlier, a summated scale was formed (POW-I-C).

Organisational performance consists of three indicators that reflect profitability, effectiveness, and efficiency. Following the recommendations of Dess and Robinson (1984), a self-reported scale on profitability was developed in the following way. Each manager indicated to what extent their firm had realised its performance objectives concerning the following five criteria: sales growth rate, gross margin, operating margin, net profits from operations, and return on shareholder equity. The response options for the scale ranged from one (highly dissatisfied) to seven (highly satisfied with the realised result). The scale had a high internal consistency (alpha=.87). For the analyses which follow, the five items were combined into a summed scale measuring overall financial performance. The sales growth rate over the last five years measures effectiveness. Efficiency was defined as sales turnover/the number of employees working in food processing.

The study also includes some variables indicating marketing-related resources as well as two contextual variables (the size and age of the firm).

3.2.2. Identification of competitive advantages

Evaluation of industry effects

Prior to aggregating the firms independent of their industry classification, a comparison was made of the competence and performance variables among the firms grouped by the three industries. ANOVA results indicated that there were significant differences in only 2 of the 19 competence variables ($p<.05$ and $p<.10$, respectively). To identify the industry category sources for this variation, the Scheffe multiple comparison test was performed. It revealed no paired comparisons significant at the 0.05 level. No significant differences were found among performance variables by industry, either ($p<.05$). Thus we may conclude that the industry effects are minimal in this study, and therefore it was appropriate to aggregate the responses.

How do the food manufacturing firms compete?

The strategy variables were refined through factor analysis in order to identify the most important dimensions of competitive advantages. An orthogonal rotation (VARIMAX) of the initial principal components factor matrix yielded five factors. A combination of minimum eigenvalue criterion and scree test were used to determine the number of factors. Because of the potential instability of factor scores with 65 firms and 19 strategy variables, the factor analysis was performed five times to (n-1) cases in order to test whether a changing of sample composition would alter the factor loadings (Kim & Mueller 1978). The analysis results were the same or similar in all runs. The results are shown in Table 1.

Marketing differentiators (factor I) compete with a broad product range typically involving specialty products and with a strong emphasis on product development and new technology. Direct advertising, brand marketing and a skilled sales force are also important dimensions of marketing differentiation. Distributor orientation (factor II) suggests an especially strong commitment to 'push marketing' and a large marketing and sales organisation necessary for its implementation. These firms emphasise serving specific market segments; e.g., they manufacture distributor brands for the integrated retail chains. Image and product development (factor III) shows high loadings on good corporate image, tight quality and cost control, and product development and innovation. This combination suggests a strategy based on efficiently producing a narrow line of niche products. Production and supplier orientation (factor IV) is characterised primarily by cost advantages based on economies of scale. This focus on large-scale manufacturing is combined with a strong emphasis on the quality and availability of raw materials, the control of

Table 1. Factor structure of competitive advantages (values [.42]).

	Factor loadings					
	I	II	III	IV	V	H^2
Emphasis on production processes and new technology	.46			.51		.71
Strong marketing and sales organisation	46	.72				.79
Continuing product development and innovation	54		.48			.75
Focus on specific market segments		.80			.71	
Broad range of products	.87					.80
Capability to manufacture specialty food products	.55					.52
Depth of product range, large number of items	.79					.76
Advertising expenditures above the industry average	.67					.69
Manufacturing of distributor brands	.47	.45				.55
Good corporate image			.81			.69
Product quality control			.70			.64
Continuing concern for lowest cost per unit			.56			.65
Competitive pricing					.85	.77
Economies of scale based on mass production				.42	.43	.74
Building brand identification					-.53	.69
Finance and operating efficiency				.68		.74
Major effort to ensure the availability of raw materials				.87		.84
Emphasis on trade marketing		.70				.68
Control of distribution channels				42		.64
I Marketing differentiation; II Distributor orientation; III Image and product development; IV Production and supplier orientation; V Low-priced products with no brand identity						
Eigenvalue	7.01	2.10	1.76	1.40	1.07	
Percentage of cumulative variance accounted for	36.9	48.0	57.3	64.7	70.3	

distributors, and operating efficiency including new technology. Factor V called "low-priced products with no brand identity" was of minor importance in the factor structure. These firms do not manufacture well-known brands (negative loading); their strength is in price competition.

Competitive advantages, bargaining power and organisational performance

The data showed that the number of primary suppliers of raw material ranged from 1 to 10. Sample median was four suppliers, and 17.5% of food manufacturers purchased over 50% of their raw materials directly from farmers. As to buyers, two thirds of total food sales is channeled through retailers and wholesalers, and the rest through industrial and catering channels (Hyvönen 1993). The correlations between the five strategy patterns and the food manufacturer's bargaining power in input and output markets are presented in Table 2.

In terms of organisational performance, Table 2 indicates that the production- and supplier-oriented strategy is positively related to overall financial performance ($p < .001$) as well as to efficiency ($p < .05$).The strategy emphasising low-priced, nonbranded products is also positively correlated with overall financial performance

Table 2. Relationships between food manufacturer's competitive advantages, bargaining power and organisational performance.

Type of Advantage	POW-W-R	POW-I-C	POW-S	Overall financial performance	Efficiency	Effectiveness
Marketing differentiation	.27*	-.04	.19	-.11	-.05	.05
Distributor orientation	.09	.05	-.21*	-.05	.17	-.14
Image/product development	-.08	-.23*	.15	-.09	.08	-.02
Production/supplier orientation	.05	.16	.24*	34***	.26*	-.13
Low-priced products with no brand identity	.05	.29**	.03	.23*	.10	.10

*** $p < .001$; ** $p < .01$; * $p < .05$;
POW-W-R (FM's power relative to wholesalers and retailers)
POW-I-C (FM's power relative to industrial and catering customers)
POW-S (FM's power relative to the primary suppliers of raw materials)
Largest pairwise N = 65
Smallest pairwise N = 58

($p < .05$). Marketing differentiation, distributor orientation, and image and product development are not significantly related to performance measures. While the correlations showed a negative direction, we complemented the analysis by correlating these three strategy patterns with the self-reported profitability measure: net profits from operations. The results (not reported here) showed that the marketing differentiation-based advantage, distributor-based advantage as well as the strategy focusing on image and product development were all negatively related to net profits from operation ($p < .05$).

Only the strategy focusing on marketing differentiation is positively related to the bargaining power in relation to wholesalers and retailers ($p < .01$). On the other hand, a low-price strategy with no brand identity is positively related to the bargaining power in relation to industrial and catering customers ($p < .01$), while the strategy based on image and product development shows a negative correlation with power in these non-traditional channels of distribution ($p < .05$). There is a positive relationship between the production- and supplier-oriented strategy and the manufacturer's power vis-á-vis the primary suppliers of raw materials ($p < .01$), while the correlation between distributor-oriented strategy and the manufacturer's power in the input market is negative ($p < .05$).

A Taxonomy of strategies in the food industry

To identify possible differences in the strategic profiles of competitive groups, the factor scores obtained from the above analysis (Table I) were utilised as the input variables to classify the firms. Ward's hierarchical centroid method based on squared Euclidean distances was used to form clusters[1]. This method is considered to be one of the most accurate hierarchical cluster methods (Everitt 1980). Ward's method produces a grouping of relatively homogeneous groups of firms which have maximum between-group variance and minimum within-group variance (Punj & Stewart 1983). A six-cluster solution was found to maximise the distances between cluster means across the five factor patterns. The pattern of mean scores that emerged from the cluster analysis shows relatively high and positive scores on several alternative strategy types. This may indicate the possibility of emphasis on more than one strategy within the groups of firms.

Next, differences between clusters on strategic variables not utilised on bases of classification are described. In particular, marketing-related resources and organisational characteristics were examined using ANOVA. Duncan's multiple range test was used in order to determine which group means were different from each other. Table 3 shows the strategic profiles of the six groups of firms along with F-statistics and Duncan's tests.

Cluster 1: Distributor-oriented, low-price strategists are larger food manufacturing firms that operate on a regional and national scale. These firms had launched an

[1] In the following the word 'cluster' is used in the statistical sense.

average of 11 new products during the previous two years. A relatively high proportion of lower-priced campaign products (an average of 49% of product range) is an indication of a strong distributor orientation. The marketing organisation averages 17 staff members. Cluster 1 accounted for 16 percent of the sample.

Cluster 2: Utilisers of differentiation- and cost-based advantages are smaller and medium-sized firms which have no clear strategic orientation. During a two-year period, new product introductions numbered 13 but a low-price strategy is not widely adopted in this group of firms. This cluster has the lowest advertising and trade marketing expenditures. The marketing organisation consists on an average of eight staff members. The 'stuck in the middle' group captured 22% of the sample.

Cluster 3: Marketing differentiators lacking cost-based advantages are large firms. The firms compete with a broad product range, having launched on an average 50 new products over the past two years. The proportion of campaign products is large, averaging 65% of product range. Consequently, a low-price strategy is commonly adopted by the firms. Cluster 3 contributes heavily to trade marketing. Advertising expenditures are the highest, and the marketing organization the largest, averaging 54 employees. The cluster accounted for 14% of the sample.

Cluster 4: Innovating differentiators lacking cost-based advantages are medium-sized and smaller firms. The group had launched an average of 15 product innovations during the previous two years. While the proportion of lower-priced campaign products accounts for an average of 40% of the product range, to some extent the group emphasises a low-price strategy. Advertising and trade marketing expenditures are relatively low. On the other hand, the marketing organisation is relatively large, averaging 18 staff members. Cluster 4 accounted for 24% of the sample.

Cluster 5: Production- and cost-oriented strategists lacking marketing competence are small firms that have a very small marketing organisation, averaging only 1.2 persons. The group had introduced an average of 12 new products during the previous two years. A low-price strategy is not common in this group. The cluster captured 8% of the sample.

Cluster 6: Distributor-oriented image and product developers are very large firms that have operated long in the business; firm age averages 53 years. The group most strongly emphasises a push strategy oriented to their distributors, which can be seen from the high proportion of trade marketing expenditures. A relatively high proportion of lower-priced campaign products demonstrates a focus on competing with price in the channels of distribution. In the group, the size of the marketing organisation is the second largest, averaging 45 staff members. Cluster 6 accounted for 16% of the sample.

With regard to overall financial performance, the analyses of the data showed that clusters 3, 1 and 6 fell below the sample average. Cluster 2 appeared to have a performance level roughly equivalent to the sample average while clusters 4 and 5 are 'high performers'. The data revealed that some firms in clusters 3, 4, and 6 manufactured distributor brands; (the results are not reported here). This explains,

Table 3. A taxonomy of competitive advantages in the Finnish food industry.

