EXPERTS' MEETING ON EXPERIENCE OF REFORMS, INTEGRATION OF EUROPEAN AGRICULTURE, AND GUIDELINES FOR POLICY ASSISTANCE IN CENTRAL AND EASTERN EUROPE AND THE CIS ECONOMIES IN TRANSITION

NATIONAL REPORT- LATVIA

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Latvian Experience in Reforms and Adjustment

A. The effects of macroeconomic stabilization policies on agriculture (e.g., prices, exchange rate, interest rate, taxation).

1. General economical development

Deep economical reforms started in 1990 were followed by recession. GDP reached the bottom in 1993, when it was just 50,7 % from the level in 1989. Last year was the first one, when this indicator really started to grow, reaching the level of 102,5% to 1995.

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Latvia: Basic Indicators of Economic Development[1]

	1994	1995	1996e
	(growth rates in percentage)		
GDP (at constant prices)	0,6	-1,6	2,5
GDP Deflator	38,3	17,4	16,2
Consumer prices	35,9	25,0	15,7
	(In percentage of GDP, unless indicated otherwise)		
Compensation of employees	35,3	14,0e	10,1
Central government budget balance	-1,9	-3,8	-1,2
External debt	9,2	9,2	8,1
Public debt	14,2	16,3	14,5

[1] Estimations and forecasts of Ministry of Economy, e - estimation, f - forecast.

Foreign trade balance	-8,2	-13,0	-16,1
Current account	5,5	-0,6	-6,8
Unemployment (end of period)	6,5	6,6	7,2
Exchange rate, LVL par SDR (end of period)	0,8	0,8	0,8
Share of agriculture in GVA	10,7	8,5	7,6

The share of agriculture in the real GDP grew immediately after the transition process was initiated, and started declining about two years ago. The reason for this is rather a deep crisis in other sectors than a retarded development of agriculture. After restructuring the economy, the output has dropped significantly in all sectors. In 1995 the agricultural output reached only 46.3 per cent of that of 1990 in constant prices, while the manufacturing output even dropped as low as 28,8 per cent.

It shows the role of agriculture as amortizator in the overall economic restructuring. Fundamental changes have happened in agriculture with more success than in industry, thus laying a good foundation for the future development.

2. Monetary policy

In May 1992, the Latvian interim currency was introduced. Initially the exchange rate to the Russian rouble was 1:1, however, due to the sky-rocketing inflation rates in the republics of the former Soviet Union the Bank of Latvia introduced differentiated exchange rates for the "soft" currencies. In June 1993 a true national currency, the Lat (LVL) was introduced. Since October 1993 the Lat became the only legal tender in the country. In February 1994 the Lat was pegged to the SDR. Exchange rates according to other currencies are fluctuating in a degree as these currencies are floating between themselves. The 'fixed' exchange rate worked as the stabilizing factor during the bank crisis in 1995.

Budget deficit was growing in 1994-1995. If in 1994 it was LVL 37.9 mln., in 1995 it was already LVL 115 mln. or 4% of GDP in the end of the year. Approved deficit for 1996 was just 59.8 mln.LVL. The real deficit was even less. State budget for 1997 is approved without any deficit. It shows strong monetary policy approach of current government.

3. Prices and inflation

Inflation has reached level just 13,1% in 1996 24 % in 1995 comparing with 24 % in 1995 and 36 % in 1994. It remains to be as lowest level in the Baltics. The prices on foodstuffs have increased by significantly lower level- only by 6 %, while on clothing- by 25.6 %, transport --by 21 % and medical care by 33.9 %. It means, some continuation of changes in price structure is taking place, and it is one of the main reasons for inflation.

