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European Regional Development Issues in the New Millennium and Their Impact on Economic Policy

THE ROLE OF THE NORDIC DIMENSION FOR FOREIGN TRADE RELATIONS OF BALTIC STATES

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Abstract

Baltic Sea Region (BSR) can be seen as one good example of an attempt to integrate countries with different development levels. However, the development stages of BSR countries are different. Foreign trade as one possibility for facilitating economic co-operation and must have a positive impact on economic development of trading partners. Baltics as small transition countries have not many possibilities for influencing foreign trade, but they are small enough to get more favourable conditions in trading with economic blocks and developed countries. Encouraging is the fact that European Union Council has approved the Action Plan for the Northern Dimension with external and cross-border policies of the European Union 2000-2003.

The aim of current paper is to analyse the current situation in foreign trade of three Baltic States (Estonia, Latvia, Lithuania) in the context of fostering economic co-operation in Nordic Dimension. To accomplish this aim:

- We analyse the openness or closeness of the trade in Baltic Sea region, find out its positive and negative aspects.
- We will look at geographical distribution of foreign trade of three Baltics and analyse it.
- We analyse the commodity structure of foreign trade of three Baltics with countries in BSR.
- We will analyse the possibilities and risks of current situation in Baltics' foreign trade in the context of economic globalisation and integration.

Data of national statistic bureau's and national banks will be used for comparing the situation in Baltics' foreign trade. The analysis will not cover transit trade and trade with services.

Introduction

Foreign trade is one art of international co-operation, which can in different circumstances have various effects on economies of trading partners. The integration of Baltic Sea countries has received a great attention not only on the bilateral, but also on multilateral level. The best example for this is the fact that European Union Council has approved the Action Plan for the Northern Dimension 2000-2003. Thus, the Nordic Dimension can be seen as the analog to the high economic activity in Mediterranean region.

The Northern Dimension covers the geographical area from Iceland on the west across to North-West Russia, from the Norwegian, Barents and Kara Seas in the North to the Southern coast of the Baltic Sea. It has the backing of the EU and the non-EU Northern Dimension partner countries Estonia, Iceland, Latvia, Lithuania, Norway, Poland and the Russian Federation. Its aim is to provide added value through reinforced coordination and complementarity in EU and Member States' programs and enhanced collaboration between the countries in Northern Europe. (Northern Dimension 2000, p. 2). Because the lack of the data the foreign trade relations with Iceland will not be treated in this paper.

One aim of the special attention on northern countries is besides joint co-ordination of actions the closer co-operation between these countries. Naturally, there are many interests of the EU countries to trade with the transition countries, as economic (trade, FDI, natural, human and scientific resources, common energy systems, fight against illegal economic activities etc.), non-economic (the safety, fight against crime, stability, lower pollution etc.) as well social (health, convergence in living standards). The transition countries are mostly oriented on economic co-operation. However, the non-economic aspects are receiving ever more attention in these countries. While the foreign trade relations of Estonia are quite intensive, the efforts of Estonia are directed to generation of common energy markets, building Rail Baltica and Via Baltica (as the part of TINA/TEN network), and the co-operation in the field of information technology. The problems of energy and transportation are very actual themes on the meetings with delegations of Lithuania and Latvia. In the case of the information technology there is

higher co-operation with Finland. (Põhjamõõde 2001.) One of the main interest of all countries is of cause the increase of trust between the partners.

In this paper we will concentrate on the economic integration of the three Baltic States (Estonia, Latvia and Lithuania) with other countries of the Baltic Sea Region (BSR) through foreign trade. The integration and co-operation in the Baltic Sea region embraces quite different countries:

- Highly developed industrial countries Denmark, Germany, Finland, Sweden, Iceland and Norway. The most attractive of them is Germany, as one of the biggest internal market having country in the world. But we must not forget Norway as the per capita richest country (in nominal as in PPP terms) of the BSR.
- Largest population having, but still politically and economically unstable and ambitious Russia, especially its North-West region and Kaliningrad.
- Relatively large Poland that has significant economic and political power in the Central Europe and is the highest GDP per capita having transition country of BSR.
- Small and relatively vulnerable in relation to economic and political shocks Lithuania, Latvia and Estonia, which are the main object of interest in this paper.

The structure of the paper is set up as follows. Firstly, we analyse the reasons to trade and what are the expectations of Baltic States in trade with countries of BSR (Northern Dimension). Secondly, we analyse the openness or closeness of the trade in BSR. Thirdly, we will look at geographical distribution of foreign trade of three Baltics. Fourthly, we analyse the commodity structure of foreign trade of three Baltics with countries in BSR. At least we will get the picture about the possibilities and risks of current situation in Baltics' foreign trade in the context of economic globalisation and integration. The analysis is mostly based on the trade data of special trade system. Only in the case of commodity structure of Latvian and Lithuanian foreign trade with their main trade partners the general trade system data is used because of the lack of other data.

