ASSESSING LITHUANIA'S COMPETITIVENESS IN THE CONTEXT OF EU ENLARGEMENT

Henrikas Karpavičius

Dr. of Social Sciences
Faculty of Social Sciences
Šiauliai University
E-mail: h.karpavicius@smf.su.lt

1. Introduction

The accession of Lithuania into the EU has undoubtedly brought to the forefront the significance of uninhibited (by trade restrictions, often still prevalent in the world market) participation of Lithuanian exporters in the very sizeable EU internal market. The analysis of the flows of goods in the EU internal market confirms a brisk rate of quantitative expansion, which provides the necessary prerequisites for new member states to achieve more efficient production. However, it is important not to forget that the EU trade policy, with regard to non-members and particularly the new economic centres such as China, may actually dampen the positive effects of internal market on new member states such as Lithuania. Of particular concern is the fact that Lithuania currently competes both intra-EU and domestically in the categories of goods where a large share of Lithuania's total exports originate. Therefore, in order to methodically assess the competitive prospects for various categories of goods that Lithuania exports to the EU, we employ the analytical tools of revealed comparative advantage (RCA) and relative trade balance (RTB). The advantage of these indicators lies in their broad applicability and suitability for comparative analysis.

The aim of this study is to:

• assess Lithuania's position in the intra-EU trade using the revealed comparative advantage (RCA) and relative trade balance (RTB) indicators (in 2005, ca. 65% of Lithuania's exports and ca. 60% of imports have been intra-EU, the shares have been stable over the last few years),

consider the "extraneous factors", more specifically the competition from China, as a possible influence on the sustainability of a comparative advantage,

evaluate whether recent trends in FDI into Lithuania have a potential to change the landscape of Lithuania's comparative advantage.

The analytical methods used: comparative analysis of statistical data, measurement of comparative advantage by two indicators.

2. World Trade and Measures of Comparative Advantage

Since the works of A. Smith and D. Ricardo introduced the concepts of absolute and relative advantage in international trade, further progress in the 20th century has been assured by the contributions of E. Heckscher, B. Ohlin, W. Stolper, P. Samuelson and others to this important area of economic theory. All of them have essential-

ly supported the idea that free trade brings important economic benefits to the participating countries, albeit the size of those benefits may be distributed unequally (the importance of world trade is clearly confirmed by the growth of world exports: 1948 – 58 bln. USD; 1963 – 157 bln. USD; 1983 – 1.838 trl. USD; 1993 – 3.671 trl. USD; 2005 – 10.159 trl. USD and the expanding membership of the WTO, currently numbering 150 countries). On the opposing side, loud voices (more of populist nature) have been basing their opposition on claims that it is the developed countries that reap most of the benefits from trading with less developed countries. At the end of the 20th / beginning of 21st century these claims have been scientifically critisised by well-known economists such as P. Krugman, P. Samuelson, J. Sachs, J. Bhagwati and M. Porter. The regional aspect of international trade is also gaining the attention of researchers. Whether based on inter-governmental agreements (EU) or memoranda of intentions (APEC), the functioning of trade systems provides an opportunity for trade and economic well-being expansion for the participating nations.

In 2004, Lithuania has become a full member of the EU, the largest regional trading block in the world, whose intra trade makes up about 28% of the world trade. This makes "the ability of European producers to compete and survive in the internal market" (European Commission, 2005) and opens new possibilities to enhance the efficiency of the national economy through aggressive export expansion and changing the structure of export industries on the global level (Z. Lydeka, 2001; A. Vasiliauskas, E. Vilkas, A. Petronis, 2002). At this junction, it is interesting to examine in more detail the sectors that attracted most FDI in Lithuania and assess whether indeed the structure of industries is changing in Lithuania.

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Measures of comparative advantage

This section discusses the country's performance in external trade using the index of revealed comparative advantage (RCA) and the index of relative trade balance (RTB).

