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Food and Agricultural Price and Subsidy Reforms in the Baltics: Progress and Prospects

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Abstract

This paper reviews the price subsidy reforms in each of the Baltic States from 1990 to 1992 and provides a comparison of the differing decisions and preliminary results. Although price levels and compensation mechanisms differ, the pattern in all three states is to let negotiations between producers and processors set producer prices and to limit the profit mark-up by processors, wholesalers, and retailers. For consumers, price increases were partially offset by direct income transfers. Although Estonia preceded the others by removing most price controls in July 1991, Lithuania and Latvia did the same in late 1991 and early 1992.

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Food and Agricultural Price and Subsidy Reforms in the Baltics: Progress and Prospects

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The Lithuanian Institute of Agrarian Economics, Vilnius, and CARD, Iowa State University, are collaborating on a number of research projects related to all facets of economic reforms in Lithuania. This paper is a result of that joint venture.

The contents of this paper may be cited with proper credit to the author, to the Lithuanian Institute of Agrarian Economics, and to the Center for Agricultural and Rural Development, Iowa State University.

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ABSTRACT

This paper reviews the price and subsidy reforms in each of the Baltic States from 1990 to 1992 and provides a comparison of the differing decisions and preliminary results. Although price levels and compensation mechanisms differ, the pattern in all three states is to let negotiations between producers and processors set producer prices and to limit the profit mark-up by processors, wholesalers, and retailers. For consumers, price increases were partially offset by direct income transfers. Although Estonia preceded the others by removing most price controls in July 1991, Lithuania and Latvia did the same in late 1991 and early 1992.

FOOD AND AGRICULTURAL PRICE AND SUBSIDY REFORMS IN THE BALTICS: PROGRESS AND PROSPECTS

The Baltic States initiated pricing policies in 1990 and 1991 that have led to greater reliance on market forces in determining price levels. Among the first steps taken by the governments was to increase producer and consumer prices and to use wage increases or direct income subsidies to partially offset the burden of higher consumer prices. Major objectives of these price reforms are to cover higher costs of production inputs, reduce or eliminate the large food price subsidies, and protect the internal market from other ruble zone consumers. By July 1991, Estonia had deregulated most retail food prices, while in Latvia and Lithuania price reforms remained within the framework of a state pricing system until late in 1991.

This paper evaluates selected price information and pricing reforms that are underway or anticipated, demonstrates how they differ in the three Baltic states and assesses their potential impact on the agribusiness sector.

Prices and Price Reforms in the Baltics

The Baltic States, as elsewhere in the former USSR, actually had two parallel retail markets outside the state market for many commodities. One was the cooperative retail market, where farms and cooperatives could sell products outside the state market, and the other was the private market, which was legally sanctioned for food products but not for manufactured goods. As an example, the Lithuanian data for these markets in Table 1 indicate that cooperative market prices were generally higher than state prices but that private market prices were much higher than both. From 1985 to 1989 the ratio between market and state prices for beef, potatoes and vegetables increased slowly and the ratio in 1989 varied from 322 percent for meat to 567 percent for vegetables. Market prices increased substantially in 1990 and 1991 as inflation and the relative scarcity of goods increased, further widening the gap between state and market prices.

Another inheritance from the Soviet system prior to the price reforms was that production inputs in agriculture were heavily subsidized and most of the production was sold through the state distribution system at fixed procurement prices. There also was a system of bonus payments to

compensate low productivity farms, which was designed to achieve similar profitability across the farms with different productivity levels. Additional bonus payments were provided for production that exceeded the government established quotas. In many cases these bonus payments went to large collective and state farms, who purchased the above quota production from individual production plots at the lower state procurement prices.

The intermediate sector, between the farm-gate and the retail market, was also heavily subsidized. In some cases, retail prices were even below equivalent farm prices, indicating that the government subsidy exceeded the intermediate processing and distribution costs. Even where retail prices were above farm-gate prices, significant government subsidies for processing and distribution existed. A major motivation of initial price reforms was to raise retail prices significantly more than procurement prices in order to reduce or eliminate these very large subsidies.

