

## **Lithuania's membership in the European Union: possible effects on Lithuania's external trade policy**

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### **Introduction**

Since the beginning of 1990's, membership in the EU has been a priority goal of foreign policy of Lithuania as well as other associated countries of Central and Eastern Europe. Although the main motives for joining the EU are of political and security rather than economic nature, the economic implications of EU membership for newly accepted countries will be very significant. The prospect of membership in the EU is already influencing the legal systems of applicant countries through the legal approximation thereby shaping their transition patterns and economic models to be achieved. The economic processes in the applicant countries are influenced by economic relations with the EU, although characterized by a large asymmetry in terms of relative share of trade and FDI flows. The integration into the EU not only implies significant allocation, accumulation and location effects for a new member-state as a result of removing barriers to the free movement of factors of production, but also requires adoption of its external economic policy rules and instruments that are necessary for the single market to function efficiently.

One of such areas of the *acquis* that a new member-state has to adopt once it joins the Union is a Common Commercial Policy (CCP) which was among the first to be harmonized at the EC level. The significance of joining the CCP for a candidate country comes from the relative weight of the EU in the world economy. In 1996, the EU accounted for 40 percent of world exports of goods and services, and for 20.4 percent of world GDP<sup>1</sup>. The weight of the EU is also reflected by its role in the multilateral organizations such as the World Trade Organization (WTO) where it acts as one of the major negotiating actors, and by its complex external commercial policy instruments applied to the different groups of non-member states. Moreover, for such a small country as Lithuania with annual foreign trade turnover equal to around 100 percent of GDP<sup>2</sup>, foreign trade plays an important role for domestic economic activity and economic growth. Thus, the adoption of the EU external economic policy will structure the framework for future foreign economic relations of Lithuania as well as have an impact on the nature of its economic policy regime in general.

This article aims at preliminary evaluation of the possible effects of EU membership on Lithuania's external trade policy regime in terms of both legal structure that embodies historical and political preferences of the EU, political implications and economic effects which might result from the changes in the regime. The latter are usually evaluated with the help of trade creation and trade diversion concepts and help to assess possible liberalization and welfare effects. The working assumption is that Lithuania will become a member of the EU around 2006. The article will start with a brief discussion of the EU external commercial policy and its instruments, then

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<sup>1</sup> International Monetary Fund. World Economic Outlook. Washington, D.C.: IMF. - October 1997. - P. 135.

<sup>2</sup> This ratio of foreign trade and GDP, according to the official estimates of Lithuanian Department of Statistics, is observed for the last several years.

proceed with presentation of Lithuania's foreign trade regime and will conclude with analysis of possible membership effects. It will be argued that the adoption of EU's external economic policy regime is a gradual process with adoption of the *acquis* in some areas as a precondition for the membership, and with further changes made after the accession itself. This implies the spread of the costs and benefits involved, and the prospect of joining the CCP is already influencing Lithuania's foreign trade relations. For example, the range of problematic issues involved in Lithuania's negotiations for the WTO membership - mainly in the areas of agriculture and audiovisual products - illustrates that Lithuania has already become a virtual hostage to the EU and US trade disputes.

While the membership in the CCP will strengthen Lithuania's position in international trade negotiations as well as provide the institutional setting for participating in further development of the common commercial policy, the adoption of the common external tariff might both create trade in certain sectors and divert trade by increasing the degree of protectionism which will probably be the case in agricultural sector. The overall long-term economic effects depend on the balance of these processes that in turn will be influenced by a number of factors on global, regional, intra-EU, and Lithuanian domestic levels presented below.

It is noted quite often by analysts that the EU itself is a "moving target", and therefore any future oriented research and prognosis should take into account the changing character of this organization. Thus, in the case Lithuania joining the CCP and its possible effects, the nature of the effects will eventually depend on the development of the Common Agricultural Policy (CAP), balance of liberal and protectionist forces inside the EU, implementation of the Economic and Monetary Union (EMU), and general economic developments in the Common Market. It should be noted, that the processes mentioned - restructuring of the CAP, for example, - are likely to be influenced by the enlargement itself.

Another important factor that is likely to have an impact on the possible effects of Lithuania's membership in the CCP is multilateral liberalization taking place in the framework of the WTO as well as further inclusion of other trade related areas such as competition. A possibility exist that there might be another round of trade negotiations completed before Lithuania is accepted to the EU (presently, the EU is pushing for the start of the next trade negotiations - so called Millennium round). Besides, the EU is in the process of implementing the obligations agreed in the Uruguay round, including significant tariff reductions. Moreover, the world and regional trade policies might experience certain changes which might affect EU's external trade regime and economic effect of preferences given to certain groups of countries.

Finally, the economic and political economy effects of Lithuania's membership in the CCP depend on the conditions on which Lithuania is accepted to the WTO. They also depend on how many neighboring associated countries will be or become members of the EU by the time Lithuania is accepted. It is neither intended nor probably possible to evaluate approximate quantitative impact of the factors mentioned above, however, being aware of them makes it easier to structure thinking about the main area of this

analysis as well as to realize the complexity of the issues the negotiation process and the membership itself involves.

### **Legal basis for the CCP**

Article 3 (b) of the Treaty of Rome includes among the activities of the Community a common commercial policy. The means of achieving it are set out in the Articles 110 to 115. Article 110 which remains in its original form underlines that the EC's commercial policy reflects the customs union established between the member states, and emphasizes that the aim of that customs union is "to contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restrictions on world trade and lowering of customs barriers"<sup>3</sup>.

