

AgriPolicy
Enlargement Network for Agripolicy Analysis

**AN ASSESSMENT OF THE
COMPETITIVENESS OF THE DAIRY FOOD CHAIN
IN LITHUANIA**

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Coordinator	Siemen van Berkum (LEI)
Authors of this report	ROMUALDAS ZEMECKIS, ALBERTAS GAPŠYS, DEIVA MIKELIONYTE, OVIDIJA EICAITE, VILIJA GIRGŽDIENE (LAEI, VILNIUS)

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1 Introduction

The aim of this report is to describe and estimate the state and performance of the dairy sector in Lithuania. The report aims to judge the competitiveness of the Lithuanian dairy sector, to identify some of the key constraints to competitiveness and to suggest some key policy interventions to improve the competitive position of the sector. The common methodology established is based upon internationally accepted definitions of competitiveness, which focus on the ability of individual industries to “profitably maintain or increase market share” in either domestic or international export markets. Structure, conduct and performance concepts are combined with resource analyses in judging the competitiveness of the Lithuanian dairy chain, to identify key constraints to competitiveness and to develop policy interventions to improve competitiveness. The study considers the entire dairy chain from small-scale milk production at the farm level through to processing and retailing activities.

The structure of the report is as follows. In section 2 an overview of the present situation and conditions in milk production and dairy processing in Lithuania is provided. Section 3 further elaborates on the issue of evaluating factors, which influence the competitiveness and efficiency of the milk chain. Based on these analyses, the sector’s strengths and weaknesses, opportunities and threats are identified in section 4. Such a SWOT analysis gives the possibility to define prerequisites and directions for the sector’s future development. The recognition of the key constraints should lead to a series of ideas for policies that may address the obstacles to further development and help to reduce the inefficiencies identified. This paper concludes with presenting some policy recommendations to help prepare the dairy chain for the challenges ahead in section 5.

The report covers the period of 1998–2007. The data are presented in national currency (Litas) and euros. Since 2 January 2002 the Litas (LTL) is pegged to the euro at the fixed rate of 3,4528 LTL to 1 EUR.

2 Overview of the sector

2.1 Sector definition: sector components and importance

Lithuanian milk production has been concentrated in the private sector. In 2006 about 69% of the milk production was delivered to dairies for processing. The rest of the milk production is retained on farms for family consumption, direct sales and livestock. Small dairy farms take a dominant position in Lithuania. In 2007 the average dairy farm had 3.3 cows.

At the processing level, the current dairy industry consists of four major companies. In 2007 these companies produced about 90% of the total sector’s output.

Beyond the processing sector, the distribution of processed milk and dairy products involves private specialised shops, private wholesalers and distribution networks of retail chains. The latter is highly concentrated in Lithuania.

2.1.1 Production and value added

In 2007 the value of milk production accounted for 23.4% in the total agricultural output (see Table 1). Although over the period of 1998–2007 the share of milk production in the total agricultural output increased from 16.8% to 23.4%, the growth rate of this indicator during the analysed period was unstable. The largest values of this indicator were observed during the last four years, i.e. since Lithuania joined the EU. In 2007 the share of EU-27 milk production in the total agricultural output made up 14%, in individual countries it fluctuated from 7% in Spain to 34% in Luxembourg (Eurostat, 2008). In 2007 according to this indicator Lithuania ranked fifth among the EU-27 member countries.

Table 1. Share of milk production in the total Gross Agricultural Output (GAO), 1998–2007

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Total GAO (value in national currency mill. Litas)	6179,5	5079,5	4616,7	4654,1	4363,6	4497,8	4552,3	5117,3	4913	6912,2
Share of milk production in GAO (%)	16,8	16,6	19,5	22,1	21,8	19,5	23,8	24,6	26,7	23,4

Source: Agriculture in Lithuania 2003 – 2007. - V.: Department of Statistics to the GovRL.

The manufacture of food products and beverages is one of the largest branches of the manufacturing industry in Lithuania. In 2007 the sales of manufacture of food products and beverages accounted for 19.9% of the total sales of manufacturing industry. The value of food products and beverages sold totalled 9.0 billion Litas (at current prices).

The production of milk and dairy products takes a significant place in the manufacture of food products and beverages. Namely, milk and dairy products contribute the largest share to the sold output of manufacture of food products and beverages. In 1998 milk and dairy products accounted for 33.9% of the total output sold of food products and beverages, in 2003 – for 22.9%, and in 2007 – for 34%.

In 2002–2005 the gross value added, created both in the manufacture of food products and beverages and in the dairy industry, was increasing. During this period the share of value added created in the dairy sector increased from 16.4% to 21.9% in the total value added created in the manufacture of food products and beverages. The data of previous years are not available in information sources (see Table 2).

Table 2. Share of GVA of the dairy industry in the food and beverage industry GVA

	1998	1999	2000	2001	2002	2003	2004	2005
Total GVA in food and beverages industry (value in national currency mill. Litas)	992,68	860,44	1205,77	n.a.	1159,5	1330,9	1494,8	1594,8
Dairy production GVA (value in national currency mill. Litas)	n.a.	n.a.	213,38	235,48	190,1	287,1	326,7	349,8
Share of GVA of the dairy industry in total food and beverage industry GVA – (%)	-	-	17,7	-	16,4	21,6	21,9	21,9

Source: Data of the Department of Statistics to the GovRL, Eurostat.

2.1.2 Product flows within the sector

In 2006 the total milk yield amounted to 1891.3 thou tonnes, of which 1296.1 thou tonnes (69%) were purchased for processing (see Figure 1). During the period of 1999–2002 the share of milk purchased fluctuated from 55% to 57%, and during the 2003–2006 period increased from 57% to 69%. In 2006 milk producers 595.2 thou tonnes of milk used on farms, of which 33% – for animal feed, and 67% – for own needs and direct sales. During the period of 2003–2006 the enlargement of dairy farms due to the withdrawal of some small milk producers from the milk production was going on. As a result, the share of milk used on farms was decreasing.