	Cluster						
	1	2	3	4	5	6	F-stat
Number of new products launched	10.7	13.2	50.0	14.9	11.7	24.4	2.400*
Proportion of lower-priced campaign products	48.6	12.4	65.0	40.0	10.3	56.7	4.417***
Advertising expenditures (%) of sales turnover	1.7	0.7	2.6	0.8	0.9	2.0	4.173***
Trade marketing support (%) of sales turnover	1.4	0.5	4.3	1.4	1.2	6.1	2.143^
Size of marketing and sales organisation	17.5	7.9	53.6	17.6	1.2	44.7	3.708**
Years of operation	26.6	29.0	46.4	22.8	48.5	52.6	2.176^
Sales turnover, mill. FIM	236.2	58.0	291.3	161.1	32.6	397.1	1.970^
Overall financial performance	3.8	4.1	3.8	4.3	4.8	3.4	n.s.
% of sample	16 %	22 %	14 %	24 %	8 %	16 %	

1 = distributor oriented, low-price strategists.
2 = utilisers of differentiation- and cost-based advantages.
3 = marketing differentiators lacking cost-based advantages.
4 = innovating differentiators lacking cost-based advantages.
5 = production- and cost-oriented strategists lacking marketing competence.
6 = distributor-oriented image and product developers.

*** $p < .001$; ** $p < .01$; * $p < .05$; ^ $p < .10$
Duncan's comparison ($p < .05$):
Number of new products CL3 > CL1, CL5, CL2, CL4;
Proportion of campaign products CL3, CL6, CL1, CL4 > CL5, CL2;
Advertising expenditures CL3 > CL2, CL4;
Trade marketing support CL6 > CL2, CL5, CL1, CL4;
Size of marketing organisation CL3, CL6 > CL5, CL2, CL1, CL4;
Years of operation CL6 > CL4;
Sales turnover CL6 > CL5, CL2;

in part, their focus on distributor orientation. Differences in marketing variables by cluster provide some confirmation of the validity of the cluster solutions. As Table 3 shows, ANOVA reveals significant group differences on four marketing variables, and three of them were marginally significant ($p < .10$).

4. Conclusions and implications

Increasing rivalry and competitive strategies in the food industry

The Finnish food sector has been dominated by the targets of domestic agricultural policy i.e. self sufficiency and income parity between farmers and workers. The sheltered and protected environment has shaped the nature of competition at the industry level. Mainly domestic inputs has been used. Exports are small. It appears that the food processing industry has not been able to build many supporting industries around the processing. Related goods and services are oriented to the domestic market. Machinery is in many cases imported. Producer oriented government policy and the lack of keen foreign competition characterise competition environment.

The strategies in the Finnish food industry are largely home-market oriented, to which, *inter alia,* distant location and trade barriers have contributed. Now membership of the EU introduces new adjustment requirements into the food chain; the period of stability is history. Data from the food manufacturing firms in three subindustries show that largest firms tend to follow either a differentiation strategy in mass markets competing with a broad product range or a distributor-oriented strategy with an emphasis on price competitiveness and trade support. We find a group of medium-sized innovative firms that emphasise a differentiated strategy in regional market segments. There are also a group of smaller firms that have no clear strategic orientation, and a group of very small local firms that are purely production-oriented.

Although the leading national firms now have bargaining power in the food chain as well as considerable economies of scale, the importance of cost cutting will increase in a deregulated market situation. It is generally thought that (gradually) opening markets may give new export opportunities especially for large-scale standard food producers, and for the manufacturers having strong brands. This surely is true, but the segmentation process of consumer markets and new requirements for product development increasingly tend to favor differentiation. We can see that consumer segments are becoming more and more heterogeneous and smaller. In larger firms, differentiation based on fewer but stronger brands to focused segments would be more profitable than widening the product range. Price always remains important to consumers, but quality, safety and ethics of production will become increasingly important. There is a growing consumer segment that is health and environment conscious and not so price conscious. These trends favor small-scale specialty producers in domestic as well as in foreign markets.

In the light of the structure of the European food industry in general, it is unlikely that small-scale and medium-sized food companies will be outcompeted by market leaders (van Dijk 1990). While most smaller firms may remain domestic, their success may then be largely dependent on the bargaining power of integrated wholesalers and retailers. Market entry, however, may be difficult because of the requirements of large-scale production and 'megabrands' of integrated retail chains. The share of retail brands is also on the increase, tightening competition. Our findings show that only marketing differentiation may increase a food manufacturer's bargaining power vis-á-vis retail chains. This kind of competence is primarily based on a broad product range, strong brands, and heavy advertising. At firm level, brand marketing creates a power advantage in terms of a consumer pull, while the manufacturers of less clearly identified products generally suffer considerable erosion in bargaining power (Watkins 1986). Because brand strategy is expensive, alternative strategies for smaller and medium-sized food manufactures would be the development of collaboration with local retailers and direct distribution through own outlets.

However, a tradeoff remains. The study implies that the firms emphasising marketing differentiation or distributor orientation are 'low performers,' while the firms following a low-price strategy with no brand identity or a production- and supplier-oriented strategy are 'high performers' relative to competitors. In fact there are pressures to lower marketing and distribution costs in the Finnish food industry (Hyvönen 1993), which are found to be somewhat higher than in some European countries. Our findings also reveal that the production-oriented firms have bargaining power in relation to the primary suppliers of raw materials. It is common, for example, that these manufacturers secure a direct and regular supply of raw materials through contracting with farmers.

Our study demonstrates that production-oriented firms may outperform market-oriented and distributor-oriented firms. The strategies that are differentiated are usually assumed to be the key to a firm's chances to earn above-normal profits (Rumelt 1987). However, there is some evidence to indicate that, *if* the market is protected from active competition (such as our setting), production orientation with its overall lack of marketing skills and resources can then be superior (Snow & Hrebiniak 1980).

In the mature industry such as food, a sustainable competitive position is not only a function of a firm's absolute size. As consumer needs and preferences are changing, it is the relative size of the firm in a specific market segment, associated with unique competencies, that become important. From a consumer's point of view, structural concentration can have negative impacts on the long-term functioning of the whole food chain. As Nelson and Winter (1982) maintain, to gain positional advantages, survive and grow, firms within an industry need competitors that constantly seek innovations.

In order to satisfy the demandig consumer firms should be able to deliver customised products at separate market niches. This brings new challenges to the relationships between farmers and industry. There is a shift to production contracts.

For example, all the Finnish poultry production is already based on contracts. Farmers prefer production contracts because they ensure the marketing of their products. In addition, farmers appreciate the advisory services concerning for example breeding and medication of the animals offered by the industry. 74 % of farmers believe that production contracts helps to improve the quality of farm products.

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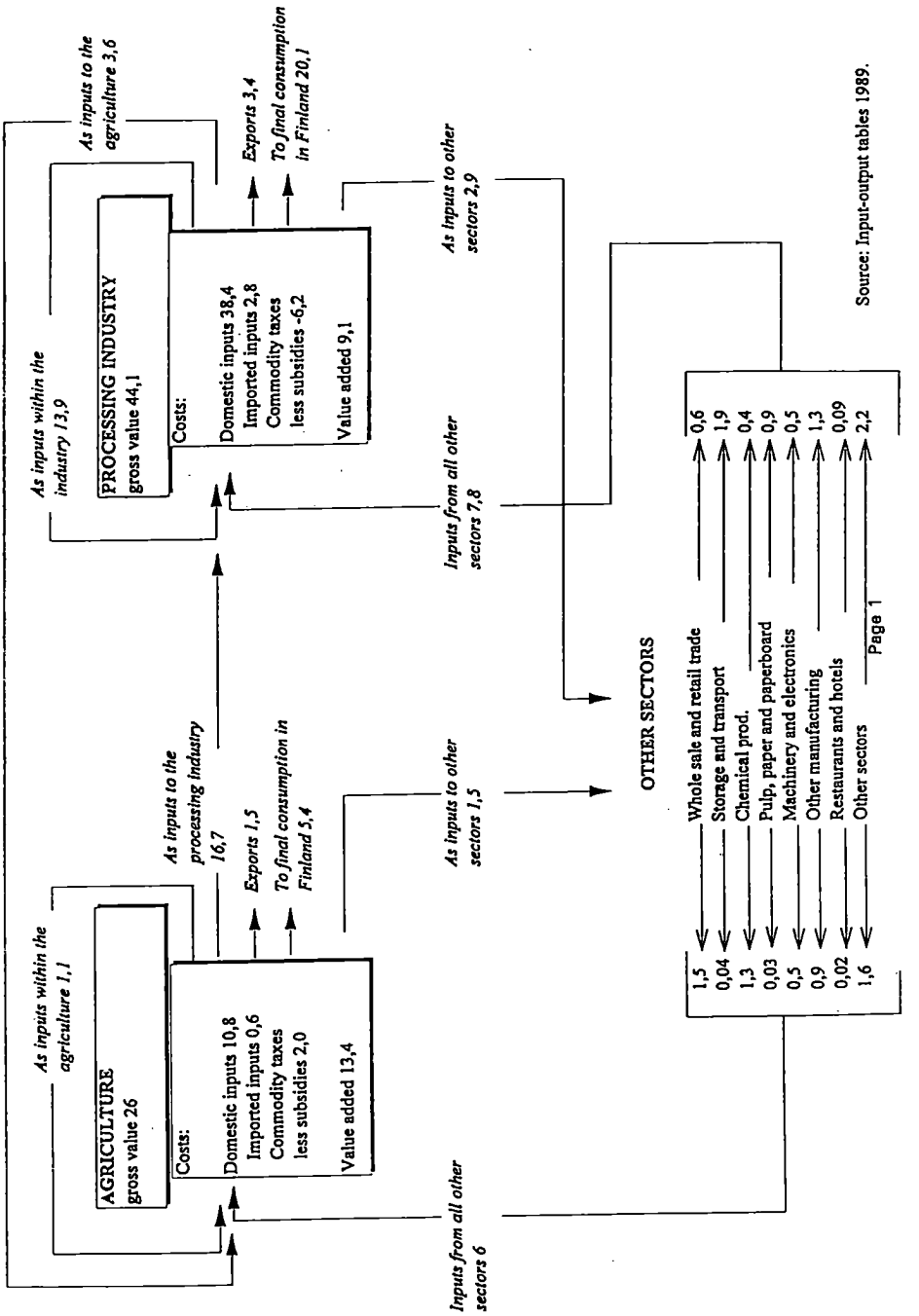
Appendix. Input and output flows within the food cluster in 1000 million Finnish markka.



Quality Assurance and Environmental Protection Aspects under Food and Agricultural Trade Liberalisation

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At present Latvia faces transitional period to the market economy and includes in the international organisations and institutions:

- establishing an association between EU and Latvia;
- WTO/GATT as observes since 1992, in the process as member 1995;
- European and Mediterranean Plant Protection Organisation (EPO) - 1993;
- European Standards Organisation (CEN);
- free trade agreements with some EFTA countries;
- Food and Agriculture Organization of the United Nations (FAO) and Codex Alimentarius Commission (CAC-Codex), 1992;
- World Organization for Animal Health (OYE) -1992.

Most important for Latvia are agreements with GATT and EU. Agreement establishing an association between the European Communities and their Member states of the one part, and the Republic of Latvia of the other part as well between GATT and Latvia will create a new climate for the economic relations between them and all for the development of trade and trade related matters and investment, which are essential to economic restructuring and renewal of tehnology.

The point of this agreements are that no country should be prevented from taking measures necessary to ensure the quality of its exports, or for the protection of human, animal or plant life or health, the environment, or for the prevention of deceptive practices.

Food control agencies of importing countries generally apply regulations which give them authority over food safety, hygiene, quality, packaging, labelling, handling and storage. These regulations include precise requirements which must be met if food products are to be admitted into the importing country. Regulations often indicate the levels of contaminants (microbiological, agricultural and veterinary, environmental and radioactive) and levels of additives. These are sometimes referred to as sanitary requirements.

