

# **The Development of Privatization in Latvian Agriculture**

**Roberts Zile**

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Report 93-BR 14

Latvian State Institute of Agrarian Economics  
Riga, Latvia

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The Latvian State Institute of Agrarian Economics is collaborating with CARD at Iowa State University on studies related to the privatization and development of agriculture and related industries in the Baltic countries.

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## **THE DEVELOPMENT OF PRIVATIZATION IN LATVIAN AGRICULTURE**

*Editor's note: This paper continues Baltic Report 92-BR 5 Changing Ownership in Latvia through Agrarian Reform, September 1992, also by Roberts Zile. In-depth discussion of the privatization mechanisms and Latvian laws relating to privatization are provided in that report.*

The two most important laws regulating land reform and land privatization in rural areas provide the legal basis for changes in land ownership and management. These laws were the starting point for reestablishing private farming. At the same time, the previous highly centralized management of agricultural production assets required that action be taken to decentralize these assets through privatization. The primary guidelines for privatizing these assets were provided in the Law on Land Privatization in Rural Areas. The law provided for a large degree of flexibility in the design and implementation of privatization at the enterprise level.

There need to be certain structural adjustments in upstream industries supplying agriculture with main inputs and downstream industries processing and marketing agricultural products. Recently the Latvian Parliament passed the Law on Privatization of Food Processing and Agro-service Enterprises. Asset privatization began in 1993 and is moving rapidly. It will undoubtedly show shortcomings and advantages of various approaches used by different industries. The purpose of this paper is to explain the legal framework for agricultural and food industry privatization, as well as to present two examples of privatization in Latvia.

### **Legal Aspects of Agricultural Land Reform**

On July 9, 1992, a Law on Land Privatization in Rural Areas was passed. It was a logical follow-up to the Law on Land Reform, adopted on November 21, 1990. This earlier law contained regulations to gradually restructure the legal, social, and economic relations in the countryside related to land use and ownership. It established the procedure for implementing land reform by defining the provisions for submitting land claims and how to comply with them, as well as creating regulations for restoring landowner rights.

The Law on Land Privatization in Rural Areas states that former landowners had the right to their landed estates if they submitted their applications before June 20, 1991. However, there were

some exceptions if the land had already been allocated to a permanent use during the first stage of land reform.

The reason privatization in rural areas is being implemented in two parallel and closely linked, yet independent, directions is rooted in the establishment of collective farms in the 1940s: all the land became state owned, but all the other assets were owned by collective farms. Although collectivization is now considered illegal, its fruits—collective and state farms—were not of equal status, even after independence was restored. Therefore, they are supposed to comply with the Law on Privatization of Agricultural Enterprises and Collective Fisheries that was adopted on June 21, 1991. For agriculture, land is the main asset, so these laws contradicted one another. Because the law regulating the first stage of land reform was adopted before the Law on Privatization of Agricultural Enterprises and Collective Fisheries regulating privatization of assets, there were instances of Land Commissions allocating land to the former owners or to new users (mainly to establish new individual farms), and the production units to be privatized (most often livestock farms) were left without any land or without enough land. So their future operation was questionable and sometimes even impossible.

The Supreme Council has adopted several amendments to these laws to correct the errors. But the courts do not have enough authority to enforce their decisions. There have been several instances of the local government and authorities disobeying court decisions, thus violating the law, and there have been no consequences.

The Law on Land Privatization stipulates that the joint-stock or limited liability companies (the former collective farms) have the right to use their land for five years. However, when a stockholder privatizes, such as a livestock farmer, there is an immediate risk of losing the land once used by this farm, because in most cases the former landowner's rights are restored. For both objective and subjective reasons there is not yet a land market in Latvia because no quantifiable property values have been established through property taxes or other measures of the property's worth. Thus, a farmer full of entrepreneurial spirit may buy a dairy farm with 100 cows, but he may not have a way to produce feed.

The land use structure has changed significantly. At the end of 1992 there were about 49,000 private farms in Latvia, with an average of 16.5 hectares per farm. This constitutes 19 percent of agricultural land. In addition, 20 percent of agricultural land is being used by companies. According to data from the local land commission, there will be 103,500 subsidiary plots.

There is also a technical problem that hampers the establishing of ownership rights in the proper sense of the word. Even though the Law on Land Privatization allows fulfillment of the formalities related to land ownership only during December 1992, a law establishing a State Land

Service was passed. It is administered by the government and deals with confirmation of ownership rights for people who already have been given land use rights under the law on land privatization. At the same time, the law establishing the Land Title Register was revived. It is controlled by the Supreme Court, and its task is to register changes in ownership. In fact, the offices of Land Title Register were set up only after April 1, 1993. Only then could individuals whose ownership rights are confirmed by the State Land Service sell their land and register the transaction in the Land Title Register.

#### **Legislation Regulating Privatization of Food Processing and Agro-service Enterprises**

In dairy processing the small dairies, creameries, and milk collection stations could be acquired for free by the local dairy producers' associations after July 1992. However, this has not happened too rapidly. In December 1992 a law was passed to regulate privatization of the 10 largest dairy plants. They were transformed into joint-stock companies, with certain quotas set for stock purchasers: not less than 70 percent for the dairy producers' associations; not more than 10 percent for the employees; and up to 20 percent as the state share, which will then be sold to investors for vouchers. Because the deadline for this process is within seven months of its beginning, producers must establish local dairy producers' associations in two to five months.

The law regulating agro-service enterprises is in its second reading in the Supreme Council. It proposes the sale of the state's capital in proportion to business done with the enterprise; the law also provides for restructuring the enterprises. The law on privatization of the 14 large meat processing plants in Latvia was prepared in spring 1993. Capital will probably be sold competitively or through auctions.

#### **Development of the Privatization of Joint-Stock and Limited Liability Companies in 1992**

After March 1992, which was the deadline for all collective and state farms to change their legal management form and be registered as a company of some type, these enterprises entered the second stage of privatization. Distribution of shares for asset privatization was somewhat different in different regions in Latvia based on specific conditions, but on the average the largest part was allocated to labor shares (Table 1).

During this stage a company shareholder could alienate (appropriate), by paying with his shares, any single or combined item from the inventory list he wished to acquire. The shareholders could also trade their share freely among themselves. Within a month after public notification, other shareholders could also apply for the same items, and often the auction determined the new owner.