Reasons to trade

If we talk about the effects the foreign trade can have on economy, then we can bring out three most important questions (Harrison, 1995, 48 p.):

1. What are the linkages of foreign trade and openness of the trade partners, and economic growth?
2. What kind of impact can foreign trade have on the employment?
3. Are there any linkages between foreign trade and FDI?

From theoretical point of view, the main question is whether (and how) the foreign trade can accelerate the economic growth. The acceleration of economic growth could be realistic due to next reasons:

- Concentration on the comparative advantage. Hence, the effectiveness will rise.
- The exploitation of economies of scale.
- Trade generates the accumulation of physical and human capital.

- Better access to technology (through contacts with business partners, incorporation of technology and know-how in imported capital goods, decrease in prices of imported capital goods).
- Higher competition and the lower probability of arising monopolies. From other side, too intensive competition can prosper the imitations, which in long run can lower economic growth (Sjöholm, 1998).
- One part of trade revenues will transform into investments and through this the economic development and growth will additionally accelerate.
- More effective policy and management process (openness will force the producers to reorient from lobby on increasing the productivity).

Practically, one of the most sensible questions in the case of liberalisation of foreign trade is the question about its impact on employment and wages. Especially acute rises this question in the primary sector of developed countries and some CEE transition countries. As we can see in following chapter, the agricultural sector is most protected sector in all countries of BSR. The transition countries of BSR could expect the rise in wages and salaries if their would concentrate themselves on labour- and skills-intensive production. Correspondingly, the institutionalisation of labour markets can be faster in open economies (if the transition shocks have led to the destruction of labour and employer unions). Also, we cannot ignore the problem of rapidly diminishing real wages (especially in the currency board system, which is the case in three Baltic States, the price adjustments can be seen as "import of inflation").

The third question concerns the openness not only to goods but also to capital. Shortly, if we think about the openness and the FDI, we could from one aspect anticipate that higher protection of some branches could make the investments more profitable than import. From other side, however, the more liberal trade can lead to higher domestic and foreign investments, which in one's turn can foster foreign trade.

If we think about the higher integration of BSR countries from the point of view of three Baltics we would theoretically anticipate that

- The countries would try to exploit their comparative advantage and try to maximise their benefits from foreign trade. The less developed countries of the region would export primary goods (raw materials, foodstuff etc.) and import capital intensive (investment) goods. Hereby, the countries would have additional revenues, they could exploit the economies of scale through larger markets (of course, if we assume the availability or/and the mobility of production factors and capacities). The import prises would fall and the investments would be cheaper compared to consumption (if the terms of trade would not change in favour of developed countries). One task of three Baltic States is to transform their comparative advantage from labour intensive goods to capital and skills intensive goods.
- The countries would follow liberal trade policy (as one direction of the Action Plan for the Northern Dimension) and reduce their tariffs, quotas and other trade barriers. The trade barriers are often used because of distortions in domestic markets. Using them can lead to differences in amounts of trade, what we expect to be theoretically and what will be actually realised.
- There must be implemented all kind of methods to rise the competition (or at least to not restrict it) on the markets and to ensure the effective allocation of production

factors. This would lead to higher effectiveness of the investments and later to higher capitalisation of the production in transition countries.

Some authors find that positive association between trade and incomes rises because countries, whose incomes are high for reasons other than trade (Helpman 1988, Rodrik 1994). The intra-industry trade, MNEs, similar standards and sanitary requirements, higher value added, technology etc. are just some of the reasons for richer countries to trade with each other. For the (mostly small) transition countries the market size, geographic closeness, historical and cultural connections can be the direct pull-effects that force the countries to choose their trading partners. As we can see later, Estonia has relatively concentrated trade as in the sense of geographical distribution.

Equally, we can expect that smaller countries have relatively higher trade share than the bigger ones. One reason for this is certainly small domestic market, which is one of the growth and welfare constraints for small countries. The lack in demand on domestic markets must be compensated by world market, which can be seen as the source of "unlimited demand". Next we will analyse the openness of the foreign trade in the BSR and the share of foreign trade in BSR countries.

The openness of the foreign trade

The easiest way to measure the openness of the foreign trade seems to be the amount of free trade agreements. From this taken Estonia, Latvia and Lithuania seem to be similar countries – all of them have free trade agreements with EFTA, EU, Ukraine, Czech Republic, Slovak Republic, Poland, Slovenia, Turkey and Hungary (Estonia has additional agreement with Faroe Islands). (see Välispoliitika 2001; The Concluded ...; The List of …). So, we could with initial look say that the foreign trade in BSR is free.

If we look at ratings of economic freedom, which are given to the Baltic region by Heritage Foundation, then we can see that from the aspect of the overall trade policy one of the most opened economies of the BSR is Estonia, followed by Denmark (see Table 1 columns 3 and 2). In this table are not included other 7 indicators of overall economic freedom (fiscal burden, government intervention, monetary policy, foreign investment, banking/finance, wages/prices, property rights).