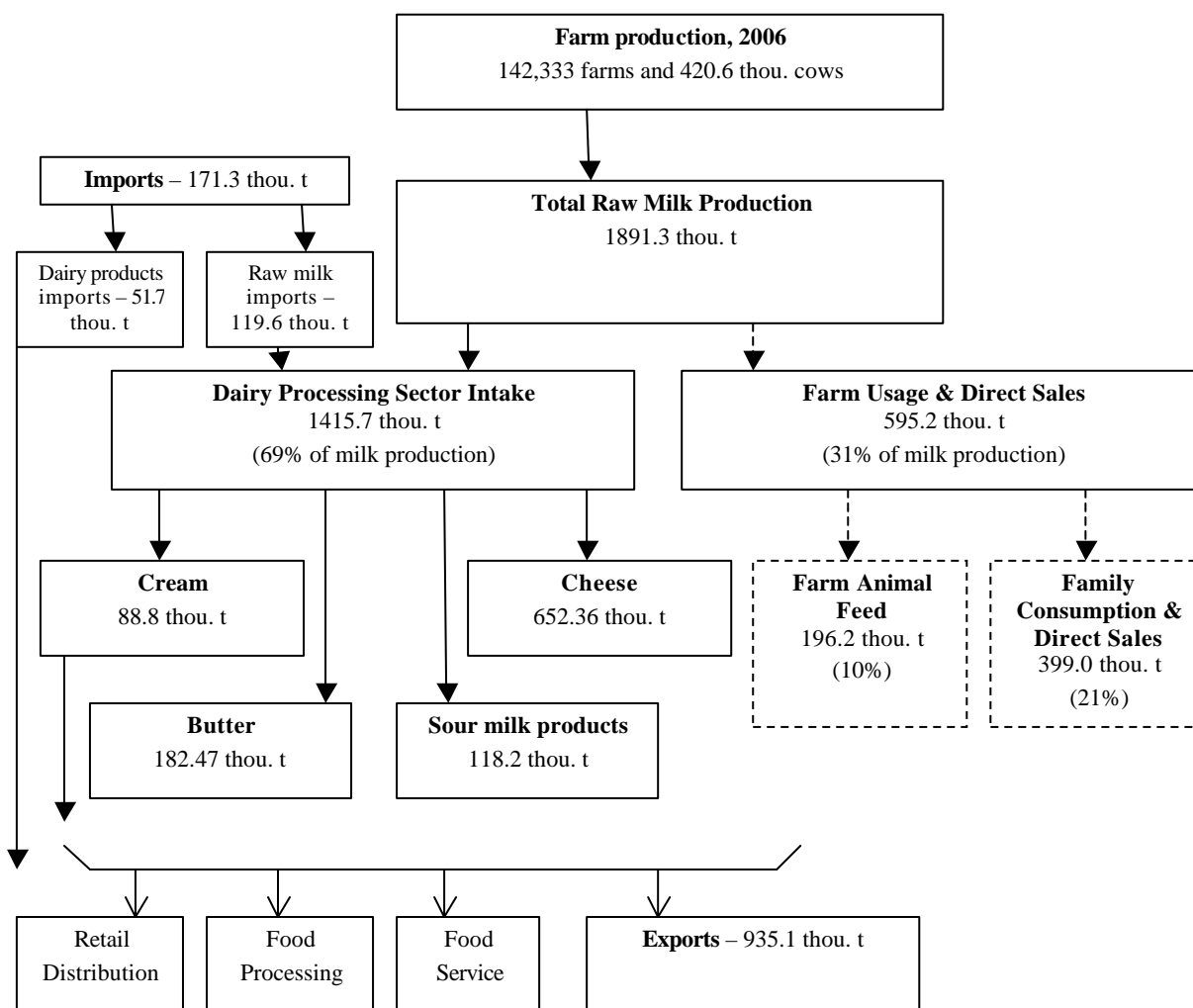


Figure 1. Overview of the Lithuanian milk sector and milk flows, 2006

2.2 Structural features of the dairy supply chain: present situation and trends overtime

2.2.1 Industry structure at primary level

As of 1 January 2008, 121 thousand farms produced milk in Lithuania. They had 396 thousand cows. Small farms with 3.3 cows per farm on average prevailed in the milk production (see Table 3). The farms keeping 1–2 cows accounted for 77% of the total number of dairy farms. They were keeping 29% of the total number of cows.

Table 3. Size structure of the livestock farms as of 1 January 2008

	FARMS			COWS			
	No. of farms	% of total	Cum. %	No. of heads	% of total	Cum. %	Average heads/farm
TOTAL	120982	100		395921	100		3,3
1-2 heads	92932	76,8	76,8	114922	29,0	29,0	1,2
3-5 heads	16570	13,7	90,5	60485	15,3	44,3	3,7
6-10 heads	6376	5,3	95,8	47329	12,0	56,3	7,4
11-20 heads	2965	2,5	98,3	42381	10,7	67,0	14,3
21-30 heads	927	0,8	99,1	23017	5,8	72,8	24,8
31-50 heads	658	0,5	99,6	25160	6,3	79,1	38,2
51-100 heads	346	0,3	99,9	23423	5,9	85,0	67,7
>100 heads	208	0,1	100,0	59204	15,0	100,0	284,6

Source: Number of livestock 2008, Data of the Department of Statistics to the GovRL.

During the 1999–2007 period the number of dairy farms decreased from 233 thousand to 121 thousand (by 48%). In 2007, compared to 1999, the number of small-scale farms was decreasing rapidly: the number of farms of 1–2 cows dropped by 52% and those of 3–9 cows – by 41%. The number of farms of 30–49 cows and of 20–29 cows was increasing most rapidly (respectively, 10.3 and 10.1 times). The number of farms of 10–19 cows and of 50–99 cows also went up (respectively, 5.6 and 4.0 times). The average size of dairy farm increased from 2 to 3.3 cows (by 65%). Although within the analysed period dairy farms were becoming larger yet remained rather small. In 2007 only 4.2% of the total number of dairy farms had more than 10 cows.

During the period of 1999–2007 the number of cows decreased from 474.4 thousand to 395.9 thousands (by 16.5%). In spite of the fact that the number of cows was going down, the milk yield was higher due to the increasing yielding capacity of cows.

2.2.2 Industry structure at processing level

The milk processing industry is one of the most concentrated and modern sectors of the food industry in Lithuania. 4 groups of milk processing enterprises (AB „Rokiškio suris“, AB „Pieno žvaigždės“, AB „Žemaitijos pienas“, AB „Vilkyškiu pieninė“) dominate in the country's dairy processing sector (see Table 4). They process over 90% of the total milk purchased in Lithuania and are the major exporters of dairy products. Other milk processing enterprises and their groups are much smaller, but some of them also export a large part of their output.

Table 4. List of large dairy companies (top 4), with their milk intake)

Name of the company	Ownership	Estimated intake per year	
		in thou. t	As % of total intake
AB "Rokiškio suris"	JSC	532,8	39,5
AB "Pieno žvaigždės"	JSC	391,2	30,1
AB "Žemaitijos pienas"	JSC	245,1	18,2
AB "Vilkyškiu pienine"	JSC	126,7	9,4

During the period of 2000–2007 the number of dairy enterprises was declining. In 2000 operated 63 milk processing enterprises with 11,462 employees, while in 2007 the number of enterprises was 32 with 6,054 employees. During the analysed period, the number of milk processing enterprises declined almost twice and the total number of employees dropped by 47% due to automation and introduction of new technologies. In 2007 small and medium-scale enterprises accounted for 81% of the total number of milk processing enterprises and large-scale enterprises – for 19%. 65% of the total number of employees of the dairy industry was engaged at large-scale enterprises (see Table 5).

Table 5. Size distribution of the dairy industry, in number of employees, 2007

Size band, in number of employees	Number of enterprises
0 – 49	18
50 – 99	3
100 – 249	5
Over 250	6

Source: Data of the Department of Statistics to the GovRL.

All Lithuanian milk processing enterprises and their subsidiaries conform to the EU sanitary and hygiene standards for food production and have licences for the export of their products to the EU countries. In 2007, 17 dairy enterprises had licences for the export to Russia.