Article 113 is probably the most frequently used Treaty provision in the exercise of the EU powers in the field of external relations. It provides that the CCP is to be based on uniform principles, particularly in regard to changes in tariff rates, the conclusion of tariff and trade agreements, the achievement of uniformity in measures of liberalization, export policy, and measures to protect trade such as those to be taken in the event of dumping or subsidies. The provisions of the Article are broad enough to include not only international agreements but also internal rules of EU law - regulations, directives, and decisions. The Court of Justice has drawn attention to open nature of the CCP and taken into account the changing nature of the world trade. The EU has exclusive competence in the field of the CCP, and member states are no longer competent to act on their own as far as commercial policy measures are concerned. For example, international agreements are negotiated by the Commission under authorization of the Council, and the Council makes decisions by a qualified majority.

### **Instruments of the CCP**

The commercial policy comprises internal rules of EU law (referred to as autonomous measures), and bilateral and multilateral agreements concluded with third countries (referred to as contractual or conventional arrangements)<sup>4</sup>. The internal EU rules relating to the CCP could be divided into two aspects: the common customs tariff (CCT), and other measures such as export regime, import regime and the commercial defense instruments. This distinction reflects that found at the basis of the multilateral WTO system of international trade regulation, that is the distinction between tariff and non-tariff measures. Although these rules are adopted by the EU on unilateral basis they are not divorced from international rules.

The CCT was established on 1 July 1968 as a part of the customs union among six founding EC members. Except for 70 'sensitive' items, the six countries agreed to determine the common external rate for each tariff category by taking an arithmetic average of the rates in that category previously applied by France, Germany, Italy, and the Benelux customs union. The CCT comprises two tariffs: an autonomous tariff and a conventional one (MFN status). The level of conventional duties is negotiated

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<sup>3</sup> Macleod, I., Hendry, I. D., Hyett, S. *The External Relations of the European Communities*. - Oxford: Clarendon Press. - 1996. - P. 266-267.

<sup>4</sup> Macleod, I., Hendry, I. D., Hyett, S. - *Opt. cit.* - P. 274.

in the context of the GATT (now WTO). As a result of the Uruguay Round, the CCT will be lowered by an average of 37 percent, with a final average rate for industrial products at a 3.6 percent<sup>5</sup>. Most of Union's external trade, however, is with countries that have preferential bilateral agreements with the EU such as an Agreement on Free Trade and Trade Related Matters signed between the EU and Lithuania. Usually preferential trade agreements reflect Union's political priorities and historical links with other states. Under the generalized system of preferences (GSP), tariff preferences are accorded to developing countries, and act as a developmental policy instrument. In general, the EU has marginally higher tariff rates than Japan and the United States. The main concern, however, is non-tariff measures applied by the Union which have become the major focus of attention recently.

EU members apply common rules of export and import regime. The basic rule is that exports from the EU to third countries are unrestricted. The same rule applies to imports into the EU although there are special rules for certain cases, for example imports from so-called State-trading countries and economies in transition except where the EU has preferential agreements (only very recently Russia was removed from the list of State-trading countries).

It is maintained that the commercial defence instruments are among the most significant commercial measures the Union can take in respect of imports and exports<sup>6</sup>. The aim of most of these instruments is protection of the EU market from imports, either because of sudden disruptions caused by such imports (safeguard measures), or because the imports are 'unfairly traded' (anti-dumping and countervailing duty measures)<sup>7</sup>. Measures also can be used to react against trade barriers enforced by third countries or to assert the Union's interest and to protect domestic markets or exporting interests. As the EU is still in the process of defining its identity and forging solidarity among its members, the impact of trade on the economies of member-states and regions is a key parameter in determining the use commercial defence instruments and trade policy in general<sup>8</sup>.

The contractual commercial policy includes agreements concluded between the EU and third countries and EU's participation in multilateral agreements. Although member-states maintain bilateral agreements in the wider area of economic co-operation, the EU has exclusive competence in the field of commercial policy. 'Tariff and trade agreements' mentioned in the Article 113 comprises a variety of agreements including participation in the WTO agreements (the Dillon round of GATT in 1961-62 was the first one when the EC's stature as an international interlocutor was recognized), commercial and economic co-operation agreements, free trade agreements, customs union agreements. Some of these, including association agreements with Central and Eastern European countries, are mixed agreements and are based on Articles 235 and 238. The range of agreements concluded by the EU with third countries because of their variety and different degrees of preferences are

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<sup>5</sup> Wolf, M. H. *The Dog that Failed to Bark: The Climate for Trade Policy in the European Union*, in Schott, J. J. (ed.) *The World Trading System: Challenges Ahead*. Washington, DC: Institute for International Economics. - 1996. - P. 127.

<sup>6</sup> Macleod, I., Hendry, I. D., Hyett, S. – Opt. Cit. – P. 278.

<sup>7</sup> Ibid.

<sup>8</sup> El-Algraa, A. M., *The Economics of the European Community*. – London: Harvester Wheatsheaf. – 1994. – P. 450.

described as 'the pyramid of preferences'. The highest preferences are negotiated with the members of the European Economic Area, lower degree of preferences is provided for in the association agreements with Central and Eastern European countries, Mediterranean states, Lome Convention members, with Commercial and Economic Co-operation agreements providing for even less preferences. The USA and Japan are not included into the preferential arrangements of the EU although the idea of a Trans-Atlantic Free Trade Area has been discussed (supported by the United Kingdom, Germany, and the Commissioner L. Brittan, and opposed by France), and the Union has been showing an increasing interest in East Asia.