The Uruguay Round of the GATT negotiations was concluded with Sanitary and Phytosanitary Measures Agreement (SPS), which formed part of the main package of agreements from the Uruguay Round.

Agreement calls countries for harmonising sanitary and Phytosanitary measures and basing their SPS measures on international standards, guidelines and recommendations. In this connection Codex Alimentarius Commission (CAC) is cited in the agreement as the international organisation whose standard, guidelines and recommendations should be the basis for harmonising food safety measures affecting human health.

In this connection food quality assurance and control in Latvia faces great changes. At present Ministry of Economy, and professionals of other ministries and institutions are working on the Quality Assurance National Programme, which is realised in the frameworks of PHARE PRAQ 92 Regional Programme. Its basic subprogram is Food Quality Assurance.

The quality of food means that the food is safe for human health and environment. The Program provides to create system (Annex), which assurance, production manufacturing, importing and realisation food which secure safety and health of humans and environment, as well as stimulate the export.

According to this the following laws and regulations were issued in Latvia:

- The Law of the Protection of Consumer Rights was adopted on October 28, 1992. It acted as an "umbrella law" after which other legislative acts were issued in the area of consumers protection.
- The Law of Veterinary Medicine was adopted on June 30, 1992. It regulates special sphere of unprocessed products from productive animals (milk, eggs, honey, etc.) and several other matters related to this sphere. The law states the task of veterinary medicine: sanitary expertise of animal husbandry with the main purpose to obtain foodstuff and raw materials which are harmless to human health and safety.
- The Food Law has been prepared and submitted for the Parliament's adoption. The Law regulates food raw materials quality and safety assurance at all stages at their circulation (production, storage, transportation etc), state supervision and quality control.

Within the framework of realisation of the National Program on Quality Assurance several documents have been issued by the Ministry of Welfare, such as the Mandatory Certification of Foodstuff, Perfumery and Toys regulations (April 12, 1994) as well as the Instruction for Obligatory Certification of Food Products, Perfumery, Cosmetics and Toys (August 17, 1994). According to these documents we have started to create an independent assessment system of products and services. The Accrediting Procedure and Certification of Testing and Calibration Laboratories was accepted on August 23, 1994.

The Latvian National Accreditation Body was formed according to the Regulation under supervision of the Ministry of Economy. This body takes into consideration criteria fixed by the EU corresponding to the EN 45000 standards series.

The basic directions of LATAK activities are as follows:

- to accredit testing and calibration laboratories, products, quality system, personnel certification bodies and inspection bodies,
- to create and to maintain Accreditation State Register.

LATAK has accredited the National Certification Centre on Food and the National Food Testing Laboratory corresponding to national standards. The creation of regional and sectorial certification centres is going on alongside with the preparation work of testing laboratories for accreditation.

National Certification Centre on Food in the checking procedure of the enterprises includes the elements of standards ISO 9000 and EN 29000, which demand also to control environmental pollution in producing process.

At present 30 enterprises are certified according to the regulations. It is planned that mandatory certification will function within the transitional period.

At present the functions of national supervision are imposed upon the Latvian State Standard, the Ministry of Welfare, the Veterinary Department of the Ministry of Agriculture, the Trade Supervision Committee, the Ministry of Environmental Protection and Regional Development dealing with all matters related to the sphere of biological agricultural products.

The most essential task of the near future is co-ordination of this supervision, distribution of inspection's functions and accreditation.

The national policy on foodstuff realisation safety is the subject matter of the Ministry of Welfare, in particular, its Department of Environmental Health. Laboratories of 31 regional centres of this Department perform hygienic inspection functions. The National centre explores the basic foodstuff problems in the country, carries out monitoring, regulates mandatory requirements for manufacturing of food products, their storage, transportation, realisation and examines standards.

The Centre co-ordinates measures taken by other institutions related to quality improvement.

Matters concerning the quality assurance of foodstuff and its raw materials are solved by the National Department of Products Quality Assurance of the Ministry of Agriculture.

As already stated above the Veterinary Department performs veterinary-sanitary expertise of raw materials from animals as well as evaluates the state of health of animals.

Certain difficulties exist in sphere of standardisation. Because the state enterprises endure financial crises, they are not capable to pay for working out the standards, meanwhile in possession of the state budget there are not such funds either. Technical committees will be established in order to work out the basic state standards (for example for meat, grains, etc.) in future.

Other difficulties are in the sphere connected to the control of imported products. Due to the fact that the country has a land frontier with 4 countries, the air and the sea boundary, control process of products flow is hindered. Currently the computerisation process of the customs and training of the personnel is going on, alongside health and veterinary inspectors of the customs are performing the control of cargoes.

Due to the fact that wholesale trade is developed poorly, and variety of companies realise import of products as well as because of lack of proper facilities needed for expertising, the network of laboratories is not completely worked out, and food control is cumbersome and imperfect.

Certain problems are related to the fact that within performance of activities and trying to follow the international directives (EU directives etc.) and harmonisation standards, for example FAO and Codex Alimentarius, Latvia have limited possibility to obtain and to use fully these documents.

There are most important food quality assurance and control problems in Latvia:

- absence of food law and food regulations;
- shortage of full complete Codex Alimentarius and absence of other international agreed documents (standards, regulations, requirements for products, production, analytical methods etc.);
- difficulties with translation international (CAC, EEC, FAO, ISO etc.) documents;
- imperfect central co-ordinating level of food quality and control;
- doubling of inspection functions, duties, jobs;
- GOST standardisation system is still in force;
- problems with organisation of food control analytic service (a lot of small bad equipped laboratories, doubling of the work, shortage of reagents, standards, internationally agreed uniform analytical methods etc.);
- absence of specialised food control infrastructure and inspection;
- mixing together different hygiene problems on the central and local level;
- improper training of food control personnel;
- poor participation of the society in these processes (absence local consumer protection organisations and small number of central organisations).

With regard to implement the Food Quality Assurance and Control Programme it is necessary to solve tasks on the following spheres:

- legislation;
- administration and organisation;
- testing, certification and inspection;

- quality systems and HACCP;
- information and training.

In the sphere of legislation it is necessary to:
- adopt the Food Law and following regulations;
- prepare a Product liability law;
- harmonise, adapt and/or work out requirements, regulations and standards connected with food safety, production, labelling, marking, storage etc. which corresponding with standards, regulations and requirements on Codex Alimentarius, EEC and other international institutions.

In the sphere of the administration and organization:
- to form a Food Council;
- to organise a Food Centre and food inspection;
- to define working zones for specialists from different inspections and institutions with aim to prevent doubled functions;
- to establish of an electronic communication system, and to develop computer software for use by official food control services;
- to establish state register of food enterprises (food production, processing, exporting, importing, trading etc.);
- to include consumer organisations in the decision making and control on the safety and quality of food;
- to develop information system, provide monitoring systematic data collection, establish data bank, which contain information about contaminants and other foreign substances in food and agricultural products as well as pathogenic agents, environmental (water, soil, air) pollution, human health situation.

In the testing, certification and inspection sphere:
- to improve technical assurance of the laboratories;
- to harmonise and introduce international accepted screening and analysing methods and standards;
- to accredit testing laboratories, certification institutions and inspections bodies in accordance with EN 4500;
- to separate actions of different inspections.

In sphere of quality systems and HACCP implementation:
- to explain to producers the essence and the necessity of EN 29000-, ISO 9000- , HACCP- , GMP-standards and to support to induce them in practice .

In sphere of information and training:
- to inform regularly the producers, exporters, importers, traders and the public (consumers) about legislation, requirements, food quality etc.;
- to train the specialists and experts of testing laboratories, certification, inspection and accreditation bodies;
- to educate quality management professionals.

Food and agricultural production has not only a significant influence on the national economy but on the environment as well. The goal of the environmental protection and the development of advanced agriculture envisaging its further involvement in EC market. To achieve this goal the environment protection policy in agriculture has to be co-ordinated with a national agriculture policy and the national programs for rural development.

Soil

A heritage of the previous socialistic large-scale agricultural production influences today's situation in the agriculture. In Latvia 230 000 ha or 14.7 % are endangered of the wind erosion and 380 000 ha or 24.3 % of water erosion. As the result of the erosion, unskilful melioration and use of fertilisers and pesticides, the percentage of the organic substances in the soil have reduced from 1.97 % in 1945 to 1.77 % in 1994. It results as a decrease of the butter capacity (soil ability to assimilate nutrients and transfer them to plants) and as a increase of spare nutrient runoff into water courses and the Baltic Sea.

23 % of the arable land is acid soil (pH>5.6), which need basic liming. The liming of soils reduced from 200 000 metric tonnes in 1990 to 8 000 tonnes in 1994. Approximately 38 % of the arable land have insufficient content of phosphorus.

Level of pollution

There are many unchanged landscapes, wide biological diversity and low level of soil pollution. Average levels of heavy metals in soil are on the level of natural background in most of Latvia. For example: average levels of Chromium (Cr) in sand in Holland and Latvia are 76.0 mg/kg and 7.7 mg/kg, respectively; and those of Lead (Pb) 65.0 mg/kg and 0.7 mg/kg, respectively.

During the transition to the market economy, the level of agricultural pollution is rapidly decreasing.

Table 1. Use of polluting inputs in agriculture 1986 and 1994, 1986 = 100.

	1986	1994
Use of mineral fertiliser	100	40
Use of organic fertiliser	100	30
Use of pesticides	100	13
Cattle	100	42

Production volume in agriculture has decreased by half since 1990. It serves as a good ecological and economical base for production of ecologically produced food for both domestic and export and markets. Latvia would become a strong competitor in the food market of EU with ecologically produced food.

Water

Latvia has 3000 lakes and 12 400 small rivers. Four major rivers originate from neighbouring countries. The mean annual volume of Latvia's rivers is 32.8 cubic km/ year with 47 % originating within the country while 53 % is water from Belarus and Lithuania. As a result Latvia has an abundance of water resources of rivers and a great potential of hydroenergy. Polluted water from neighbouring countries is running through Latvia causing additional environmental problems.