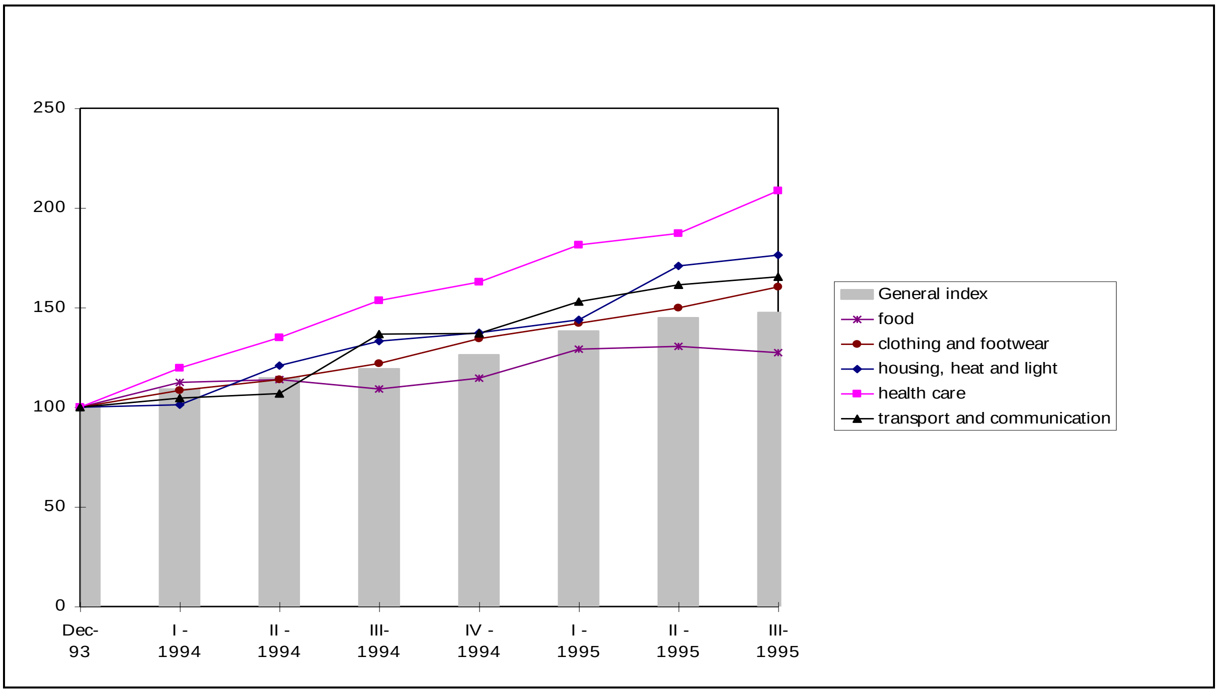

Figure 1. Dynamics of consumer price index in 1993-1995

At the same time this structure of inflation growth in unfavorable for agriculture. In 1996 the prices for such products as butter and fats, fish and fish products, spices, sugar and soft drinks have gone up only by a few per cent. Prices for fresh vegetables and potatoes have even gone down. It is caused by low purchasing power of Latvian population and strong competition on external markets. Generally the price for food products is comparatively closer to the world market price.

It should be pointed out, since January 1, 1997, Free Trade Agreement between Baltic states on agricultural and food products came into force, which does not expect more any tariff barriers in between.

Under current monetary policy agricultural sector will be faced by serious constraints due to continuous increase in energy (there is already announced schedule to increase excise tax on fuel and also tariffs on electricity) and machinery prices (which still have not reached Western price levels, while also prices on NIS produced machinery are increasing by about 30% per year) as well as those for chemicals, not having adequate increase in farmgate prices. It will push producers to increase efficiency of their production to survive.

B. Land, labor, farm inputs and capital markets

4. Land reform and farming structures

It can be said 1997 is a year when the Land reform is concluded. All the land required by private individuals is distributed in the both ways- through restitution (the major part) and giving into use and after to be privatized also in terms of land titles.

As a result former large scale socialist type of farms are replaced by a large number of small agricultural units. According to the statistical data, average size of family farms is 19,7 ha, and they occupy 52 per cent of total agricultural land. Household plots and private subsidiary farms take up 32 per cent, state farms and statutory companies -- 12 per cent. Thus more than 84% of agricultural land are processed by families, other 12% by private companies and just less than 4% by state (mainly experimental farms and training farms for schools) and local governments (as leased plots to people living in towns and villages).

