Trade and Trade Policy Developments in the Baltic States after Regaining Independence before Joining the EU

by

Dr. Erika Sumilo, University of Latvia, Riga, Latvia

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INTRODUCTION

In 1991, when Estonia, Latvia and Lithuania regained their independence, there was a definite tendency by the rest of the world to see the three countries as a single region. Internally, within the Baltics, broad cooperation had also been a cornerstone of foreign policy of all three Baltic states. On the highest level the foundation for a strengthening of Baltic cooperation had been laid by establishing the Baltic Assembly, which is a cooperation institution between the Parliaments of Estonia, Latvia and Lithuania, the Baltic Council of Ministers, which is a cooperation institution between the Governments, and regular meetings of the three Baltic states Presidents. One of the first steps to conceive for greater economic integration had been taken with signing the Free Trade Agreement between the Baltic states, which had a significant symbolic and practical meaning for the cooperation of the Baltic states. Finally, all three countries had set a course towards integration with the European Union and intra-Baltic cooperation with reason was seen as a necessary precondition to facilitate Baltic membership in the EU.

Small and open economies like the Baltic countries are especially dependent on foreign trade. Since independence was restored, all three countries had made steady progress toward replacing the centrally planned, socialist system imposed during the Soviet period with a structure based on free market principles. The Baltic countries had to absorb very significant changes in the terms of foreign trade and considerable efforts were made to reorient trade to Western markets. They placed trade liberalisation among the fundamental ingredients of an early phase of transition process. The reasons for this central role of trade liberalisation are linked to both external economic considerations and the potential domestic economic impact (OECD, 1994, pp.15-16). From the external perspective, trade liberalisation is expected to upgrade the technological level of the national economy. In addition to broadening and redirecting of imports, it is hoped that trade liberalisation will bring about an increase in exports therefore helping in building up demand for domestically produced goods. Furthermore, the key role of trade liberalisation is found in price reform and competition (anti-monopoly) policy (Mikic, 1998, p.421).

Since the very beginning of 1990s the Baltic countries had been fully committed to a liberal multilateral trade policy. To intensify the liberal trade policy, they had concluded agreements on Most Favourable Nation (MFN) status and Free Trade Agreements (FTA) with a number of countries. Their foreign trade policy was being co-ordinated with the trade policy of the European Union and the World Trade Organisation.
The purpose of the paper is to examine foreign trade development and trade policy liberalization attempts in the Baltic countries, mainly Latvia, in 1990s in the context of cooperation of the Baltic states.

TRADE DEVELOPMENTS IN THE BALTIC STATES IN 1990s

In all three Baltic countries foreign trade makes a big proportion in the structure of their GDP. Foreign trade has been one of the important factors that facilitate their economic growth. The main comparative advantages of the Baltic countries, which determine their specialization in the world market after regaining their independence and during the whole transition period, have been related to their geographical location, highly qualified labor and relatively low wages.

Initially, after regaining their independence the Baltic states got engaged in inter-industry trade. They traded mostly raw materials (timber, fuel and metals from Russia and Ukraine) for equipment and consumer goods. The Baltic states started to harmonise their legislation according the EU standards, signed regional trade agreements with the EU, which to some extent facilitated the development of intra-industry trade in such groups of commodities as textiles and equipment. Moreover, all Baltic states implemented liberal trade regimes and joined the WTO, which also alleviated the trade development. Little by little the proportion of intra-industry trade increased, for example, the exports of textiles made of raw materials imported from the EU.

Clearly, total trade has been growing until 1998 in all three counties, both exports and imports. Clearly also, imports have been growing more rapidly than exports, so that a widening trade deficit is in evidence in all three. Until 1998 Estonia and Latvia had shown the smoothest trends while Lithuania had been the most volatile. Starting with 1998 trends of foreign trade for all three countries were not that persistently progressing as before due to the consequences of financial crisis in Russia. The Russian crisis hit Baltic economies very hard. The export of agricultural products and foodstuffs to Russia fell by at least 30% in the last quarter of 1998 as compared with the previous year and in some sectors continued to fall significantly in the first half of 1999. (13)

In the period of 1993-2002 all three Baltic countries had a negative foreign trade balance, except 1993, when Latvia’s trade balance was positive. Until 1998 the deficit of trade balance grew each year in all three countries, and only in 1999 it started to decrease. In 2001 Lithuania had the biggest trade balance deficit, followed by Latvia and Estonia. (3,7,8,9,10) Whereas at the time of regaining independence, trade with Western Europe and the EU was virtually non-existent in all three countries,
it has grown since by a significant amount at the same time as trade with Russia and other CIS countries has decreased significantly.

At the end of 1990s all three countries had the same main trading partners – the EU (mainly, Germany) and Russia. Latvia’s exports went mainly to Germany, Russia and Sweden; Lithuania’s respectively, to Russia, Germany and Latvia; and Estonia’s – to Finland, Sweden, Russia and Germany. This structure of exports remained stable in the years before joining the EU. (3,7,8,9,10)

It is notable however that CIS continued to be one of the largest trading partners of all three Baltic states, despite its decline in both relative and absolute terms.