In reality the foreign trade policies of three Baltic States have some differences. Estonia is still a country with a very open foreign trade policy. Latvia and Lithuania, however, protect their economies more. This is confirmed by the fact that Estonia has a long time used no restrictive tariffs (average tariff rate in Estonia was 0% until January 1 2000), whereas all other partners defend their markets. For example, the average MFN tariff rates are in Latvia and Lithuania 15 %, in Poland 16.4% and in EC 5.3%. Moreover, for example, Latvia has many free trade agreements, but still the tariff quotas for imports and exports are envisaged for Slovenia, Slovakia, the EU and Hungary. Similarly behaves Lithuania. (See also The Uruguay ... 1996, p. 28; CEEBIC 2001; Market Access ... 2001, Agriculture … 2001).

Table 1

Index of Economic Freedom 2000-2001

	Overall rank		Overall score		Foreign trade		Regulation		Black market	
	(1)		(2)		(3)		(4)		(5)	
Country	2001	2000	2001	2000	2001	2000	2001	2000	2001	2000
Denmark	14	27	2.05	2.25	2	2	2	2	2	3
Estonia	**14**	**22**	**2.05**	**2.2**	**1**	**1**	**2**	**2**	**2**	**2**
Finland	23	22	2.15	2.2	2	2	3	3	1	1
Germany	20	22	2.1	2.2	2	2	3	3	1	1
Latvia	**46**	**44**	**2.65**	**2.65**	**2**	**2**	**3**	**3**	**4**	**4**
Lithuania	**42**	**61**	**2.55**	**2.9**	**1**	**1**	**3**	**3**	**4**	**4**
Norway	38	28	2.45	2.3	2	2	3	3	1	1
Poland	54	53	2.75	2.8	2	2	3	3	3	3
Russia	127	122	3.7	3.7	4	4	4	4	4	4
Sweden	29	31	2.25	2.35	2	2	3	3	1	1

Source: Heritage Foundation. The foundation gives ratings for ca. 155 countries.

Estonia protects its markets modest. The tariffs cover just some in Estonia produced and processed agricultural and food products – corn; vegetable; fruits; meat; poultry; milk and milk products; eggs; organic fats. So we can say that the effective protection for more processed products is low, the tariffs are introduced to protect just agriculture production and in some extent processing of them. One of the goals seems to be just to study tariff procedures to prepare Estonia for joining EU. The fact is that only one third of the import of the agricultural and food products are coming from non-free-trade-countries and they have possibilities for importing these products through the countries to which Estonia implements no tariffs.

As a result, arithmetical average of tariff rates does not reflect the real openness of markets either. The free trade agreements still leave some opportunities to protect certain sectors (Eastern Europe ... 1997). There are many reasons for this. Just some of them are next:

- Generally the higher tariff rates have been set to protect the goods produced on domestic market and more liberal attitude is performed in the sectors where a particular country does not have any production. Hence, the weighted-average method gives considerably higher level of tariff rates than presented earlier (especially in the case of agricultural and food products). For example, even the post-Uruguay round tariffs are in average lower. In the EU 3 per cent of the 5113 products are considered as national spikes, i.e. about 150 products have comparably high protection. Even so, the protectionism is higher in Poland and especially in Norway (see additionally OECD 1999).

- Mostly, the consumer goods are higher protected than intermediate and capital goods. Especially drastic is this in the case of Norway (see additionally OECD 1999, pp. 129-147).

- Many developed countries use governmental subsidies, e.g. the subsidies paid in agriculture (PSE – Producer Subsidy Equivalent) are more than 40% of production costs in the EU and additional export subsidies are also possible. In Estonia the PSE is below 10% of agricultural production costs.
- There exist many non-tariff restrictions, e.g. quotas, standards, packages' requirements, bureaucratic barriers, import licenses, double-checking-system etc. Estonia has no quotas, Latvia and Lithuania have implemented some (e.g. Latvia use quotas to products of the EU origin: pig meat, poultry meat, cheese, tomatoes, meat products). Most of the quotas implemented by Lithuania are subject to agricultural products (animals, corn, butter, sugar, potatoes etc.), but some of them are subject to industrial products (e.g. non-standard clear bottles, canning bottles 0.35 liters and 3 liter volume, specific boat furniture). (Agriculture … 2001., CEEBIC 2001) However it seems that even Latvia and Lithuania do not protect their markets double – there is no wide simultaneous use of tariffs and quotas.