Table 1. Structure of Latvian fixed capital

	Labor Shares	Collectivized Shares	Reserves
	(percent)		
Districts			
Riga	86	7	7
Tukums	57	39	4
Valka	74	14	12
All Latvia	76	20	4

The company had no rights to appropriate the object for actual privatization. Thus, by October 1992, about 15 percent of companies' assets were actually privatized. According to unofficial estimates by the Latvian State Statistics Committee, by January 1, 1993, 25 percent to 30 percent of companies' assets might have been privatized (Table 2).

By October 1992 several companies had been liquidated, and the large enterprises had ceased to exist as legal entities. The agricultural producers in these pagasts (county-like administrative units) are individual full-time farmers, part-time farmers, cooperative service enterprises (such as mechanical stations and grain driers) owned by farmers, as well as some limited liability companies owned by a few members. In most cases, medium-sized livestock farms are owned by a limited liability company. In some instances the large livestock farms have empty buildings that remain and the livestock are sold separately, but this is due to a weak domestic market, where it is difficult to sell agricultural products at the price that would cover production costs.

Depending on farm specialization, size, location, and other important considerations, agricultural assets had different structures. Categories of agricultural assets for Latvia are presented in Figure 1.

Privatization of agricultural assets was carried out through two main stages: closed and public auctions. Assets for privatization were evaluated in balance sheet value as a starting price. As a rule, an auction price for actual purchase of assets was higher than the balance sheet value. This was true for both closed and public auctions, but to a different extent (Figures 2 and 3). Also, there were significant differences in auction prices for different types of production assets privatized at different times in 1992 (Figures 4 and 5). Since the demand for agricultural machinery was growing with rapid reestablishment of private farming, the auction price for this kind of agricultural asset was growing constantly through 1992.

The drought of 1992, difficulties with acquiring feed grain, the collapse of external meat markets, and a weak domestic market determined a slightly different situation in the relationship



Table 2. Dynamics of privatization in the Latvian agriculture and food industry

	May 15, 1992		July 1, 1992		January 1, 1993	
	Value <sup>a</sup>	Percent	Value <sup>a</sup>	Percent	Value <sup>a</sup>	Percent
<b>Farm Production</b>						
Privatized value	96,309	3.0	272,052	8.6	446,310	14.1
Nonprivatized value	3,067,884	97.0	2,892,141	91.4	2,717,883	85.9
<b>Nonfarm Production</b>						
Privatized value	8,589	3.5	24,903	10.0	76,496	30.8
Nonprivatized value	239,524	96.5	223,210	90.0	171,617	69.2
<b>Nonproduction</b>						
Privatized value	28,342	3.4	115,212	14.0	255,477	31.0
Nonprivatized value	796,754	96.6	709,884	86.0	569,619	69.0
<b>Agricultural Machinery</b>						
Privatized value	9,910	24.6	40,309	100.0	40,309	100.0
Nonprivatized value	30,399	75.4	-	-	-	-
<b>Livestock</b>						
Privatized value	10,051	14.7	68,412	100.0	68,412	100.0
Nonprivatized value	58,361	85.3	-	-	-	-
<b>Other</b>						
Privatized value	17,092	4.8	23,367	6.6	80,277	22.7
Nonprivatized value	336,041	95.2	329,766	93.4	272,856	47.3

<sup>a</sup>Value of assets in 1,000 Latvian rubles (LVR).

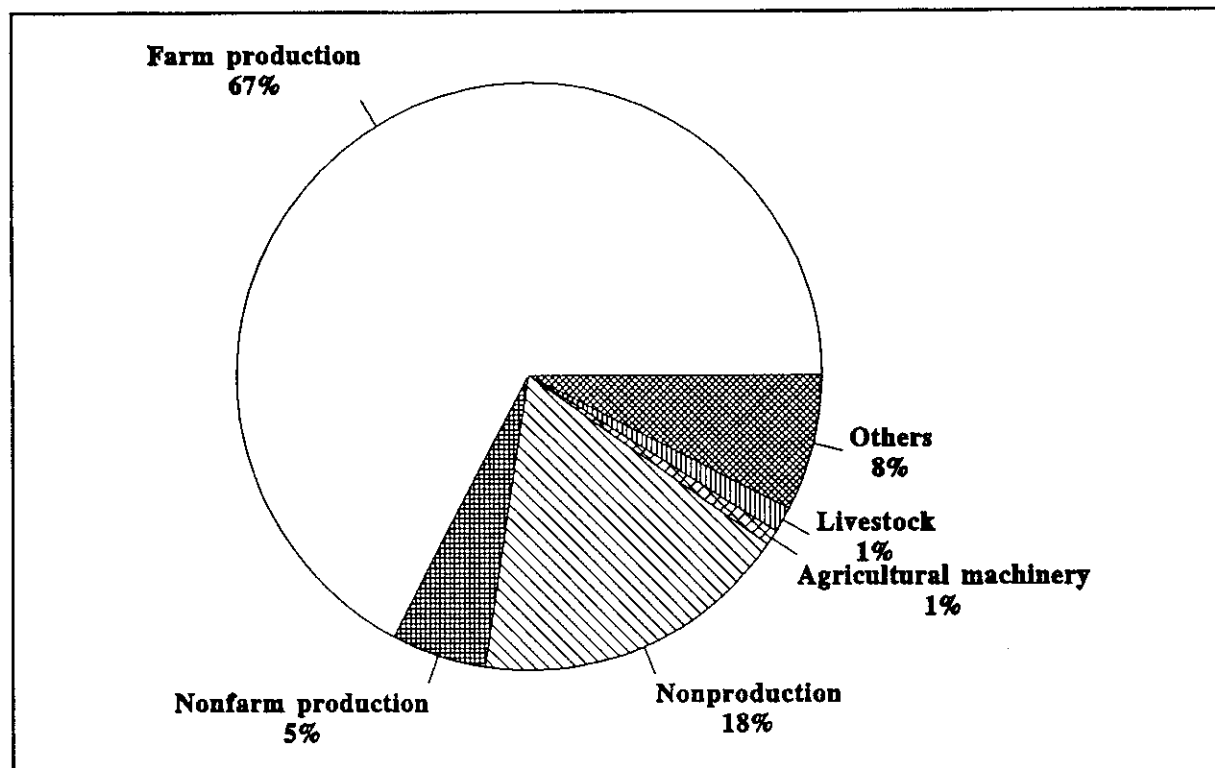


Figure 1. Structure of agricultural enterprise assets available for privatization shown as a percentage of total asset value