- The RCA index compares the country's exports, both total and for a specific industry, with those of a reference area (world, intra-EU). Values higher (lower) than 1 imply that a country (or a given industry) performs better (worse) than the reference area, and are interpreted as a signal of comparative advantage. The RCA indicator is used to rank the country's products according to their comparative advantage.

$$RCA_{c,p} = \frac{\dfrac{X_{c,p}}{NX_c}}{\dfrac{ex_p}{EX}} ,$$

where:

$\chi_{c,p}$: Export (intra-EU) of the country c for the product p,

NX_c: Total (national) export (intra-EU) of the country c,

ex_p: Exports total for the intra-EU for the product p,

EX: Total exports for the intra-EU.

- The RTB index is used to measure performance developments over time. The intra-EU indicator compares the trades balance (exports minus imports) for a group of products to the total trades (exports plus imports) of that group of products.

$$RTB_i = \frac{(X_i - M_i)}{(X_i + M_i)},$$

where X is the value of exports and M is the value of imports.

The strong competitive performance is confirmed by a high and positive value of the RTB index (EU sectoral competitiveness indicators, 2005).

3. Factors affecting Lithuania's Comparative Advantage

There is, of course, a great multitude of factors. Within the confines of this article, we will touch upon only the most relevant ones for the medium-term macroeconomic development.

The Context of Intra-EU Trade

The EU internal market represents a colossal value of goods moving freely without the hindrance of trade barriers. In 2003, internal exports reached 1878,5 bln. €, in 2004 – 2028,4 bln. €, in 2005 – 2153,9 bln. €. The EU leaders have been emphasising the importance of qualitative changes to the internal market, arguing that "removing the remaining barriers will create new opportunities for market entrants and the resulting competition will spur investment and innovation. This is all the more important against a backdrop of '*tagnating intra-EU trade in goods*' and stalling price convergence" (A new start for the Lisbon strategy, 2005). However, quantitative growth of the internal market has continued and this is to be viewed as a positive news for the new member states, characterised by large shares of GDP created through exports.

Indeed, as Table 1 confirms, Lithuania's exports to the EU have grown by over 20% p.a. in 2004 and 2005, exceeding the growth of GDP as a whole.

Furthermore, a more detailed breakdown of export performance by SITC product groups makes it clear that Lithuania's exports in SITC product groups 0, 1 and 3 have been responsible for most of the increase in Lithuania's intra-EU exports (Table 2).

It, therefore, comes as little surprise that the RCA indicator has been showing the fastest improvement in SITC product groups 0,1 and 3, in addition to a relatively stable and high RCA indicator in SITC product groups 6, 8 and 9. Also, looking at the RTB indicator for Lithuania in the context of intra-EU trade, surpluses are visible in SITC product groups 0, 1, 2,3 and 4, hence essentially re-enforcing the same message as the RCA indicator (Table 3).

It can be stated that export structure is dominated by low value-add goods, as opposed to innovative products. Based on OECD goods classification by technology category, the lion's share of Lithuania's exports falls under category I: low-technology (food products, beverages, tobacco, textile, wood and wood products) and medium-low technology (refined petroleum, plastic products) manufactures, and a relatively small share of category II goods: medium–high technology manufactures (chemicals, some elements of machinery and equipment).

Table 1. **Exports by SITC Product Groups, bln. €**

	SITC Product Groups* by years								
	Exports								
	0–9			0+1			2+4		
	2003	**2004**	**2005**	**2003**	**2004**	**2005**	**2003**	**2004**	**2005**
1. EU-Σ	2761,4	2997,7	3224,9	215,5	223,2	235,9	72,7	82,9	88,9
1.1. intra	1878,5	2028,4	2153,9	166,3	174,1	183,3	54,9	62,5	65,6
1.2. extra	882,9	969,3	1071,0	49,2	49,1	52,6	17,8	20,4	23,3
2. Lithuania Σ	6,16	7,48	9,49	0,64	0,80	1,14	0,39	0,46	0,52
2.1. intra EU	3,85	5,00	6,20	0,37	0,57	0,83	0,30	0,33	0,37
2.2. extra EU	2,31	2,48	3,29	0,27	0,23	0,31	0,09	0,13	0,15