The other significant characteristic of CCP is differentiation of trade regime according to different commodity groups. The sectors protected most highly by external barriers are agriculture, textiles, apparel. In addition, the EU gives special protection to certain sectors that have relatively low trade barriers in such partners as the USA and Japan: autos, certain electronic products, and cinematic films. The strong differential treatment across sectors is reflected in trade agreements where so-called 'sensitive' sectors as a rule have less liberal trade regime. This is true for EU's trade relations with both developed and developing countries. The liberalization of trade in such areas as agriculture and textiles was also differentiated from the trade liberalization process in industrial goods negotiated with Lithuania and other Eastern and Central European countries.

This brief overview provides with the main features of EU's external economic policy regime. The CCP was devised because it was seen as a necessary component of the customs union and the common market of the EC members-states. Its concrete shape has developed in response to a number of internal and external political, economic, technological, ideological and personal factors such as WTO agreements, EC enlargement, domestic sectoral groups, economic performance of the EU economies, prevalent economic ideology, personality of Commissioner responsible for the external trade policy. In the nearest future, the interplay of these forces will also influence the character of the CCP, with the WTO negotiations and Eastern enlargement expected to be relatively significant in this respect. The changing multilateral agenda was reflected in the Treaty of Amsterdam where it was stated that the Council would have power to decide to give the EU powers to negotiate and conclude agreements on trade in services and intellectual property signals the importance attached by the EU to these areas of external economic relations. The Eastern enlargement is likely to provoke discussions similar to those that followed the announcement of the Single Market Programme. The main question is whether further process of integration is establishing a 'Fortress Europe', an inward-looking and difficult of access to the outside world, or it contributes to liberalizing the economic relations with the outside world<sup>9</sup>. The impact of the enlargement on the EU's external economic policies will in turn influence the economic dynamics of its new member-

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<sup>9</sup> There are rather diverging views expressed concerning the effects of the Single Market Programme on the EU's external economic policies. For a variety of views see Hanson, B. T. What Happened to Fortress Europe?: External Trade Policy Liberalization in the European Union. International Organization. - 52 (1). - Winter 1998. - P. 55-85; Scott, N. Protectionism in Western Europe in Salvatore, D. (ed.) Protectionism and world welfare. Cambridge: Cambridge University Press. - 1993. - P. 396-418; Wolf, M. The Resistible Appeal of Fortress Europe. - London: Centre for Policy Studies. - Rochester Paper 1. - 1994.

states. The discussion of this question follows below, after the introduction of Lithuania's external trade regime.

### **Development of Lithuania's foreign trade regime**

In Lithuania as well as in other CEECs, foreign trade liberalization represented important external dimension of transition process. It was connected with price liberalization, as imports were expected to help to align domestic prices with world market prices, and increase domestic competition. Besides, it was to become one of the main sources of providing the country with hard currency. It was supposed to encourage export-led economic growth and provide for imported capital goods to revitalize the economy. Finally, reorientation of foreign trade from former Soviet markets to Western countries and its reintegration into the world economy, besides being a central part of country's transition to a market economy, had important political and security implications for Lithuania<sup>10</sup>.

Before the transition, foreign trade in Lithuania was conducted by state agencies, and it was strictly regulated by quotas and licenses. As a result, entire foreign trade system had to be built, and by now significant foreign trade liberalization and reorientation can be observed.

Lithuania has undertaken a number of unilateral and contractual measures to liberalize its foreign trade regime. Already by the end of 1992, virtually all goods were priced according to international prices. In 1993, a new trade law was adopted under which remaining quantitative restrictions on exports were eliminated. On the import side, a nearly uniform tariff structure with low rates was introduced. The liberalization culminated in the acceptance of the obligations of Article VIII of the IMF's Articles of Agreement establishing formally current account convertibility.

The liberalization of foreign trade did not represent a linear process, but could rather be characterized by uneven dynamics. Some import tariffs were introduced during the process amending the tax system and introduction of a value added tax; some tariffs were raised after initial liberalization, for example, agricultural import tariffs were raised from average of 25 percent to 44 percent in July 1994<sup>11</sup>. There were several reasons presented for the stop-and-go process of foreign trade liberalization: (1) the limited transparency of trade policy measures; (2) low degree of involvement of anti-protectionist forces such as user industries in trade policy making; (3) pressures from various interest groups, power of which was stemming from their position in the home market<sup>12</sup>. The latter factor seems to be important also in explaining the current foreign trade policy, and the negotiations of Lithuania's membership in the WTO which are to be discussed below.

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<sup>10</sup> Čičinskas, J., Cornelius, P. K., Treigienė, D. Trade policies and Lithuania's reintegration into the global economy in Buračas, A. (ed.) *Lithuanian Economic Reforms: Practice and Perspectives*. - Vilnius: Margi raštai. - 1997. - P. 347-385.

<sup>11</sup> International Monetary Fund. *Lithuania - Recent Economic Developments*. IMF Staff Country Report No. 96/72. - August, 1996. - P. 32.

<sup>12</sup> Čičinskas, J., Cornelius, P. K., Treigienė, D. - *Opt. cit.* - P. 359.