Figure 3. Structure of public auction prices in Latvia

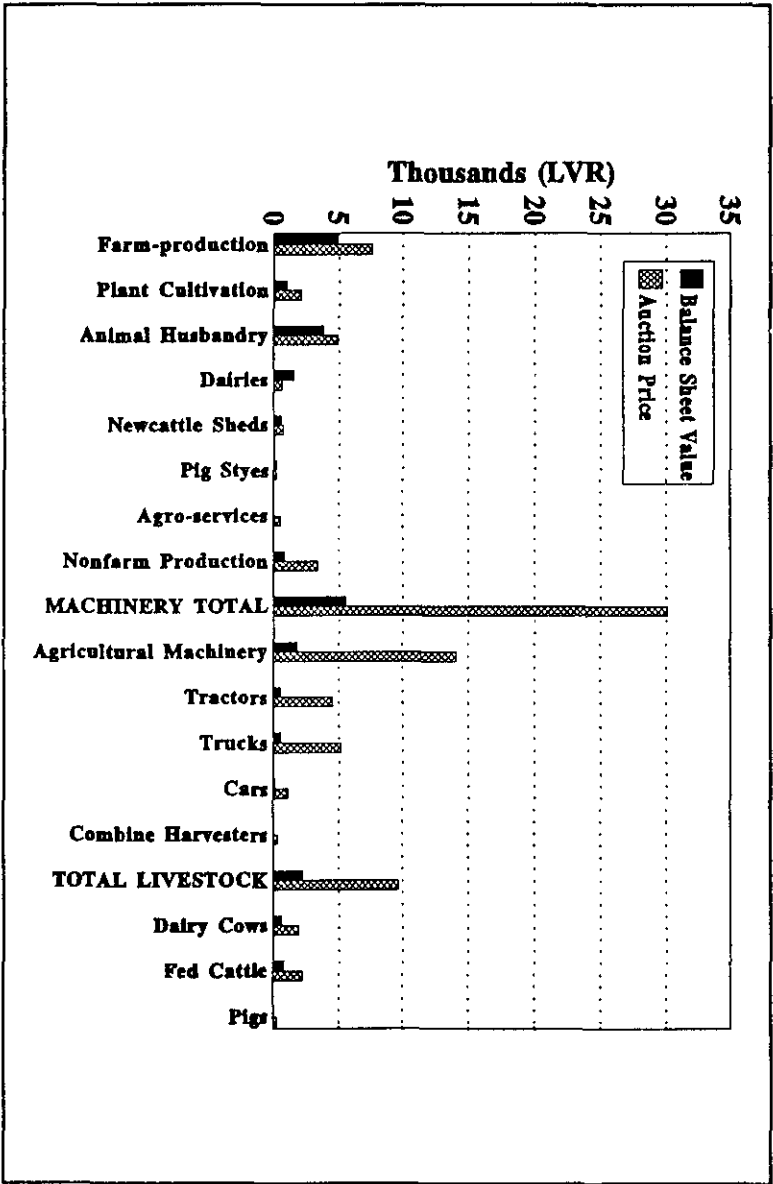
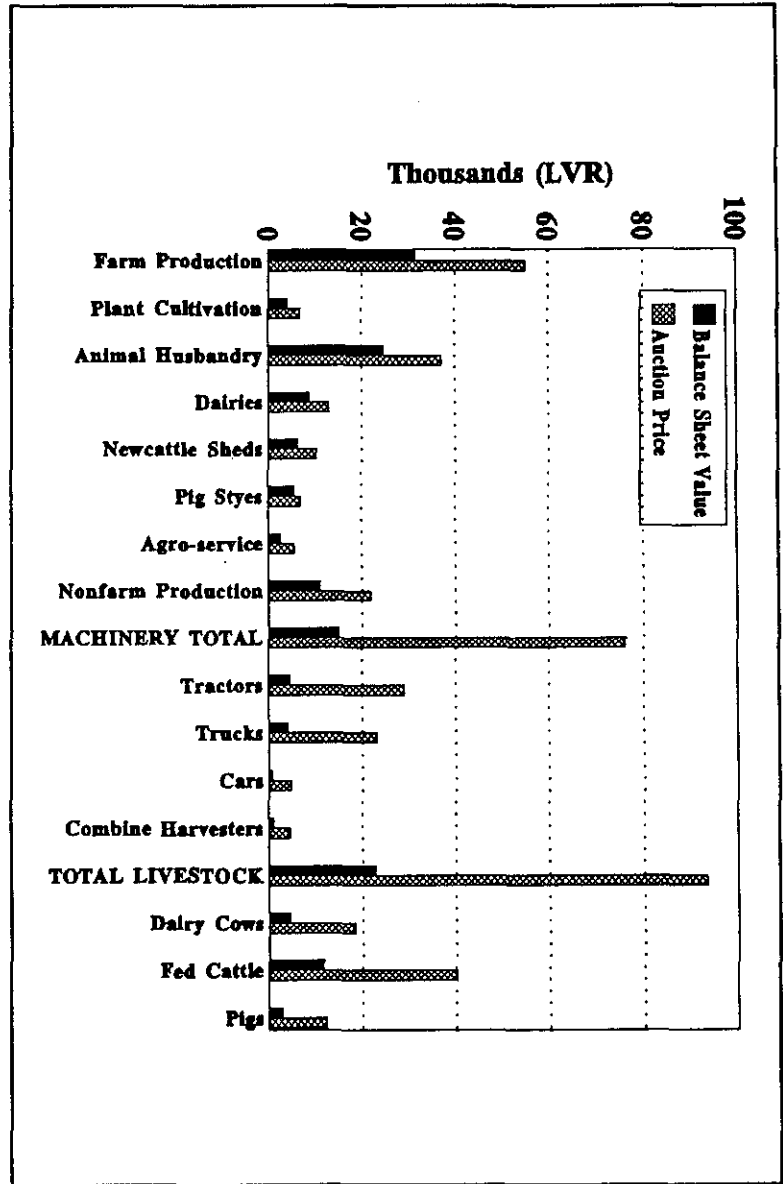