	SITC Product Groups* by years								
	Exports								
	3			5			7		
	2003	**2004**	**2005**	**2003**	**2004**	**2005**	**2003**	**2004**	**2005**
1. EU-Σ	106,1	120,32	172,6	407,8	445,8	488,4	1159,2	1254,8	1321,6
1.1. intra	79,3	88,3	128,5	265,3	291,4	322,3	761,5	816,3	840,2
1.2. extra	26,8	32,0	44,1	142,5	154,4	166,1	397,7	438,5	481,4
2. Lithuania Σ	1,24	1,87	2,57	0,46	0,60	0,82	1,60	1,62	1,95
2.1. intra EU	0,42	1,15	1,58	0,37	0,43	0,54	0,89	0,83	0,97
2.2. extra EU	0,82	0,72	0,99	0,09	0,17	0,28	0,71	0,79	0,98

	SITC Product Groups* by years		
	Exports		
	6+8+9		
	2003	**2004**	**2005**
1. EU-Σ	741,7	808,5	855,9
1.1. intra	511,4	555,3	582,7
1.2. extra	230,3	253,2	273,2
2. Lithuania Σ	1,82	2,12	2,49
2.1. intra EU	1,50	1,69	1,91
2.2. extra EU	0,32	0,43	0,58

* According to the Standard International Trade Classification (SITC Rev. 3), product groups are defined as follows: sections 0 and 1 (food and live animals, beverages and tobacco), sections 2 and 4 (crude materials, except fuels), section 3 (mineral fuels, lubricants and related materials), section 5 (chemicals and related materials), sections 7 (machinery and transport equipment), sections 6, 8 and 9 (other manufactured products).

Increasing the production of such goods is not a viable or economically efficient enterprise, given that relatively cheap labour costs and raw materials supplied at a discount to world prices are unlikely to remain for long.

New Frontier of "Economics Opportunities" – The Case of China

In view of the conclusions reached above, we turn our attention to the emergence of China as a threat to a rather fragile competitive advantage in intra-

Product groups according to SITC	RCA			RTB		
	2003	2004	2005	2003	2004	2005
0–9 total	0.919	0.958	0.978	−0.106	−0.115	−0.089
0+1	0.749	0.914	0.937	−0.011	0	0.064
2+4	1.019	0.951	0.965	0.304	0.200	0.233
3	0.454	0.838	0.827	0.909	0.933	0.915
5	1.235	1.096	0.998	−0.333	−0.363	−0.357
7	0.846	0.786	0.781	−0.378	−0.509	−0.508
6+8+9	1.196	1.160	1.126	0	−0.074	−0.088

*RCA and RTB indicators are calculated by the author, using data from Eurostat, IMF, WTO, WB, and Lithuanian Statistical Department.

Table 3. EU-25–China trade flows*, bln. €

	Exports			Imports			RTB		
	2003	2004	2005	2003	2004	2005	2003	2004	2005
0–9 total	41.17	48.19	51.84	105.39	127.46	157.99	−0.438	−0.451	−0.506
0+1	0.53	0.63	0.80	1.64	1.79	2.23	−0.512	−0.479	−0.472
2+4	1.61	2.26	3.21	1.49	1.82	2.36	0.039	0.108	0.153
3	0.12	0.11	0.06	0.68	1.17	0.73	−0.700	−0.828	−0.848
5	3.73	4.43	5.19	3.77	4.01	5.06	−0.05	0.050	0.013
7	26.37	30.76	31.21	47.96	61.96	73.72	−0.290	−0.336	−0.405
6+8+9	7.95	9.12	10.17	49.53	56.40	73.30	−0.723	−0.722	−0.756

* According to the SITC.

Table 4. Lithuania–China trade flows in selected product groups, mln. €

| Year | | | Total | | Of which: clothing | | Machinery and mechanical appliances; electrical equipment, total | | Vehicles, aircraft, vessels and associated transport equipment, total | | Miscellaneous manufactured articles | | | |
											Total		Of which: furniture	
	Exp	Imp	Exp	Imp	Exp	Imp	Exp	Imp	Exp	Imp	Exp	Imp	Exp	Imp
2004	9.4	237.0	1.4	24.6	0.1	14.0	1.8	95.3	0.1	15.4	0.4	19.7	0.4	7.4
2005	11.1	291.2	1.4	24.9	0.1	13.2	0.9	124.2	0	17.3	0.1	21.1	0	8.3

EU that Lithuania currently has in certain categories of goods (Table 3) and with China (Table 4).