In Lithuania dairy enterprises the largest share of milk purchase from farmers and family farms. However, the share of milk purchased from agricultural companies and enterprises is slightly increasing. In 2003, 15.4% of milk (of basic fatness) was purchased from agricultural companies, whereas in 2007 this share accounted for 17.9%. Due to the lack of raw milk, since 2005 dairy enterprises started to import raw milk from large-scale milk producers of neighbour countries. Over 2005 they imported 38 thousand tonnes of raw milk, in 2006 – 119.6 thousand tonnes, in 2007 – 121.1 thousand tonnes (3.2 times more than in 2005).

In 2003-2007 the profitability of major Lithuanian dairy enterprises, which were in the list of Vilnius Securities Exchange, fluctuated from -3.0 to 5.3%; and the largest profitability was reached in 2007.

Table 6. Net profitability of major dairy enterprises in 2003 – 2007, %

Indicator	1999	2000	2001	2002	2003	2004	2005	2006	2007
Net profitability	-3,0	2,9	4,4	-0,8	3,3	4,9	3,6	3,1	5,3

Source: <<http://www.lt.omxgroup.com>>.

2.3 Production, consumption and trade developments

The supply and demand balance sheet summarises the key developments in production, consumption and trade since 1998 (see Table 7). Although the production of milk in 1999, compared to 1998, declined, since 2000 it started to grow. The period of 1998–2006 can be divided into two periods of the export development: 1) the decrease (1998–2003); 2) the increase (2004–2006). The import during the analysed period was unstable. In 2006 in comparison with 1999 the per capita consumption of dairy products increased from 190 to 273 kg (by 44%) per year. In 1998–2004 the consumption was going up and in 2005–2006 down. In summary, it can be stated that during the last seven years the consumption was rather stable, on the average of 275–285 kg per capita.

Table 7. Supply/demand balance sheet on dairy products (thou. tonnes), 1998 - 2006

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Initial stocks	192,7	95,6	191,7	187,2	168,2	174,1	211,3	137,0	151,2
Usable production	1929,9	1714,2	1724,7	1729,8	1770,9	1796,1	1848,7	1861,6	1891,3
Imports	54,8	43,4	170,5	134,1	61,4	28,1	25,3	92,4	171,3
Total resources	2177,4	1853,2	2086,9	2051,1	2000,5	1998,3	2085,3	2091,0	2213,8
Exports	1168,8	715,8	700,2	668,0	615,4	583,0	696,8	742,2	935,1
Total domestic uses	913,0	945,7	1199,5	1214,9	1211,0	1204,0	1251,5	1197,6	1122,6
animal feed	170,0	169,2	208,5	210,2	214,0	202,7	210,9	215,4	196,2
Losses	0,6	0,6	2,6	0,5	0,7	0,7	0,8	0,7	0,8
other expenditure	67,0	42,0	38,1	26,0	14,5	6,9	21,6	17,2	-
human consumption	675,4	733,9	950,3	978,2	981,8	993,7	1018,2	964,3	925,6
per capita, kg	190	208	272	281	283	287	296	283	273
Final stocks	95,6	191,7	187,2	168,2	174,1	211,3	137,0	151,2	156,1
Self-sufficiency, %	211	181	144	142	146	149	148	155	168

Source: *Agriculture in Lithuania 2003 – 2007*. - V.: Department of Statistics to the GovRL.

Production

The trends in the production of dairy products are presented in Table 8. In 2007, compared to 1998, the production of all dairy products, except butter, increased. The production of butter declined due to the changed (in 2006) methodology on the attribution of products to milk fats. More and more milk fats were produced and exported as sweet cream. Therefore, the production of cream increased significantly. The increase of production of dairy products was conditioned by the larger consumption and export of dairy products. In 1998–2007 mostly increased the production of cream (48.2 times), yoghurt (4.6 times), lactose (4.4 times) and fresh cheese (3.8 times). Lithuanian dairy enterprises mainly specialise in the production of cheese. Cheeses made up the largest shares in the structures of sales and export of dairy products. During the analysed period country's milk processors produced on average 50.2 thousand tonnes non-processed and processed cheeses per year.

Table 8. Trends in dairy production, 1998–2007

Product, thou. tonnes	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Drinking milk	80,9	73,0	75,1	77,6	85,9	78,1	74,6	79,2	83,6	97,8
Cream	0,9	1,0	1,0	1,1	1,4	11,8	26,1	41,9	41,8	43,4
Kefir, sour milk	28,6	27,5	26,1	29,1	31,3	28,1	27,3	29,1	33,9	35,3
Yogurt	3,8	6,3	5,7	6,8	11,6	15,5	15,2	14,6	18,1	17,3
Sour cream, sour cream and vegetable fat mixture	19,8	17,6	17,9	19,1	20,0	21,3	26,8	22,7	25,1	26,6
Curd, curd and vegetable fat mixture	12,6	11,7	11,0	11,2	11,7	11,3	12,1	13,4	18,0	21,5
Unripened or uncured cheese	6,0	5,3	5,1	5,5	5,8	6,4	7,6	7,7	20,8	22,6
Butter and other fats and oils derived from milk; dairy spreads	35,9	26,3	19,4	18,3	17,5	17,6	15,6	16,1	11,8	12,3
Non-processed and processed cheese	35,8	35,5	41,6	50,6	49,2	50,0	56,4	65,1	65,7	52,3
Dried milk, buttermilk and whey products	32,9	26,6	18,2	17,7	16,0	25,0	29,2	27,8	35,8	35,7
Ice-cream	13,8	13,0	12,3	14,1	16,0	15,0	12,4	13,7	13,7	24,3*
Lactose	1,7	0,6	4,8	5,3	5,1	5,1	4,9	6,4	7,4	7,5
Canned dairy products	12,4	9,2	3,5	6,1	8,8	7,7	9,6	11,7	14,8	22,0

* mill. litres.

Source: *Statistical Yearbook of Lithuania 2003 – 2007*. - V.: Department of Statistics to the GovRL.

Economic and Social Development in Lithuania 2007 December, V.: Department of Statistics to the GovRL.

Consumption

The consumption of milk and dairy products as well as of other food products is conditioned by nutrition habits and income of the population. Traditionally Lithuanians consume plenty of dairy products. The present consumption level in Lithuania is conditioned by the limited population income.

In 1998–2006 the consumption of milk and dairy products increased by 44%, but the growth of consumption was unstable. In 1998–2004 the per capita consumption of milk and dairy products was increasing and reached the maximum – 296 kg per year, but in 2005–2006 it started to decline (see Figure 2).

The introduction of new fermented dairy products, particularly desserts, was one of the reasons that influenced the increase of the consumption of milk and dairy products in 1998–2004.