Despite the protectionist forces mentioned, and partly due to the obligations under international agreements the process of tariff reduction was advanced relatively far by now. The trade-weighted average tariff in 1995 was at 4.3 percent with a large majority of products zero-rated<sup>13</sup>. According to some estimates, the weighted average tariff for industrial goods presently is approximately 2-3 percent with average tariff for agricultural goods around 12 percent being one of the lowest in the region<sup>14</sup>. In 1997, the estimated exports constituted around 44.6 percent of GDP, while estimated imports were equal to around 56.7 percent of GDP<sup>15</sup> illustrating a relatively open character of Lithuanian economy.

Lithuania applies certain non-tariff measures like stamp tax for certain imports (alcohol, oil products), and threshold prices for sugar, oil, and grains that are incompatible with WTO rules of import/export regulation. These issues and agreement on agriculture support programs (tariff quotas, domestic support and export subsidies, minimum purchase prices) continue to present obstacles for joining this organization. While during the negotiations Lithuania was considering applying for transition periods in areas such as sanitary and phytosanitary measures, technical barriers to trade and trade related aspects of intellectual property rights, it has recently been agreed to apply standard provisions from the moment of accession.

Recently steps were taken to introduce the legal basis for the trade defense instruments in Lithuania. The draft law on Antidumping was finalized in the beginning of 1998, and the draft laws on safeguards and countervailing measures are being prepared. Important impetus for preparation of these laws was given by the negotiations of the WTO membership, while at the same time they are drafted taking into account the provisions of the relevant laws in force in the EU.

Unilateral liberalization was paralleled by the efforts to conclude free trade agreements with Western countries. The most significant of them - The Agreement on Free Trade and Trade Related Matters with the European Union - was concluded in July 1994, and entered into force on January 1, 1995. It aims at establishing free trade area between the EU and Lithuania progressively within a transitional period of up to six years on a basis of asymmetry. Some sectors - agriculture, textiles, and fisheries - are regulated by separate rules. The Free Trade Agreement provisions later were incorporated into the Association Agreement which was signed by Lithuania and the EU in June 1995, and came into force on February 1, 1998. Quantitative restrictions for Lithuania's exports of textiles to the EU were removed by the beginning of 1998.

Lithuania has free trade agreements signed with a number of other countries. Trilateral free trade agreements in industrial goods and in agricultural products among the Baltic states are in force. Lithuania has bilateral free trade agreements concluded with EFTA states, Poland, Czech Republic, Slovakia, Slovenia, Ukraine, and Turkey.

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<sup>13</sup> The EU Commission.. Agenda 2000. Commission Opinion on Lithuania's Application for Membership of the European Union. - Brussels. - 1997. - P. 19.

<sup>14</sup> Figures provided by officials of the Ministry of Foreign Affairs in the seminar on the WTO and Lithuania's accession to it, January 27-28, 1998.

<sup>15</sup> IMF staff projections.

Lithuania applies preferential customs duties when goods imported into its territory originate from the countries with which free trade agreements are in force. Presently, trade with countries that fall into this category constitute around half of Lithuania's foreign trade turnover. Conventional customs duties are applied to products originating in a number of countries including neighboring states such as Russia, and Belarus as well as Canada, Australia, the USA, and Japan (the latter two apply unilaterally the Generalized System of Preferences to Lithuania). Finally, around 4 percent of foreign trade is governed by autonomous customs duties, including trade with such countries as Israel and Mexico.

Significant foreign trade reorientation has taken place since the beginning of the reforms. According to the Lithuanian Department of Statistics, Lithuania's trade with the EU in 1991 accounted for only 2 percent of total Lithuania's foreign trade volume. In 1997, the share of the EU in Lithuania's foreign trade reached 41 percent of total foreign trade turnover<sup>16</sup>. The share of Lithuania's trade with Western countries increased at the expense of trade with Commonwealth Independent States (CIS) which has declined from 85% in 1991 to 36% in 1997. However, Russia accounted for the most significant share of Lithuania's foreign trade equal to 24.3 percent in 1997 with Germany being in the second place with 15.8 percent. Most of Lithuania's exports (46.4 percent) went to CIS, while major share of imported goods came from the EU (44.7 percent). Country's imports from the EU last year increased by 37 percent, and exports to the CIS rose by 16.7 percent<sup>17</sup>. Major part of Lithuania's foreign trade flows are with the Baltic sea region countries reflecting the influence of geographic, historical, and, to a certain extent, political factors.

The analysis of dynamics of Lithuania's foreign trade flows is not relevant to the topic of this article, and is of interest only inasmuch as it might illustrate the potential effects of adopting the CCP after joining the EU. The discussion given above provides a background for the analysis of the possible implications for Lithuania after adopting the CCP of the EU.

### **Pre-accession measures**

One of the principal effects of accession to the EC/EU is that from the date of accession the provisions of the Treaties and the acts adopted by the EC's/EU's institutions before accession bind a new member-state. These provisions apply to this state under the conditions laid down in those Treaties and in the Act of Accession. The basic principle underlying each accession so far, and constituting what is called 'the classical method of enlargement', has been that the existing body of Community law and practice applies to a new member-state, subject to temporary transitional exemptions and special arrangements to accommodate their concerns. These transitional and other arrangements negotiated by a candidate country are laid down in the Act of Accession.

In terms of external economic relations, the general rule is that agreements entered into before the date of accession by any of the Communities with one or more third

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<sup>16</sup> Lithuanian Ministry of Economy. Prognosis of Lithuanian Republic's economic and social development in 1998-2000. - Vilnius. - January 1998. - P. 27. Preliminary estimates.