So we can say, one of the greatest problems for Baltic States, especially for Estonia, in developing foreign trade with other countries in the BSR is the imbalance in trade policy – trade partners' protectionism versus relative openness of Baltic States (especially Estonia). The exceptions are the relationships with each other, while there are no tariff restrictions to any commodity group. Estonia, Latvia and Lithuania have ratified the agreement of non-tariff trade barriers that would mean recognition of certificates and quality requirements of all parties signed (Official Delegations ... 1997).
In trade with developed countries the Baltic States as conditions' takers must take over the standards' systems of EU and, so, in the nearest future invest a lot of money into sanitation and safety systems. Especially for Estonia it will mean losing the cost-competitiveness of many processing industries, because the agricultural sector is from beginning of transition unprotected against subsidised import from developed countries and so there are lower prices in this sector because of higher import competition on the markets. As we can see later, the imports of more processed agricultural products (food) are dominating compared to the imports of agricultural raw materials and this has certainly some chain effects on the whole sector.
As a result of complete openness, Estonia has the highest foreign trade share in GDP (see Table 2). The export/GDP ratio was 65.8% and import/GDP ratio was 85.6% in 2000. This indicator has been as an average 1.5-3 times higher compared to other countries of the Baltic Sea region in many years. The next position in this "openness" indicator holds Lithuania (export to GDP and import to GDP ratios are respectively 33.9% and 48.6%).
At the same time, Estonian extremely liberal foreign trade policy has also a negative side -– Estonian foreign trade deficit is also the highest in the region (deficit/GDP ratio was 19.8% in 2000, compared to 18.5% and 14.7% in the case of Latvia and Lithuania).

Table 2

Foreign trade indicators' share in GDP in the Baltic Sea region in 1997–2000

	Export/BIP (%)				Import/BIP (%)				Saldo/BIP (%)			
Country	**1997**	**1998**	**1999**	**2000**	**1997**	**1998**	**1999**	**2000**	**1997**	**1998**	**1999**	**2000**
Denmark	28	26.5*	28.4*	n.a.	25	26.5*	25.7*	n.a.	2.2	1.2*	2.7*	n.a.
Estonia	**49.1**	**51.2**	**48.8**	**65.8**	**76.0**	**75.3**	**67.1**	**85.6**	**-26.8**	**-24.1**	**-18.2**	**-19.8**
Finland	32	33.6	32.4*	n.a.	24	25.2	24.5*	n.a.	7.8	8.4	7.9*	n.a.
Germany	24	25.1	27.2*	n.a.	21	21.7	23.4*	n.a	3.6	3.4	3.8*	n.a
Latvia	**29.7**	**29.8**	**25.9**	**26.1**	**48.3**	**52.4**	**44.2**	**44.6**	**-18.6**	**-22.6**	**-18.3**	**-18.5**
Lithuania	**40.3**	**34.5**	**28.2**	**33.9**	**58.9**	**53.9**	**45.3**	**48.6**	**-18.6**	**-19.4**	**-17.2**	**-14.7**
Norway	31.6	27.6	29.8*	n.a.	24.3	26.6	22.9*	n.a.	7.3	1.0	6.9*	n.a.
Poland	19	19.4	n.a.	n.a.	32	32.1	n.a.	n.a.	-12.4	-12.7	n.a.	n.a.
Sweden	37	37	37.1	n.a.	29	29.8	30	n.a.	7.8	7.2	7.1	n.a.

* preliminary results

Sources: Annual indicators 2001; Central Statistical ... 2001; Danmarks ... 2000; Danmarks ... 2001; Federal Statistical ... 2000; Statistics Finland ... 2001; Statistics Lithuania ... 2001; Statistics Norway ... 2001; Statistics Sweden … 2000; Sveriges Riksbank ... 2000; Sweden's Statistical Databases 2001 authors' calculations.

Foreign trade deficit started to decrease in the second half of 1998. The reason for this was not the relative speed of export growth compared to the import but the economic recession that decreased the demand for import. The crises in Russia in1998 had the strongest short run impact on Latvian export. But Latvian export to Russia began to rise at the end of 1998. This was not the case in Estonia and especially in the case of Lithuania, i.e the export to Russia declined.

Therefore, one cannot say that decrease in foreign trade deficit shows increase in competitiveness of domestic products but this is traditional process accompanying economic recession. The Estonian balance of trade worsened in the IV quarter 1999, because of drastic increase in imports. The last one can in some extent be associated with implementing of tariffs from January 1 2000 .

As we said, Baltic States as small countries are in great extent depending on foreign trade. But not only the foreign trade is very important – the same holds by domestic trade. For example the Estonian and Latvian economy have very high share of the service sector (ca 70%). If we would have a look on the turnover statistics of domestic trade, we would see that the magnitude of the domestic wholesale is the same as the magnitude of foreign trade. For example the proportion of Estonian retail sale and whole sale turnover to GDP are respectively 29 and 69.6%. For Germany these figures are 16 and 29,4%. (Sources: Federal Statistical Office Germany 2001a,b; Annual indicators 2001; ESA 2001, authors' calculations). The reason for this is that the bigger countries have just more possibilities to differentiate their economies and to focus on more sectors, while small countries have often very homogenous economy.

Geographical distribution of foreign trade of Baltic States

In the beginning of the transition period the importance of the EU member states (12) in Central and East European countries (CEEC) export was in average 20-25%. This indicator was considerably lower in the Baltic States, because most of the export was directed to the countries of Council of Mutual Economic Assistance (ca 50% in CEEC and 65% in the case of the Baltic States) (Sheets et al. 1998; McDonald et al. 1994, p. 297).

