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Estonian Foreign Trade on the Threshold of Joining the EU

Estonia, together with Poland and Hungary, heads the list of eastern European candidate countries in its progress towards meeting the criteria for EU membership, according to the assessment by the European Commission published in November 2000. Estonian foreign trade still shows a deficit, however. The following article analyses the reasons for this, evaluates the effects to be expected from EU membership and discusses the policy implications.

Estonia, as a small country, must inevitably take an active part in world trade. Local producers can supply only a fraction of the ever wider assortment of both consumer and investment goods demanded, while other goods have to be imported from abroad. In a balanced economy imports are paid for from export revenues. Imports that are paid for from loans from abroad and from foreign aid were a characteristic of the Estonian economy in the early years after Estonia regained its independence. This could not be maintained over an indefinite period. In the long term, the level of imports can only be raised if Estonia's exports become competitive on foreign markets.

At the same time, foreign trade also has an important balancing effect on production within Estonia. The small domestic market often cannot provide sufficient demand for Estonian production and the oversupply has to be directed towards foreign markets. As specialisation increases – a general trend in the world economy – the geographical area of the import and export markets has to widen. The transition from inter-industry trade to intra-industry trade should rebalance the effects of a decreasing number of export articles that in turn result from increasing specialisation.

This article aims to characterise the trends of development of Estonian foreign trade, to analyse past and present problems and to forecast possible changes. The main thrust of the article is to highlight relations with the EU, Estonia's main trading partner. The aims of the paper are as follows:

- to characterise the formation and development of Estonia's foreign trade relations after the demise of the Soviet Union by commodity sections, main trading partners and the nominal terms of exports and imports;
- to evaluate the balance of Estonian foreign trade, to analyse the reasons for the trade deficit and to discuss resulting policy implications;
- to analyse the methods and means permitted by the WTO and the EU for the protection of Estonian producers (especially agriculture) without harming the principles of free trade;
- to evaluate the effects on foreign trade of Estonia's future entry into the EU, emphasising the impact on exports and imports.

During its periods of independence (1918-1940 and 1991 onwards), Estonia has always put strong emphasis on the development of foreign trade. In the first period of independence, Estonian exports rose very quickly, from US$ 5.3 million in 1920 to US$ 27.7 million in 1938 (more than a five-fold increase). This is remarkable, especially taking into account the depreciation of the Estonian kroon (the yearly average exchange rate was 232 EEK/US$ in 1920 and it rose to 375.8 EEK/US$ by 1938). The emphasis was on obtaining a balance in the foreign trade account,

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although deviations on both sides were relatively large.[1]

As for the foreign trade of the Estonian Soviet Socialist Republic (ESSR), which was incorporated into the Soviet Union, an adequate judgement cannot be made, as goods circulated according to administrative orders at governmentally fixed prices which were far from the market value. The foreign trade statistics of the Soviet Union show that the trade balance of all the Soviet Republics showed a deficit. The Central Planning Committee of the Soviet Union had a surplus and distributed imports to all the Republics. An adequate judgement also cannot be made about the volume of trade, as the rouble was not freely convertible and its exchange rate did not represent its real market value. For example, transition from the official exchange rate of the rouble to the three times cheaper commercial exchange rate decreased the evaluation of Estonian foreign trade in 1998 compared to 1982 more than two times.[2]

The dissolution of the Soviet Union meant, first of all, the collapse of administratively formed trading relations between the republics of the formerly unified group of nations. In the years 1990-1992, Estonian exports in physical terms to the former republics of the Soviet Union decreased by 52% and imports originating from these countries decreased by 56%. Due to the high real devaluation of the Estonian kroon, the volume of Estonian foreign trade in monetary terms in 1991-92 decreased by about six times. The domestic market was too small to compensate for this fall and it took time to develop new trading relations on the basis of the market economy. In the East, the obstacles were the underdevelopment of market economy structures and political tensions. Estonia had to build up trading partnerships with the West, but here the problem was weak knowledge of these markets and limited business experience.