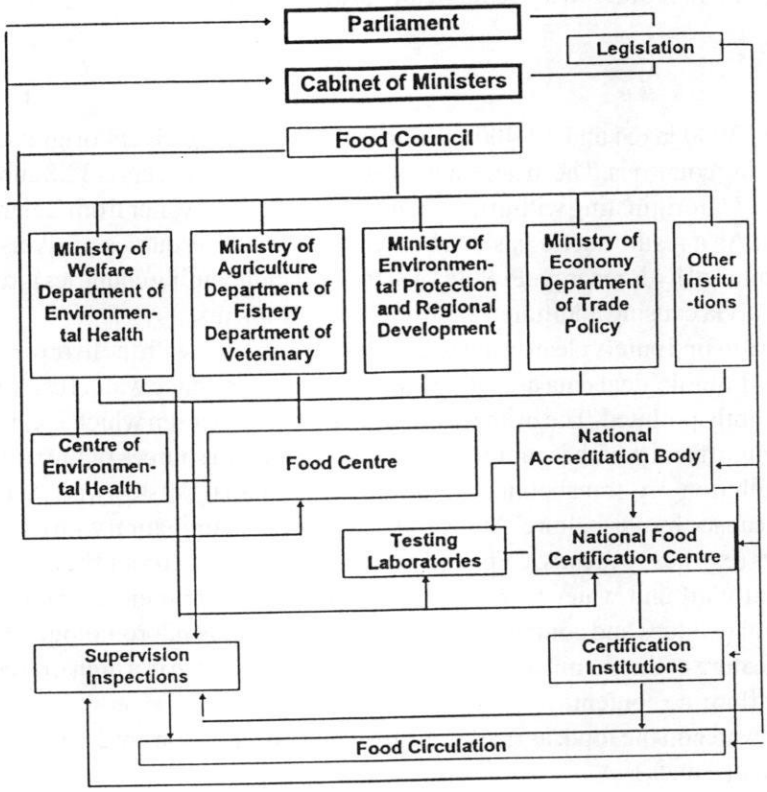
It is hard to find purely clean water in Latvia. In accordance with the hydrochemical and the hydrobiological data available, the main part of surface water (ca. 85 %) is at least slightly polluted. The primary problem is eutrophication which is caused by nutrient runoff and which is rapidly increasing. The main sources of the water and the air pollution are transboundary pollution, municipal waste waters and the pollution caused by agriculture. At several places the contamination with hazardous substances (e.g. heavy metals, CFS) and accumulations of them could be mentioned.

Generally ground water is not polluted, does not contain either industrial or agricultural residues and contaminants, and possesse stable microbiologic indices. Specific feature of the chemical composition of ground watern is a high iron content and a low fluorine content.

Waste water on the food, agricultural and fishery production are 21.3 % from all waste water (Annex).

Annex (1/3)

Food Quality Assurance



Waste water on the food and agricultural production, 1993

Th. U/m^3 per year

	Total waste water	Clean water	Dirty water			
			total	without clearing	clearing nonconformity with standard	conformable with standard
Food production	20500.2 4.8 %	11903.1	8597.06	360.50	4882.03	3354.53
Agricultural production	14598.2 3.4 %	319.8	14278.4	2780.96	5773.07	5724.33
Fishery production	41408.0 13.1 %	27461.0	13947.0	12012.4	1925.00	9.64

USSR standards

National Supervision of Food

Annex (2/3)

Ministry of Welfare
Department of Environmental Health

Ministry of Agriculture
Department of Veterinary
Inspection of Produce Quality
Department of Fishery

Ministry of Environmental Protection
and Regional Development

Trade Supervision Committee

Latvian Centre of Standardization
and Metrology

LEGISLATION

Laws:	On Protection of Consumer Rights October 28, 1992
	On Veterinary Medicine June 30, 1992
	Food Law

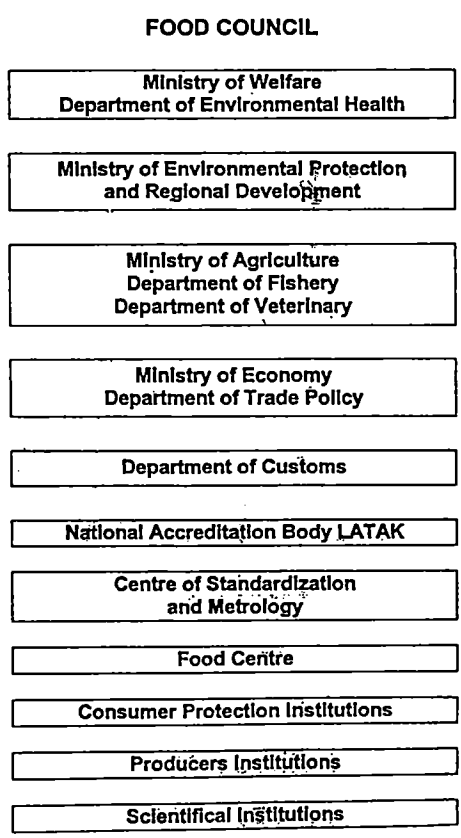
Regulations	On the Mandatory Certification of Food Products, Perfumery, Cosmetics and Toys April 12, 1994
	Instruction for Obligatory Certification of Food Products, Perfumery, Cosmetics and Toys August 17, 1994
	About Testing and Calibration Laboratory, Certification and Inspection Organization Accreditation Procedure August 23, 1994

Annex (3/3)

LEGISLATION (1995)

Laws:
- On Certification and Accreditation
- On Manufacturers Liability
- On Products Safety
- On Unity of Measurement

Harmonization the standards and requirements which EU directives and Codex Alimentarius requirements



The Effect of a Liberal Policy of the Market Economy on Foreign Trade and the Cost of the Food Basket in the Estonian Republic

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The Republic of Estonia became independent again in August 1991. On June 20 next year Estonian kroon was taken into use that laid a basis on the successful development of the state. Three months later, i.e. on September 20, the Parliament and the President were elected. A transition from the mandatory to the market economy had consolidated.

The election union *Isamaa* won the Parliament elections and formed a government in co-operation with five other parties. The new government was confirmed on October 21, 1992. The government put into practice a liberal policy of the market economy that had been ratified with a coalition agreement by the government coalition and was met with approval by the several western countries.

The applied right-wing policy of the market economy laid a basis on the generally successful development of the Estonian Republic. The liberal policy of the market economy does not make it possible to apply protectional measures for any branches of the economy. Consequently, there were not foreseen any subventions to agriculture by the government. The Land and Agricultural Reform being carried out in agriculture did not hook with Property Reform that made the restructuration of agriculture more difficult.

The first result of the liberal economic policy in agriculture is an decline of the production level both in plant growing and animal husbandry. The data on the reduction of the total output are available in statistical publications and it has been expressed at several meetings, in the press and other channels of the mass media.

Here are only some numbers on the reduction of agricultural production. Comparing the indices of the total output of 1994 with the level of 1991 it can be claimed that the total yield of grain dropped from 939 400 metric tonnes to 502 000 tonnes or 46.6%, milk production dropped from 1 092 600 tonnes to 811 600 tonnes or 25.1% and meat production in live weight from 260 000 tonnes to 128 900 tonnes or 50.4%.

During the same period the growing capacity and great relative importance of agricultural products in export was relieved. But the effect of the continuous decline of agricultural production on the balance of foreign trade and through it on the food basket and living standard of Estonian population were left unanalysed.

Table 1. Capacity of foreign trade in million Kroons

	Export	Import	Balance (±)	Export, Import=100
1992 total	5548	5128	+421	108
among that agri-cultural products	974	517	+456	188
relative importance %	17.5	10.1	x	x
1993 total	10,642	11,847.8	-1206	90
among that agri-cultural products	2499	1772.4	+726	141
relative importance %	23.5	15.0	x	x
1994 total	16,947	21,536	-4589	79
among that agri-cultural products	3635	3436	+198	106
relative importance %	21.4	16.0	x	x

Table 2. The Export and the import of foodstuffs in 1994 in the Republic of Estonia according to the data of the National Customs Board.

	Export mil.kr	%	Import mil.kr	%	Balance mil.kr
Live animal, meat and meat products	198	5.4	249	7.3	-52
Dairy products	745	20.5	115	3.3	+630
Vegetable fats ans oils	79	2.2	252	7.3	-173
Grain, flour, flour products	73	2.0	278	8.1	-205
Fish and fish products	1115	30.7	162	4.7	+953
Sugal, cocoa, coffee, sweets	677	18.6	989	29.1	-321
Alcoholic, drinks	225	6.2	413	12.0	-189
Orher	523	14.4	969	28.2	-446
Total	3635	100.0	3436	100.0	+198
Without fish and fish products	2520	x	3274	x	-755

Below there are some conclusions on of the effect of the liberal policy of the market economy on the balance of foreign trade and the cost of population's food basket basing on the data in Tables 1 and 2.

1. The great relative importance of the export of agricultural products in the total export and the positive balance of foreign trade have been presented as the examples of agricultural success during recent years.

2. According to the data in Table 1, the positive balance of the foreign trade of agricultural products was actually deeply negative in 1994 already if we omit the export of fish and fish products (Table 2).

3. The import of artificially cheap agricultural products due to western export support pushes aside local agricultural production.

4. As a rule, the exported agricultural products are declared below the world market price in the customs but they may be sold with higher prices than the prices of local production.

5. The content and the cost of the food basket have been calculated differently by different institutions. But a general result is that the lack of protection of the domestic market and the inflation have caused a rapid rise of the cost of the food basket. According to the data of the State Statistics Board the minimum cost of the food basket in kroons rose in 1995 as follows: 308 kroons in January, 323 in February, 332 in March and 344 kroons in April.

6. The continuation of the liberal policy of the market economy will deepen the crisis of Estonian agriculture, reduce the level of self-sufficiency of agricultural products, increase the import of agricultural products, rise the cost of the food basket decreasing so the living standard of the majority of population.

It can be said as conclusion that there should be made corrections in the present agricultural and liberal policy of the market economy in order to protect the interests of the majority of population.

Consumption of Agricultural Products in Estonia

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1. Introduction

The consumption of food in Estonia was close to the developed countries' level until 1991. Comparing Finnish and Estonian data from 1990, we see that the latter consumed less only milk products and fruit (Table 1). Food was relatively cheap at this time and no attention was paid to the economy.

Table 1. Food consumption per capita (kg) in 1990.

	Finland	Estonia
Cereals	74.2	96.3
Potatoes	63.9	103.0
Sugar	34.1	44.5
Vegetables	52.4	64.0
Fruit	89.5	36.0
Meat	66.8	64.0
Eggs	11.1	17.0
Fish	18.0	24.0
Milk (without butter)	400.0	316.0
Oils and fats	15.2	15.0

The situation changed greatly when Estonians had to pay more for food and when the supply of all goods in shops drastically increased. There was not enough money for fulfilling all wishes and the expenditures on food were cut. The consumption of food during last years is presented in Table *2*.

Table 2. Food consumption per capita (kg) in Estonia 1992-1994.

	1992	1993	1994
Cereals	84.0	78.5	82.3
Potatoes	76.8	106.1	100.6
Sugar	17.8	21.0	22.5
Vegetables	57.7	56.1	60.7
Fruit	34.2	52.1	41.2
Meat	44.2	40.1	37.4
Eggs	10.6	11.0	10.7
Fish	11.9	14.8	14.7
Milk (without butter)	190.3	189.0	187.8
Oils and fats	9.9	11.9	12.4

As we see the food consumption has diminished greatly since 1992. The greatest decrease can be noticed in sugar, meet and milk consumption. Since 1993 the consumption of potatoes, vegetables and fat began to increase. What can be considered as normal consumption for Estonia? We can take the data from Finland as an example that could satisfy our people. The food consumption in Finland has been relatively stable (Table 3).

Comparing the data of Estonia and Finland we can be more or less satisfied only with the consumption of cereals, potatoes, vegetables, eggs, and fish. The consumption of sugar and oils show the trend to increase but significantly low consumption of fruit and especially meat remains.

Table 3. Food consumption per capita (kg) in Finland 1992 and 1993.

	1992	1993
Cereals	75.6	74.8
Potatoes	61.6	59.2
Sugar	36.6	34.6
Vegetables	52.6	55.0
Fruit	87.9	84.6
Meat	65.2	62.3
Eggs	10.9	10.7
Fish	22.5	16.0
Milk (without butter)	383.9	386.3
Oils and fats	17.0	16.5

2. The consumption of purchased and self-produced food

The food consumption consists of two parts:
- purchased food and
- the food that is produced by the consumers themselves (self-produced food).