As we can see from tables 3 and 4 the most geographically concentrated foreign trade from Baltic States has Estonia. Estonia has also the highest proportion of the trade with countries of BSR countries. Estonian foreign trade was mostly oriented to Finland and Russia in 1993 but the importance of Russia has fallen in 1998. The reorientation of the foreign trade from CIS (especially Russia) has taken place in the case of Latvia and Lithuania too. The result is that the share of Russia in Latvian and Lithuanian exports began to decline in 1998. So, if 1996 the share of export to Russia was in the case of Lithuania in 1996 and 1997 ca 24%, then in 1999 it was just ca 7%.

Table 3

Geographical distribution of Estonian, Latvian and Lithuanian export in 1993, 1999 and 2000 (%)

Country/Region	**1999**			**2000**		
	Estonia	**Latvia**	**Lithuania**	**Estonia**	**Latvia**	**Lithuania**
Finland	22.7	1.9	1.0	31.3	1.9	1.3
Sweden	22.0	10.7	4.2	19.8	10.8	4.4
Germany	8.3	16.9	16	8.2	17.2	14.3
Denmark	4.6	6.1	6.2	3.3	5.8	4.9
Baltic Sea region of the EU	**57.6**	**35.6**	**27.4**	**65.1**	**35.7**	**24.9**
Norway	n.a.	n.a.	1.1	n.a.	n.a.	1.1
Estonia	XXX	4.7	2.4	XXX	5.3	2.3
Latvia	8.0	XXX	12.8	6.8	XXX	15.0
Lithuania	3.3	7.5	XXX	2.7	7.6	XXX
Russia	5.3	6.6	7.0	1.9	4.2	7.1
Poland	n.a.	n.a.	4.5	n.a.	n.a.	5.5
Other	25.9	45.6	44.8	23.5	47.2	44.1
Total	**100**	**100**	**100**	**100**	**100**	**100**

Sources: Estonian Foreign Trade in 1994; Other … 2001; Statistics Lithuania ... 2001; Latvijas Banka … 2001; authors' calculations.

Table 4

Geographical distribution of Estonian, Latvian and Lithuanian import in 1993, 1999 and 2000 (%)

Country/Region	1999			2000		
	Estonia	Latvia	Lithuania	Estonia	Latvia	Lithuania
Finland	37.0	9.1	3.1	37.6	8.6	2.6
Sweden	10.0	7.2	3.4	10.5	6.7	3.4
Germany	9.5	15.2	16.5	9.5	15.7	15.1
Denmark	3.1	3.9	3.9	3.0	3.6	3.1
Baltic Sea region of the EU	**59.6**	**35.4**	**26.9**	**60.6**	**34.6**	**24.2**
Norway	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Estonia	XXX	6.4	1.5	XXX	6.2	1.2
Latvia	4.3	XXX	2.0	4.1	XXX	1.6
Lithuania	2.1	7.3	XXX	2.0	7.6	XXX
Russia	7.8	10.5	20.1	8.0	11.6	27.4
Poland	n.a.	n.a.	5.7	n.a.	n.a.	4.9
Other ?????	26.2	40.4	43.8	25.3	40.0	40.7
Total	**100**	**100**	**100**	**100**	**100**	**100**

Sources: Estonian Foreign Trade in 1994; Other … 2001; Statistics Lithuania ... 2001; Latvijas Banka … 2001; authors' calculations

If we look at the geographical distribution of import, then we can say that the picture is in some extent differing from export (table 4). Estonia is even more concentrated on Finland, Latvia has also higher import from Finland and Lithuania has quite high share of import from Russia.

A general rule is that export has increased slower than import. However, Estonian export to Sweden and Lithuania has increased faster than import. The result is that Estonia has maintained positive foreign trade balance only with Sweden, Denmark, Latvia and Lithuania. The positive foreign trade balance with Sweden has increased but the Estonian surplus in trade with Latvia and Lithuania the surplus has declined during the last years. It can be assumed that foreign trade deficit with Finland and Germany does not reflect the interest of these countries' producers to enter to Estonian market, but Estonian distributors are concentrated on importing from these countries.

Lithuania has most positive trade balance with Latvia and Ukraine, but the considerable decline in deficit in balance of trade can be seen in trade with Denmark. In the trade with Belarus the balance is still positive, but the surplus has continuously declined. The highest deficit has Lithuania in trade with Russia and Germany.

Latvia has the highest trade surplus in trade with United Kingdom and most highest deficit in trade with Finland. Positive is that the exports and imports are not so geographically concentrated as for example in Estonia.

Altogether, foreign trade of three Baltic States with more developed countries in the BSR has been increased relatively fast. However, it should be mentioned that those countries' import from Central and East-Europe has not significantly increased and this means that the competition with other Central and East-European countries in entering to high-income markets in the Baltic region has intensified. For example, Estonian share in Swedish import has remained ca 1% during the last years. Good example of competition for the market share is the textile production, which is leading export article in Estonia and also in other Central and East-European countries.