<sup>17</sup> Vilnius Bank. Lithuanian macroeconomic Review. - No. 17. - March 1998. - P. 8.



countries or international organizations are binding on a new member-state. A new member-state is required to adjust its position in relation to international organizations and those international agreements to which one of the Communities or the other member-states are parties to take account of their rights and obligations arising from their accession to the EU<sup>18</sup>. This general rule is given detailed effect in the Act of Accession in the light of the circumstances of the acceding member-state, and the transitional arrangements might deal with the specific aspects of the CCP, including quantitative restrictions on goods, the Generalized System of Preferences, association and trade and co-operation agreements, and relations with particular regions and groupings of third states. Provisions are also made for the negotiation of amendments to the Communities' agreements with third countries, and for the application by the member-states of the existing agreements<sup>19</sup>.

These rules forming a part of the classical enlargement method will most probably be applied during the accession process of the CEECs, and the concern of the EU with the applicants ability to assume the obligations of the membership seem to prove this. Therefore, with these principles in mind, it is possible to discuss likely impact of Lithuania's membership in the EU on its external economic relations, allowing for a possibility of several scenarios depending on the constellations of internal and external factors outlined in the introduction. However, before these scenarios are discussed, the measures taken in Lithuania in light of future accession to the EU and adoption of its external economic policy regime will be outlined.

In the Agreement on Free Trade and Trade Related Matters between the European Communities and Lithuania, there are provisions expressing the willingness of the parties to the agreement to liberalize trade on the basis of GATT principles. The same commitment was expressed in the preamble to the Association (Europe) Agreement. In the Article 29 of the Europe Agreement the parties make reference to the Article VI of the GATT relating to the meaning of dumping and in case of it agree to the possibility of taking appropriate measures in accordance with it. In the section of the Europe Agreement related to the movement of workers, establishment, and supply of services, parties agreed to progressively adjust the provisions taking into account the respective obligations of the parties under the GATS. The Article 64, made reference to the Articles VI, XVI and XXIII of the GATT which are to be applied before the rules of the EC concerning the competition policy (Art. 85, 86 and 92 of the EC Treaty) are adopted in Lithuania. Article 65 of the Europe Agreement makes reference to the GATT provisions concerning the restrictive measures relating to imports to be applied in the case of balance of payments difficulties.

These are usual provisions that are often a part of economic agreements and reflect the acknowledgment of internationally accepted principles. They show the commitment of Lithuania to adhere to GATT/WTO principles and to act as a reliable partner in the international economic affairs. However, not being a member of the WTO and not having the legal framework and expertise necessary to apply external economic policy instruments, Lithuania in practice has not been able to make use of these provisions. Another, probably more important, implication is the resulting pressure to construct commercial defense instruments that are not functioning in

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<sup>18</sup> Macleod, I., Hendry, I. D., Hyett, S. – Opt. Cit. – P. 228.

<sup>19</sup> Ibid.

Lithuania. In a more general sense, the Free Trade Agreement and Europe Agreement presented an initial framework for economic integration - free trade area in industrial goods - into the EU both by means of negative integration and by providing for the adoption of certain trade related policies by Lithuania. This implied the adoption of EU's policies and the institutions responsible for them, and the setting of standards that have priority status for Lithuanian policy-makers who have been acting as policy-takers in respect of the EU. This process was reinforced by the adoption of the White Paper.

There were no provisions in the White Paper related specifically to the Common Commercial Policy. But there were measures indicated to be taken by the applicant countries in harmonizing the customs procedures. During Stage I, parallel to the creation of the free trade area with the EU, Lithuania started the implementation of measures related to the harmonization of legal norms with the Community Customs Code. Lithuania has established the Combined Nomenclature of the EU, adopted the new system of cumulation of origin between European countries, and currently is implementing a long-term programme to harmonize product standards and the procedure of establishing compliance of these standards with those of the EU. Stage II outlined in the White Paper concerns the adoption of the full Community legislation with a view of joining the customs union upon accession.

In the Opinion on Lithuania's Application for the Membership of the EU, issued in the summer of 1997, the Commission noted that Lithuania should be able to meet EU requirements in the field of trade and international economic relations in the medium term<sup>20</sup>. In the field of development policy, Lithuania would need to make significant progress if it is to meet EU requirements within the next few years. The most critical assessment was made in relation to the adoption of the Community customs rules. It was maintained that Lithuania would need to continue major efforts to align its organization and staff to the duties that have been carried out by a modern customs administration. If it did so it may be able to meet EC requirements in the medium term.

The recent initiative of the Commission has been the development of the Accession Partnership to re-enforce the preparations of the applicant countries for membership in the EU. The program will be implemented in Lithuania by adopting the National Program for the Adoption of the Acquis drafted by Lithuanian authorities. This programme and its priorities are based on the conclusions of the Opinion, and are divided into two groups - short and medium term. It is expected that Lithuanian authorities will take further measures reinforcing institutional and administrative capacity in the field of customs functions during the year 1998. It should be noticed that Lithuanian authorities had to change original priorities and their grouping after the Commission presented its own suggestions. It was justified by the need 'to facilitate further dialogue' with the EU, and once again illustrated the policy-taker status of Lithuania. This implies that in general, as well as in the area of external economic policy, the program may reflect the priorities based on the interests and concerns of the EU rather than priorities of Lithuania and its transition needs. In its turn this means that even before becoming a member of the EU and joining the

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<sup>20</sup> The European Commission. Agenda 2000. Commission Opinion on Lithuania's Application for Membership of the European Union. - Brussels. - 1997. - P. 81-83.

customs union and the CCP, Lithuania will have a major part of the relevant acquis adopted. Those priority aspects of the acquis are primarily related with measures in the area of customs administration and implementing Community Customs Code as these are a necessary precondition for the efficient functioning of the customs union. However, the harmonization in the area of the CCP is taking place in the negotiations of Lithuania's membership in the WTO. This provides an illustrative example of the efforts of the current external economic policy-making in Lithuania to align its position in multilateral negotiations with that of the EU, and to take account of a future membership in the CCP.