The relations between these two parts by the product groups are presented in Table 4.

The portion of self-produced food is great in the consumption of potatoes, vegetables and fruit, and also of eggs and meat. The portion of self-produced potatoes, meat, eggs, and milk have increased during the last two years.

In addition to the rural families the urban families also produce some fruit, vegetables and potatoes for themselves. It comes mostly from the so called garden-co-operatives where about 55 000 people are involved. All together about 300 000 families use kitchen gardens of some form.

Table 4. Portion of purchased food per capita (kg), 1992-1994.

	1992			1993			1994		
	Pur-chased	Total	% of pur-chased	Pur-chased	Total	% of pur-chased	Pur-chased	Total	% of pur-chased
Cereals	83.4	83.9	99.3	77.0	78.5	98.1	81.1	82.3	98.5
Potatoes	24.1	76.8	31.3	26.1	106.1	24.4	26.2	100.6	25.9
Sugar	17.4	17.8	97.4	19.8	21.0	94.4	21.6	22.5	95.9
Vegetables	21.5	57.7	37.2	18.4	56.1	32.9	19.4	60.7	32.0
Fruit	7.8	34.2	22.8	11.4	52.1	22.0	13.3	41.2	32.4
Meat	35.8	44.2	80.8	29.8	40.1	74.3	28.0	37.4	74.9
Eggs	7.9	10.6	74.6	7.8	11.0	70.7	7.6	10.7	71.2
Fish	10.0	11.9	83.9	12.7	14.8	860	12.7	14.7	86.4
Milk (without butter)	172.1	190.3	90.4	162.1	189.0	85.8	163.0	187.8	86.8
Oils and fats	9.7	9.9	98.0	11.6	11.9	97.9	12.2	12.4	98.3

3. The consumption of urban and rural families

It is interesting to compare the consumption of the urban and the rural families. The respective data is presented in Table 5.

Table 5. Consumption of urban and rural families per capita (kg) 1992-1994.

	1992		1993		1994	
	Rural family	Urban family	Rural family	Urban family	Rural family	Urban family
Cereals	92.7	80.9	83.7	76.2	96.9	80.5
Potatoes	93.0	71.3	125.7	97.7	128.2	89.2
Sugar	19.7	17.2	20.4	21.2	22.1	22.7
Vegetables	60.5	56.8	56.8	55.7	60.1	61.0
Fruit	34.7	34.0	56.3	50.2	41.6	41.1
Meat	48.4	42.8	42.9	38.9	40.4	36.2
Eggs	10.8	10.6	10.9	11.1	11.0	10.6
Fish	10.6	12.4	14.3	15.0	14.8	14.7
Milk (without butter)	192.0	189.8	189.5	189.0	187.8	187.8
Oils and fats	8.5	10.3	10.9	12.3	11.5	12.7

Rural families consume 20% more cereals, 44% more potatoes and 12% more meat but 9% less fat than urban families. It that the diet of implies rural families includes 20% more energy and also a bit more protein and fat than the urban one. Due to the consumption of their own production rural families spend 21% less money on food than urban families.

4. Income, expenditure, consumer price index

The income per family member rose 2.3 times from January 1993 to January 1995. Expenditures on food have increased less than total expenditures (figure 1): the proportion of food expenditure has decreased from 46.0% to 36.6%.

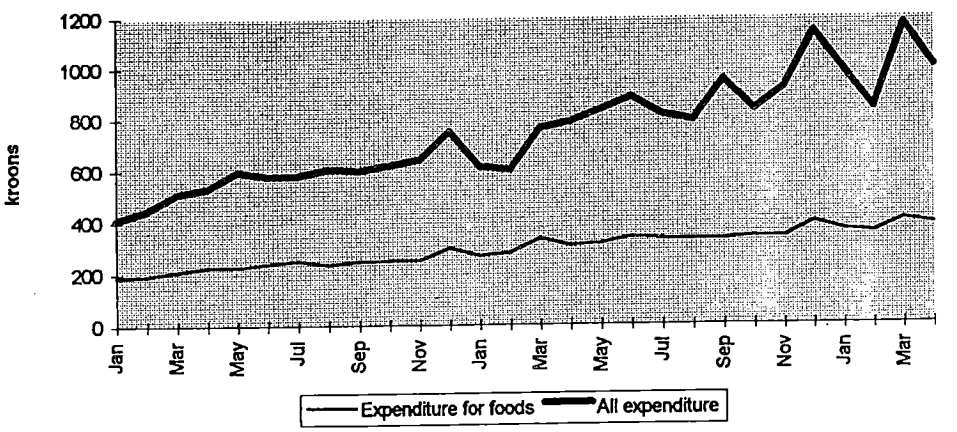

Figure 1. Expenditure per household member (kroons) 1993-1995.

The prices of food rose relatively less than the price of other goods and services. From January 1993 to January 1995 the price-index of consumer goods and services has risen 190 points but the price-index of food 160 points (Figure 2).

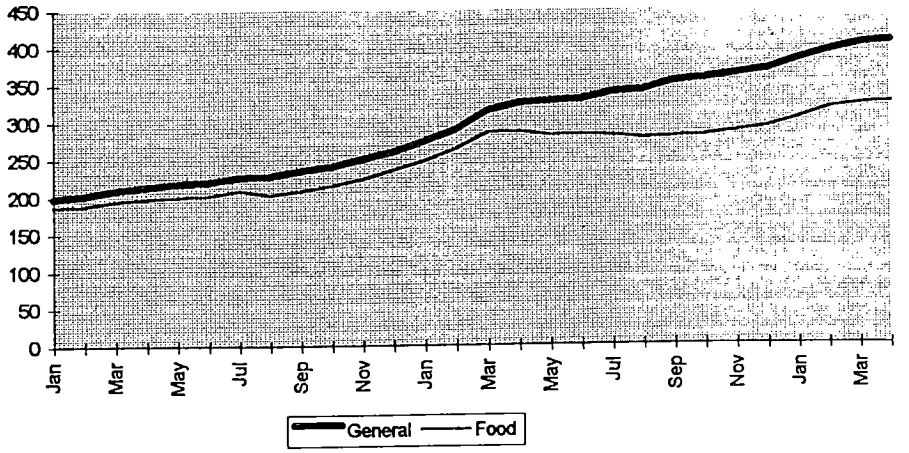

Figure 2. Consumer price-index (June 1992=100), 1993 - 1995.

We compiled and compared food baskets with different nutrition value and price. The calculations show that the cost of different food baskets with same nutrition value can differ up to the 20%.

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Enlargement of the European Union Meat Markets and Its Impacts

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1. Introduction

At January 1, 1995, the internal market of the European Union was extended to three new member states: Austria, Finland and Sweden. The enlargement of the internal market affect producers, consumers and traders in different ways, depending on the product in question and the location, where they operate. This paper examines the implications of the EU enlargement for the actors on the meat markets. When assessing the impact of the current enlargement on the meat markets, the following different perspectives can be taken: What will be the situation for meat production in the new member states when market conditions change? How will production and consumption in the new member states develop in the future? What will be the implications of the enlargement for the market balance in the rest of the EU? What does the enlargement mean for the old member states? These questions form the basis for this article. Initially, certain features of meat industries in the new member countries, such as production, consumption and trade, are briefly outlined. The next section paid attention to the adjustments in agricultural policies in the new member states as a consequence of the accession, and to the problem of adapting EU-12 GATT commitments to the EU-15. It is followed by analysis about the impacts of EU enlargement on the meat markets in the new member countries and in the EU as a whole. The final section summarises the findings.

2. Outline of meat markets in the new member states

Meat production in the three new EU member states (Austria, Finland and Sweden) is rather small compared to the production of the EU-12. In 1994 production of beef and veal and of pigmeat in the three new member states amounted to about 6% of the EU-12 production, whereas the production of poultrymeat was about 3% and that of sheepmeat about 1% of the EU-12 production. Austria is the largest meat producer

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[1] The paper is drawn from the more extensive study carried out by Siemen van Berkum and Ida Terluin of the Agricultural Economics Research Institute (LEI-DLO), The Hague, and Jyrki Niemi of the Agricultural Economics Research Institute (MTTL), Helsinki (Berkum et al. 1995).

Table 1. Self-sufficiency rates of meat in Austria, Finland and Sweden and NEU-3 meat production in comparison to the EU-12.

	Self-sufficiency			Share (%) of EU-12 meat production
	Austria	Finland	Sweden	
Beef and veal	142	115	91	6.0
Pigmeat	102	107	100	6.2
Poultry meat	86	100	99	2.9
Sheep meat	73	82	69	0.8

of the three new member states: about half of the meat production in the new member states originates from that country. The new member countries are either more or less self-sufficient in meat or have a limited surplus (Table 1). The production of beef and veal and pigmeat is predominant in each of the new member countries. The production of sheepmeat and poultry meat is of less importance.

From the point of view of the EU-12, the new EU member states are minor trading partners in the meat market. The share of the new member states in the value of total meat exports of the EU-12 amounted to 0.7% in 1992 and the share in total imports to 1%. The EU-12 has a trade deficit with the new member states: the value of EU-12 meat imports from the new member states exceeds that of EU-12 exports to these countries. The trade deficit declined from about 130 million ECU in 1986 to about 50 million ECU in 1992. Regarding the individual countries, in 1992 the EU-12 had a trade surplus with Finland of about 5.5 million ECU and a trade surplus with Sweden of 82 million ECU. On the other hand, the EU-12 had a trade deficit with Austria of almost 140 million ECU in 1992. This deficit showed a continuous rise since the beginning of the 1990s.

Meat exports of the EU-12 to the new member states consist mainly of pigmeat exports to Sweden. The other two most sizeable trade flows- although of a moderate extent - are poultry meat exports to Austria and beef exports to Sweden. Meat imports of the EU-12 from the new member states are mainly beef imports from Austria. The EU-12 also imports small amounts of pigmeat from Sweden and poultry meat from Austria (Table 2).

Denmark is the largest meat exporting country to the new member states. Denmark mainly exports pigmeat to Sweden and some beef as well. EU-12 meat exports to Finland also originates mainly from Denmark. Germany exports pigmeat to Sweden, but to a lesser extent than Denmark. There are small German exports of all types of meat to Austria. Finally France is a relatively big exporter of poultry meat to Austria. Italy is the largest destination of beef exports from Austria.

Table 2. Meat trade of Austria, Finland and Sweden with the EU-12 in 1992 (in tons).

	Austria		Finland		Sweden		NEU-3	
	Exports to EU	Imports from EU	Exports to EU	Imports from EU	Exports to EU	Imports from EU	Exports to EU	Imports from EU
Beef	63,395	618	88	270	1,962	2,711	65,445	3,599
Sheep/goat	0	498	0	72	0	63	0	633
Pigmeat	194	791	326	531	1,618	30,793	2,138	32,115
Poultry meat	967	5,228	5	492	54	885	1,026	6,605

3. Policy setting

3.1. Earlier policy setting

The agricultural policies of the three new member countries have historically developed along lines similar to the CAP. The main principles of agricultural policy of these countries have not differed very much from the one of the EU. Reasonable incomes for the agricultural population, stabilising markets and availability of supplies at reasonable prices are common objectives of agricultural policy in the new member countries and the EU. The policy instruments used by the new member countries and the EU are to a large extent also similar: price support, quotas, intervention arrangements on the internal market and a system of border protection together with export support for surplus production, as well as direct income aids.