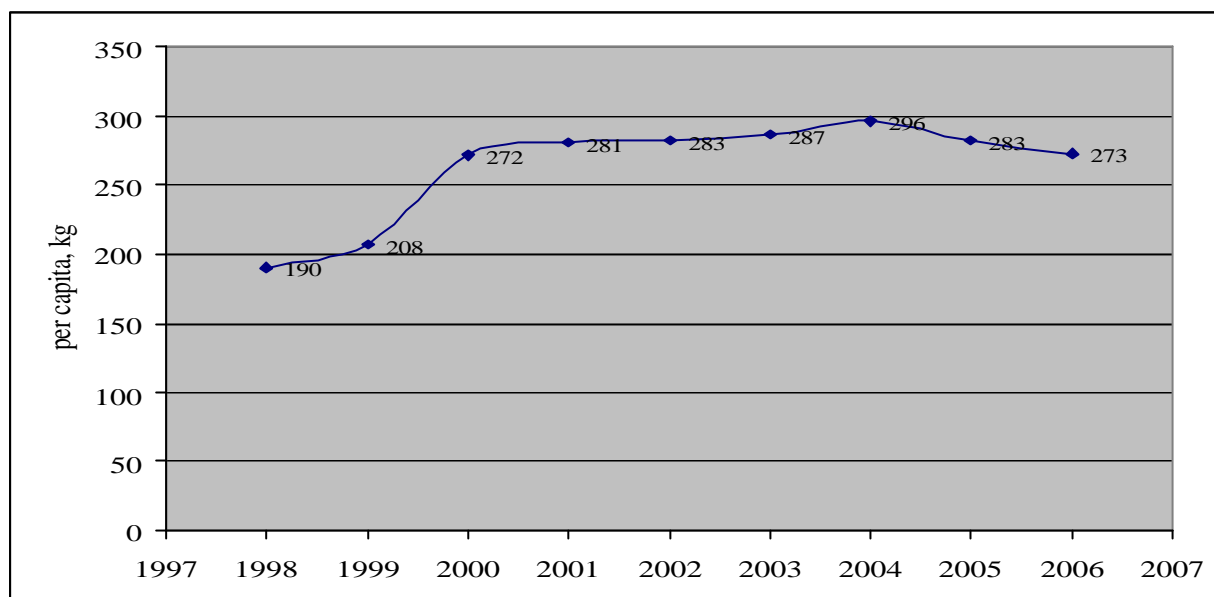


Figure 2. Consumption of dairy products per capita, kg

Consumption of individual dairy products in 2003–2007 is shown in Table 9. In 2007, compared to 2003, the per capita consumption of drinking milk declined from 111.5 to 95.7 kg (by 14%) per year, that of butter dropped from 3.5 to 2.8 kg (by 20%), but the per capita the consumption of cheese increased from 10.6 to 12.7 kg (by 20%) per year.

Table 9. Per capita consumption of main dairy products (kg), 2003 - 2007

	2003	2004	2005	2006	2007
Drinking milk	111,5	93,5	95,1	n.a.	95,7
Butter	3,5	1,3	2,8	1,4	2,8
Cheese	10,6	10,0	13,5	12,8	12,7

Source: Eurostat, 2008.

Eurostat (Food: From farm to fork statistics, FOOD-CH-CONCAP, and Population statistics, DEMO_PJAN).

In 2007 the per capita consumption of drinking milk in the EU-27 was 82.5 kg per year, that of butter – 4.2 kg, cheese – 16.5 kg. As data show, the consumption of drinking milk in Lithuania exceeded the EU-27 average (116%) but the consumption of butter and cheese was lower than the average and made up, respectively, 67 and 77%.

Trade

The balance of Lithuanian foreign trade in dairy products during the entire period of 1999–2007 was positive (see Table 10). Every year the export exceeded the import. The lowest difference was in 2000 (3.8 times), and the most significant in 2004 (even 14.2 times). In 2006–2007 the export exceeded the import 4.6 times. Although during the entire 1999–2007 period the export exceeded the import, the growth of import was more rapid than the growth of export: the import went up 6.6 times and the export 2.9 times. The data of export and import of individual dairy products are presented in the Annex 1.

In 2007 the value of exported dairy products totalled 1394.4 million Lit. The export growth was the most rapid in 2004 and 2007, respectively, 41% and 36% in comparison with the previous year. The most important influence on such situation had the EU single market opened in 2004 and the increase of world demand and prices in 2007.

In 2007 the value of imported dairy products amounted to 304.7 million Lit. The import significantly increased in 2005, i.e. 2.4 times in comparison with 2004, due to the lack of raw milk, price differences, the increase of dairy products assortment, and simplified trade conditions in the EU single market. Up to 2005 raw milk was not imported into Lithuania. Due to the shortage of raw milk in Lithuania, in 2005 milk processors from large milk producers of neighbour countries imported 38 thousand tonnes of raw milk (29% of the total import), in 2006 – 119.6 thousand tonnes (52%), in 2007 – 121.1 thousand tonnes (48%).

Table 10. Exports and imports of dairy products, 1999–2007

	1999	2000	2001	2002	2003	2004	2005	2006	2007
Total exports of dairy products, mill. Lit.	478,6	582,5	662,6	559,2	564,5	796,7	888,6	1027,5	1394,4
Total imports of dairy products, mill. Lit.	46,1	153,8	137,8	54,0	42,4	56,2	134,0	224,4	304,7
Foreign trade balance of dairy products, mill. Lit.	432,5	428,7	524,8	505,1	522,2	740,4	754,5	803,1	1089,7

Source: MoA Foreign trade data base (Data of the Department of Statistics to the GovRL).

Up to 2005 the largest share in the export structure of dairy products made up cheese and curd, and concentrated milk and cream (in 1999 cheese and curd accounted for 42% of the total export and concentrated milk and cream 31%; in 2002, respectively, 68% and 14%; in 2004, respectively, 55% and 13%). In 2005 the sales of less-processed milk fats on the foreign markets became more profitable. As a result, the percentage of non-concentrated milk and cream in the export structure increased. In the meantime, the percentage of milk powder declined, mainly due to a significant decrease of the export of whole milk powder. Therefore, since 2005 the largest shares in the export structure of dairy products made up cheese and curd, and non-concentrated milk and cream (in 2005 cheese and curd accounted for 54% of the total export and non-concentrated milk and cream 15%, in 2007, respectively, 46% and 20%).

In 1999–2002 non-concentrated milk and cream, and fermented or acidified milk and cream accounted for the largest share in the import structure of dairy products (in 1999 non-concentrated milk and cream – 41% of the total import, fermented or acidified milk and cream – 28%; in 2002, respectively, 49% and 24%). In 2003–2004 the percentage of concentrated milk and cream in the import structure decreased significantly. During this period fermented or acidified milk and cream, and cheese and curd were among the largest imports (in 2007 fermented or acidified milk and cream accounted for 31% of the total imports and cheese and curd – for 22%). In 2005–2007 (when raw milk was imported) the largest share in the import structure made up non-concentrated milk and cream and fermented or acidified milk and cream (in 2005 non-concentrated milk and cream accounted for 30% of the total import and fermented or acidified milk and cream – for 21%; in 2007, respectively, 51% and 16%).