Data in Table 3 would seem to confirm the views expressed above, showing the worsening RTB in virtually all SITC product groups in the period from 2003 to 2005.

Turning our attention to Lithuania's position with regard to China (Tables 4 and 5), it is not so much the fact that Lithuania has a very large (relative to its exports) and increasing trade deficit with China that is disconcerting (Table 4), but rather the observation that China's surpluses with the EU-25 seem to be occurring in the same categories of goods where Lithuania's export position is relatively strong with respect to intra-EU trade.

Table 5. **Lithuania's foreign trade flows *, bln. €**

Broad Economic Categories	2003				2004				2005			
	Exp	Imp	Balance	RTB	Exp	Imp	Balance	RTB	Exp	Imp	Balance	RTB
Total	6.16	8.53	−2.37	−0.161	7.48	9.96	−2.48	−0.142	9.49	12.50	−3.01	−0.137
Capital goods	0.76	1.71	−0.95	−0.385	0.61	1.79	−1.18	−0.492	0.78	2.00	−1.22	−0.439
Intermediate goods	3.08	4.76	−1.68	−0.214	3.96	5.82	−1.86	−0.190	5.05	7.63	−2.58	−0.203
Consumption goods	1.65	1.46	+0.19	0.061	2.02	1.78	+0.24	0.063	2.44	2.15	+0.29	0.063
Other (motor spirit, passenger motor cars)	0.66	0.60	+0.06	0.048	0.89	0.57	+0.32	0.219	1.23	0.72	+0.51	0.262

* According to the classification by Broad Economic Categories (BEC).

Of note are SITC product groups 0 to 4 where Lithuania currently has a surplus with the EU, but so does China, at least partially, and also in product groups 7 to 9 where Lithuania has a high RCA, but China's exports to EU are rising fast in these product groups. The implication then is that Lithuania's further export growth to EU-25 may be challenged by China, hence eroding its future comparative advantage.

A detailed study characterising trends in international economic integration has revealed interesting features of trade in goods that apply to China and the EU-10. Both entities have deficits in "intermediate goods" categories and surpluses in "consumption goods". In addition, China shows surpluses in "total" and "capital" goods, while the EU-10 is in deficits in those categories. The conclusion is that "China has strengths in the labour-intensive stages of the production process of a wide range of low-technology sectors and in the labour-intensive stages of the production of ICT-related goods. The EU-10 group is also specialised in the production of low-technology, labour-intensive goods" (The EU economy: 2005 review, 2005). In other words, the EU-10 (and likely to an even greater extent the EU-25) is experiencing head-on competition from China on its turf, and that competition is intensifying.

Lithuania's trade flows according to BEC indirectly mirror this conclusion. As Table 5 shows, Lithuania is likewise displaying increasing deficits in capital and intermediate goods over the period 2003–2005.

It is for this reason that we now turn to consider the FDI inflows into Lithuania as a possible precursor to a shift of comparative advantage to different industries.

FDI and its Impact on the Growth of Export Industries in Lithuania

The expansion of Lithuania's export markets is dependent on the FDI flows into Lithuania's manufacturing sector. Over the last five years of breath-taking economic growth, the rankings of the country groups providing the largest FDI inflows (the EU accounts for about 65%) into Lithuania have not changed substantially (after the completion of the acquisition of the "Mažeikių Nafta" oil refinery by a Polish group, the EU share of FDI will increase further and that of CIS will decline). Over the last five years, the stock of FDI has risen 2.5-fold from 2.71 bln. € at the start of 2001 to 6.92 bln. € at the start of 2006. FDI into the manufacturing sector has increased 3.5-fold from 0.78 bln. € or 28.8% of total FDI to 2.74 bln. € or 39.6% of total FDI. It is important to note that the structure of FDI has seen little change over the last five years (with an exception of refined petroleum products), continuing to favour the main export sectors of Lithuania (textile, clothing, furniture, chemicals, transport equipment) (see Table 6).