The level of support measured by Producer Subsidy Equivalents (PSE) in agriculture has, nevertheless, been higher in all new member states than in the EU. Finland had the highest PSE, while the support levels in Austria and Sweden were closer to the EU (Table 3).

Table 3. Agricultural support in Austria, Finland, Sweden and the EU-12 in percentage PSE (1989-1994).

	Austria			Finland			Sweden			EU-12		
	1989-91	1993e	1994p	1989-91	1993e	1994p	1989-91	1993e	1994p	1989-91	1993e	1994p
All products	48	59	62	70	64	67	57	53	51	45	49	50
Beef and veal	53	61	64	66	60	61	55	55	46	53	60	60
Pigmeat	22	52	54	51	54	53	29	45	37	7	10	10
Sheepmeat	23	12	12	-	-	-	90	31	30	98	57	59
Poultrymeat	50	48	49	44	33	32	34	16	12	23	25	23
Dairy milk	61	71	71	74	69	70	70	66	62	63	62	63

Source: OECD, 1994.

The desire to become part of the EU led to a change in direction of the agricultural policy of the accession countries in recent years. However, border protection remained relatively high. In Finland, agricultural policy was revised in order to facilitate the shift to the CAP. The revisions of the legislation aiming to reduce the differences between Finland and the EU and stressing the needs for unification were completed by autumn 1993. The new price system adopted in 1994 resembled that of the EU. The price level remained, nevertheless, much higher, and the support was paid according to the same principles as in the past. The purpose of the new legislation was to make it necessary for the authorities to follow almost similar practices as in the EU (KETTUNEN 1995).

Sweden embarked upon a series of radical reforms in late 1980s which provided for the abolition of internal price support and export refunds, a reduction in border controls and restrictions on intervention buying. Dairy quotas were abolished in 1989 but, despite this, a balance on the market was maintained by the removal of all export subsidies on dairy products from 1990. Short term direct income payments were introduced to help alleviate the effects of the reforms on farm gate prices (OECD 1994). As a result of this reform, price levels in Sweden moved closer to the EU level. These moves made it easier for Sweden to fully integrate into the CAP in January 1995.

3.2. Accession agreement

The Treaty concerning the conditions of accession (ACCESSION TREATY 1994) of Austria, Finland and Sweden to the European Union has a great impact on meat production in the new member states. National agricultural policies are replaced by the CAP. For meat production the clauses and stipulations of the Accession Treaty can be divided into three major groups: 1) agreements on production and premium quotas, 2) decisions on the level of support and the support regions and 3) arrangements concerning the transitional period.

The negotiation outcome concerning special beef premium and suckler cow premium quotas for Austria, Finland and Sweden correspond to present herd size (Table 4). In the new member countries beef is largely a side-product of milk production. Thus, the beef sector is very much dependent on the system regulating milk production. If the quantity of milk production stays at a level that corresponds to the present situation, the calf reserve would also stay at about the present level. The quota allocations for the new member countries correspond to the amount of milk delivered to dairies in 1992.

With respect to price adjustment, the EU effectively achieved its objective of immediate alignment of producer prices. Therefore, the new EU countries had to shift to the common EU market area immediately upon accession, i.e. in January 1995.

Table 4. Accession agreements on production and premium quotas of the new EU member countries (heads unless otherwise stated).

	Austria	Finland	Sweden
Special beef premium quota	423 400	250 000	250 000
Suckler cow premium quota	325 000	55 000	155 000
Ewe premium quota	205 651	80 000	180 000
Milk quota, mill. kg	2 625 000	2 552 000	3 300 000

In connection, all border controls were abolished in trade with other member states. As CAP common prices are applied, and being considerably lower than producer prices in the new member countries (with the exception of Sweden), it was agreed that "degressive national aids to farmers should be authorised where support levels differ significantly". For example, in Finland the producer prices decreased on average about 40-50%, which was a severe shock to the whole price system. At the last stage of the negotiations it was agreed that the duration of the transitional period will be five years.

The Accession Treaty (1994) includes also long-term support arrangements. For Austria and Finland it was important to reach a long-term support package that would guarantee the profitability of agriculture, although the producer prices will drop considerably when prices were adjusted to the EU level (FINNISH GOVERNMENT 1993). Finland was pushing for Less Favoured Area (LFA) status for all of its agricultural area, but eventually settled for mountain LFA area status for 85%, i.e. about 1.9 mill. ha. In Austria about 70% of the agricultural area is included in the LFA support.

In addition, Austria has the opportunity to provide extra national aid (Grundbetrag) to small farms for a period of ten years, where existing LFA allowances are insufficient, and where these farms already received aid in 1993. For Finland and Sweden an important borderline is the 62nd parallel, to the north of which and in adjacent areas to the south permanent, so-called nordic agricultural national support can be paid. This national nordic support must be paid on the basis of the hectares of agricultural land or heads of animal. The support may not lead to an increase in production or in the level of overall support observed during a pre-accession reference period determined by the Commission.

Finland also pressed the Union to grant permission to pay direct national aid in the case that "serious difficulties resulting from accession" remain after full utilization of all the forms of support mentioned above. Therefore, the Commission may authorise Finland to grant national support to facilitate the full integration of producers into the CAP. This support is not specified in any way.

3.3. Uruguay round GATT agreement

The problem of adapting EU's GATT schedules as a result of enlargement was virtually untouched during the accession negotiations. It is, however, clear that the new member countries are obliged to take over the EU's legal commitments in terms of both domestic policy and external trade. The EU must enter the new World Trade Organisation (WTO) as entity which embodies all of its component parts at the time the WTO becomes operational. This means that the EU's existing schedule of GATT commitments must be withdrawn, and replaced by a whole new set of figures relating to the EU-15. But the details of exactly how this should be worked out in practice still need to be negotiated within the EU (AGRA EUROPE 1994).

The GATT agreement on agriculture imposes reduction commitments on member countries in the following three areas: domestic support, market access (including tariffication), and external trade measures (export volume and subsidy restrictions). On the issue of domestic support, the revised EU-15 figures can be assessed simply by adding to the aggregate measure of support (AMS) values for the EU-12 those for each of the new member states. This will in any case be non-contentious, given the wide margin by which the EU, even in its enlarged form, will have already complied with its commitment to reduce the AMS by 20 % compared with the 1986-88 average. As the 20 % reduction is binding only for the global level of support, there is no percentage commitment for the individual sectors. In the EU meat and meat products are broadly subject to the same percentage reduction as the other commodities.

In the areas of market access and export subsidies, the task of absorbing the GATT commitments of the new member countries into those of the EU-12 may prove to be a complex one. The immediate problem is one of determining exactly how much trade occured in each product group, since trade monitoring systems were not the same for the reference period in question. Therefore, there have been problems reconciling the data for the different countries and the EU. The second problem is one of the trade-offs.

The inclusion of three new members in the EU is also a potential source of friction that preferential access provisions for third countries initially granted by the new member countries will be undermined by being incorporated into the EU system. The US in particular is likely to seek compensation under Article XXIV of the GATT if this were to occur, as they did when Spain and Portugal joined the Community (BER 1994). Under Article XXIV:6 of the GATT accord, contracting parties are supposed to discuss measures to compensate affected parties for trade damage caused to them by tariff increases in a country which becomes part of a customs union, and threfore takes on that union's customs arrangements.

With respect to export subsidies, the EU has to make substantial cuts both in terms of export volumes and expenditure on export subsidies for all categories of meat. The EU-12 export ceilings within GATT are based on subsidised export over the period 1986-90, which were to a large extent directed towards the new member countries. The new member countries have similarly traded with the EU-12 during the reference period. A large proportion of the trade between the new member states and the EU was subsidised. In determining the export commitments for the EU-15, simply adding together the existing export commitments of the EU-12 and NEU-3 (gross trade figures), fails to recognise that a large portion of the subsidised trade was between the new member countries and the EU. However, using net trade figures which take internal EU-EFTA trade into account would reduce the amount and value of export subsidies available to the EU-15. The result would be a reduction in the EU's overall export ceilings. Therefore, gross trade figures would give the EU exporters better access to the third country markets than net trade figures would (AGRA EUROPE 1994).

With respect to minimum access, the EU-12 and, separately, each of the new member countries have established reduced-tariff quotas for products where past imports amounted to less than 3 % of domestic consumption. Simply adding together the existing minimum access quotas (gross minimum access quota) of the EU-12 and the new EU-3 would not take into account either the revised ratio of imports to consumption within the EU-15, or the fact that significant parts of the trade in question has been internal trade between the EU-12 and the three EFTA countries. Since intra EU trade would no longer be considered imports, as far as determining the filling of a minimum access quota, third countries would now be able to fill this quota at the reduced tariff. Therefore, a gross minimum access quota would in nearly every case give third country exporters better access to the market than would a net quota which takes internal EU-EFTA trade into account. The EU will probably prefer to use a net minimum access quota (AGRA EUROPE 1994).

It is, however, unlikely that EU's trade partners would accept a combination of net minimum access figures and gross export commitments. The EU probably has to adopt a single methodology for both sets of figures.

In the meat sector products have been aggregated for the purposes of establishing minimum access quota. The minimum access quota for the EU-12 is initially at zero, as imports in the base year (1986-88) amounted to more than 3 per cent of domestic consumption. The same applies to Sweden. The minimum access quotas for Austria and Finland are initially set at 3 per cent of domestic consumption. Because the combined consumption and imports of meat of the new member countries is very small in relation to the EU-12 (see Table 1.3), the dilemma between gross and net minimum access quotas has no real impact on EU's meat markets. The difference between gross and net figures is very small compared to the EU-12 import volumes. In the case of export subsidies, the dilemma between gross and net trade figures is

slightly more important for EU producers. The gross trade figures would give the EU exporters better access to the third country markets than would a net trade figure. Therefore, in the meat sector EU would probably prefer to use gross trade figures for both export commitments and minimum access quota. However, in the process of political evaluation of the merits and demerits of netting out the EU-15 GATT figures, the EU Commission has to look at the agricultural sector in the EU as a whole. The new schedules have then to be approved by all the member countries of the EU (AGRA EUROPE 1994).

4. The impact of EU membership on the meat markets in the new member countries

The current shifts in agricultural policy will have major implications for meat production and meat markets within each of the new member countries. Agricultural policies of the new member countries are altered substantially implying a new price structure, production quotas and direct income payments to tillable land and animal units. This section looks in detail at the effects of price and subsidy changes on meat production, trade and meat processing industries within each of the new member countries.

There are close physical and economic links between meat production and primary processing in the new member countries; the development in the latter influences volume and structure of meat production as well as farm gate prices. On the other hand, the competitiveness of primary production affects the profitability of domestic processing. In general it can be observed that vertical relations in the marketing chain are quite sensitive to changes in contractual and policy provisions that define the price structure of primary and processed products (ANDERSSON 1995).