In 1999 and 2003 the largest amounts of dairy products were exported to U.S.A., Russia and other CIS countries, and to the EU-15 member states, while in 2007 – to the EU-27 member states, and Russia and other CIS countries (see Table 11). The decrease of the export to U.S.A. was caused by the lower exchange rate of the U.S. dollar; as a result, the real prices of sold products went down. Moreover, the export of the main product - cheese - to the U.S.A. was not granted EU subsidies. The increase of the export into the EU was caused by the fact that after Lithuania joined the EU, milk processing enterprise freely without any restrictions

could export their products to any EU member state. Besides, some countries, which were active Lithuania's trade partners, have become members of the EU. The increase of the export to Russia and other CIS countries was caused by export subsidies for the export into third countries. Besides, the Russian market is well known for Lithuanian milk processors and Lithuanian dairy products are of great demand on this market.

In 1999 and 2003 the largest amounts of dairy products were imported from EU-15, Russia and other CIS countries, and neighbour countries – Latvia, Estonia and Poland, while in 2007 – from the EU-27 member states.

Table 11. Trade totals, main destination of exports and main origin of imports, 1999, 2003 and 2007

	1999	2003	2007
Total exports of dairy products:	478,6	564,5	1394,4
• USA (%)	27	25	0,3
• EU (%)	23	24	64,6
• Russia and other CIS countries (%)	29	22	30,2
• Latvia and Estonia	5	15	-
• Other countries (%)	16	14	4,9
Total imports of dairy products:	46,1	42,4	304,7
• EU (%)	42	32	99,9
• Russia and other CIS countries (%)	29	11	-
• Latvia (%)	4	21	-
• Estonia (%)	7	8	-
• Poland (%)	14	17	-
• Other (%)	3	11	0,1

Source: MoA Foreign trade data base (Data of the Department of Statistics to the GovRL).

2.4 Government policy

2.4.1 Regulatory framework of the dairy sector

In Lithuania all EU measures in the common market organisation for milk and dairy products are in force under Council Regulation (EC) No 1255/1999 On common Organisation of the Market in Milk and Milk Products. Under the single payment scheme from the national budget to milk producers is paid a payment for quota milk produced in the corresponding quota year. In 2007 this payment amounted to 15.3 EUR/t, and in 2008 – 16.8 EUR/t. The production of milk is limited by the milk quota system. The national milk production quota was not exceeded yet. It is expected that in 2007-2008 quota year milk production also will stay within the quota. Milk processing enterprises were granted export subsidies but in July 2007 they were withdrawn.

Up to 2007 the State supported the purchase of pedigree heifers. In 2004–2006 the state aid (1.4 million EUR) partially (up to 50%) compensated the purchase of 7.7 thousand of pedigree heifers, of which 31% of heifers were purchased from breeding-grounds of the EU member states.

Over the 2004–2007 period 56.2 million EUR were paid to milk processing enterprises as export subsidies for the dairy products exported into third countries.

Dairy farms and milk processing enterprises were active in modernisation of farms and enterprises. Total support under SAPARD and SPD is shown in Table 12 (see Table 12).

Table 12. Support to dairy farms and milk processing enterprises under SAPARD and SPD

Support periods	No of farms	Amount, mill. EUR	No of milk processing enterprises	Amount, mill. EUR
SAPARD	87	16,2	3	8,8
SPD	58	12,5	4	11,5

Source: Data of MoA.

The Rural Development Programme provides for about 116 million EUR for enterprises of the dairy sector in 2007–2013.

2.4.2 Other dairy sector relevant policy areas e.g. environment policies, competition policy etc.

The number of dairy farms that have the milk quota and supply milk for processing exceeds 60 thousand (the average farm has about 5 cows). Four major dairy companies produce about 90% of the total sector's output. Such oligopoly in the dairy industry is a negative phenomenon that leads to dictation of prices to milk producers. Since milk processors themselves collect milk from farmers, the competition factor is minifying even more. It is supposed that for this reason the purchase prices of raw milk in Lithuania are the lowest among the EU member states.

On 23 of March 1999 the Seimas of the Republic of Lithuania adopted the Law on Competition. The Article 9 of this Law provides for criteria and conditions under which the undertaking is considered as a dominant competitor, i.e. it can be independent from other competitors, suppliers or purchasers and conducting unilaterally it can make an impact on the prices of goods, entrance into the market and other conditions. Unless proved otherwise, the undertaking with the market share of not less than 40% shall be considered to have a dominant position in the relevant market.

In the retail trade there is a mutual dependence between the market of food sales (to the final consumers) and the market of purchase (from suppliers). In 2007 the Competition Council of the Republic of Lithuania carried out a wide-ranging survey on the market position of major retail trade networks. The findings of the survey showed that in Lithuania, as in other countries, the major trade networks have market power and use it on purpose to receive larger discounts from suppliers, to force them to pay different taxes or to fulfil other requirements. Therefore, with reference to the experience of other countries and taking into consideration the proposals of the associations that represent interests of suppliers, it is expedient to pass the Good practice rules (Codex) that include measures regulating the protection of food suppliers from available unfair trade practice.

According to the environmental requirements, since 2008 the farms keeping more than 300 cows must be in compliance with the EU standards. In the 2004–2008 period over 4 thousand farms took the opportunity and used EU and national aid for the implementation of measures of the Milk directive and nearly 2 thousand farms – for the implementation of measures of the Nitrate directive measures.

On 21 of June 2005 the Seimas of the Republic of Lithuania adopted a new version of the Law on Planned Economic Activity Environmental Impact Assessment. The Law regulates the process of economic activity environmental impact assessment and interrelations among

the participants of the process. Such assessment must be done selectively on farms that have more than 200 animals.

On 14 of July 2005 the Minister of Environment and the Minister of Agriculture passed the order on the Approval of environmental provisions for manure management.

3 Performance of the dairy supply chain

3.1 Performance at farm level

3.1.1 Yields

Although in 2007 the number of cows decreased in comparison with 1999, the average milk yield per cow increased from 3228 to 4708 kg, by 46% (see Figure 3).