Most of those small family farms (but not only them) are not economically viable, because of lack of management capability to operate commercially in a market economy. But this is not the only reason. After the price squeeze, taken place in 1990-1994, general economic conditions for farming have become significantly unfavorable compare to the previous period and increase in efficiency did not follow these changes. Partly it is characterized by PSE calculations, provided by OECD, which shows the same low level of support to agriculture as in Estonia and much lower as that in West and Central European countries, with which Latvia has to compete on external and even internal markets.

The farm size in physical terms does not characterize livestock production: the size of herd they own is more important. In case of Latvia a small scale production dominates in all types of livestock production. About 90 per cent of herd is concentrated in the farm groups from 1-9 heads per farm.

5. Land market

Land market in Latvia is rather undeveloped. There is an opinion legal constraints to own land by foreigners and slow process of land registration are the main reasons for this. Due to that some changes in land privatization legislation were made in 1997, even more liberalizing rules for this market. But this is not the only reason. May be even more important are two others:

- low profitability of major lines of agricultural production and
- low income opportunities outside agriculture.

A higher land tax could encourage land market, and, as a result, the production units will become bigger and economically more viable, even if prices remain stable. But at the same time it would become as additional burden to producers.

6. Agricultural employment

The number of people employed in agriculture still remains high, about 18 % of total number of employed (see Figure 2).

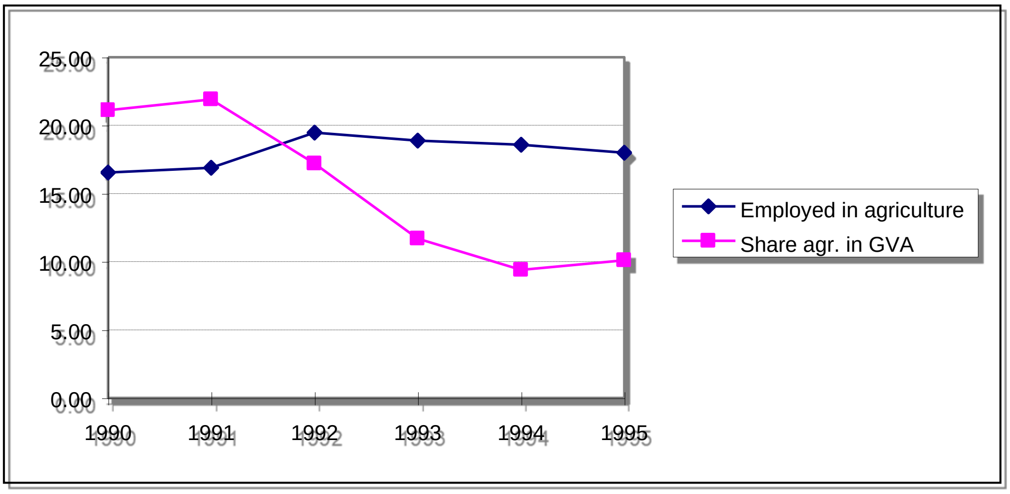

Figure 2. Share of agriculture in GVA and in total employment

Source: State Statistical Bureau.

However, it should be taken into account that many people do not choose the life in the countryside guided by economic considerations. In order to survive in the current economic situation, one should transform from self-subsistence farming to real farm business. This is not a thing anybody can accomplish, since, apart from knowledge in agronomy and veterinary, one also needs certain understanding and skills in accountancy, law and marketing. If we analyze the people employed in agriculture according to age structure, one-fifth of agricultural employees are over 60, and 42% of agricultural employees are over 50. 19% are in the age group below 30, and only 9% in the age group from 31 to 35. This also partly explains the poor mobility of rural population and the lack of capability to adapt to the new economical situation.

At the same time it should be pointed out, most of rural population has no other job opportunities, but till now, about 30% are living there. The rural labor forces in Latvia are very immobile, and for many people it is more a lifestyle and less a business.

Thus it can be concluded dominating of agriculture in rural economy has become a problem for the both- agriculture and the whole rural economy. And statement that just farm size should increase and the efficiency of farming will increase is not sufficient if not diversification of rural economy will not take place.

7. Inputs

Most of the inputs used in Latvian agriculture are imported. The distribution of inputs is fully private and is shared among a lot of companies- newly emerged and also established as the result of privatization of state owned enterprises.