Since monetary reform, Estonian foreign trade has continuously increased in nominal terms. In 1998, exports in monetary terms were about seven times higher than in 1992, and imports were 11 times higher.[3] The nominal growth of foreign trade was rapid, but considering the low base from which it started (the production potential created during the Soviet period) and high inflation (consumer prices had risen 3.4 times by December 1998 compared to December 1992)[4] the real purchasing power of exporters on the domestic market rose quite modestly.

Great changes have also occurred in the composition of the trade balance since independence. In 1992 and the first half of 1993, the Estonian trade balance was roughly in equilibrium (slightly negative). This was mainly due to the export restrictions applied by Russia before Estonian monetary reform was introduced in June 1992 and the fact that the strong devaluation of the Estonian kroon in the course of the monetary reform had an adverse effect on imports and a positive effect on exports in the second half of 1992 and in 1993.

Since the third quarter of 1993, the Estonian trade balance has fluctuated but was always "in the red" and the deficit rose continuously up to the end of 1998, as the growth of exports was slower than that of imports. In 1993 the deficit on the balance of trade and services was EEK 928 million, and in 1998 that figure was as high as EEK 7,669 million. There was a sudden increase in the deficit in 1997 that accompanied the rapid economic growth. Notwithstanding the decline in the rate of growth in 1998 and actually even recession in the fourth quarter, the deficit kept growing, although only by a few hundred million kroons.[5] Since the first quarter of 1999 the deficit has decreased and in the third quarter the trade and services balance showed a surplus for the first time. However, this was mainly due to the extraordinary and largely seasonal surge in exports of services. The trade balance alone was still in deficit, though this deficit has been decreasing since last year. The surplus on the trade and services balance was not sustainable and in the fourth quarter there was a deficit again. With economic growth import demand, which was quite depressed in 1999, will also start to rise.

The Restructuring of Estonian Foreign Trade

Exports and imports are ambiguous notations, as they comprise both the final consumption of goods and inward processing as well as re-exports and re-imports. Certain difficulties also arise from the accounting of customs warehouses. In the exports of

[1] The Statistical Office of Estonia: Foreign Trade 1998, Tallinn 1999, p. 13.

[2] Ibid.

[3] Ibid.

[4] The Statistical Office of Estonia: Estonian Statistics 1999, Monthly No. 7, p. 49.

[5] The Bank of Estonia: Estonian Balance of Payments, short version. http://www.ee/epbe/sdds/bp_short_eek.html.en

Estonian products, the share of goods produced in Estonia has decreased (from 64.7% in 1996 to 52.3% in 1998) and the share of re-exportation after inward processing has increased (from 19.5% to 24.5%). The share of exports from customs warehouses is also quite significant, making up more than 20% in 1997/98.[6] The inward processing of imported goods and their re-exporting is not a negative phenomenon, taking into account the current state of development of the Estonian economy, but the value added in Estonia is still too modest (though it increased from 5% in 1996 to 10% in 1998).[7]

The predominance of imports over exports is not necessarily a negative phenomenon. The process of reconstruction and modernisation of the economy can be viewed as an emergency situation in which investment goods (means of production, machinery etc.) are mainly imported. If it leads to the strengthening of the export potential, it will form the source for the future payback of loans. The problems arise when the majority of imports are consumer goods as this means living at the expense of the future. Therefore, to evaluate the prospects of development of foreign trade, a closer look must be taken at the structure of exports and imports by commodity sections.

In the development of the structure of Estonian trade by commodity sections, great changes have occurred since independence. The structure of exports and imports reveals the contradictions of the development of Estonian foreign trade.

The first positive sign regarding exports is increasing diversification in the commodity sections. This increases the potential for resistance on the part of the Estonian economy to sudden falls in foreign demand in certain sectors. Estonian economic potential could be positively assessed due to the fact that the volume and share of exports of machinery and equipment (commodity section XVI) have grown rapidly since independence. But unfortunately this should mainly be attributed to exports of low-value-added goods after inward processing. Estonia's comparative advantage in terms of its large forest resources is revealed in the growth of the share of wood and articles of wood (section IX) in exports from 7.9% in 1992 to 12.7% in 1998 – here our main natural resource is "added value". Notwithstanding the concessions made by the EU concerning terms of trade, the share of textiles and textile articles (section

[6] The Statistical Office of Estonia: Foreign Trade 1998, op.cit., p. 95.