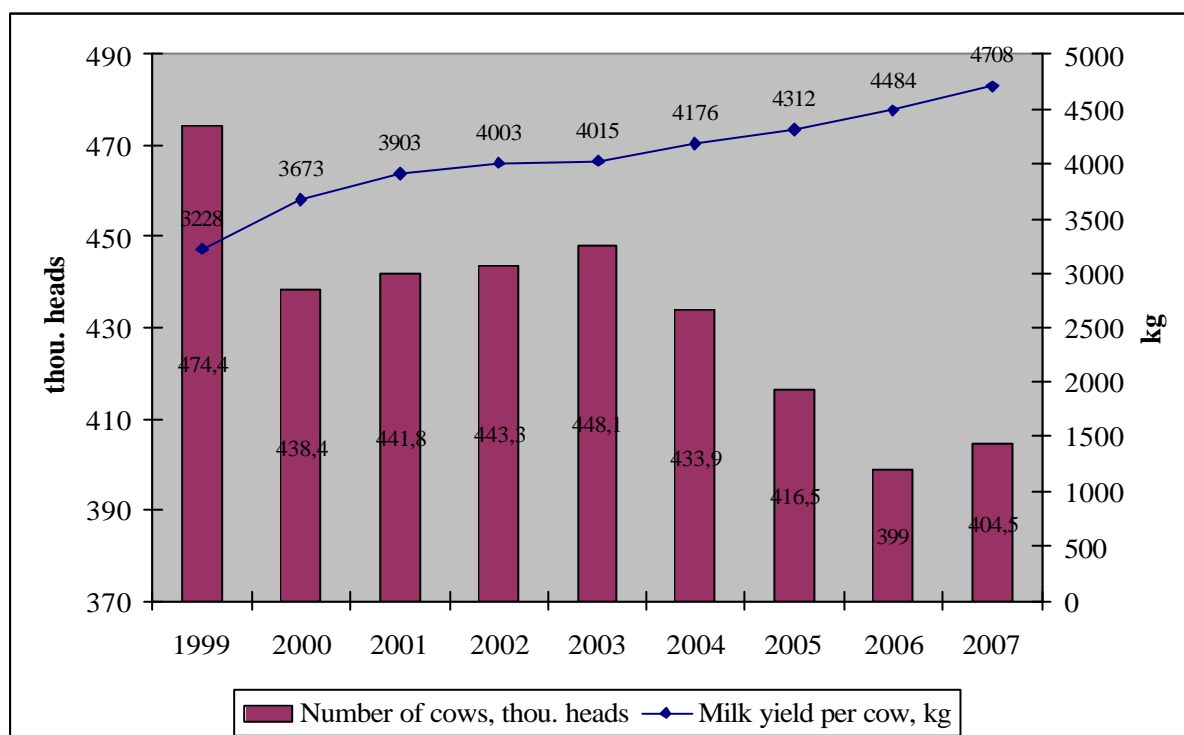


Figure 3. Number of cows and milk yield per cow, 1999–2007 (at the end of the year)

Source: *Agriculture in Lithuania 2003 – 2007*. - V.: Department of Statistics to the GovRL.

The average cow productivity in Lithuania was rather lower than in some other EU member states. In 2006 Lithuania and neighbour countries – Poland and Latvia – according to the average milk yield ranked last among the EU-25 countries accounting only for about 70% of the EU average. The highest cow productivity among the EU member states was in the Scandinavian countries (Denmark, Sweden and Finland) and in the Netherlands (see Table 13).

Table 13. Number of cows, average herd size, and milk yield in the country at hand and in some selected EU member states, 2006

Country	Dairy Cows (thou.)	Average Herd Size	Average Cow Yield (kg per cow p.a.)
Lithuania	399	3	4484
Latvia	182	3	4492
Poland	2637	4	4533
Netherlands	1443	61	7743
Germany	4030	38	6849

Source: *Agriculture in Lithuania 2006*. - V.: Department of Statistics to the GovRL, ZMP-Marktbilanz MILCH 2007.

The average cow productivity in Lithuania is low because of the prevailing of small and not specialised farms with outdated cow feeding and keeping technologies. Not good enough genetic potential of cow herd and poor fodder cause low productivity of cows as well. Besides, in small-scale farms cows are being milked even up to 12 years age. The majority of cows are of the Lithuanian black-white breed.

In 1995–2005 cow productivity in Lithuania and neighbour countries – Poland and Latvia was increasing (see Table 14). The enlargement of farms allows feeding of cows in a more rational way and improving the selective work leading to the continuously increase of the average cow productivity in Lithuania.

Table 14. Development in milk yield per cow p.a. – country at hand and in some selected EU member states in 1993, 1995, 2000, 2002 and 2005

	1993	1995	2000	2002	2005
Lithuania	2910	3010	3673	4003	4251
Latvia	n.a.	3074	3898	3958	4364
Poland	n.a.	3230	3778	4019	4387
Netherlands	n.a.	n.a.	7296	7187	7568
Germany	n.a.	n.a.	6122	6272	6761

Source: *Agriculture in Lithuania 2003 - 2006*. - V.: Department of Statistics to the GovRL, ZMP-Marktbilanz MILCH 2003 – 2007.

3.1.2 Prices

Milk purchase prices

The prices can be compared since 1993 when the national currency Litas (Lt) was introduced. In 1993–2007 milk purchase prices fluctuated from 273 Lt/t in 1994 to 687 Lt/t in 2007. Up to 2004 the market of milk purchase in Lithuania was closed and the purchase price of milk depended on the situation of milk processing enterprises. The purchase price of milk was influenced by the competition of milk processing enterprises, changing global prices of dairy products, fall of the exchange rate of the U.S. dollar against the Euro (the Litas as well). The purchase price paid to small-scale milk producers for their milk was much lower than to large-scale producers, in particular on late years. On the one hand, such situation was caused by the higher costs of milk collection from small farms, and on the other hand, small not organised milk producers had no negotiation power to protect their interests individually. The prevailing of small-scaled dairy farms in Lithuania was one of the key reasons for the low average milk purchase price (see Figure 4). The average milk purchase price in Lithuania was among the lowest ones in the EU member states.

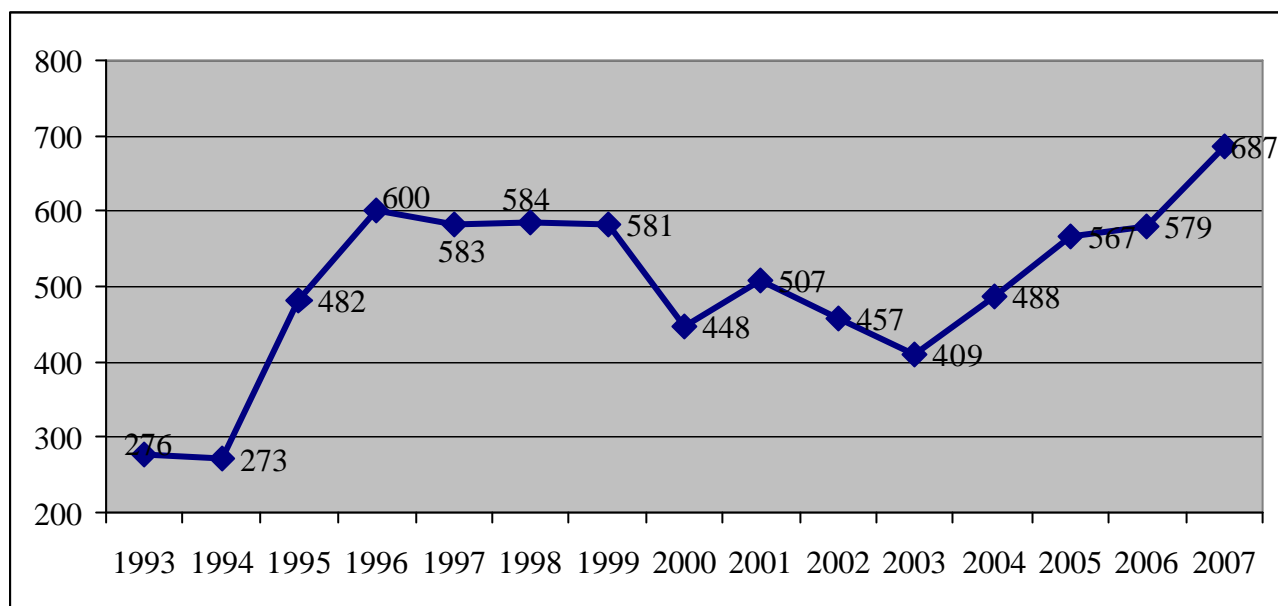


Figure 4. Milk (3.4% fat, 3.0% protein) purchase price, 1993-2007, Lt/t (Farm gate price)

Source: Data of the Department of Statistics to the GovRL.