The elimination of border protection between new members and the EU-12 will reduce barriers to trade as well as trade related transaction costs. This is expected to reduce domestic retail prices as well as producer prices and to increase imports of meat. The manner in which adjustment in the meat sector (primary production as well as the processing industry) proceeds, depends on existing agri-industrial structures and the relative competitiveness among different types of firms, commodity sectors and countries. The accession will affect meat production differently in different regions also depending on the formulation of compensatory policies. The adjustment process will therefore be by no means uniform. Furthermore, the new member countries exhibit significant regional variations within national boundaries.

4.1. Austria

Support of Austrian pigmeat and poultry meat was until the accession above the EU-12 level, whereas support in the beef sector was about the same as that in the EU-12 (see PSE Table 3). In the first months upon accession producer prices for pigmeat fell by about 20 %, those of poultrymeat by 25 % and those for beef by 15 %. Meat production is expected to decline by around 5-7 % in 1995. It is estimated that the average farm income will decrease by about 20% (WIFO 1993). Retail prices of meats declined by about 2 % during first half of 1995 due to cheaper raw materials and the abolition of import duties.

The decrease in meat prices as a result of accession will depress Austrian meat production. Considering the relatively high self-sufficiency rate of beef (140% in 1993), it is expected that Austria will remain an exporter of beef. The self-sufficiency rate of pigmeat is expected to decline to about 80-85%, that of poultrymeat to 70% and that of veal to about 90% due to a decrease of the dairy cattle population, whereas the self-sufficiency rate of sheepmeat will probably rise somewhat (PVVE 1994). It is projected that by the year 2000 Austrian meat consumption is somewhat above the present level due to lower prices. Nevertheless, the increase in consumption will be limited, since the present per capita consumption is already rather high. Meat imports are expected to be considerably above those in 1993. These imports will largely consist of pigmeat and to a lesser extent of poultrymeat. It is expected that there will be Austrian exports of high quality beef products to other EU countries.

Like the primary agricultural sector, the Austrian meat processing industry is a small-scale business. Weak aspects of the Austrian meat processing industry are (PVV 1993:18):

- dependence on government subsidies for a number of activities;
- high production costs compared to the EU;
- minor emphasis on product innovation;
- insufficient specialisation on quality markets.

Strong aspects of the meat processing industry are amongst others a high product quality and a favourable capital formation. The meat processing industry intends to invest in the coming years about 200 million ECU in modernisation and increases in scale. Slaughterhouses are also small-scale enterprises with few specialisations and rather high production costs. This puts them in a disadvantaged position, as it is expected that the Austrian meat processing industry will import large amounts of raw meat from the other Member States after accession to the EU, since these can supply raw meat at lower prices compared to the Austrian slaughterhouses (PVVE 1994:7). It is not known whether imports already showed an increase in the first months upon accession, since the Austrian trade registration system is currently involved in an adjustment process towards the EU registration system.

4.2. Finland

Membership of the EU-15 opened the gates to foreign meat and this has reduced domestic prices. During the first months of EU membership, Finnish producer prices of meats dropped roughly as much as was anticipated at the time the national support package was prepared. The biggest decreases in producer prices were seen for pigmeat (50%). The producer price of beef and poultry meat decreased by 40% and 45%, respectively. Despite the price reduction, pork production is expected to remain stable around 170,000 tonnes in 1995. Beef production continues to decrease by 6 %. The production of poultry meat is forecast to grow by 9 %.

Initial estimates indicate that the retail prices of meats have decreased as well. In February 1995, an early report by the CONSUMERS' RESEARCH CENTER (1995) showed that the retail price of meat decreased by about 10% immediately upon accession. Pork and poultry meat retail prices decreased most, by 18%. Beef retail prices decreased by about 10% and those of sausages by 9%.

Lower retail prices have stimulated strong growth in pork and poultry meat consumption. In 1995 the consumption of pork and poultry meat are forecast to grow by 13 % and 12 %, respectively. Beef consumption is expected to stay at the same level as in 1994. It is likely that the growth in the consumption will continue, but will remain slow, because the price and income elasticities are small (LAURILA 1990). Furthermore, the national consumption habits are not expected to change very much, and the integration will mainly affect the consumption through changes in the price relations. For example, Consumers' Research Center (1995) reported that consumers have replaced low quality meat (sausages, etc.) with high quality meat (pork cutlets, broiler meat) during the first months upon accession due to the drop in prices of meat.

Roughly 10,000 tonnes of meat were imported by Finland during the first half of 1995. Most of the meat was imported from Denmark. This tonnage fell short of predictions that import could take a share of 10-15% of the domestic market in Finland. Preliminary data collected by custom officials indicate a share of 6-7 %. Because domestic meat prices fell considerably at the turn of the year, this may have made Finland a less interesting export target for international traders.

On market prices only, the future of Finnish meat production would be very difficult (MARTTILA & NIEMI 1993). As a result of the national support package prepared by the Government, the income losses of producers are partly compensated for. However, even with compensation the new support system may cause problems at the farm level. A situation in which the income obtained through producer prices is barely adequate to cover the variable costs depress motivation. The dependence of meat producing farms on direct support will increase considerably. For example, on combined pig farms of average size (22 sows, 74 pig places) the share of direct support of farm income rises to 100% (KETTUNEN & NIEMI 1994).

EU membership will cause also considerable adjustment problems in the Finnish meat processing industry, in which the main emphasis is on processing local meat products into foodstuffs. International comparisons show that the productivity of labour in the Finnish meat processing industry has been behind those of the northern EU countries (WIDERI 1991). However, in the long-run context, entry into the EU is likely to foster a more competitive industry, increasing adoption of new technologies and lower costs (NIEMI 1993).

KETTUNEN AND NIEMI (1994) estimated that no significant changes will occur in Finnish meat production during the transitional period. In practice, the Accession Treaty sets maximum limits to beef production in Finland. Firstly, beef production is tied to milk production, which cannot be increased. The milk quota is equal to the production of 1992. There is very little specialized beef cattle in Finland. In 1994 specialized beef operations accounted for only 10% of total beef production. Secondly, the beef premium quota system ties profitable beef production to the present level. The maximum limits for pigmeat and poultry meat production are also set at the present level in the Accession Treaty. National support to farms is determined on the basis of the present number of animals and area. The support must not lead to an increase in production. Thus there are no possibilities to increase pigmeat and poultry meat production.

4.3. Sweden

The accession into the EU presents a serious challenge to the Swedish meat sector, too. However, the pressures for change in Sweden are not as severe as they are in Finland. Sweden initiated a structural reform of its agricultural policy in the late 1980s which brought the level of protection much closer to the one in the EU-12.

With the anticipated accession into the EU, the producer price of beef began falling as early as September 1994. At the beginning of 1995 beef prices were approximately 10 % lower than at the same time in 1994. The decrease in the prices of production inputs has alleviated the adjustment to the new situation to some extent. In the case of pork, the producer price in Sweden has been 15-20 percent higher than the average producer price in the EU-12. Therefore, EU-membership caused a drop in the price received by pork producers as well.

Poultry meat prices have remained relatively stable in the last quarter of 1994 and in the first quarter of 1995. Swedish poultry meat producers have prepared themselves already for several years to take up the challenge from increasing competition by closing unprofitable farms, bringing down costs, and creating an agressive marketing strategy based on Sweden's rigorous environmental legislation.

In Sweden meat retail prices fell by a few percentage points following the entry to the EU, according to the National Central Bureau of Statistics. It was predicted

last year that Sweden's membership in the EU would lower meat prices by 5% at once. During the first half of 1995, beef retail prices decreased by 9 %. Retail prices of pork and poultry meat decreased by 6 % and 5 %, respectively.

In 1995 beef production is expected to grow by 6-7 %. Pork and poultry meat production are likely to stay at the same level as in 1994. The consumption of all meat products is forecast to increase in 1995. Beef consumption is expected to increase most, by 6 %. Pork consumption is expected to increase by a few percentage points.

The different forecasts published about the future of Swedish meat sector are quite incompatible. JONASSON (1994) shows that in the long run total output by Swedish meat producers should meet about 90% of domestic consumption. The most optimistic forecast is the one commissioned by the 'STEERING GROUP FOR SWEDISH FOOD EXPORT' (1995), which predicts an increase of 20% in meat production, resulting in high growth rates for exports of meat and meat products from Sweden.

The future of some sectors, e.g. pork production in Sweden, is crucially dependent upon the productivity in slaughter and processing industry and its ability to pay a high price for the raw material input. The competitiveness of Swedish meat sector is weakened chiefly through the inefficient structure of the meat processing industry (RABINOWICZ 1991). Although Swedish livestock farms rank among the most productive in Europe, and although production costs could be cut down by increasing farm sizes, the poor cost-effectiveness of the meat processing industry represents an ongoing disadvantage (BOLIN ET AL. 1992).

5. Conclusions

The new member countries are minor players in meat production and trade in relation to the EU and its major export producers. Depending on the product, the total output of the new member countries varies between 1-6% of EU-12 production. The highest shares are in beef and pigmeat (6%) and the lowest in sheepmeat (1%). As a result of the accession, the EU population will rise by 6 % to 370 million and gross domestic product by 7% to 5.9 trillion ECU. The three new member countries have a combined population of only 20 million and are either more or less self-sufficient in meat or have a limited surplus. In addition, all three countries have a rather slow growing population. For this reason and because of the lack of consumption growth per capita, it is expected that in the near future the growth in consumption of meat will be limited in the new member countries. In this respect, prospects for additional meat exports to the present low levels from the EU-12 to the new member states are rather limited.

EU-12 members will undoubtedly look toward the new member countries as potential new export destinations. Because of the agreement reached on the GATT Uruguay round to cut the volume of subsidised exports by 21%, new members of the EU will face a strong pressure from the old members to swallow their surpluses, which have to be absorbed intra-EU to a larger extent than before. The new member states offer possible outlets for pigmeat and high quality beef from several EU countries, but they can themselves compete on the EU market with high quality beef from Austria and salmonella-free pigmeat and poultrymeat from Finland and Sweden. New market outlets are important for countries like Denmark and the Netherlands, which have a strong orientation to and dependence on agricultural exports. Denmark's meat industry with a geographically convenient position has high expectations of the meat markets of Finland and Sweden. In particular, the abolition of high import levies in Finland, the decline in Finnish meat production in the longer term, coupled with Denmark's relative nearness to the Finnish market and a certain similarity in consumer tastes - will provide opportunities for Danish meat exports.

The accession of the new member countries to the EU eventually affects production and consumption of meat products in the new member states and thereby influences market balance also in the rest of the EU. In the short and medium term, however, the accession has only limited impacts on the meat markets in the EU, as one would expect consumer demand in the new countries to be met mainly by domestic production. Austria and Finland will be able to compensate meat producers through subsidy regimes of a social character. The income level of livestock producers decreases, but not so much that this would drive them out of business. According to a number of studies, significant changes will not occur in the meat production of the new member countries during the first five years of EU membership. In the longer term, farm support is expected to be reduced and in step with the disappearance of subsidies, markets will open for imports from other EU countries.

The enlargement has no strategic impact on the EU's meat processing sector. Meat processing is probably the most fragmented sector of the food processing industry in Europe. Thus competition in the processing sector will continue to be particularly fierce. The overcapacity problem will remain and even get worse. The traditional processed meat sector will not expand and is liable to suffer from increased competition from imports as a result of the GATT agreement. In any case, enlargement can be expected to work to the EU's advantage since the new member countries will inevitably increase their sourcing for within the EU to the detriment of third country suppliers.