[7] Calculated on the basis of Table 3, p. 7, in: Eesti Pank: Eesti maksebilanss. Rahvusvaheline investeerimispositsioon, Välisvõlg 1998, Eesti Pank, 1999.

XI) in exports decreased from 14.1% in 1992 to 11.5% in 1998. The decreasing export competitiveness of agricultural products is disappointing – the share of live animals and animal products (section I) in exports fell from 11.2% in 1992 to 6.2% in 1998. Development is curtailed here by the protectionist trade policy of all Estonia's main trading partners. Reliance on cheap (subsidised) imported raw materials contributed to the rise in the share of foodstuffs (section IV) in exports but the Russian devaluation in August 1998 hit these hard. In the case of metals (section XV) and minerals (section V), Estonia is to a significant degree a re-exporter and thus their diminishing share in the structure of exports is easily understandable and expected.[8]

In the structure of imports, the first positive assessment concerns the sudden fall of the share of minerals (mainly fuels and oil) from 27.2% in 1992 to 6.3% in 1998, signifying a fall in the quantity of so-called "forced imports" on the Estonian economy. Unfortunately the structure of imports does not quite reflect a specific orientation towards investments. The fact that the largest share of imports is taken up by machinery and equipment (in 1998 25.5%) is undoubtedly quite favourable but a big part of it actually results from the importation of household appliances and goods for inward processing. Among transport equipment, cars for domestic use and for re-export made up a large share. The growing share of foodstuffs and agricultural products in the structure of imports is an indication of danger for Estonian agriculture. For example, the share of animal products in imports rose from 0.4% in 1992 to 5% in 1998. The volume of imports of foodstuffs surpasses the volume of its exports. The countries of origin of imported foodstuffs are mainly the EU member states, where agricultural production is made artificially cheaper by subsidies, and the EU domestic market has been closed by various import restrictions to producers from outside the EU. Unfavourable customs duties and the devaluation of the rouble caused great damage to exports of Estonian foodstuffs and agricultural products to Russia. Exports to Russia had until then been the main source of decreasing the deficit in the trade in these commodities.

Within a few years Estonia turned from being a net exporter of paper and cellulose into a net importer. Estonia is therefore unable to manufacture and add value to one of its main resources – wood. Exports of paper and cellulose instead of timber would provide more revenue and also create jobs. The major obstacle is the need for an enormous amount of investment for establishing factories to produce these goods competitively.

Estonia has a significantly positive balance in the trade of timber and paper (in 1998 EEK 3.7 billion) and furniture (in 1998 EEK 951 million).[9] Estonian trade in textiles and clothing is more or less in equilibrium (weakly negative). With regard to all the remaining commodity sections, Estonia faces a trade deficit. The main part of the deficit can be attributed to machinery, equipment and transport vehicles.

The accelerated growth of imports compared to the growth of exports has raised the deficit in the balance of payments on current account since independence. In 1997/98 the trade deficit stabilised at slightly less than EEK 16 billion. The trade deficit was half balanced out by the surplus in trade in services. The positive balance in services, which had grown every year since regaining independence, worsened in 1998 and thus in 1998 the expected turnaround in the current account deficit did not occur. Due to the recession that began in the fourth quarter, the current account figures for 1999 look much better. In the third quarter of 1999 the current account turned positive – 278 million kroons[10] which is 1.5% of the period's expected GDP.