During the Soviet era there was only one fertilizer producing factory in Latvia, and some agricultural machinery industry. Privatization of these enterprises is slow and lacking perspective, since a considerable amount of investments is required to improve out-of-date equipment and to rebuild buildings.

A lot of small units, some of them part of the former large agroservice enterprises, are now producing different kind of agricultural machinery (excluding tractors and combine-harvesters) and repairing agricultural machinery as well.

Because the Latvian market is too small it is not profitable to invest in the building of new Latvian upstream industry. Moreover, due to the decline of EU-agriculture in the course of the CAP reform the EU-upstream industry will try to compensate their loss of EU-market shares by gaining shares in the Eastern Europe. The EU agricultural input producers are more interested in developing a trade network in Eastern Europe to keep their market share, than in investing in upstream industries. Already now a decrease in some prices for agricultural chemicals is observed, which can partly be explained by fight between the importers for their market shares, which, certainly, is advantageous for Latvian producers and could increase competitiveness of agriculture.

In the future the price for some inputs such as fuel and electricity could increase due to the alignment with the World Market price and the tax system improvement. A gradual increase of excise tax for fuel and diesel is envisaged. For the time being, farmers are receiving input support for diesel.

8. Credit availability.

Under the Soviet system credit did not play an real economic role for producers. Short and long term credits were available for extremely low rates according to distribution schedules, very much like the other resources. As an economic factor, credit gained some significance only after transition started, when agriculture became one of the sectors applying for credits. But it lasted only up to 1992. Since that interest rates have increased tremendously, reaching 80-120% of interest.

Credits became unavailable to agricultural producers for two reasons: there were other sectors of economy to be credited and rates were so high, that crediting of agriculture became too risky, because the level of profitability was not sufficient, even more in general agricultural production was generating loses. Only some preferential credits issued in 1992- 1993 to processing enterprises from the so called G-24 credit line can be mentioned in relation to that period..

This is the reason why, in order to promote investments in agriculture, the government has created several special institutions to deal with agricultural credits- Agricultural Financing Company (AFC), State Land and Mortgage Bank, State company ‘Agroinvest’, later Rural Development Fund. But only AFC with its 5 regional offices due to access to preferential World Bank credit line in amount of 21 mil. USD with interest rate 14 %, has become an important credit source to farmers up to 1995. Since that, following general macroeconomic improvements, also some commercial banks have started to deal with credits to agriculture at interest rates around 25 to 35 % for medium term credits. It has made credit more available throughout Latvia. But interest rates still are relatively high, especially compared to agricultural and food products’ component in CPI calculations, which shows that price increase for this group does not follow an average CPI.

9. Taxation and agriculture

Tax concessions provide some indirect support to agriculture, especially to individual farmers. The following tax concessions are in force.

Excise tax on diesel fuel is redeemed to the tune of 120 l of diesel fuel per hectare of land (owned or in permanent tenure).

Property used exclusively for agricultural operations (or intended to be used so) is not taxed with property tax.

Case-by-case approach can be applied to land tax payable by individual farmers.

Bigger agricultural producers will benefit from corporate income tax relieves: the annual payable sum will be reduced by 10 Lats for each hectare used in agricultural production. The small producers, alternatively, have a 20% discounted on the calculated income tax amount. It should be noted that not all the farmers are taking the advantage of tax concessions due to bureaucracy and lack of sufficient information and education.

Despite there are several tax relieves for agricultural producers, the prevailing trend is towards abolition of different kinds of concessions.

C. Public, semi-public and private institutions catering for agriculture and food processing sector (e.g. research and related services; farmers associations; marketing and credit agencies)

10. Science

Research basically is carried out in Agricultural University and specialized state research institutes, as well as in several plant and livestock selection and experimental farms. Since 1996 some reorganization of research institutions is taking place. Some of experimental farms have been privatized or are in the process. And research institutes are being integrated into University as its structures. In practice it will not change efficiency and orientation of research, because distribution of funding will remain the same as previously.

It should be pointed out, that there is no any permanent state budget's funding for any of research institution. All the finding is provided on contract (project) basis. But the problem is the major part of funding is distributed by expert council, consisting of only the most experienced scientists, not every when looking at current priorities, but sometimes more at their own institutions financial needs. And under lacking of strong farmers' organizations there is little hope, the system can change quickly.