Table 1. Lithuanian state, cooperative, and retail average prices for selected food groups, 1985 to 1989

	1985	1986	1987	1988	1989
Meat					
			(rubles per kilogram)		
State retail price	1.83	1.85	1.94	2.17	1.95
Cooperative price	2.22	2.38	2.41	2.56	2.60
Market price	5.06	5.36	5.24	5.32	6.28
			(percent)		
Market/state price ratio	276.50	288.60	270.10	245.20	322.10
Potatoes					
			(rubles per kilogram)		
State retail price	0.11	0.12	0.12	0.15	0.14
Cooperative price	0.90	0.84	0.78	0.90	0.33
Market price	0.38	0.40	0.47	0.45	0.54
			(percent)		
Market/state price ratio	345.50	333.30	391.70	300.00	385.70
Vegetables					
			(rubles per kilogram)		
State retail price	0.37	0.40	0.44	0.42	0.46
Cooperative price	0.97	1.03	1.16	1.23	1.16
Market price	2.31	2.12	2.64	2.48	2.61
			(percent)		
Market/state price ratio	624.30	530.00	600.00	590.50	567.40

SOURCE: *Lithuanian Statistical Review* 1989.

Producer Price Reforms

The first step in the price reform process, in fall 1990, was to partially deregulate input prices across the former republics of the USSR. To the then-Baltic Republics who had declared or were seeking independence, this was an external factor requiring a price policy response. The first response was to raise procurement prices in October 1990 to offset the rising costs of production inputs. Although the range of procurement price increases was from 50 to 200 percent, procurement

prices generally doubled from previous levels. As an example, the Latvian procurement price increases are shown in Table 2. Pricing decisions differed somewhat in Lithuania and Estonia, but the magnitudes of increases were similar. Since the complex system of bonus payments was also eliminated at this time, the actual prices received by farmers did not increase as much as the increase in procurement prices. Since the bonus payments were highest in livestock and dairy production, the net price increase to producers of these commodities was significantly less than that for crop commodities.

As input prices continued to rise in late 1990 and early 1991, producers continued to pressure the government for higher procurement prices, and governments responded with additional procurement price increases over time. The periodic increases in Lithuanian procurement prices are summarized in Table 3. In the case of crops harvested in the fall, the announcements in January only indicated intentions. The actual procurement prices for the 1991 crops were those in October 1991. The fact that these are two to three times higher than procurement prices in October 1990 is indicative not only of the increase in input costs, but also of the pressure of producer groups and competition among the Baltic States to keep production within their borders. There appeared to be little consultation among the Baltic States as these price changes were implemented. The increase in livestock and dairy product prices were influenced both by the increased production costs and by the need of the governments to obtain products that had been committed in contracts with other cities and republics of the former USSR. It is also important to recognize that a portion of these price increases was offset by new taxes on producer profits.

A snapshot of the differences in procurement prices across the three Baltic States is shown in Table 4. Not only does this indicate some significant differences in price levels but also in those prices that have been deregulated. Contract pricing, which involves negotiations between buyers and sellers, is a partial deregulation and indicates that the state no longer fixes the producer price. As of April 1991, relatively few basic commodities had been changed to contract pricing, although it was a mechanism widely used for input prices and nonagricultural commodities.

In July 1991 Estonia virtually eliminated the state pricing system for food and agricultural products and replaced it with a system of producer support prices and retail markup restrictions that allows the market to function with relatively little government intervention. Latvia and Lithuania introduced similar pricing systems later in 1991. Producer prices in all three states are now set through regional consultations between producers and processors.

Table 2. State procurement prices in Latvia for agricultural products

Commodity	Before 1990	October 1990
	(rubles per metric ton)	
Soft wheat	130	250
Rye	170	300
Oats	130	250/490*
Barley (for feed)	130	250/300*
Barley (for beer)	180	380
Sugar beets	58	82
Flax (I grade)	460	1240
Flax (Low grade)	310	780
Cattle (beef)		
Highest category of weight	1860	4810
Medium category of weight	1550	4010
Low category of weight	1162	3000
Hogs		
I Category	2280	4750
II Category	2110	4420
III Category	1894	3970
IV Category	1553	3030
V Category	3000	6600
Poultry (Chickens and broilers)	2100	3320
Milk		
I Grade		
< 10° C	320	695
> 10° C	310	580
II grade	288	535
Low quality	248	320

SOURCE: Unpublished data provided by the Latvian Research Institute of Agricultural Economics 1991.

* Higher price for ecologically pure production.