Free trade agreements had a different impact on the economy of each Baltic country. Starting with 1997 Latvia’s trade balance with Estonia had been negative. Only in 1999 the trade deficit started to decrease. In 1999 Latvia’s imports from Estonia decreased by 12%, but exports decreased less – by 3%. Latvia’s imports from Lithuania in 1999 increased by 7%, compared to 1998, but exports decreased by 4%. In 2000, compared to the previous year, Latvia’s trade deficit with Lithuania grew by 20%, but with Estonia – fell by 4%. Latvia’s imports from Lithuania increased by 16%, but from Estonia – by 9%. Latvia’s exports to Lithuania grew by 13%, but to Estonia – by 27%. In total, in 2000 Latvia’s trade deficit with the other Baltic countries still grew a little. In 2001 increase in Latvia’s exports to Estonia and Lithuania took place in all groups of commodities, but mainly in such groups as metals and machinery, agricultural and food products, which in total made more than a half of entire increase of exports to the Baltic countries. In 2001 Latvia’s trade deficit with Lithuania and Estonia increased again. Latvia’s total exports to Lithuania grew by 19%, but to Estonia – by 20%. However, imports grew more rapidly from Lithuania – by 27%, and from Estonia – by 15%. Peculiar, that increase in both – exports and imports from/to Latvia from the other Baltic countries was almost in the same groups of commodities – timber, food products and light industry products. In 2002 Latvia’s trade deficit with Lithuania increased by 52%, and with Estonia – by 4%. Latvia’s total exports to Lithuania grew by 15%, but imports grew more – by 32%. Latvia’s total exports to Estonia grew by 17%, but imports grew less – by 11%. The growth in exports from Latvia to Lithuania and Estonia is mainly explained by the growth in exports of food products and timber products, but in imports – by growth in imports of minerals and food products.
In late 1990s Latvia was exporting to Estonia mainly food products, timber and timber products, chemical products, machinery and equipment, and paper goods. Estonia was exporting to Latvia – chemical products, machinery and equipment, food products, textiles and metals. Latvia’s exports to Lithuania consisted mainly of chemical products, food products, timber products, paper and carton, machinery, equipment and electrical goods, textiles. Main Lithuania’s export goods to Latvia were minerals (fuels, oil products), food products, metals, machinery, equipment and electrical goods. Estonia was exporting to Lithuania food products, machinery and equipment, chemical products and metals. Estonia in turn was importing from Lithuania food products, machinery and equipment, chemical products.

Estonia’s trade balance with Latvia during the late 1990s had been positive. It got almost doubled if imports is measured by country of consignment, which means the country from which goods are dispatched to the imported country. This makes us think that the competitiveness of goods produced in Latvia was quite low, however Latvia’s competitiveness as a transit country was much higher. Latvia’s trade balance with Estonia had been negative in the recent years and fluctuated more or less at the same level. Latvia’s exports to Lithuania had been growing, although Lithuania’s exports to Latvia had been growing faster. As a result Latvia had a trade deficit with Lithuania which had had a tendency to increase. Lithuania’s trade balance with Estonia had been positive if measured by country of origin, which is the country in which the goods are manufactured or substantially transformed, and negative if measured by country of consignment. Lithuania’s trade balance with Latvia also had been positive. (3,7,8,9,10)

Thus, we are left with the overall conclusion that there was significant trade within the region. What is also clear is that intra-Baltic trade was not as significant as trade with the EU. For example, in Latvia exports to Lithuania and Estonia grew from 9% of total exports in 1995 to 14% in 2002 while exports to the EU grew from 44% in 1995 to 60% in 2002. The hope for intra-regional trade to grow in importance was that if trade with the rest of the world gave rise to greater specialization and resulting economies of scale as the market area served grows, and if the specializations chosen by each country are not the same, then the economies of scale may also promote increased trade within the region, even though the region by itself may not be large enough to produce the economies of scale in question.
Intra-regional trade patterns by the late 1990s show that the main importer for the Baltic States was Germany. An important importer from Estonia and Latvia was Sweden. Finland was an important importer from Estonia and Russia was still an important importer from Latvia and Lithuania. (19)

BALTIC STATES’ INTEGRATION

The Baltic Free Trade Agreement was signed in September 1993 and came into force on April 1994. Its goal was to create a free trade zone for:
- extending trade to promote harmonious development of the economic relationship between Estonia, Latvia and Lithuania and thereby to speed up the progress of economic activity and employment conditions, to increase labour productivity, financial stability and recovery of the three countries;
- ensuring honest conditions of competition in trade between the sides;
- developing and intensifying, as far as possible, cooperation in areas that are not covered by the agreement, especially stimulation of investment environment protection and boosting the creation of a common Baltic market.