Figure 2. Structure of closed auction prices in Latvia



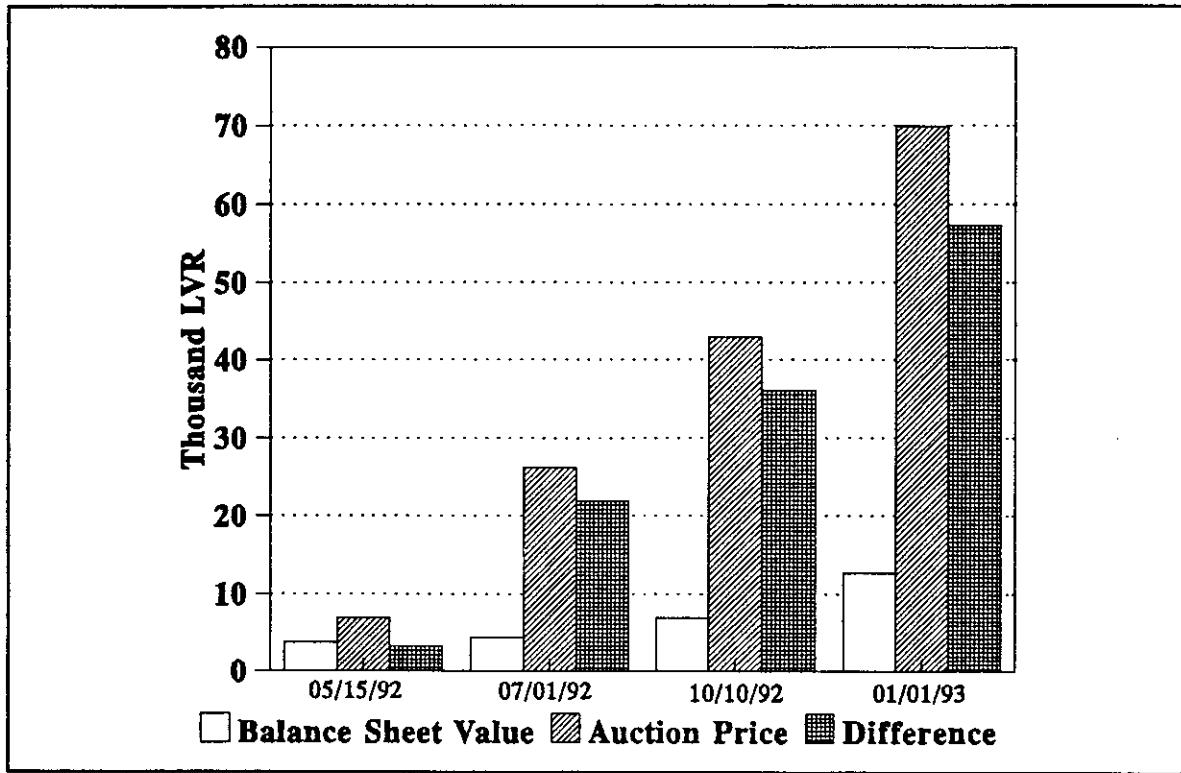


Figure 4. Agricultural machinery auction prices and balance sheet values

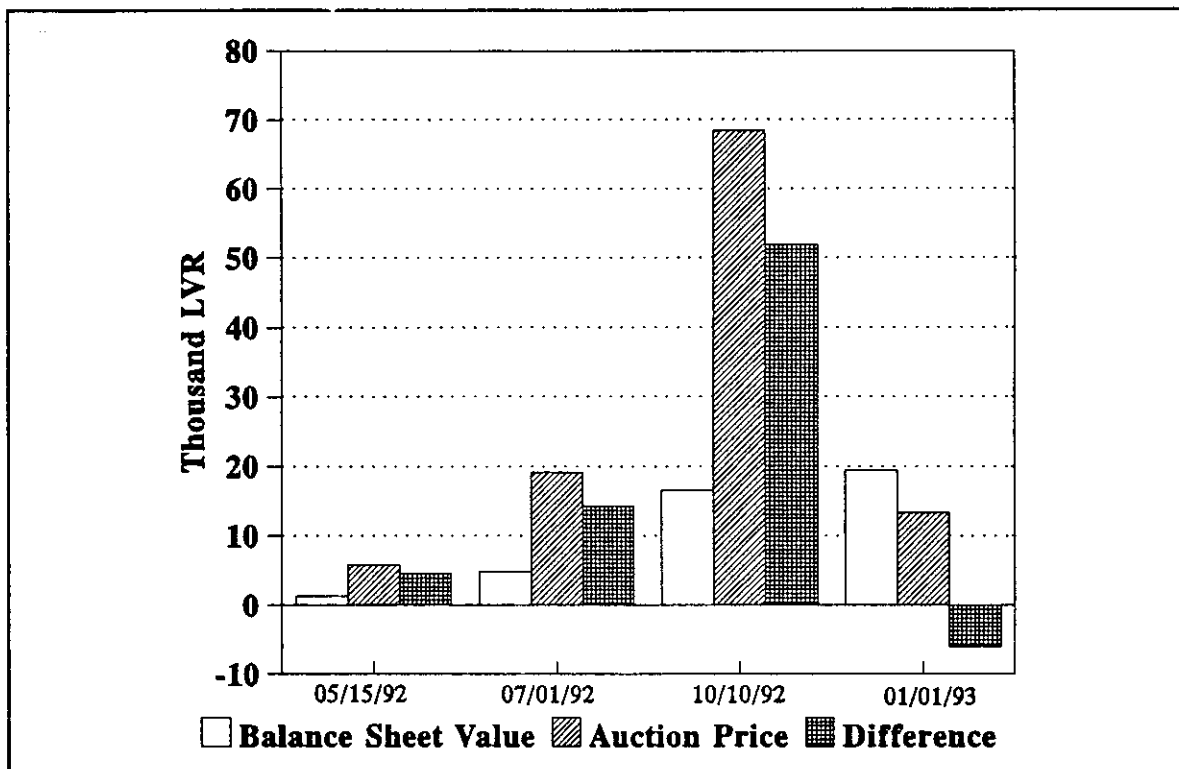


Figure 5. Livestock auction prices and balance sheet values

between balance sheet and auction price values for livestock. By the end of 1992 livestock were sold at a price hardly, if at all, covering balance sheet values.

In order to provide a better insight into the development of privatization, examples from the privatization experience of two companies are presented. The privatization methods were formulated with the assistance of researchers from the Latvian State Institute of Agrarian Economics. The companies are Ilzene and Skanaiskalns, located in northern Latvia. They are between 150 and 250 kilometers from the capital, Riga, and were fairly typical collective farms.

### **Privatization of the Ilzene Shareholding Company**

In order to fulfill the provisions stipulated by the Law on Privatization of Agricultural Enterprises and Collective Fisheries, all the fixed assets of the former collective farm Ilzene were assessed according to the situation on July 1, 1991, and an inventory list was compiled. It included combined items: technical equipment and machinery had to be transferred together with the whole combined unit. Transfer of units began as soon as the limited liability or joint-stock company was registered.