Commodity structure of foreign trade of Estonia Latvia and Lithuania

The share of processed products has increased compared to the share of unprocessed products in most of CEE countries' export and import since the beginning of the 1990s. Most important export products in Central and East-Europe are textile and wood. Small size of Baltic States determines the concentration to relatively limited product range – two groups of commodities formed 43.4% of total export in 1999 for Estonia (compared to 43.6 % of import). It should be noted that traditional export articles (wood, paper, clothing, food, and furniture) form 52.9% of total export (29.8% of total import). For Lithuania the same export articles (wood, paper, clothing, food, and furniture) form 43.5% of total export (27.1% of total import) (see statistics from Statistics Lithuania 2001, Other … 2001). At the same time, capital-intensive commodities (machinery and equipment, chemical products, vehicles) form only 33 % of total Estonian export (51% of total import). In Lithuania the appropriate goods form ca 27% of exports and 38% of imports. In the case of Estonia we must also take into account the fact that high importance of machinery and equipment is caused by high share of sub-contracting for developed countries' corporations, i.e. re-export of details (value-added in Estonia is about 10%) and textile products.

If we analyse the structure of merchandise exports and imports in general, then it seems that Estonia and Lithuania have more optimistic picture in foreign trade than Latvia. The exports of manufactures are higher than in Latvia, but it is still low compared to most other countries of BSR (see also table 5). In the case of Lithuania the exports and imports of manufactures are mostly balanced, but this is the result of higher import share of traditional goods.

In Lithuanian export is positive the fact that food articles are dominating over agricultural raw materials. This is not the case in Latvia, where export of agricultural raw materials is dominating over the export of more processed foodstuff.

Table 5

Export and import shares of agricultural products, raw materials and manufactures in 1999 (%)

Country	Food		Agricultural raw materials		Fuels		Ores and metals		Manufactures	
	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP
Denmark	21	12	3	3	4	3	1	2	66	77
Estonia	**11**	**13**	**11**	**3**	**4**	**7**	**5**	**3**	**69**	**74**
Finland	2	6	7	3	2	9	3	5	85	75
Germany	4	8	1	2	1	6	2	3	84	70
Latvia	**6**	**12**	**30**	**2**	**3**	**11**	**4**	**2**	**57**	**73**
Lithuania	**11**	**12**	**3**	**6**	**15**	**14**	**2**	**2**	**67**	**65**
Norway	9	7	1	2	50	3	7	5	27	82
Poland	9	7	2	2	5	7	5	3	77	80
Russia	1	19	4	1	41	2	11	2	25	42
Sweden	3	7	4	2	2	6	2	3	83	77

Source: World Development Indicators (WDI) 2001, pp. 210-217.

For Estonia it is positive that the proportion of high-technology exports has risen continuously (see table 6). So, Estonia has better chances to transform its comparative advantage from labour intensive to knowledge intensive production.
In principle Estonia, Latvia and Lithuania should have a relative advantage also in producing and exporting, and in competing with import of agricultural products. However, in regard to the particular product group most countries have established the strictest protection mechanisms and domestic production subsidies. Next we analyse the situation of foreign trade of three Baltic States more precisely. In the case of Estonia the analysis is done using the data based on special trade system. For Latvia and Lithuania the data based on the general trade system are used because of the lack in other data.

Table 6

High-technology exports (% of manufactured exports)

Country	1995	1996	1997	1998	1999
Denmark	16.02	16.91	17.93	18.25	20
Estonia	**6.23**	**8.86**	**9.15**	**11.7**	**13.45**
Finland	14.82	16.41	19.28	22.09	23.98
Germany	13.64	13.63	14.45	15.36	16.65
Latvia	**5.18**	**5.22**	**6.48**	**4.01**	**4.08**
Lithuania	**3.67**	**3.59**	**3.8**	**3.3**	**11.67**
Norway	14.09	15.02	15.03	16.33	16.54
Poland	2.87	3.06	2.73	3.03	2.76
Russia	..	9.74	9.34	12.11	15.72
Sweden	16.45	17.67	19.48	20.66	21.59

Source: The World Bank Group 2001.

Estonian primary export-import activities with Sweden and Finland are based on subcontracting. It means that 50-55% of Estonian export is based on materials, details and semiproducts, being processed here and re-exported. Subcontracting has less importance in trade with Denmark and Germany. Accordingly, one can differentiate various country groups (there was no comparable data about Poland and Norway) (see also table 7):

Firstly, Latvia and Lithuania. Since the beginning of transition period Estonia has maintained more or less traditional export structure with Latvia and Lithuania (chemical products, food, metals and metal products, etc.). The positive trend is that the structure of manufactured goods' export to Latvia has changed – computers and cables are quite important export articles now. The import structure is similar with export structure – it means that labour- and resource-intensive products form most of the import.