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Memorandum

ARVYDAS KUODYS, ANDRIS MIGLAVS, MATI SEPP & JOUKO SIRÉN

The fifth Finnish-Baltic seminar of agricultural economists was held on June 12-14, 1995, in Helsinki, Finland. The theme of the seminar was "Trade liberalisation and its impact on farm economy." The topic is actual for all the participating countries. Finland is a new member in the European Union and her food sector including agriculture has faced new challenges. There is a big structural reform going on in agriculture in the three Baltic countries, and the agenda for the EU enlargement may eventuate that in some years the Baltic economies are fully integrated into the Common Market.

The seminar was organised by the Finnish Agricultural Economics Research Institute. In addition to the Finnish and Baltic delegations, two representants from the European Commission participated. The seminar consisted of four sessions: (1) The role of agricultural economics research in the restructuring of agriculture, (2) Evolution of the agricultural trade liberalisation, (3) New challenges for agricultural policy, and (4) Trade liberalisation and food chain. One day was reserved for excursion in a dairy farm and a meat-processing factory. The participants took a look on the activities of the Agricultural Economics Research Institute. Individual participants visited also government officers.

The seminar was opened by Dr. Kalevi Hemilä, Minister of Agriculture and Forestry. In the opening address he pointed out that the year 1995 will be remembered as the year when the feelings of uncertainty described the decision-making in Finnish farms. The uncertainty set up by the new agricultural policy and new market rules was added by the delayed decisions concerning support programmes and extraordinary rainy spring. Minister Hemilä predicted that the need for rationalisation requires that Finnish farms will be going through a period of restructuring before they are competent to produce at the prices which are valid in the European Union.

The papers and discussions dealt with the impacts of agricultural trade liberalisation both on the farm level and on the whole agricultural and food sector. The presentations on urgent problems in the agrarian reform aroused great interest and lively discussion. The three Baltic countries are facing a number of similar problems concerning the transition from the planned economy to the market economy. The EU membership would have large impacts on the agriculture and food sectors. A lot was discussed on the evolution of the Common Agricultural Policy with special emphasis on the possible accession of the countries of central and eastern Europe. The central issue is whether the CAP should be changed drastically once again or should we think in terms of development on the basis of the principles set out by the 1992 reform. The

key issue is the large agricultural potential of the CEEC. For example, the total agricultural area of the three Baltic countries taken together is about 7.4 million ha, which is about 5% of the comparable area in the EU. An important part of the production potential is, however, not used efficiently at present.

The themes of the seminar were covered mainly from the European point of view. At this moment, the economic and trade relations between the EU and the Baltic countries are directed by the Europe Agreements. Main objectives of the Agreements are cooperation in the cultural and economic field, the conclusion of a free trade area, and an option for the EU membership. The ground work concerning the full membership in the EU is going on. The participants concluded that, because of similar problems, closer ties between the Baltic institutes would be beneficial. In order to prepare the future negotiations, the European Commission is carrying out a series of country studies on agricultural sectors.

In the Baltic countries, the economic reform included gradual refusal of the state price regulation in the early 1990s. As a result, food prices increased rapidly. Because wages increased at a slower pace the share of food in consumers' budget increased. Consumers substituted more expensive products, such as meat, with less expensive products, such as potatoes and cereals. Simultaneously, cheap imported food started to overcome the domestic production. Estonian trade policy is one of the most libralised in the world at present. About the only protection for agriculture has been the overvalued currency. Because tariffs and other trade restrictions remain as a rule in the world trade of agricultural commodities, probably also Estonia should consider of a certain level of border protection, that can shelter agriculture from the excessive variability of world market prices.

In Finland, the EU membership decreased the producer price of milk by about 20%, whereas the producer prices of eggs and cereals decreased more than 50%. The producer prices for pigmeat and beef decreased more than 40%. However, consumer prices of food products decreased merely 7% on average. The future of dairy production seems to be relatively good, but other production lines are in serious difficulties.

The critical question concerning the agricultural sectors in the Baltic countries is, on the other hand, how food imports will be regulated and, on the other hand, how the Baltic suppliers manage in the export markets. At the moment the production costs are lower than in the EU countries but the costs are gradually increasing. A general feature is that the cost of production has gone up while, due to low purchasing power and relatively free imports, producer prices have remained at a low level.

Food quality and food safety are increasingly important issues. In the Baltic republics, it is necessary to work out national food-quality-assurance programmes, possibly including the harmonisation of national legislations with the EU directives and other international agreements.

The participants expressed their satisfaction with the results of the seminar. The discussions supported a conclusion that agricultural economists will have a major role in developing the economic policies in agriculture during the transitional period. There is a great need for sharing experience and research results concerning economic and social problems of farming and marketing. It was stated unanimously that the tradition of Finnish-Baltic seminar should continue. The EU representants should be invited to join the seminar also in the future. The participants expressed their high satisfaction with the way the seminar was organised and the warm atmosphere that was characteristics to the seminar.

A debt of gratitude is acknowledged to the Finnish Ministry of Agriculture and Forestry for the financial support.

The sixth Finnish-Baltic seminar of agricultural economists will be held in Latvia. The theme is to be chosen by the host institute.

"Trade Liberalisation and its Impact on Farm Economy"

THE FIFTH FINNISH-BALTIC SEMINAR OF AGRICULTURAL ECONOMISTS

Helsinki, Finland, June 12-14, 1995

PROGRAMME

Monday, June 12

Place: Agricultural Economics Research Institute

Session 1: The role of agricultural economics research in the restructuring of agriculture

Chairman: Professor Jouko Sirén

9:00	Welcome address Professor Jouko Sirén
9:10	Opening address Dr. Kalevi Hemilä, Minister of Agriculture and Forestry
9:20	Panel discussion: *The role of agricultural economics research in the restructuring of agriculture: Need for refocusing?* Participants: Minister Kalevi Hemilä Director Mati Sepp Director Andris Miglavs Professor Arvydas Kuodys Professor Viktor Jullinen Dr. Tomás García Azcaráte Chairman: Professor Jouko Sirén
10:45	Coffee break
11:00	Introduction of the Agricultural Economics Research Institute
11:30	Group photo
12:00 - 13:30	Lunch

Appendix 1. contin.

Session 2: Evolution of the agricultural trade liberalisation
Chairman: Director Mati Sepp

13:30 *The evolution of the CAP in the European Union: Some reflections*
Tomás García Azcárate and Martin Strittmatter
Discussion
14:45 Coffee break
15:00 *Agricultural trade liberalisation: Expectations and reality*
Mati Sepp
15:20 *Lithuanian agriculture in transition: Problem solution*
Viktoras Vaikutis & T. Vaicechovskis
15:40 *Adaptation possibilities for Latvian farmers under conditions of trade liberalisation*
Rota Snuka & Andris Miglavs
16:00 *The effect of EU membership on incomes of farms during the transitional period 1995-2000*[1)]
Esa Hiiva & Laura Alastalo
16:20-17:00 Discussion

Tuesday, June 13
Place: Sokos Hotel Pasila

Session 3: New challenges for agricultural policy
Chairman: Professor Arvydas Kuodys

9:00 *Recent changes in Lithuanian agriculture*
Arvydas Kuodys
9:20 *Estonian agricultural policy and European integration*
Valdek Loko
9:40 *Creation of legal and conceptual base for Latvian agricultural policy*
Roberts Zile & Andris Miglavs
10:00 Discussion
10:20 Coffee break
10:40 *Possibilities of the formation of protectionist policies in Estonia considering its joining with the international structures*
Tõnu Mertsina & Viktor Jullinen

[1)] The paper will be published separately as a research report of the Agricultural Economics Research Institute.

11:00 *State regulation of economic relations in agriculture and its impact on financial situation*
Irena Krisciukaitiene
11:20 *Estonian family farming in the conditions of unregulated domestic market and limited export*
Jaan Timmermann
11:40 Discussion
12:00 - 13:10 Lunch

Session 4: Trade liberalisation and the food chain
Chairman: Director Andris Miglavs

13:10 *Structures and interrelationships in the food chain: The case of Finnish market*
Raija Volk & Saara Hyvönen
Discussion
13:50 *Quality assurance and environmental protection aspects under food and agricultural trade liberalisation*
Ligita Melece
Discussion
14:20 Coffee break
14:40 *The effect of a liberal policy of the market economy on foreign trad and the cost of the food basket in the Estonian Republic*
Jaan Kivistik
15:00 *Consumption of agricultural products in Estonia*
Tõnu Akkel
15:20 *The impacts of EU enlargement on the European meat markets*
Jyrki Niemi
15:40 Discussion
16:00 Discussion on the next seminar and future cooperation

Wednesday, June 14
Excursion in a dairy farm and food factory

9:00 Departure
10:00 Visit to a dairy farm in the province Uusimaa,
entrepreneurs: Sirkka and Pentti Saario, Vihti
12:00 Lunch and visit in LSO Foods meat-processing factory, Vantaa
15:00 Back in the hotel

Appendix 2.

"Trade Liberalisation and its impact on farm economy"

THE FIFTH FINNISH-BALTIC SEMINAR OF AGRICULTURAL ECONOMISTS

LIST OF PARTICIPANTS

Estonia

Estonian Institute of Agrarian Economics
Dr. Mati Sepp, Director
Dr.Tõnu Akkel
Dr. Valdek Loko
Dr. Jaan Timmermann
Estonian University of Agriculture
Dean, Prof. Viktor Jullinen
Prof. Jaan Kivistik
Tõnu Mertsina, MSc

European Commission Directorate-General for Agriculture
Dr.Tomás García Azcárate, Deputy Head of Unit for Studies and Overall Approach
Dr. Martin Strittmatter

Finland

Director Mikko Siitonen, Association of Agricultural Advisory Centres
Tuomo Heikkilä, Government Institute for Economic Research
Hans Brenner, Ministry of Agriculture and Forestry
Lasse Nyman, Ministry of Agriculture and Forestry
Juhani Leppälä, Ministry of Agriculture and Forestry
Dr. Juhani Rouhiainen, Ministry of Agriculture and Forestry
Dr. Heikki Isosaari, Pellervo Economic Research Institute
Dr. Raija Volk, Pellervo Economic Research Institute
Prof. Matti Ylätalo, University of Helsinki

Agricultural Economics Research Institute
Prof. Jouko Sirén
Prof. Matias Torvela
Prof. Lauri Kettunen
Dr. Maija Puurunen
Dr. Ilkka Laurila

	Marja Hokkanen, MSc
	Esa Hiiva, MSc
	Juha Marttila, MSc
	Jyrki Niemi, MSc
	Simo Tiainen, MSc
	Minna-Mari Vehviläinen, Agr. Stud.
Latvia	*Latvian State Institute of Agrarian Economics*
	Andris Miglavs, Director
	Roberts Zile
	Rota Snuka
	Ligita Melece
Lithuania	*Lithuanian Institute of Agrarian Economics*
	Prof. Arvydas Kuodys, Director
	Dr. Irena Krisciukaitiene
	Prof. Viktoras Vaikutis
	Ruta Ruikiene, interpreter

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