Because there was no high concentration of shares in one hand—14,500 rubles on average with about 60,000 rubles as the largest amount—the movement of shares among shareholders began immediately. On many occasions the shares were lent on mutually advantageous terms. What is characteristic for the Ilzene collective farm is that fixed assets were transferred only for shares.

The annual meeting decided that the joint-stock company would buy up the shares from the retired persons residing in the pagast, if they agreed, at three shares per year at their face value. Then the company would buy all shares from retired persons residing outside the pagast. As soon as the process of alienation transfer started, some competition appeared. Regulations for auction sales were worked out. These demanded that if claimants would buy up and have the shares registered before the auction, then payment purchases could be made only with shares. For the greenhouses, the initial bid was 3,500 rubles and the highest was 47,000 rubles. For the dehydration factory, the initial bid was 4,600 rubles and the highest was 51,000 rubles. For separate agricultural machinery units, the sale price occasionally exceeded the initial bid 30 times or more, with an average difference of 50 percent. A permanent auction board was established.

In some instances the claimants canceled their participation in the auction and shared the item on mutually acceptable terms. It should be noted that the objective of the auction, to determine the new owner for the object, still needs to be defined legally. Attempts to have very high bids led to cattle slaughtering on the privatized livestock farms, and production ceased.

The auction board accepted applications from other claimants within one month after a

shareholder had expressed a wish to sell an item. There were no more than two competitors who wished to buy livestock farms. Trading with shares took place among the shareholders at mutually agreed upon prices and on a large scale. On only one occasion did a shareholder offer his shares to the board, who helped to sell them. The general trend in the movement of shares was from many shareholders to few.

The result of privatization is private ownership of all service objects, all livestock farms (except for the farm complex), and nearly all apartments and residential buildings. The alienated shares have reduced the capital from 5,866,000 rubles to 2,876 rubles. Seventy of the initial 390 shareholders have used up all their shares. Table 3 and Figure 6 illustrate the rate of privatization for Ilzene.

People who were forced to put their property into a collective farm were given an opportunity to repossess their own buildings. Their total value constituted only 0.1 percent of the capital.

The collective farm Ilzene was privatized in an orderly, well-organized manner. The drawback was the slaughtering of cattle on the privatized livestock farms, which created dissatisfaction. There was also some reluctance to privatize because many people had little understanding of what they were going through. For example, there has been practically no

Table 3. Dynamics of privatization for the Ilzene shareholding company

	May 15, 1992		July 1, 1992		October 10, 1992	
	Value <sup>a</sup>	Percent	Value <sup>a</sup>	Percent	Value <sup>a</sup>	Percent
Plant Cultivation						
Privatized value	28	77.8	28	77.8	28	77.8
Nonprivatized value	8	22.2	8	22.2	8	22.2
Animal Husbandry						
Privatized value	170	12.3	837	60.6	1,203	87.1
Nonprivatized value	1,211	87.7	544	39.4	178	12.9
Service for Main Production						
Privatized value	244	19.4	380	30.2	380	30.2
Nonprivatized value	1,014	80.6	878	69.8	878	69.8
Nonfarm Production						
Privatized	100	65.8	141	92.8	152	100
Nonprivatized	52	34.2	11	7.2	-	-
Nonproduction						
Privatized	-	-	16	2.0	250	31.2
Nonprivatized	802	100	786	98.0	552	68.8
Machinery, Livestock, Other						
Privatized	48	40.6	48	40.6	68	100
Nonprivatized	20	29.4	20	29.4	-	-

<sup>a</sup>Value of assets in 1,000 Latvian rubles (LVR).

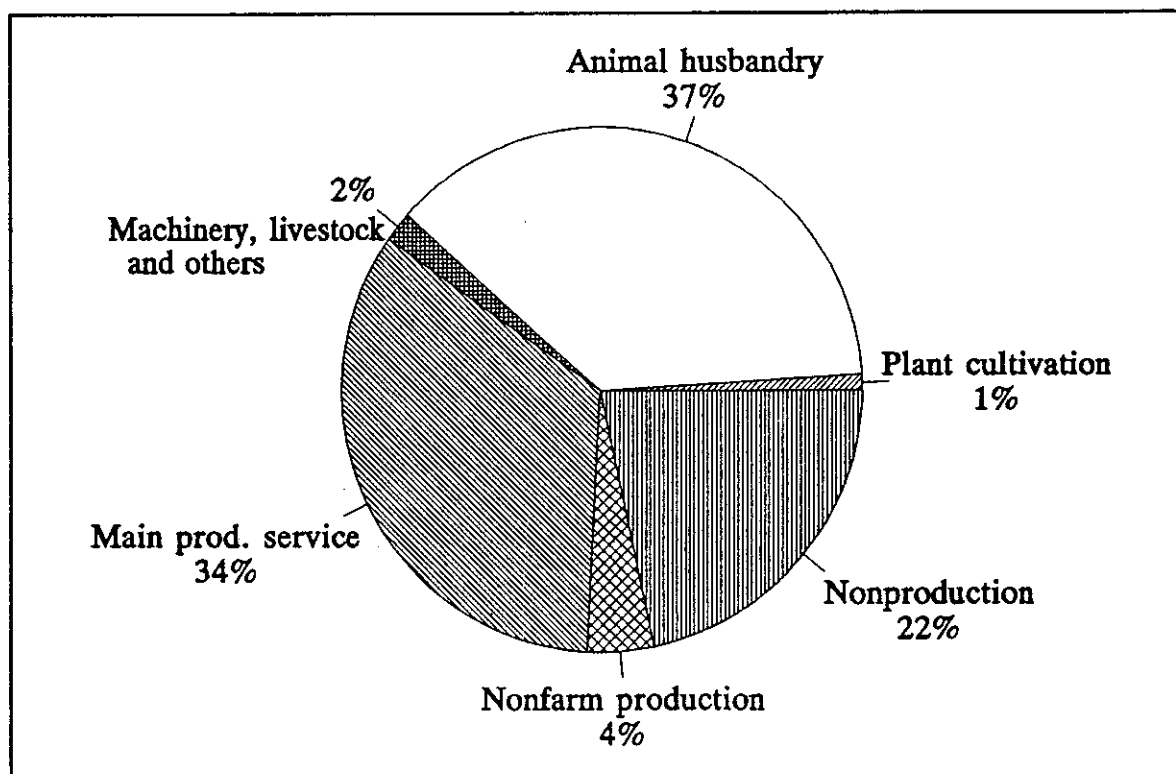


Figure 6. Structure of inventory for Ilzene shareholding company

development since August 1992; people expected the face value of shares to be raised approximately threefold.