Table 6. **FDI flows into selected manufacturing sectors**

Manufacturing sector	2001 01 01		2006 01 01	
	mln. €	%	mln. €	%
Total	780.0	100.0	2740.0	100.0
Of which:				
food products and beverages, tobacco products	312.8	40.1	469.2	17.1
Textiles	101.4	13.0	95.6	3.4
Clothing	23.2	3.0	43.4	1.6
wood and wood products	37.7	4.8	57.9	2.2
refined petroleum products, nuclear fuel, chemicals	49.2	6.3	1390.2	50.8
office machinery and computers, electrical machinery n. e. c.	14.5	1.9	49.2	1.8
radio, television and communication equipment	37.7	4.8	26.1	0.9
medical, precision and optical instruments	8.7	1.1	20.3	0.8
motor vehicles, other transport equipment	55.7	7.1	84.7	3.1
Furniture	8.7	1.1	37.7	1.4

On the evidence to date, there is precious little to suggest that Lithuania is experiencing FDI inflows that are likely to facilitate a change in the structure of export industries.

Conclusions

In this article, we aimed to assess Lithuania's competitive position by factors such as intra-EU trade, China and FDI. While comparative advantage indicators are improving for certain categories of export goods, we also point out that China's position is likewise strengthening in similar categories of goods. Is that a problem? After all, the EU internal market is deep enough to accommodate many exporters. It is, of course, true that the EU market is a huge playing field. However, countries like Lithuania will undoubtedly find it hard to compete with the economies of a scale that China and other large developing countries can achieve. Although one perhaps should not read too much into a single case, but the recent bankruptcy of the medium-high technology equipment producer "Ekranas" painfully illustrates that despite the size of the EU market, only so many players can survive. Yet another

risk (not addressed in this study) for small countries like Lithuania is that because of the need to acquire a scale of production, industries are likely to be made up of only a few companies, the implication being that management errors of only a few companies can affect a country's competitive position. In larger economies, intra-country competition may better ensure that comparative advantage remains in the country, even if one company is taken over by another domestically.

While, of course, we admit that our study has not been focused on offering solutions to Lithuania's export industries, our analysis of intra-EU trade flows, China's trade with the EU and FDI inflows into Lithuania has revealed that:
* Lithuania's comparative advantage is concentrated in low to medium value-add goods;
* the position of the emerging economic powers like China is also strong and improving in similar categories of goods;
  FDI inflows into Lithuania have not produced any evidence that FDI inflows up to now have been focusing on industries that may be unlikely to suffer substantially from competition with large emerging economies like China.

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LIETUVOS ŪKIO GAMYBOS SEKTORIŲ KONKURENCINGUMO VERTINIMO ASPEKTAI ES PLĖTROS KONTEKSTE

Henrikas Karpavičius

Santrauka

Lietuvai tapus ES nare ypatingą reikšmę įgyja visateisis mūsų šalies ūkio subjektų dalyvavimas didžiulėje Europos Sąjungos vidaus rinkoje, nevaržomoje jokių protekcionistinių priemonių, dažnai naudojamų globalioje tarptautinėje prekyboje. 2005 metais Lietuvos prekių eksporto apimtis ES vidaus rinkoje buvo apie 65%, o importo – apie 60% bendro prekių judėjimo srauto.

Šie rodikliai apibūdina ūkio gamybos sektorių konkurencingumo lygį ES vidaus rinkoje, taip pat iš dalies patvirtina žinomų pasaulio mokslininkų nuomonę apie daugiaplanę užsienio prekybos naudą visoms procese dalyvaujančioms šalims.

Detali analizė (pagal atskirų produktų grupes) atliekama panaudojant RCA (lyginamasis konkurencinis pranašumas) ir RTB (santykinis prekybos balansas) rodiklius. Identifikuoti šių rodiklių kiekybines reikšmes ypač aktualu nedidelėms ir sparčiai besivystančioms nacionalinėms ekonomikoms, iš jų Lietuvos, formuojančioms trumpalaikius ir ilgalaikius ūkio gamybos sektorių plėtros prioritetus.