Estonia's Trading Partners

As foreign trade becomes more important for a country, the more important the structure of its trading partners becomes from the point of view of securing economic development and political independence. Estonia managed to reorient itself from the East to the West in a shorter period than its Baltic neighbours – in 1998 the share of the EU in its exports made up more than 60% and in imports approx. 75%.[11] Estonia differs from its Baltic neighbours also in that the direction of foreign trade based on the natural structure of competitive advantages is developing – imports from the West exceed exports into the West and trade with the East is conducted vice versa. Taking into account that from the West Estonia can import high quality products, especially machinery

[8] The Statistical Office of Estonia: Foreign Trade 1998, op.cit., pp. 54-56.

[9] Eesti Pank: Eesti maksebilanss. Rahvusvaheline investeerimispositsioon, Välisvõlg 1998, Eesti Pank, 1999, Table 6, p. 9.

[10] The Bank of Estonia: Estonian Balance of Payments, short version. http://www.ee/epbe/sdds/bp_short_eek.html.en

[11] The Statistical Office of Estonia: Foreign Trade 1998, op.cit., p. 60.

and equipment, we may consider the regional structure of trade to be favourable for Estonia. Still, the deficit on the trade account results mainly from trade with the EU and should be attributed to asymmetric trade conditions (protectionism of the EU versus openness of Estonia).

The structure of Estonian exports by trading partners is very understandable and normal for a country emerging onto the scene of world trade – the main export partners are neighbours. Whether this also corresponds to Estonia's inherent competitive advantages in the world economy must be subjected to a more profound analysis. The ten biggest export partners made up 84.6% of total exports in 1994 and 83.5% in 1998.[12] This means quite a large geographical concentration of exports. It is still impossible to predict further diversification, though the number of trading partners has increased. The increasing of the diversification of exports is undoubtedly an important task, as this would imply more stable foreign trade.

The diversification of imports is greater than that of exports – the ten biggest import partners made up 81.4% of total imports in 1994 and 74.7% in 1998.[13] The diversification of imports has increased more rapidly in recent years than that of exports. The importance of Finland as a source of imports is considerable although this has already fallen from 32.6% in 1995 to 22.6% in 1998. Estonian importers still do not know the real sources of goods on the world market and therefore Finland acts as a country of transit for western goods en route to the Estonian market.

The comparison of the most important countries in exports and imports shows the asymmetry of trade in the Baltic region – Latvia and Lithuania make up a considerably larger share of Estonian exports than of Estonian imports (in 1998 14.1% of exports compared to 3.6% of imports).[14] This asymmetry reveals the stronger competitiveness of Estonian goods but aggravates the functioning of the Baltic Free Trade Agreement that has been in force for industrial products since April 1, 1994, and for agricultural production since January 1, 1997.

Need for Balance in Agricultural Products

The main objective of the state in foreign trade relations is to secure equilibrium – equal conditions of competition for domestic and foreign producers. In its simplest form this equality would be guaranteed in the case of the absence of all trade restrictions throughout the whole world. But in many important areas world trade is not fully open for Estonia and there is unfair competition on the part of foreign producers.

Estonia has too small a market for most of its products to attract bigger production-oriented investments with the goal of servicing the domestic market. Estonia could attract greater investments only if free access to foreign markets was granted. In this area the situation in the coming year is still unclear. In the long run, the solution would be to join the EU but the negotiations on accession terms are currently still taking place. When forming the foreign trade policy for the next five years it must be taken into account that Estonia may still not be a full member of the EU. The EU is also Estonia's main competitor. The balancing of foreign trade terms with the EU is therefore of utmost importance for securing the further development of the Estonian economy..

Estonia has opened its economy entirely but Estonia's main trading partners have closed several important markets to Estonian producers via customs duties and other trade restrictions. EU duties and production and export subsidies discriminate against Estonian agriculture and the food processing industry (SITC commodity chapters 1-24) compared to the EU countries and to other sectors of the economy in Estonia. Estonian agriculture is evolving under conditions where it is practically impossible to exploit its production and export potential. The EU has closed precisely those markets where Estonian producers are more competitive and where most of Estonian export potential lies. Apart from closing its own market to Estonian producers, the EU companies, using the production and exports subsidies of the EU, intrude with the same products into the Estonian market. The originally more costly EU products appear more competitive than the originally cheaper Estonian products of the same quality because of subsidies. This means the direct violation of the principles of an open economy and a free market. The Estonian government should bear its national interests in mind and react to this with adequate means to equalise the conditions of competition (primarily by means of balancing duties). The situation becomes dangerous owing to the fact

[12] Ibid.