In the pagast territory several cooperatives have been established. The employees do not believe in any future prospects for these under the circumstances of privatization, because the cooperatives are gradually turning into small collective farms. Agriculture output has decreased mainly as a result of privatization. The main problem people are facing is maintaining the social infrastructure. External circumstances such as gaps in legislation and high inflation also contributed to delays in privatization at Ilzene.

#### **Privatization of the Skanaiskalns Limited Liability Company**

The general meeting dealing with the issues of privatization and reorganization took place on November 26, 1991. The fixed capital of this collective farm was valued at 7,597,000 rubles and 3,497,000 rubles (46 percent) were allocated to capital shares.

The inventory list in Skanaiskalns was compiled comparatively precisely, because the members of the collective farm realized its significance, but this was not the case with many other collective farms.

The inventory list was regarded as an offer of tangible items for privatization. Figure 7 illustrates the structure of the inventory list. This list was detailed by the board members, who are specified in the by-laws. Some changes were introduced according to the decision of a general meeting. Initially the company had 5,000 hectares of land at its disposal, of which 2,200 hectares was agricultural land. By the end of 1992 the total acreage was reduced by approximately 5 times due to restitution of former landowners' rights. The total livestock of Skanaiskalns consisted of 1,100 cattle including 450 dairy cows, 800 pigs, and 50 swarms of bees.

In less than a year (by October 15, 1992) the capital of Skanaiskalns decreased by 80 percent, 1,528,000 rubles. The company membership decreased by 511 members, or 65.4 percent (from 782 members on November 26, 1991, to 271 members on October 15, 1992). If initially an average capital share was 9,715 rubles per member, then on October 19, 1992 it was 5,638 rubles per member. The majority of shareholders own only one capital share, at a face value of 1,000 rubles, or a split share. But there is one owner of 2,250 capital shares. The proportion of shares not taken out by their owners constitutes 33 percent of fixed capital.

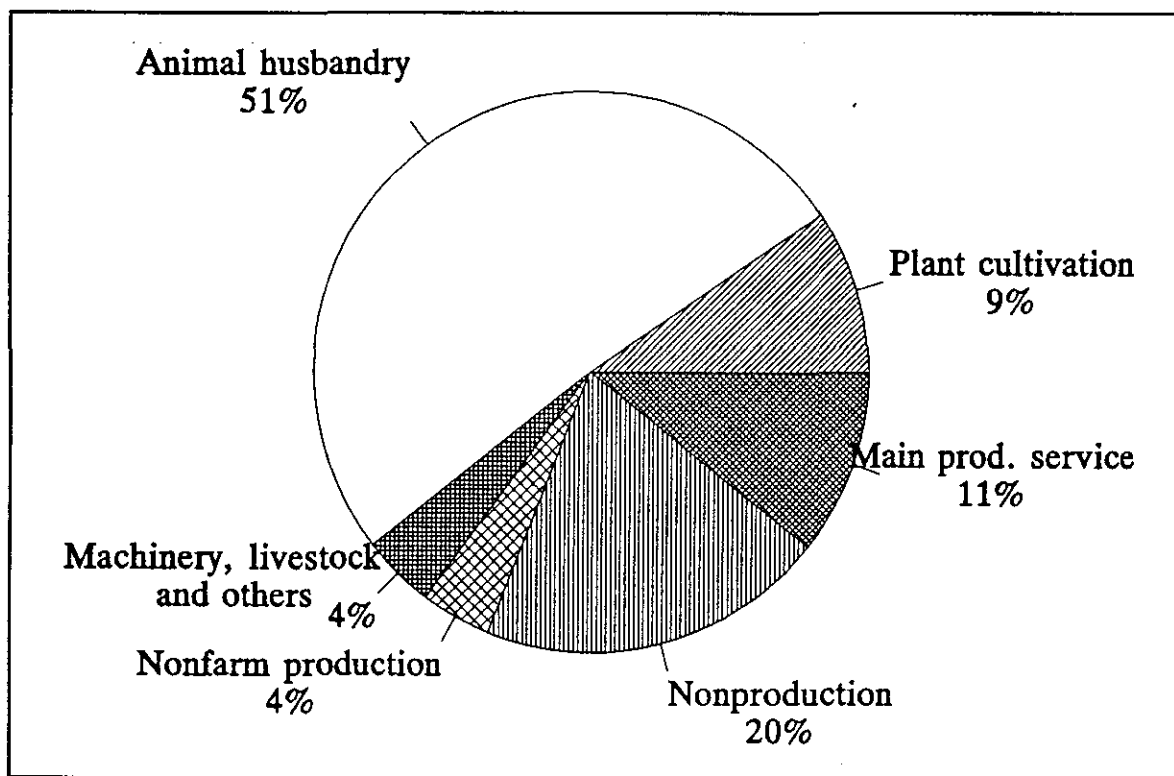


Figure 7. Structure of inventory for Skanaiskalns limited liability company

During 1992 the pace of privatization was rather even. At the beginning it was nonagricultural production units and residential houses and apartments that were privatized. Yet by October 15, 1992, production had practically ceased in Skanaiskalns (Table 4). Almost all assets of Skanaiskalns company were privatized at or close to balance sheet values (Figure 8).

Skanaiskalns was privatized by five limited liability companies and by the farmers residing in the pagast. It is essential to note that, with the exception of one limited company owned by 24 members, the rest of the companies are owned by one to seven individuals. It means that the assets of Skanaiskalns are in the hands of new owners who do not plan to move towards joint ownership. Within the newly established limited liability companies, ownership is changing and the general trend is toward concentration. Although in the territory of Skankalne pagast a decline in agricultural production is observed (apart from Skanaiskalns there were also other agricultural producers like individual full-time and part-time farmers), it is mainly due to overall problems of agricultural markets and weather conditions in 1992 rather than a result of privatization.