11. Education

Agricultural education is provided by state education system, consisting on professional schools, collages and Latvian Agricultural University (LAU). Schools and collages providing basic agricultural education are located through all the Latvia. To get more specialized secondary education it is recommended to attend several specialized colleges.

Agricultural University in its seven faculties give higher education (bachelor and master degree or diploma) in agronomy, zootechnics, agricultural engineering, forestry, food technology, economics, veterinary, land improvement and melioration.

12. Advise

In 1992 as a new unit was established Latvian Agriculture Advisory Service (LAAS) with strong support of Danish government. It has the central office, located very close to LAU, and regional offices, located in each administrative district, as well as a number of local consultants. Total number of employed people employed in this institution is more than 400. Currently the reorganization of LAAS is taking place with the idea to privatize it in near future.

LAAS provides advise in agronomy, taxation, bookkeeping, veterinary, and various other fields. As one of the newest is advise in forestry, taking into account a big number of new owners is not less important as advise in pure agriculture.

Also agricultural schools and colleges provide some advise, using potential of their teachers.

13. Market promotion.

In 1995 there was established the Market Promotion Center At the Latvian State Institute of Agrarian Economics. One of the main activities of the Center is to publish information on prices in agricultural and inputs' market-- in Latvia and also in Baltics and Europe.

Advise on marketing of products also can be reached in this Center.

LAAS tries to establish a database on farmers' offers to sell some equipment and other resources not needed more in their farms.

14. Associations

There are not developed many strong farmers' organizations in Latvia. Only few of them can be mentioned. Among them is Latvian Central Dairy Association, which includes the majority of milk producers. Also Farmers' Federation should be pointed out, which is the oldest private farmers' organization in Latvia, but its influence was limited due to lack of clear common interests and strategy vision. Recently an organization of agricultural companies was established as some kind of trade union for this type of enterprises.

Some other professional based organizations exist in the fields of horticulture, grain production, sugar production and some others.

15. Credit agencies

As it was already mentioned, there exist some specialized state owned credit agencies, which were created basically to deal with some preferential credit lines, provided by international assistance-- AFC to deal with the World Bank credit line in $21 mln. And Rural Development Fund -- to deal with USA and Finland assistance.

AFC is operating very successfully-- there is no one lost credit during three years of operation. And in this period it was almost only really available credit line for agricultural producers. At the same time it should be pointed out, these credits were more available for already well established private farmers, nor newly emerged ones. And of course, this relatively small credit line could not solve all the problems existing in rural crediting.

In 1992 there was established State Land and Mortgage Bank, which did not invest too much in developing of rural credit system, mainly due to lack of credit resources. Now the merging of the both institutions (also AFC) is under consideration.

In 1996 there were established the first three local credit saving cooperatives- with assistance of EU funding. But their future is still under strong consideration.

D. Trade capacities and comparative advantages in trading of agricultural and food products, and the country expectations for their future development.

Since 1993 Latvia has experienced a fundamental change in terms of the composition of imports and exports as well. It concerns the both- structure of products and structure of trade partners by countries.

As statistics show, structure of exported products has changed significantly within 1993-1994. The share of dairy produce and also meat has declined from 57 % in 1992 to 41 % in 1995. It was replaced by fish products and sugar confectionery. Also within group of meat and its products share of industrially processed meat products has increased. Partly it can be explained also by lack of available meat resources produced by Latvian agricultural producers. Business of meat processing industry is largely based on imported unprocessed meat.

It shows also increasing competitiveness of processed food comparing to primary agricultural products in line with advantages of see located country.

Also structure of imports has changed. Share of sugar and cereals that were 20.2 % and 26.4 % in 1992 respectively, now has decreased to 11 % and 4.1 % in 1995. It is replaced by fish and beverages and also by other products (see statistical annex, table 8).

Official estimates indicate, that Latvia imported about 4800 tones of meat products in 1995. Since 1994 Latvia continues to be as net importer of meat.

E. The major policy issues under discussion arising from the implementation of reform policies (e.g. environmental, social and others).

Up to now there are no real structural, environmental and social Policies, related to agrifood sector and rural areas in Latvia.