In September 1992, Lithuania got an observer status to the GATT. The process of Lithuania's accession to the GATT/WTO has started in the beginning of 1994 and lasted for more than four years. The negotiations included a number of bilateral and multilateral meetings during which Lithuania's foreign trade regime and related external economic policy matters were presented, problematic areas were identified which currently are the level at which the customs duties for agricultural products are to be 'frozen', export subsidies and domestic support in agriculture, and trade regime in audiovisual products. In spite of the importance of the WTO membership for Lithuania, for a number of reasons the accession negotiations lasts for more than four years although Lithuanian part showed attempts to readjust its position on certain issues. There are different categories of reasons for this, including difficulties related with the transition nature of Lithuanian economy - unclear long-term patterns of comparative advantage, for example, - and concerns of the major WTO members not to create a precedent for derogations from the rules when Russia negotiates the membership.

Probably the most important factor is a protectionist stance that the Lithuanian part has chosen in terms of agricultural policy, and the level of appropriate ceiling binding and export subsidies as well as the general binding of customs duties. The level at which the tariffs are 'frozen', and can not be exceeded after a country joins the WTO is chosen depending on tariffs applied before the membership. This means that Lithuania would have relatively low customs duties as 'a point of departure' in future WTO negotiations. This, however, is not in the interest of agricultural interest groups in Lithuania, and through the institutional structure of forming the bargaining position of Lithuanian part these sectoral interests determine the protectionist stance of Lithuanian negotiators.

The other important factor is a perspective membership in the EU, and the CCP and agricultural support regime to be adopted by Lithuania. Joining these common policies of the EU might result in a general increase of customs duties for industrial products applied by Lithuania (although this will depend on a number of factors and commodity groups), and most probably will result in a higher degree of protection in the agricultural sector<sup>21</sup>. In such a case other WTO members have a right under the Article XXIV (6) of the WTO to demand for compensation to cover the costs that

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<sup>21</sup> This argument was already used by agricultural interest groups in Lithuania trying to secure preferable level of protection. In December 1997, the heads of the sugar factories declared that sugar production and protection level in Lithuania should meet the requirements applied in the EU. This statement was directed against intentions of Lithuanian authorities to amend the law to comply with the WTO rules.

result from the increase in the level of external protection. Taking into account the disputes of the USA and the EU, particularly France, over the issues of trade barriers to trade in agricultural and audiovisual products during the Uruguay Round, there is a high possibility of the USA (and maybe some other countries) demanding compensation. Moreover, such claims were made during the earlier enlargements of the EU. According to some estimates, after the accession of Sweden, Austria and Finland, because of the increase of tariffs in sectors where the EU's external tariff was higher than in the new members compensations received by the USA alone amounted to between 150 - 200 million USD<sup>22</sup>. Thus, Lithuanian authorities are in a paradoxical situation where the membership in the WTO is an unofficial precondition for the accession into the EU, but at the same time trying to take into account the requirements of the membership in the Union's CCP presents one of the main difficulties during the multilateral negotiations. Although Lithuanian negotiators arranged meetings with the EU Commission before a number of bilateral and multilateral meeting at the WTO to co-ordinate the position of Lithuania, and consequently revised initial offers, so far this have not resolved the problem. It is likely that in the future, the obligations under the Europe Agreements will be more important for Lithuanian authorities than WTO rules.

The points presented above clearly illustrate that the membership in the EU and its external economic policies is not a single-decision process. It is a gradual process the impact of which on Lithuania's external policy regime and well as related domestic policies is already felt or will be felt before the actual date of entrance into the EU. For example, the range of problematic issues involved - mainly in the areas of agriculture and audiovisual products - illustrates that Lithuania has already become a virtual hostage to the EU and US trade disputes. The gradual nature of the process makes the economic benefits and costs of the process to be widely spread, and more difficult to identify. However, certain effects related with the adoption of the CCP by Lithuania after accession to the EU can be distinguished and discussed.

### **Accession and possible effects of joining the CCP**

As it was noted before, accession to the EU means adoption of the *acquis* related with the CCP by the new member-state. While applicant country might negotiate the transitional arrangements in certain areas depending on their effect on the efficient functioning of the single market, the end result of the accession most probably will be adoption of the related *acquis* in full as it is laid down in the Treaties.

Thus, after joining the EU, Lithuania will have to adopt the autonomous as well as conventional arrangements of the CCP. First, this implies the adoption of the CCT applied by the Union at the time of joining it. At present, the weighted average rate of external tariff for industrial goods applied by Lithuania is lower than the one applied by the EU, although it differs depending on the commodity groups and customs duties for some (furniture, for example) are higher in Lithuania. The final impact, however, will depend (1) on the level at which tariffs applied by Lithuania are binded when it becomes the WTO member (if this happens before joining the EU); (2) the decisions on further trade liberalization agreed in the next WTO round (if it takes place before Lithuania's accession to the EU). As a result of joining the CCP, both possibilities of

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<sup>22</sup> Dent, C. M. *The European Economy. The global context.* - London: Routledge. - 1997. - P. 107.

having to raise and decrease the general level of customs duties on imports of industrial goods remain. Trade creation (or diversion) effect will also depend on a number of countries that join the EU together with Lithuania because the larger share of foreign trade is conducted inside of the customs union of the EU, the larger are the possibilities for trade creation and welfare gains for consumers.