There are several conclusions to be drawn from the privatization experience of Skanaiskalns. The collective farm could no longer exist as a uniform enterprise, because already in 1991

Table 4. Dynamics of privatization for the Skanaiskalns limited liability company

	May 15, 1992		July 1, 1992		October 10, 1992	
	Value <sup>a</sup>	Percent	Value <sup>a</sup>	Percent	Value <sup>a</sup>	Percent
Plant Cultivation						
Privatized	425	68.7	618	100	618	100
Nonprivatized	193	31.3	-	-	-	-
Animal Husbandry						
Privatized	107	3.2	1067	32.1	3125	93.9
Nonprivatized	3220	96.8	2260	67.9	202	6.1
Service for Main Production						
Privatized	-	-	94	13.5	560	80.7
Nonprivatized	694	100	600	86.5	134	19.3
Nonfarm Production						
Privatized	88	33.1	266	100	266	100
Nonprivatized	178	66.9	-	-	-	-
Nonproduction						
Privatized	574	43.4	856	64.6	1324	100
Nonprivatized	750	56.6	468	35.4	-	-
Machinery, Livestock, Other						
Privatized	26	9.3	85	30.4	280	100
Nonprivatized	254	90.7	195	69.6	-	-

<sup>a</sup>Value of assets in 1,000 Latvian rubles (LVR).



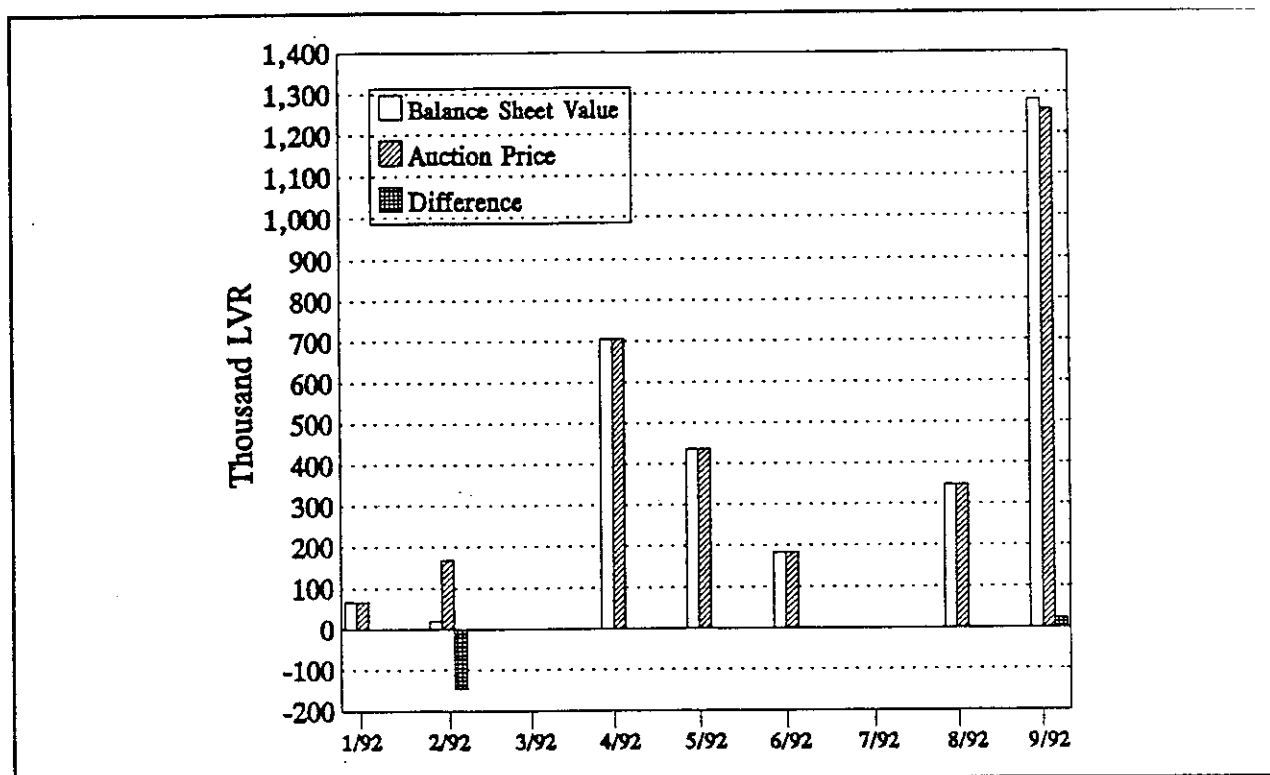


Figure 8. Auction prices of main privatization units of the Skanaiskalns limited liability company

disintegration forces were strong and by that time collective farm members had established three companies in order to privatize the collective farm assets and to start private enterprises.

By fall 1992 in the pagast a completely new design of entrepreneurship originated, and it has already been legally recognized. The local government of Skankalne pagast has assumed responsibility for nearly all social and public service infrastructures as part of the government's capital shares. The residential development of apartment buildings is actually operating as an apartment cooperative, without having settled the legal formalities (apartment owners prepared the buildings for winter).

In most cases there were auctions to sell single units of machinery or livestock from the inventory list; combined units were alienated by individual claimants even when auctions permitted declining prices. Current assets and activities as well as other assets, even though their new values were not included in the inventory list, were appropriated only for capital shares. The exceptions were apartments and residential buildings. The initiative demonstrated in the privatization of Skanaiskalns proved that only 15 to 20 percent of the former collective farmers are capable of becoming entrepreneurs. As a production company Skanaiskalns has entered the liquidation phase; actually, its operation has ceased. It is of vital importance that liquidation be carried out in the

quickest way possible, while there is still some cash and money in bank accounts at the end of the agricultural year to cover the liquidation quotas, and before this money is spent on fixed costs.

### **Conclusions and Recommendations**

Beginning July 1, 1991, the objective of the former collective farm privatization law was to distribute the production units and other assets of these large enterprises among individual farmers, other entrepreneurs, and farmers' cooperative service associations. This was to happen within two to five years, and would totally change the structure of agricultural production in Latvia.

The main objective was to encourage and accelerate private entrepreneurship in each pagast. An effort was made to preserve the production potential of the large livestock farms and mechanical workshops of the former collective farms. It was very important to follow the principles of social justice and to respect individual privacy. Since July 1, 1991, the course of events has been influenced by a number of factors and events. The process of land reform changed slightly due to changes in the political situation. In general, this slowed the pace of privatization of collective farm assets. The inflation rate increased rapidly from December 1991 to December 1992; for example, for agricultural inputs the prices increased 50- to 100-fold. This definitely accelerated the privatization process: the shareholders, under psychological stress, were compelled to obtain property with their shares.