Table 3. Lithuanian state procurement prices for major agricultural products

	1989	Oct. 90	Jan. 91	Apr. 91	May 91	Oct. 91
	(rubles per metric ton)					
Grains Total	162	410	640	640	640	1000
Potatoes (for food)	204	253	600	600	600	900
Sugar beets	65	110	250	250	250	250
Meat (liveweight) ^a						
Beef (middle quality)	2,871	3,330	4,000	5,010	7,200	7,200
Pork (II class)	2,839	3,480	4,220	5,260	8,010	8,010
Mutton (middle quality)	3,391	4,170	^b	^b	^b	^b
Poultry (Chickens)	2,221	2,500	3,000	3,600	4,700	6,500
Eggs (1000 units)	87	90	135	135	135	160
Milk	371	553	553	567	567	581

SOURCE: Unpublished data provided by the Lithuanian Institute of Agrarian Economics.

^a 1989 prices are simple averages; the later prices are for an intermediate quality of the commodity.

^b Contract prices are negotiated, not fixed.

Table 4. State procurement prices for main agricultural products as of April 1991

Commodity	Lithuania	Latvia	Estonia
	(rubles per metric ton)		
Grains	640	550	600
Sugar beets	250	136	^a
Beef (liveweight)	5,671	5,260	6,150
Pork (liveweight)	5,138	4,985	5,250
Poultry (liveweight)	3,535	^b	5,050
Mutton (liveweight)	^b	6,500	^b
Milk	567	705	590
Eggs (1000 units)	135	^b	^b

SOURCE: Unpublished data provided by the Lithuanian Institute of Agrarian Economics.

^a Estonia does not produce sugar beets.

^b Contract prices are negotiated, not fixed.

Retail Price Reforms

Estonia, Latvia, and Lithuania preempted the April 1991 retail food price increases in the rest of the former USSR by an earlier announcement of their own retail price increases. Estonia was the first to take this step, but by late March 1991, Latvia and Lithuania had followed. As seen in Table 5, the new retail prices were three to four times higher than the old prices. However, there was also significant variation in some prices among the Baltic States. These higher retail prices were accompanied by income subsidies and wage increases to partially offset the higher cost of food. In Lithuania wage increases preceded price increases and generally kept pace with price inflation. (Savings account balances were also credited with 40 to 50 percent increases, but these funds cannot be used for consumption.) Since these price increases were still in the framework of state pricing and retail systems, the free market prices of food continued to remain substantially above the state prices. An example for Latvia (Table 6) indicates that market prices continued to be 2 to 5 times higher than state prices.

As already indicated, Estonia deregulated most food prices in July 1991. Lithuania began the process of increasing state retail prices of foodstuffs in October and November 1991 and deregulated prices in early 1992. Latvia did not increase its state retail prices from April 1991 until December 10, 1991, then deregulated most prices. As a consequence of these differing policies, the retail prices of foodstuffs in state-owned shops as of late November 1991 varied significantly across the three Baltic States (Table 7). In all cases where comparisons are available, Latvia still had the lowest prices. However, it is interesting to see that many food items cost less in Estonia's deregulated markets than in Lithuania's state retail shops. Notable exceptions were sugar and potatoes, which had much higher prices in Estonia.

Another important sign that the deregulated market is working in Estonia is that the free market prices of most foodstuffs in November 1991 were lower in Tallinn than in Riga and Vilnius (Table 8). Generally, market prices were also significantly lower in the Baltic cities than in Minsk and St. Petersburg.

The stark contrast in the distortions that were still present in the November 1991 pricing structure of Estonia compared with Lithuania and Latvia can be seen in the ratio of market to state prices in Table 9. Although these are very crude calculations and not adjusted for quality differences, there appears to be essentially one market in Estonia, as the deregulation has generally removed the distinction between the state stores and the free market for commodities. The fact that the free market pork price in Tallinn appears to be 50 percent above the state price may be partially explained by differences in average quality of the meat. In Vilnius the price gap between market and state prices is substantially larger, but the distortion is largest in Riga, where state prices were not increased until December. These figures, especially the generally lower free market prices in Estonia, indicate that Lithuania could deregulate prices without major disruptions. Latvia's state retail prices were more heavily subsidized in November 1991, so the shock of deregulation was greater there. Prices in all three states surged between November and early March as the price deregulation in Russia was anticipated and realized and production costs continued to rise rapidly (Table 10). State and private prices were nearly the same in Tallinn, while the widest gap between these prices was usually observed in Moscow.