[13] Ibid., p. 61.

[14] Ibid., pp. 60-61.

[15] Ibid., p. 103.

that the losses resulting from foreign discrimination cause some to suffer more than others. The losses are most severely felt in rural regions and this harms regional development in Estonia. In order to avoid the decline of these regions that would be a direct consequence of the shortcomings of foreign trade policy, the state should direct considerable funds from the general budget towards supporting these regions. This has not been done sufficiently so far and therefore foreign trade has had an adverse effect on rural development.

Estonia, a country with strong agricultural traditions and a developed foodstuffs industry, imports more agricultural products than it exports. The deficit is increasing. The imports of agricultural products have grown rapidly from EEK 0.5 billion in 1992 to 11.4 billion in 1998 (ca 22 times). The growth of exports has lagged behind – 7.2 billions in 1998 is only 7.5 times higher than 973 millions in 1992.[15]

Article 5 of the WTO agreement on agriculture states that all member countries can implement protective measures if the volume of imports exceeds a certain level or the price of imported goods in domestic currency falls below a certain level.[16] In Estonia the amount of agricultural imports exceeds this level several times, no matter what methodology is used for the calculations. At the same time the prices of agricultural products have grown several times more slowly than the general inflation level and also here comparison with the defined levels gives Estonia the right to implement balancing duties. These should be imposed immediately, as the experienced bureaucracy of the EU and WTO is able to prolong the decision process for several years.

In the Europe Agreement, the EU allowed Estonia to impose countervailing duties over a two-year period (from 1995 to 1997). In its assessment of Estonian progress in the "Agenda 2000" the EU Commission stated clearly concerning a possible imposition of trade restrictions by Estonia, "This should not be taken as a change in the liberal direction of trade policy but as a reaction to the very specific problems of the agricultural sector".[17] One partner cannot give more clearly its permission to another to impose the countervailing duties contrary to its own subsidies. Notwithstanding this statement, the lobby groups oriented on the profits derived from mediating this unfair competition succeeded in preventing the imposition of tariffs in both the parliament and government. In fact, the possibility of development would be taken out of the hands of Estonian agriculture before Estonia can join the EU. The problems of Estonian agriculture would not be solved with accession to the EU since the effective production quotas in the EU are based on the level of production during the three consecutive years before accession. Besides, the restoration of previous levels of agricultural production would be quite expensive.

The only way to retain agricultural production in Estonia would be by starting a new dialogue with the EU based on the WTO rules. The WTO rules of implementation of general protective measures are set out in Articles XIX, XXX and XXI of GATT. Article XIX prescribes when emergency action (e.g. restrictive measures other than normal tariffs) can be taken against imports that are injuring domestic producers. An escape clause permits a country to suspend tariffs or other concessions when increased imports cause, or threaten to cause, serious injury to the producers of competitive domestic goods. GATT Article XIX sanctions such "safeguard" provisions to help firms and workers injured or damaged by increased imports adjust to the rising level of import competition.

As a result of the Uruguay Round an independent agreement, the Agreement on Safeguards concerning protective measures, was concluded.[18] This agreement recognises a country's right to withdraw or modify concessions granted earlier, or to impose new restrictions, if a product is "being imported in such increased quantities ... as to cause or threaten to cause serious injury to domestic producers" and to maintain such restrictions "for such time as may be necessary to prevent or remedy such injury" (GATT Article XIX entitled "Emergency Action on Imports of Particular Products"). This is exactly the situation in Estonia in the area of all main agricultural products. But the procedure for implementing safeguards within the framework of the WTO is time-consuming and complicated and thus in effect Estonia, a WTO member since November 1999, cannot rely on this agreement, as after years devoted to the "investigation" Estonian agriculture would be bankrupt. The only chance is to act promptly and implement counterbalancing duties now. All WTO further "investigations" would only prove the adequacy of these measures. This would enable Estonian

[16] The Results of the Uruguay Round of Multilateral Trade Negotiations, Legal Text, reprinted in 1995 by the WTO, Geneva, p. 43.