The prices, of course, also rose. Changes in the economic environment due to market development included free prices, changes in relative prices, and a protectionist agricultural policy. All this slowed the privatization of collective farm assets, because agricultural producers found it difficult to market their products. The demand for Latvian foodstuffs declined considerably in Eastern markets as well as in the domestic market. The pace of actual privatization in agricultural production was much quicker than the pace of privatization in agricultural input-producing and agricultural output-processing enterprises and in trade. This had an adverse effect on privatization because a private entrepreneur, and above all, an individual farmer, had to deal with state monopolies.

But at the end of 1992, the privatization of input and output enterprises began to move from its earlier standstill. According to statistical data at the end of 1992, the number of livestock in Latvia declined compared with 1991 numbers. In 1992 there were 91 percent of milk cows, 91 percent of total cattle, 69 percent of hogs, and 52 percent of poultry. But compared with other Baltic countries, the situation is not so bad (see Table 5). The most unpleasant consequences Latvia might face would be elimination of the individual farmer from the group of agricultural producers. It is vital to retain the small farmers as representatives of Latvia's traditional rural lifestyle, even if

the domestic agricultural products may be inefficient and costly. We have concluded that the following circumstances, enumerated in priority order, influenced this development.

1. The current marketing problem was caused by price increases for agricultural products, and resulted in the loss of Eastern markets. It is worthwhile to remember that during the centralized planned economy this sequence worked in Latvia: import concentrated feed and export meat. When this system collapsed, there were difficulties with finding feed for pigs and poultry.
2. The state processing enterprises and the attempt to "liberalize" prices were both inadequate. Combined with the awkward payment system and banking system, it caused a two- to six-month delay in payments to farmers and agricultural production companies for their products.
3. The farm grain price was too high compared with other products. In 1992, it made livestock farming unprofitable.
4. The privatization of joint-stock companies' and limited liability companies' assets, like any structural change, at first caused a decrease in production.

However, these decreases in livestock production are not severe enough to jeopardize the structural and ownership changes now occurring in Latvia. Future projections for agricultural privatization are presented in Figure 9. It is predicted that by 1997 more than 80 percent of the Latvian agricultural and food industry will be privatized. Privatization of agricultural and service sectors will lead the process and will actually be close to completion.

Table 5. Changes in agricultural production in the Baltic countries, 1990-92

	Latvia	Estonia	Lithuania
	(number in thousands)		
Individual Farms			
1990	7.5	3.7	2.9
1991	17.5	7.3	5.9
1992	50.2	8.6	73.0
	(percent)		
Change in Milk Production			
1991/1990	92	90	92
1992/1991	88	75	77
1992/1990	87	62	70
Change in Meat Production			
1991/1990	96	84	85
1992/1991	85	67	80
1992/1990	89	74	82
Change in Grain Production			
1991/1990	92	98	102
1992/1991	82	63	66
1992/1990	56	42	46

SOURCE: Latvian State Institute of Agrarian Economics

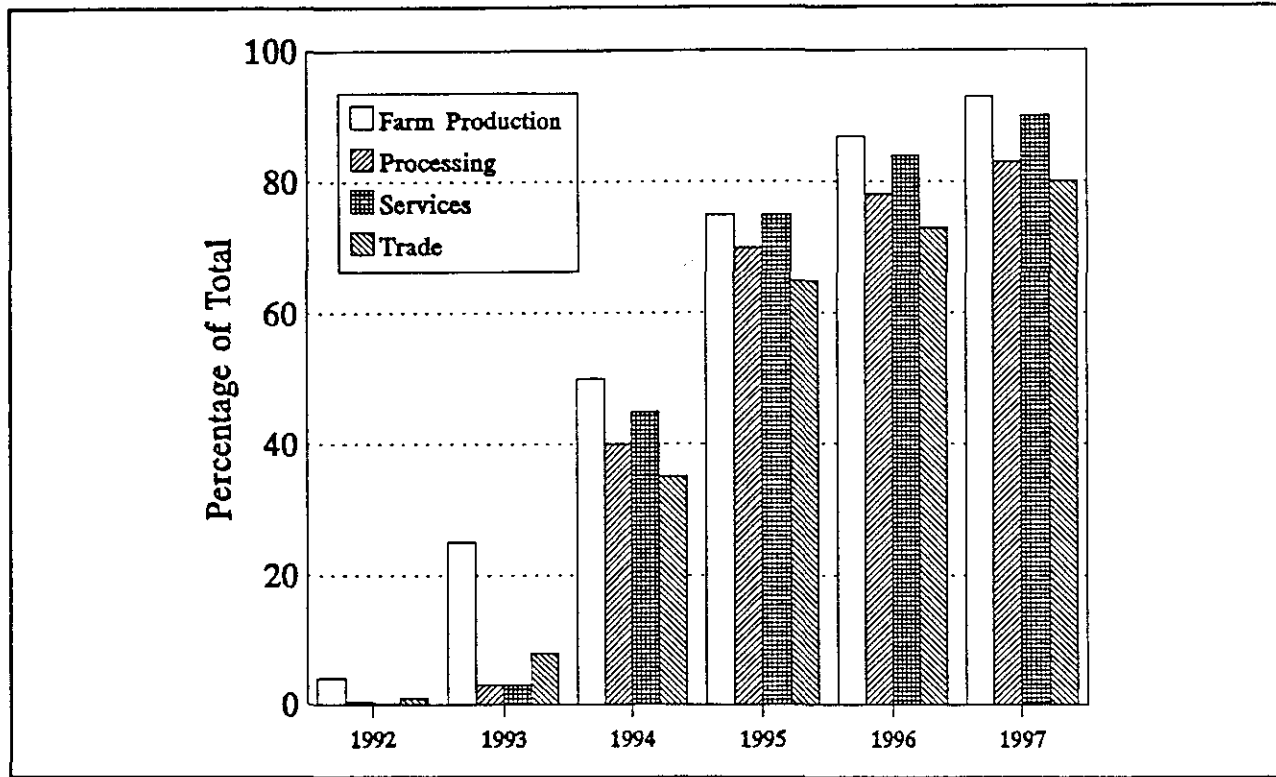


Figure 9. Projected percentage of private property in branches of agribusiness

### Summary

After the privatization and restructuring process is over and new production and service structures are in place, it is likely to expect recovery of Latvian agriculture and improvements in technology and efficiency. The Latvian example can serve as a valuable experience for other nations who are beginning privatization of their agricultural and food sectors.

## **DATA SOURCES**

Estonian Institute of Agriculture and Land Improvement, unpublished data.

Latvian State Institute of Agrarian Economics, unpublished data.

Lithuanian State Institute of Agrarian Economics, unpublished data.