Table 5. Baltic retail prices for main food commodities as of March 26, 1991 compared with old prices

	Old Price	Lithuania	Latvia	Estonia
		(rubles per kilogram)		
Beef ^a	1.80	7.80	7.20	7.55
Pork ^a	1.94	6.20	7.30	4.80
Sausage	2.90	8.30	12.30	8.36
Hot dogs	2.60	7.10	7.30	6.49
Chicken	2.70	8.50	6.50	4.53
Milk (1 liter)	0.26	0.73	0.60	0.62
Butter	3.40	9.90	10.00	9.90
Sour cream (1 liter, 35% fat)	1.20	3.90	4.00	6.24
Cheese	2.90	8.7	8.60	8.02
Sugar	0.80	3.75	0.90	2.20
Eggs (10 units)	1.00	2.40	^b	2.95

^a Prices for lowest category of meat, which is almost unavailable.

^b Contract prices are negotiated, not fixed.

Table 6. Latvian old and new state retail prices compared with recent private market prices

Commodity	State Price			Market Price ^a	Market/State (%)
	Old Price	March 1991	Increase (%)		
	(rubles per kilogram)				
Beef	1.80	7.20	(300)	13-15.00	194
Pork	1.94	7.30	(276)	18.00	247
Chicken	2.70	6.50	(141)	12-15.00	208
Milk	0.26	0.60	(231)	3.00	500
Cottage Cheese	0.75	5.05	(573)	12.00	238
Cheese	2.90	8.60	(197)	--	--
Butter	3.40	10.00	(194)	20.00	200
Sour cream	1.20	4.00	(233)	14.00	350
Eggs (10 units)	1.00	^b	^b	4.00	--
Potatoes	0.12	^b	^b	1.20	--

SOURCES: State price data from Latvian Research Institute of Agricultural Economics; market prices from newspaper *Atmoda*, Riga, Latvia.

^a February or March 1991.

^b Contract prices are negotiated, not fixed.

-- not reported.

Table 7. Retail prices in state-owned shops, November 18-24, 1991

	Vilnius	Tallinn	Riga
	(rubles per kilogram)		
Bread	1.5-2.88	0.70-1.40	m.d.
Chicken	11.0-12.23	10.0-14.0	6.5
Beef	14.4-41.85	14.0-23.0	7.2
Pork	15.15-27.75	13.0-16.0	7.3
Boiled sausage	17.90	16.0-22.0	12.3
Frankfurters	16.80	19.0-21.0	7.3
Butter	16.10	24.0	10.01
Eggs (10 units)	7.0	4.50-5.50	*
Sugar	7.50	15.40-21.40	0.9
Potatoes	1.70	3.0-5.0	*
Onions	6.0	7.0	--
Carrots	2.88	3.50-4.50	--
Cabbage	1.60	1.50	--
Honey	58.00	50.00	--
Cheese	-	17.00-22.00	8.6

SOURCES: Estonian, Latvian, and Lithuanian Research Institutes 1992.

^a Contract prices are negotiated, not fixed.

-- missing data.

Table 8. Prices of products in market places, first week of November 1991

	Tallinn	Riga	Vilnius	Minsk	St. Petersburg
	(rubles per kilogram)				
Beef	20	35	35	55	80
Pork	22	40	45	55	80
Chicken	12	22	45	57	35
Eggs (10 units)	5	12	13	15	20
Potatoes	4	3	2	7.5	4.5
Onions	8	6	4	5	9
Tomatoes	9	10	6	13	15
Apples	4	5	4	12	8

SOURCES: Estonian, Latvian, and Lithuanian Research Institutes 1992.

Table 9. Ratio of average market prices to state prices, November 1991

	Tallinn	Vilnius	Riga
Beef	1.08	1.24	4.86
Pork	1.52	2.10	5.48
Chicken	1.00	3.87	3.38
Eggs	1.00	1.68	*
Potatoes	1.00	1.18	*

* Contract prices are not known.

Table 10. Retail prices in state shops and private markets, March 3-4, 1992

Commodity	Vilnius	Riga	Tallinn	Minsk	Moscow
	(rubles per kilogram)				
Bread					
State	3.4-5.0	4.5	6.7	1.5-3.9	3.5-5.0
Beef (top grade)					
State	77-96	64	127	75	80-140
Private	--	90	120	--	170
Pork (I grade)					
State	50-66	58-60	82	55	59-78
Private	70-80	80	80	80-90	110-140
Chicken					
State	54	38	50	35-43	40
Private	--	15-20	12	--	50
Butter					
State	78-102	155	165	42	136
Private	130-180	200	160	80	150-170
Eggs (10 units)					
State	13-19	23	25	13.5	15-17
Private	18-20	25-30	27	18	20-25
Potatoes					
State	2.4	4.5	12	2.4	4.0
Private	5	9	14	4-5	18

SOURCE: *Lietuvos Aidas* 1992.