The different situation will most probably be in agricultural sector where the level of protection in the EU is likely to be higher than in Lithuania by the time the latter becomes a member of the EU. Thus, the accession is likely to increase the level of protection in Lithuania, divert trade and result in welfare losses for consumers. As it was discussed in the previous section, the increase of external protection is likely to cause the discontent of other WTO members and provoke claims for compensation. At the same time, benefits might be derived by agricultural producers in Lithuania, however, this largely depends on the CAP reform, and possible transition periods before participation in the CAP support programs.

One of Union's unilateral measures reflecting its historical links and developmental politics is application of Generalized System of Preferences which Lithuania will have to adopt. That implies granting tariff concessions and access to the market for a number of developing countries, and contributing to the European Development Fund which provides financial aid under Lome convention. This implies adoption of the policies that are not relevant for Lithuania, and are not based on economic grounds and political concerns of its population. Meanwhile, accession will mean abolishing of GSP regime applied to trade with Lithuania by the USA and Japan.

Finally, the customs duties collected at the border of Lithuania will be collected to the EU budget after joining the CCP and the customs union. This will deprive Lithuanian government from using customs duties as a source of budget revenues.

Membership in the EU also implies common application of external non-tariff measures. Lithuania will adopt common rules for export and import regimes applied by the EU members. This will require abolishing remaining export duties that presently include six commodity groups, mainly timber products. In general, it would imply adopting EU's special rules, for example special barriers for imports for State-trading countries which presently include relatively important trade partners of Lithuania - Belarus and Ukraine, and result in trade diversion. Upon accession Lithuania will have to refrain from all subsidies that are incompatible with the common market and to submit all state aids to a constant review by the Commission which acts as a sort of 'anti-subsidy policy force'<sup>23</sup>.

As it was mentioned before, the commercial defense instruments are among the most significant measures the EU can take in respect of imports and exports. Adoption of these instruments by Lithuania might have a significant impact on its foreign trade regime. The use of these instruments is not established in Lithuania yet, therefore the application of anti-dumping duties, countervailing and safeguard measures adopted by the EU might increase the level of protection in Lithuania. However, as the EU Commission has noted, experiences from previous accessions has shown that the

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<sup>23</sup> Bofinger, P. The Political Economy of the Eastern Enlargement of the EU. - Discussion Paper No. 1234. - London: CEPR. - August 1995. - P. 7.

automatic extension of existing anti-dumping duties to the new member state prompts third countries to raise problems in terms of the compatibility of this with relevant WTO provisions<sup>24</sup>. It was also noted that automatic extension creates a potential for third countries for circumventing EU's commercial defense measures when before accession substantial quantities of the products subject to measures are exported to the territory of the future member-state, and after the accession are released for the free circulation in the EU's customs territory. Therefore, it is likely that only commercial defense measures applied by the EU after Lithuania's accession might be extended to Lithuania. For these reasons the likely impact of protectionist measures might be less significant. However, there are no signs that the EU might be inclined to decrease the use of such measures, and as it was noted in the WTO Report 1996, the EU 'continues to be one of the most frequent users of anti-dumping procedures'<sup>25</sup>. Lithuania would not probably adopt the protectionist measures in certain areas without joining the EU, like, as some have noted, it was "a safe bet that without Community, the United Kingdom and Germany would not have footwear protection today, that UK agricultural protection would be lower, that Denmark would not have an arrangement on Japanese cars, etc."<sup>26</sup>. On the other hand, initiating protectionist measures at the EU level with its bureaucratic procedures might prevent local interest groups in Lithuania from frequent recourse to these measures. Moreover, it is suggested that EU membership entails a major shift in the balance of power between national lobbies strengthening the power of such groups as consumers and exporters whose interests are often neglected in political decisions on trade policy<sup>27</sup>.

Joining the CCP implies adoption of agreements concluded by the EU and third countries and multilateral agreements to which the EU is a part. Simultaneously preferential agreements between Lithuania and third countries, for example, the free trade agreement with Ukraine, will have to be terminated. Thus, Lithuania will adopt 'the pyramid of preferences' in a form of a range of preferential agreements with between the EU and third countries that characterise EU's policy of 'managed liberalism'. It will involve both trade creation and trade diversion for Lithuania. (1) It will mean abolishing all remaining barriers to the movement of factors of production with current associated countries which will be or become members of the EU at the time as Lithuania. (2) It will involve reduction of non-tariff barriers to trade with EEA countries. (3) It might result in increase of barriers to trade with the associated countries that stay outside the EU, especially in the field of agriculture. The preferential agreements between Lithuania and them in force at the moment will have to be terminated which. (4) Barriers to trade with Eastern European countries that have commercial and economic co-operation with the EU might increase. However, if free trade agreements between the EU and CIS are negotiated, the trade diversion effect for Lithuania might be less significant. (5) If plans to create a free trade area among the EU and Mediterranean states until the year 2010 succeed, Lithuania will gain free access to this region. (6) Lithuania will join Lome Convention if it is extended after the year 2000 for the next decade. The effects of this are likely to be

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<sup>24</sup> The European Commission. Agenda 2000. - Opt. cit. - P. 81.