[17] Agenda 2000. Komisjoni arvamus Euroopa Liidu liikmeks astumise avalduse kohta, Tallinn 1997, p. 18.

[18] The Results of the Uruguay Round ... op.cit., p. 315.

agriculture and rural life to be saved. Actually since January 1, 2000, Estonia has imposed tariffs on agricultural imports originating from the third countries (countries with which Estonia does not have a free trade agreement). But this concerns only one third of imports and just diverts imports towards countries with which Estonia does have a free trade agreement (including the EU).

The WTO permits the implementation of counterbalancing measures in the case of subsidised exports of foreign trading partners. GATT Article VI permits the use of countervailing duties – specific duties imposed on imports to offset the benefits of subsidies to producers or exporters in the exporting country. If a country imposes subsidies on its production or exports, this will be classified as unfair competition. If these subsidies harm, or will potentially harm in the future, the domestic production of another country, then the other country will have the right to counterbalance the unfair competition with import duties. That well characterises the Estonian situation. In the Estonian market for agricultural products Estonia faces subsidised imports from other countries.

In the EU, overall, the financing of production costs by the state was 33 percentage points higher in 1997 than in Estonia (42% : 9%). This means that the EU companies had an advantage of one third of production costs. Under these conditions we cannot speak of normal competition – this is a directly and openly unfair competitive advantage for products originating from the EU. Estonia should on average impose a 50% counterbalancing tariff that should be differentiated according to the subsidies in different commodity groups in order to dilute this advantage. Until accession to the EU, the EU will remain a competitor of Estonia and balancing the trading terms with the EU should be one of the main tasks of Estonian foreign trade policy. This is an important matter which still has to be stressed.

The Impact of Integration into the EU

Accession to the EU is the officially declared objective of all the main political parties in Estonia. The effects of the accession on foreign trade have yet to be fully assessed. Integration into the EU will significantly change the Estonian foreign trade position in world trade. The influence of integration into the EU on the Estonian exports sector should be analysed separately from the impact of import terms on the Estonian economy.

All currently effective export subsidies or export tariffs that influence (either positively or negatively) exports of goods to third countries will have an impact on Estonia's export sector. At the same time the attitude of third countries, namely their foreign trade terms for Estonia, will change. The impact of accession to the EU on Estonian exports can be assessed as follows:

☐ Where the export of goods from Estonia to the EU is restricted or aggravated by EU current trade barriers. After joining the EU, the various trade barriers (import tariffs and export subsidies) will be abolished and Estonia will also be subject to internal market measures (production subsidies and regional assistance as well as environmental and social security requirements). This mostly concerns trade with agricultural products and foodstuffs. In principle this means the opening up of a large market with excellent purchasing power for Estonian producers. Due to the open economy, production costs and prices are lower in Estonia and thus Estonian exporters can demand higher prices and therefore raise their profits on the EU market. But at the same time we should consider that the price of raw materials and other production inputs will rise to the EU level as their unrestricted imports from the world market will no longer be available. On the other hand, after entering the economic and monetary union, Estonian companies will have to sustain competition on the same terms as their EU counterparts. The introduction of environmental and health care standards and, to a lesser extent, the social security standards of the EU would drive most Estonian companies out of business. But at the same time, the companies and trade unions of current EU member states will not tolerate the "wage, social and environmental dumping" of the Central and Eastern European countries that would endanger their jobs, incomes and profits. The development of Estonian foreign trade in so-called "sensitive" sectors (sectors where the EU lacks competitiveness and that are therefore protected) depends on the compromise reached on opposing interests.