Just recently it was agreed on the necessity to start to deal with less developed regions in Latvia, where unemployment is higher and, consequently, population income level and living standards are lower. Partly it could also help agriculture to solve its problems.

F. Agricultural and food strategy objectives

After the long discussion carried out by different parties and groups of producers on long term development strategy for Latvian agriculture the law “On Agriculture” was passed on November 8, 1996. It sets the main objectives for the Latvian agricultural policy and scope of instruments to be used to implement it.

The declared objective in the Agricultural law is “… to maintain the development of agriculture as one of the branches of national economy and to set a long term agricultural policy”. Several main goals should be achieved:

- the development of an efficient agricultural policy for the transition period until a possible entrance into the EU, to implement necessary structural adjustments and to increase competitiveness in international markets;
- to create preconditions for an environmentally friendly and socially oriented agriculture, for the rational use of natural resources and taking into account regional differences;

- to create a pre-condition for the development of the rational enterprises of different types to produce competitive products on lesser costs, to increase agricultural production efficiency;
- to maintain employment in rural areas;
- to try to equalize income in agriculture to the average in the national economy;
- to set out main principles of market regulation in agriculture;
- to maintain the development of agricultural science and education.

Some of the goals are contradictory and it is obvious the implementation of the law will require some compromises between all of them. However, several points should be mentioned.

1. It can be found in the document that the need for agricultural development to be efficient is prevailing over agricultural income maintenance.
2. Several statements are formulated more as rural development objectives rather than agricultural policy goals. Among them can be mentioned the necessity to create the pre-conditions for the maintenance of employment in rural areas; the development of different types of enterprises; the rational and environmentally friendly use of existing natural resources.

Comparing the goals and instruments mentioned in the Law “On agriculture” to those requirements and principles set by GATT/WTO, existing free trade agreements and EU association agreement, no significant contradictions can be found. Even more, there is a statement in the law, any type of support to agriculture and rural development should not contradict the principles and statements of international agreements signed or going to be signed by Latvia.

G. Trade policy

In November 1993 the government of Latvia made a decision to accede to GATT/WTO. In accordance with this decision all the legislation on trade and trade related aspects have been drafted based on the WTO principles.

The strategic objective of Latvia is to become GATT/WTO memberstate already in 1997, and the last round of negotiations concluded in February in Geneva ensure in possibility of it.

Meanwhile, when Latvia is not yet a WTO memberstate, a lot of multilateral and bilateral negotiations are taking place. The main subject is the reduction of import tariffs for the following product groups: meat and meat products, milk and milk products, vegetables, grain and products, sugar, alcoholic and non-alcoholic beverages.

From the existing agreements in effect, Latvia’s most important achievement is the Free Trade Agreement signed with the EU on 18 July 1994, which came into force on 1 January 1995. A half year later the Association Agreement between EU and Latvia was signed, and the above mentioned trade agreement became an integral part of it. Under the agreement, Latvia has been granted a four-year transition period in which to adjust its non-agricultural economy to competition within a Western European environment, while a six-year transition period has been agreed for agriculture.

Presently Latvia has concluded four Free Trade Agreements on trade in agricultural products, apart from EU, with Slovenia, Chech Republic and Slovakia, as well as with European Free Trade Association (Iceland, Norway, Liechtenstein, Switzerland).

Under the Baltic Free Trade Agreement, which came into force since 1 January, 1997 also Estonia and Lithuania should be mentioned to this group. Despite some predictions that already in the first days after the agreement is effective, Latvia will be flooded with the less expensive produce of the neighboring country, actually trade was not lively at all during the first months of this year.

The next step to be taken is the establishment of the Baltic Customs Union. The importance of it has been acknowledged by the Baltic Assembly since December, 1995. The different customs barriers policies varying between the three countries potentially would lead to problems in the future. A common concept used in negotiations about joining the EU and WTO, would facilitate the process.

The best strategy for Latvia would be to maintain an open trade regime and a low price support policy in order to sustain and encourage greater competitiveness. Placing grater emphasis on improving the economic efficiency of the whole agri-food chain would enhance its competitiveness and improve the terms of trade for agricultural producers and processors.