For a long time the prices of raw milk purchase and dairy products were stable. But the increase of export of dairy products in summer 2007 caused the increase of prices in the Lithuanian market also. The prices of dairy products as well as of other food products went up. According to the structure of the consumption, Lithuanian residents spend about one third of their income on food products, therefore, the increase of prices has a great influence on the household budget.

In 2006, due to structural changes in the dairy sector, the prices were going up: a bigger number of large-scale dairy farms developed, to which milk processing enterprises paid a considerably higher purchase price than to the small-scale farms, leading to the increase of the average milk purchase price. In September–December 2007 the impact on the rise of purchase price of raw milk was caused by the increased demand on dairy products and the corresponding demand on raw milk. In 2007 the average purchase price of milk increased by 68% in comparison to 2003 and reached 199 EUR/t. However, the purchase price of milk in Lithuania in 2007 still remained almost the lowest in the EU-25 member states, except only Romania. One of the key reasons of such situation was the fact that the dairy farms in Lithuania were the smallest among the EU member states and small milk producers were paid a considerably lower price than the large producers.

At the end of 2007 and the first half-year of 2008 the average purchase price of natural milk in Lithuania suffered the most considerable fluctuations among the EU member states. In November 2007, in comparison to November 2006, the growth of milk purchase price was 54% (in some other countries 27–44%), while in June 2008, in comparison to November 2007, it decreased mostly (by 30%, in other countries – by 8–20%). In June 2008 this price again was the lowest in the EU member states (see Table 15).

Table 15. Natural milk purchase prices in the Baltic States, Poland and EU (except Romania and Bulgaria) in June 2007 and 2008

	2007	2008	2008, compared to 2007, %
Lithuania	704	800	114
Latvia	823	888	108
Estonia	853	998	117
Poland	875	1010	115
EU*	995	1195	120

* 4.2% fat, 3.35% protein.

Source: www.vic.lt (Agriculture and Food Market Information System), www.csb.lv, www.milkprices.nl, www.state.ee, www.stat.gov.pl, www.mdcdatum.org.uk.

Despite the fact that the average purchase price of natural milk in Lithuania is one of the lowest in the EU countries, lately milk processing enterprises imported raw milk from neighbour countries, mainly from Latvia (the import of raw milk from Latvia accounted for 99% of the total import of raw milk). There are a few reasons for the import of raw milk. Firstly, milk processing enterprises lack raw milk since their production capacity allow to process larger amounts of milk. Secondly, the difference between the average purchase prices of natural milk in Lithuania and Latvia is the least. Lithuanian milk processing enterprises the largest amounts of raw milk import from large Latvian farms; the purchase price of natural milk from the Latvian large farms is almost the same as from the Lithuanian large farms. Thirdly, some Lithuanian milk processing enterprises are situated near the Lithuanian–Latvian board; therefore, the costs of milk collection from the Latvian farms are lower than from the remote Lithuanian farms.

3.1.3 Gross margins

According to the FADN data of 2003–2007, the dairy farms (the average farm – 12 cows), in which two thirds of cattle were cows, and income from milk production made up 60%, were profitable. Over the entire period of 2003–2007 the profitability from production increased from 22.0% to 26.9% (see Figure 5). The highest profitability from production was in 2004 – 34.8%. The total profitability including subsidies during the analysed period increased from 38.8% to 65.4%. The highest total profitability was in 2006 – 72.2%.

In such farm the gross margin per cow per year on average was about 600 EUR (including subsidies).

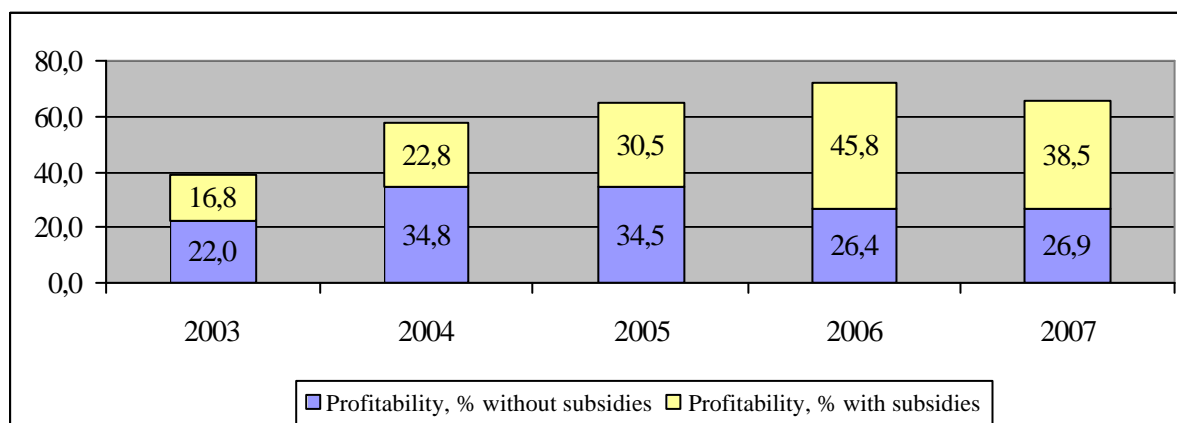


Figure 5. Average profitability in dairy farms, 2003-2007, %

Source: Data of FADEN, 2003–2007 and prognosis for 2007.

In Lithuania there are about 90% of farms keeping up to 5 cows, therefore, the profit of large part of these farms is rather low.

The income from milk production left after the deduction of variable costs in the farms of different size are relatively equal – on average the gross margin per cow differ slightly (see Table 16).

Table 16. Gross margin at Lithuanian dairy farms, 2006

	Average dairy farm	Large-scale dairy farm
Number of cows	12	338
Yield (kg/cow)	5034	6147
Grassland (ha)	8,3	169
Other crops (ha)	30	1305
Values in €per 100 kg milk		
Total revenues	25,26	30,99
- Milk and dairy products	20,56	23,72
- Other revenues	4,70	7,26
Total calculated costs	11,13	16,80
- Feed concentrates	10,38	15,33
- Health care	0,52	1,18
- Other costs	0,23	1,46
Gross margin per 100 kg of milk	14,13	14,19
Gross margin rate (of return on milk sale)	69%	60%
Gross margin (total revenues less variable costs)	8874	298098

Source: Data of FADEN 2006.

3.2 Performance at industry level

3.2.1 Turnover and employment in the dairy industry

In 2000 the sales of Lithuanian milk processing enterprises amounted to 1128.1 million Litas, and the exports totalled 465.2 million Litas. In 2007, in comparison with 2000, the sales increased 1.9 times and reached 2158.7 million Litas, and the exports went up 3 times and reached 1394.4 million Litas (see Figure 6). Over the period 2000–2007 the share of export in the total sales fluctuated from 41 to 65%, and the largest percentage (65%) was observed in 2007.