Table 7

Estonian foreign trade structure with the Baltic Sea region countries in 1999

	Lithuania	Latvia	Sweden	Finland	Denmark	Germany
Estonian exports	Chemicals (24%)+	Chemicals (25%)+	Machinery and equipment (48%)+	Machinery and equipment (37%)-	Metals and metal products (29%)+	Timber paper etc (27%)+
	Foodstuffs (24%)+	Foodstuffs (18%)+	Timber paper etc (20%)+	Clothing, footwear, headgear (24%)+	Timber paper etc (25%)+	Furniture etc. (24%)+
	Machinery and equipment (10%)+	Machinery and equipment (11%)+	Clothing, footwear, headgear (15%)+	Timber paper etc (14%)+	Furniture etc. (20%)+	Machinery and equipment (17%)-
	Clothing, footwear, headgear (9%)-	Clothing, footwear, headgear (11%)-	Metals and metal products (6%)-	Furniture etc. (8%)+	Clothing, footwear, headgear (8%)-	Clothing, footwear, headgear (15%)+
	Metals and metal products (9%)+	Metals and metal products (10%)+	Furniture etc. (4%)+	Other industrial products (6%)-	Foodstuffs (6 %)-	Metals and metal products (5%)-
Estonian imports	Foodstuffs (27%)+	Clothing, footwear, headgear (24%)-	Machinery and equipment (34%)+	Machinery and equipment (48%)-	Machinery and equipment (25%)-	Transport equipment (19%)-
	Chemicals (20%)+	Chemicals (20%)+	Clothing, footwear, headgear (20%)+	Clothing, footwear, headgear (10%)+	Foodstuffs (24%)-	Machinery and equipment (22%)-
	Mineral products (13%)-	Foodstuffs (15%)+	Chemicals (14%)-	Chemicals (8%)-	Chemicals (12%)-	Chemicals (18%)-
	Clothing, footwear, headgear (11%)-	Machinery and equipment (13%)+	Metals and metal products (10%)-	Metals and metal products (7%)-	Clothing, footwear, headgear (11%)-	Foodstuffs (11%)-
	Machinery and equipment (9%)+	Timber paper etc. (7%)+	Foodstuffs (6 %)-	Transport equipment (6%)-	Metals and metal products (10%)+	Metals and metal products (8%)-

+ Estonia is in particular commodity group net exporter to particular country; – Estonia is a net importer.

Sources: Bank of Estonia; authors' calculations.

Secondly, Sweden and Finland. More than 35% of export to Finland and 45% of export to Sweden are machinery and equipment (mostly re-export of processed products). Export of wood, paper, furniture and clothing (primarily subcontracted works of clothing industries) have become also important. Estonian import from Finland and Sweden is first of all determined by subcontracting and processing of unfinished products (i.e. machinery and equipment are the most important import articles, followed by clothing and vehicles).

Thirdly, Denmark and Germany. Wood, paper and furniture, metals and textile products are the main articles exported from Estonia to Denmark and Germany. Subcontracting is not very important in the case of these countries. Import from Denmark and Germany shows that Estonia doesn't take part of the intra-industry trade – machinery and equipment are the main imported products, followed by vehicles and chemical products (regarding of these commodity groups Estonia is net importer). Relatively big importance of food products in the foreign trade and trade balance deficit with these countries comes from the Estonian unilateral openness and the subsidising policy carried out in the EU. The structure of export points to the need of increasing the share of capital-intensive production in Estonian export. Especially in last year has increased the importance of machinery and equipment in import form Germany. Also the exporting and re-exporting to this country has increased essentially.
In the case of Latvian foreign trade we can distinguish some trading partners' groups too, but these groups are not so clear-cut (see table 8).

Table 8

Latvian foreign trade structure with other countries of the BSR in 1999*

	Latvia			
	Germany	**Sweden**	**Russia**	**Lithuania**
Exports	Wood (29.8%)	Wood (64.1%) +	Textiles (27.7%) +	Chemicals (19.1%) +
	Textiles (26.8%) +	Textiles (19.8%) +	Machinery and equipment (13.7%) –	Machinery and equipment (17.6%) +
	Base metals (14.7%) +	Machinery and equipment (5.7%) –	Food, beverages etc. (10.2%) +	Textiles (13.2%) –
	Minerals (8.1%) +	Miscellaneous manufactured articles (2.6%) +	Chemicals (9.0%) –	Food, beverages etc. (9.6%) –
	Miscellaneous manufactured articles (6.8%) +	Live animals, animal products (1.9%) +	Minerals (6.3%) –	Minerals (8.0%) –
	Germany	**Sweden**	**Russia**	**Lithuania**
Imports	Machinery and equipment (16.9%) –	Machinery and equipment (18.5%) –	Minerals (46.1%) –	Minerals (27.9%) –
	Transport equipment (13.8%) –	Textiles (14.1%) +	Base metals (16.5%) +	Food, beverages etc. (12.7%) –
	Chemicals (8.2%) –	Transport equipment (11.7%) –	Chemicals (12.6%) –	Textiles (10.0%) –
	Textiles (8.1%) +	Pulp, paper (7.4%) –	Machinery and equipment (8.5%) –	Machinery and equipment (8.6%) +
	Base metals (5.9%) +	Chemicals (4.2%) –	Articles of stone, ceramic, glass (4.2%) –	Chemicals (7.7%) +

* Data are given in general trade system.
+ Latvia is in particular commodity group net exporter to particular country; – Latvia is a net importer.
Sources: Estonia, Latvia, Lithuania. 2000; authors' calculations.