<sup>25</sup> Cited in Pelkmans, J., Carzaniga, A. G. The Trade policy Review of the European Union. The World Economy. Global Trade Policy 1996. - Oxford. - 1996. - P. 89.

<sup>26</sup> Winters, L. A. The European Community: a case of successful integration? in De Melo, J., Panagariya, A. New Dimensions in Regional Integration. - London: CEPR. - 1994. - P. 211.

<sup>27</sup> Bofinger, P. - Opt. cit. - P. 9.

insignificant because of a small share of trade relations with these countries. (7) If the plans to create a Trans-Atlantic Free Trade Area succeed, Lithuania will gain free access to the NAFTA. The net welfare effects for Lithuania's consumers will depend on the balance of these factors. However, it is likely that more trade will be created, especially if most of the Baltic sea region countries become EU members, and a free trade agreement is negotiated among the EU and the CIS which are responsible for a significant share of Lithuania's foreign trade. The positive effects might arise in a form of dynamic gains from becoming a member of the largest common market area in the world.

A rather evident positive effect derived from the participation in the CCP will be the increase in negotiating power in international negotiations. Of course, the use of this power in terms of international liberalization depends on the balance achieved inside the EU, or the Council of Ministers, in particular. However, small countries which are big traders have usually more liberal regime, therefore it is possible that Eastern enlargement of the EU might strengthen the case for liberalism. Besides, the problem of 'regulation without representation' faced by the EFTA states would be resolved, and Lithuania will be able to participate in the EU decision-making process instead of acting as a passive policy-taker. Although it is unlikely that in such a way Lithuanian representatives would be able to exert major influence on the process, it would provide a stable forum for exchange of views, expression of opinion by way of voting, and getting the decisions passed by way of forming coalitions and bargaining.

The accession is a process based on a mutual adjustment of the EU and the new members states. Although the new member state accepts the obligations related with the existing *acquis* of the Union, the enlargement itself changes the dynamics inside the EU institutions and influences the outcomes of the policy-making process. This seems to be especially the case after the Eastern enlargement. Therefore, the question is how that might affect EU's external economic policy. While there is a possibility that the enlarged Union might become more inside-oriented because of the increase of its diversity and resulting necessity to cope with it, the argument might be turned around to say that widening of the EU will contribute to more open and liberal external economic policies. The analysis of possible impact of membership of Lithuania's external economic policy illustrates quite clearly the complexity of the issues involved in the accession process of one state.

### **In a place of conclusions**

Analysis of possible membership effects helps the applicant countries to be aware of the positive as well as problematic issues involved. Anticipating the effects of joining the common policies and institutions of the EU contributes to the clarification of the position before and during the negotiations. Even taking into account that the new member-states will have to adopt fixed *acquis* - with or without temporary derogations and transitional arrangements - awareness of both specific and broader issues involved in the process might increase the bargaining power and gains from the membership. Rephrasing one statement, if Lithuanian authorities are interested in quick negotiations once they start, they should have a clear-cut negotiations strategy based a several carefully selected priorities<sup>28</sup>.

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<sup>28</sup> Inotai, A. Prospects for Joining the European Union. Foreign Policy. - vol. 3. - 1997. - P. 44.

This article discusses the possible impact of joining EU's external economic regime, specifically the CCP, for Lithuania. The process of joining the CCP is not a matter of a single decision but it is a gradual process. This implies that substantive human and financial resources are invested before the main aim of the membership is achieved. It also means that the economic regime constructed by the EU and reflecting its historical and geopolitical preferences, internal bargaining outcomes, external relations, etc. is adopted by Lithuania. This process stabilizes the legal and economic environment in Lithuania provided that EU regulation is used by the government to remove barriers for business and not to employ it as an additional instrument of economic control. However, certain aspects of the regime might not be relevant for Lithuania (developmental policy, for example), or are difficult to combine with the other aims of current Lithuania's foreign trade policy (negotiating membership conditions in the WTO in areas of trade in agricultural goods and audiovisual products).

Joining the largest regional economic arrangement in the world will increase the negotiating power of Lithuania in the multilateral forum. It would resolve the problem of 'regulation without representation' in the relationship with the EU while the advantages of being an insider will depend on the actions of Lithuania's representatives and supporting coalitions. The adoption of the CCP might have different impact depending on the sector with agriculture most probably becoming more protected. Finally, Lithuania will have to adopt EU's preferential agreements and to abandon the ones it applies currently. As a result and in addition to joining the common market of the EU, barriers to trade with EFTA states and CEECs joining the Union might be further reduced (with most of which Lithuania has free trade agreements signed), while barriers to trade with the CIS might increase. The static trade creation and trade diversion effects will depend on the barriers to trade in force and share of trade with respective partners. The dynamic trade creation effects for Lithuania are likely to be significant due to economies of scale, increase in competition and specialization, however, they require a separate analysis.

It is evident that at present, the nature of many factors remain unclear which makes evaluation of economic costs and benefits analysis complicated. Such an analysis remains to be accomplished in the future, especially when ex post analysis becomes possible. The picture remains partial without the evaluation of anti-monopoly scenarios, i. e. the impact of non-membership, analysis of membership effects on separate sectors of the economy and for different groups: consumers, producers and the government. These are just several directions of possible research.

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