The Baltic Free Trade Agreement did not provide a transition period.
The agreement covered only a selected number of products. It did not include agricultural raw materials or processed agricultural products, or fish products or textiles. Commodities included were subject to rules of origin requirements.

Concerning industrial products, the agreement provided for elimination of all export and import duties. All existing export and import duties were to be cancelled with two exceptions: Latvia retained export tariffs for limestone, firewood, logs and scrap metal and Lithuania retained export tariffs for drinks, untanned leather, leather and timber.

The agreement provided also that new qualitative export or import restrictions would not be imposed. The agreement cancelled all existing quotas, except that Estonia retained export quotas for oil shale, gravel, clay and quartz sand.

The Baltic States’ agreement on free trade in agricultural products is perceived as a logical continuation to the gradual economic integration for the Baltic States. The Baltic States’ Free Trade Agreement did not cover agricultural raw products. The three states left this question for a period of two years. In June 1996 such an agreement was signed, and in January 1, 1997 it came into force.
The goals of the agricultural free trade agreement were:
- the creation of a free trade zone for agricultural, food and fish products;
- the promotion and harmonization of mutual economic ties;
- the liberalization of agricultural policy;
- the creation of a fair competition environment between the Baltic States.

The agreement covered only products of Lithuanian, Latvian and Estonian origin. The agreement cancelled the three states’ respective export and import duties on agricultural products. All quantitative export and import restrictions and similar measures also were cancelled under the agreement, with the proviso that protective measures can be reintroduced if local production is under threat.

One of the concerns under the agreement was the higher level of subsidies for agriculture in Lithuania. 10% of the Lithuanian budget went to subsidize agricultural companies to support national agricultural programs. This was 4.4 times larger than the Latvian case.

With respect to Estonia, it should be mentioned that the agreement was not expected to influence its foreign trade turnover with Latvia and Lithuania. In Estonian exports, the main role was played by EU countries and the place of cheap Lithuanian products had already been taken by Finland. Despite active discussions about the necessity and usefulness of the Agreement on Free Trade in Agricultural Products, the real situation showed that there were no significant changes in the trade balance of the Baltic countries and that none of the three markets for agricultural products had yet been influenced, in either a positive or a negative sense, to any appreciable degree.

A third phase of the BFTA, signed in November 1997, was aimed at removing non-tariff barriers and came into force on 1 July 1998. In 1998 at the meeting of the Baltic Heads of Government, it was resolved to create a common economic area with a common free market in labour and services as well as in goods. This aim was reiterated at the meeting in 1999.

The BFTA represented a major liberalization of intra-Baltic trade. However, in practice it had been troubled by a number of disputes.

The OECD regional assessment of the Baltic States commented that “despite the radical nature of the BFTA the level of intra-Baltic trade has not much changed”. (13)

EU INTEGRATION
There had been a tendency on the EU side to see the three countries as a bloc, such that they all would join at the same time. Although within the region, Estonia has been commonly regarded as the front-
runner in terms of likelihood of meeting the conditions for EU membership for the next round of expansion. Estonia itself some time ago, based on this, had begun to argue that the three countries should be treated separately in terms of their membership applications and that one should not be held up because of the others. Various EU officials had begun to echo this sentiment as had officials of current EU member states.

The European Council initiated an enlargement process as a comprehensive task which involved all ten candidate countries into the pre-accession process. Nevertheless, negotiations started in spring 1998 only with the first five candidate countries: Hungary, Poland, Estonia, Czech Republic and Slovenia. In 1999, at the meeting in Helsinki the European Council made a decision to begin the negotiations with the rest of the candidate countries: Bulgaria, Latvia, Lithuania, Slovakia and Romania. In September, 2002 at the meeting of the European Council in Copenhagen all three Baltic countries got officially invited to join the EU. The integration of Estonia, Latvia and Lithuania into the European Union now is dependent on the results of referendum in each country. Referendum in Lithuania with a positive result took place in May, 2003. The similar event took place in Estonia and Latvia in August and September, 2003 respectively.

Joining the EU, the markets of the Baltic countries have become a part of the internal EU market and without doubt this substantially influenced their business environment first of all in terms of protection. After joining the EU trade policy became an EU competence, and the Baltic countries had to implement the external trade policy of the EU.

CONCLUSIONS

Baltic States’ foreign trade had grown and diversified, both in structure and trading partners, since independence. The development of foreign trade had been promoted by the liberalization of foreign trade policy which had reduced or eliminated barriers on exports and imports.

The share of trade with the EU was becoming more and more dominant in the Baltic States’ trade. Latvia’s main export products were wood and wood products which were followed by textiles.

Integration process coincided with the acceptance and adaptation of the EU directives in the Baltic States constituting the EU model and allowing the economies to adjust to the EU market.

The issue of Baltic regional integration was a short term one insofar as EU integration subsumed the regional integration question in the longer run.
The growing foreign trade between the Baltic States and Western Europe coupled with the conclusion of free trade agreements had been an important step towards EU membership.

Bibliography


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