-- no price data available at this time.

Price Reform Impacts

In the midst of this dynamic and rapidly changing situation, it is difficult to assess the quantitative impacts of the policy changes. Since the initial conditions were that both producers and consumers were being subsidized by the government, removing these subsidies places economic stress on both producers and consumers. The tension between producers, who want prices to be higher, and consumers, who want to minimize price increases, is exacerbated by the inefficiency of the production and distribution system. For example, if the intermediate costs of processing and distribution are high and the government removes consumer subsidies, retail prices will need to be substantially above producer prices in order to cover the intermediate costs. If these costs can be reduced, the gap between farm and retail prices will become smaller to the benefit of both producers and consumers.

As consumers suffered losses in real income, governments found it difficult to reduce subsidy expenditures. A preliminary study of price reforms by Kazlauskiene, Devadoss, and Meyers (1991) indicated that in the early stages of Lithuanian price reform there appeared to be a large enough gap between producer and consumer prices to eliminate most of the processing subsidies. However, as procurement prices continued to increase in 1991, these gains disappeared; and the total food and agriculture subsidy cost to the Lithuanian government in 1991 was about the same as in 1990. In Lithuania, as in Estonia and Latvia, subsidies were essentially eliminated by February 1992.

Another important impact of price reform is the effect on food consumption and the real income of consumers. Even with the income subsidies and wage increases, real incomes are declining due to the sharp price increases of food and nonfood consumer goods. One would expect this to cause shifts in expenditures from nonfood to food products, from higher cost processed foods to lower cost basic foods and possibly a reduction in the total quantity of food consumed. Kazlauskiene, Devadoss, and Meyers (1991) made preliminary estimates of the consumption impacts of price changes implemented by April 1991. It was estimated that the 1991 price increases would lead to increased food expenditures of about 240 percent and an increase in the portion of incomes spent on food from 27 percent in 1990 to 57 percent in 1991. Per capita consumption for most foods was estimated to decline, but this decline was most dramatic in the less essential foodstuffs. The decline in consumption was also expected to lead to fewer grain imports and greater export availability of livestock products, but this has been offset by declines in livestock numbers and production.

Another estimate of the consumption impacts of price increases comes from the household consumption survey conducted quarterly in Lithuania. Comparing the second quarter of 1991 with the second quarter of 1990, the average prices of most commodities were 200 to 300 percent higher

in 1991. Households reported a decline in consumption of nearly all commodities at the same time as their expenditures increased by 215 percent.

None of these estimates are very reliable, but they point in similar directions. As food price subsidies are removed, it is inevitable that consumers will shift to consumption patterns more consistent with their lower real income levels. This usually will mean a lower quality diet with fewer livestock and processed products and more basic foodstuffs. However, if these price increases are also accompanied by the introduction of market economy systems, consumers will benefit from the greater availability of food and reduced shopping time. The economy as a whole will also benefit from productivity increases, as workers spend less time in queues to buy food. These benefits are no consolation to the unemployed and pensioners, but it preferable to devise safety net programs for the disadvantaged rather than to subsidize both the rich and the poor.

Conclusions

The situation in the Baltics is changing so rapidly that the data in this paper will soon be out of date. However, Lithuania and then Latvia did follow the example of Estonia in deregulating most of the food and agricultural markets. After internal liberalization, the Baltics still need to make important decisions about external liberalization. During 1992 each of these states will probably issue its own currency and establish monetary policies that include decisions on how exchange rates will be determined. Decisions will have to be made on the degree of protection openness for food and agricultural markets. Currently, imports are essentially free of tariffs or quotas and exports of food products are restricted by export licensing.

Until now the Baltics, like many other former other republics of the USSR, have become more protective of their internal markets as they achieve independence. Hopefully, as the benefits of removing internal distortions are realized, the Baltic States will also recognize the benefits of reducing external distortions and generating conditions that increase the opportunities for trade. A natural first step in this process would be open borders and coordinated policies among the three Baltic States. Since these three economies are rather similar, the gains from trade among them would not be great; but gains in economic efficiency could be significant.

DATA SOURCES

Atmoda. Various issues. Newspaper. Riga, Latvia.

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Unpublished data were obtained for 1989-92 from the research institutes of Estonia, Latvia, and Lithuania.