ES vidaus rinkai daro įtaką daug veiksnių, tačiau Lietuvai ypač reikšmingas šios rinkos atvėrimas „naujų galios centrų", ypač Kinijos, prekių importui. Tyrime fiksuojami duomenys (RCA ir RTB pavyzdžiu) patvirtina Lietuvos ekonomikai nepalankias tiesiogines ir netiesiogines tendencijas. Lietuvos ir Kinijos dvišalė prekyba prekėmis, sudarančiomis ženklią mūsų šalies eksporto dalį (tekstilės medžiagos ir dirbiniai, mašinos ir mechaniniai įrenginiai, elektros įrengimai, transporto priemonės ir įrenginiai, baldai), pastaraisiais metais tampa vis labiau nesubalansuota Lietuvos ūkio subjektų nenaudai. Didelę grėsmę Lietuvos eksporto potencialui kelia sparti ES ir Kinijos prekybos plėtra, ypač Europos Sąjungai nepalankus ir 2003–2005 metais sparčiai blogėjantis prekybos paminėtomis prekėmis balansas.

Lietuvos užsienio prekybos struktūrinė analizė pagal Makroekonomikos kategorijų klasifikatorių (BEC) fiksuoja nežymų teigiamą RTB rodiklį vartojimo prekių grupėje, tačiau ženklų neigiamą šio rodiklio dydį tarpinio vartojimo prekių ir investicinių prekių grupėse. Tai patvirtina Europos Komisijos institucijų 2005 metais atlikto tyrimo išvadas, jog naujosios ES šalys (ir Lietuva), eksportuodamos žemo bei vidutinio technologinio lygio prekes tarptautinės prekybos kontekste patenka į stiprų Kinijos (ir kitų sparčiai besivystančių didelių ekonomikų) konkurencinio spaudimo lauką.

Pagal tyrime naudojamą kompleksinę konkurencingumo lygio vertinimo metodiką atlikta tiesioginių užsienio investicijų ir jų pasiskirstymo pagal ūkio sektorius rodiklių analizė nepatvirtina ženklių eksporto struktūrinių pokyčių galimybės.

ASSESSING LITHUANIA'S COMPETITIVENESS IN THE CONTEXT OF EU ENLARGEMENT

Henrikas Karpavičius

Summary

After Lithuania's accession to the EU, the participation of Lithuanian enterprises in a very sizeable intra-EU trade, unrestricted by protectionist measures, acquires an ever greater importance. In 2005, Lithuania's exports to the EU amounted to 65% of total exports, whereas imports reached 60%. These figures would seem at first sight to reflect positively on Lithuania's competitiveness in the EU and confirm the assertions of many prominent economists about the multi-faceted benefits of foreign trade to its preachers.

To gain a deeper understanding of Lithuania's comparative advantage, a detailed analysis by product groups has been conducted, using the metrics of Revealed Comparative Advantage (RCA) and Relative Trade Balance (RTB). Quantifying comparative advantage is particularly important to small and rapidly growing economies that are still looking to define their both short- and long-term economic development priorities.

The developments of intra-EU trade are affected by a multitude of factors, however, we single out the effects of opening of the EU market to imports from new 'economic centres', especially China, because of the competitive threat it poses to countries like Lithuania. In this context, our analysis using RCA and RTB metrics highlights unfavourable, both direct and indirect, tendencies for Lithuania. Looking at Sino-Lithuanian trade in goods that account for the lion's share of Lithuania's total exports (textile, machines and mechanical equipment, electrical equipment, transport vehicles and equipment, and furniture), it becomes clear that the trade balance in these goods is shifting not in Lithuania's favour. Furthermore, a breath-taking growth in the Sino–EU trade and, in particular, EU's deteriorating trade balance with China in the aforementioned goods categories over the 2003–2005 period raises serious questions about the future of Lithuania's export industries.

The structural analysis of Lithuania's foreign trade using the BEC (Broad Economic Categories) classification reveals a slightly positive RTB value in the 'consumption goods' category, but a substantially negative value in the 'intermediate' and 'investment goods' categories. This seems to confirm the conclusions reached in a study by European Commission in 2005, that the new member states (including Lithuania), owing to their exports of low to medium grade goods by technological sophistication, will be severely pressurised by competition from China and other fast-developing countries.

Analysis of foreign direct investment (FDI) flows by economic sectors does not provide evidence that major changes in the export structure are underway to mitigate the effects of competition with China and other fast-growing countries.