The **first group** forms from Russia, Lithuania (and Estonia). With them has Latvia long-lasting experience in foreign relations. The main groups of exports are textiles, chemicals, machinery and minerals. The picture in import articles is not so homogenous, but it can be said, that the imports are raw materials intensive (especially minerals) and other products (especially chemicals, machinery) do not have very important place in import structure.
The **second group** establishes from Germany and Sweden. The picture of exports is not so positive – the main articles are wood, textiles (similar is the Latvian export to the Denmark). At the same time, the imports are more capital intensive (machinery, transport equipment, chemicals). Similar is the structure of the import from Poland. Hence, it seems that the position of Latvia in trade with other countries is worse than it was in the case of Estonia. The picture seems not more optimistic for Latvia in trade with other countries (UK, Ukraine).

Table 9

Lithuanian foreign trade structure with other countries of the BSR in 1999*

	Lithuania			
	Germany	**Poland**	**Denmark**	**Russia**
Exports	Textiles (30.8%) +	Minerals (31.0%) +	Textiles (53.9%) +	Live animals, animal products (14.8%)
	Wood (13.4%) +	Textiles (14.2%) +	Transport equipment (11.3%) +	Transport equipment (14.2%) +
	Chemicals (9.0%) –	Wood (11.7%) +	Wood (5.8%) +	Machinery and equipment (13.1%) –
	Miscellaneous manufactured articles (8.6%) +	Machinery and equipment (9.4%) –	Machinery and equipment (5.6%) –	Food, beverages etc. (9.4%) +
	Machinery and equipment (8.6%) –	Chemicals (7.5%) –	Miscellaneous manufactured articles (5.5%) +	Textiles (8.8%) +
	Germany	**Poland**	**Denmark**	**Russia**
Imports	Machinery and equipment (21.9%) –	Chemicals (17.7%) –	Textiles (31.9%) +	Minerals (72.2%) +
	Transport equipment (19.2%) +	Machinery and equipment (13.0%) –	Machinery and equipment (17.4%) –	Machinery and equipment (8.3%) –
	Chemicals (12.1%) –	Plastics, rubber (12.0%) –	Base metals (10.1%) –	Base metals – (3.9%)
	Textiles (11.5%) +	Pulp, paper (9.3%) –	Food, beverages etc. (8.3%) –	Plastics, rubber (3.6%) –
	Plastics, rubber (6.5%) –	Base metals (7.9%) +	Chemicals (6.0%) –	Transport equipment (2.5%) +

* Data are given in general trade system.
+ Lithuania is in particular commodity group net exporter to particular country; – Lithuania is a net importer.
Sources: Estonia, Latvia, Lithuania. 2000; authors' calculations.

Concerning Lithuania we can say that the structure of export to and especially import form Germany and Poland is quite similar – the proportion of capital intensive products' export is low compared to imports (see table 9). Individually can be viewed Lithuanian trade relations with Denmark where the great proportion has commodity group "textiles". Mainly the textiles are imported for inward processing. In the trade with Russia has Lithuania grate proportion of machinery and equipment, but this is due to nuclear equipment and machinery.

Concluding remarks

Most of the Estonian foreign trade partners belong into the Baltic Sea region. In the case of Latvia and Lithuania, the concentration on this region is in some extent smaller. There are a lot of positive (+) and negative (–) economic and political factors that influence foreign trade of Baltic States.

+ Good relations with main trading partners (for Estonia Finland and Sweden, for Latvia Germany and Russia, and for Lithuania Germany and Latvia) and increase in Western Europe's import demand due to the gradual recovery economic growth.
+ New technologies and more optimal use of labour have caused the growth in productivity.
+ Importance of the foreign direct investments has grown (especially in the case of Estonia).
+ Increase in subcontracting (especially in the case of Estonia), but this makes at the same time economies more vulnerable.
– Unilateral openness to foreign competitors.
– Food products are not meeting the sanitary requirements of developed countries. At the same time they have pressure from subsidised EU-products.
– Fast increase in prices compared to the developed industrial countries. Increase in real exchange rate of currencies (all three Baltic States have fixed currencies).
– Export is often concentrated on labour and raw material intensive sectors. At the same time, export of the developed countries of the Baltic Sea region is focusing on capital-intensive products because of the higher profit margin in these sectors.

Therefore, Estonia, Latvia and Lithuania are vitally interested in expanding and strengthening co-operation in BSR. However, there are many problems based on differences in the stage of development, foreign trade policy and economic structure of the countries that need to be solved.

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