☐ Where the terms of imported goods currently in force set by third countries differ for the EU and Estonia. After joining the EU, Estonia will face the same conditions that are currently in force in the EU. In the case of some goods, Estonian export terms into third countries will worsen. For example, Estonia will have to cancel free trade agreements with third countries (definitely the Ukraine but probably also Latvia and Lithuania) and implement the EU treaties with third countries. On the other hand, in this respect positive changes should also be expected as the EU, a trading partner with very strong market power, is not discriminated against in world trade. For example, after joining the EU, Estonian goods on the Russian market will face the same trading regulations as other countries. The widely acknowledged quality standards of the EU will also positively influence the image of Estonian products on the world market.

☐ Where the trade terms for goods are the same for both Estonia and the EU. No changes should be expected after joining the EU. Indirect positive changes should result from the aforementioned improvement in the image of Estonian products.

The effect of integration into the EU on imports and through imports on the economy is difficult to determine. In the case of imports, goods originating from the EU and from third countries must be examined separately. On balance, the influence of the integration into the EU on the Estonian import sector should be evaluated negatively.

☐ On joining the EU, direct export subsidies by the EU for exports to Estonia will be abolished and thus these goods will become more expensive on the Estonian market. Estonian producers and consumers will no longer profit from the EU subsidies, since the EU only subsidises exports of these goods that have to compete with domestic production on the export market. The cancellation of export subsidies thus actually eliminates the source of unfair competition and enables Estonian products to acquire the position on the EU market that corresponds to their inherent/natural competitiveness. However, due to its smaller market Estonian producers will be price-takers on the EU market which means that consumers will have to pay more. The producers will, on the other hand, get a chance to increase their profits until the moment their production costs adapt to the EU level.

☐ Imports originating from third countries will be more expensive for Estonia as an EU member state, either due to the addition of tariffs to the price of a good or the diversion of imports to the relatively more expensive production of the EU or their favoured trade partners. The EU has imposed customs tariffs on more than 10,000 commodities. In addition to tariffs, imports of cheap goods are often prohibited by a very small import quota being imposed on goods originating from third countries that inevitably forces the consumer to purchase these goods from the EU internal market, though the price level is higher there. Trade diversion effects will become apparent in the "sensitive" sectors of the EU (agriculture, foodstuffs industry, coal and steel, textiles, the car industry and a few others).

Conclusions

Regaining its independence gave Estonia the opportunity to develop its foreign trade on the basis of a market economy. As a result, Estonian foreign trade has been re-oriented from an administratively enforced eastern direction to a selection of trade partners based on the usefulness and profitability of trade relations. The nature of inherent competitive advantages has an important impact on the diversification of foreign trade by commodity sections. This is the reason why great changes have occurred in the structure of both imports and exports since independence. The structure of foreign trade has not yet stabilised.

Entering on the world trade scene after half a century of isolation is a complicated process. This has entailed a new division of the market that the trading partners in their own interest cannot accept. Estonian foreign trade policy has so far been based on naïve-liberal principles and has totally opened its market to competitors. Trading partners, on the other hand, act according to their own interests and do not respond to the openness of the Estonian market with the opening of their market to Estonian products. On the contrary, with the help of state subsidies for producers and exporters, the competitors intrude into the Estonian market using unfair trading. Estonia has not reacted adequately to this. Therefore the sectoral structure of the Estonian economy is distorted and no longer corresponds to the structure of inherent competitive advantage.

The transition period of Estonia's foreign trade will come to an end with accession to the EU. This will be accompanied by a great change in the terms of foreign trade. Its influence on the Estonian economy will be contradictory. In sum it should have a positive impact on the export sector. But the situation regarding imports will worsen on entering into a protective economic union. The overall influence on the economy will depend on whether the Estonian economy succeeds in adapting quickly to the high standards of the EU or whether production will be favoured at the expense of social security, health care and environmental protection. Our trading partners will not accept this kind of "dumping". If Estonia wants to enjoy the subsidies available in the EU, it will also have to follow the commonly accepted rules of behaviour in the EU.