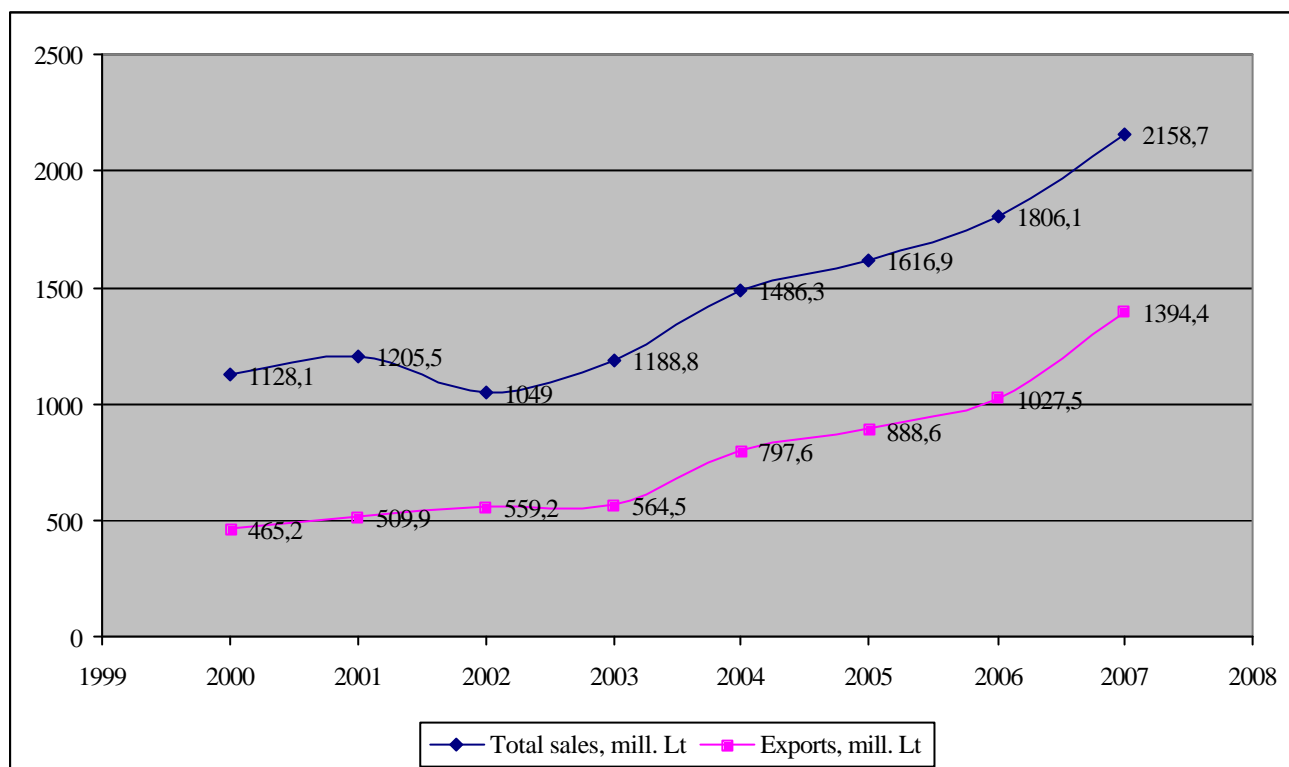


Figure 6. Total sales and exports of the Lithuanian dairy industry million Litass, 2000–2007

Source: Data of the Department of Statistics to the GovRL.

In 2007 the number of milk processing enterprises declined almost twice in comparison with 2000, and the number of employees decreased by 47% (see Table 17). In 2000–2007 the process of production concentration was going on in the dairy industry. In 2007 four largest enterprises produced about 90% of the total sector’s output.

Table 17. The number of milk processing enterprises and the number of employees, 2000-2007

	2000	2001	2002	2003	2004	2005	2006	2007
No of milk processing enterprises	63	62	51	39	32	31	30	32
Number of employees	11462	10615	10116	10472	10877	9806	9386	6054

Source: Data of the Department of Statistics to the GovRL.

3.2.2 Value added and profits

Already during the period of preparation for a membership in the EU, all efforts were focussed on the competitiveness of the dairy products produced in Lithuania and sold on the EU single market and the markets of third countries. Milk processing enterprises modernised technologies and upgraded equipment using the SAPARD and EU structural aids and own capital as well. As already stated above, in 2004 the sales of dairy products increased significantly. In 2003–2006 milk processing enterprises were profitable (see Table 18). During this period the value added per employee created in the milk processing industry increased from 7.9 to 14.5 thousand EUR, or by 84%.

Table 18. Selected performance indicators of the dairy industry of Lithuania in 2003–2006

Years	Net Profit, mill. EUR	Value Added, mill. EUR	Value Added per employee, thou. EUR	Productivity thou. EUR	Net Profit/Employee, thou. EUR
2003	4,29	83,2	7,9	37,6	0,4
2004	16,55	94,6	8,7	44,5	1,5
2005	15,48	101,3	10,6	54,1	1,6
2006	14,89	135,7	14,5	62,7	1,6

Source: Data of the Department of Statistics to the GovRL, Eurostat.

The indicator of Gross Value Added (GVA) per employee can be used for comparison of competitiveness and economic potential of companies and activities. In 2006 the value added per employee created in the dairy industry was larger than that created in the food industry and in the manufacturing, respectively, by 41 and 49% (see Table 19). Over the period of 2003–2006 the profit per employee in the dairy industry increased 4 times, while in the food industry – by 70%, and remained unchanged in the manufacturing industry.

Table 19. Gross Value Added and profit per employee in the dairy sector, food industry and manufacturing in Lithuania in 2003–2006

	GVA per employee, 2006		Profit/loss per employee, 2006	
	2006, thou. EUR	2006/2003 index	2006, thou. EUR	2006/2003 index
Dairy industry (15.5)	14,5	1,84	1,6	4,0
Food industry (15)	10,3	c	1,6	1,7
Manufacturing (D)	9,7	1,43	1,5	1,0

Source: Data of the Department of Statistics to the GovRL, Eurostat.

The indicator of GVA per employee is also often used for international comparisons of competitiveness and economic potential of companies and activities. The comparison of this indicator of the Lithuanian dairy industry with the EU-25 competitors' shows that in 2005 the GVA per employee in the Lithuanian dairy sector reached only 24% of the average EU-25 level (latest available data are 2005 figures). The GVA per employee in the Lithuanian dairy industry was 10.6 thousand EUR, only the figure for Slovakia (8.2 thousand EUR) was lower. In the EU-15 old member states, in 2005 the GVA per employee was much higher, and ranged to 83.9 thousand EUR in the Netherlands and 86.3 in Ireland.

3.2.3 Market share developments

Data on market share for milk indicate that in 2003 and 2006, all domestic consumption was from produce sold by Lithuanian dairies (see Figure 7). In 2004 and 2005, the very small domestic consumption was from foreign competitors. In 2006, in comparison with 2003, the consumption of milk increased by 6%.

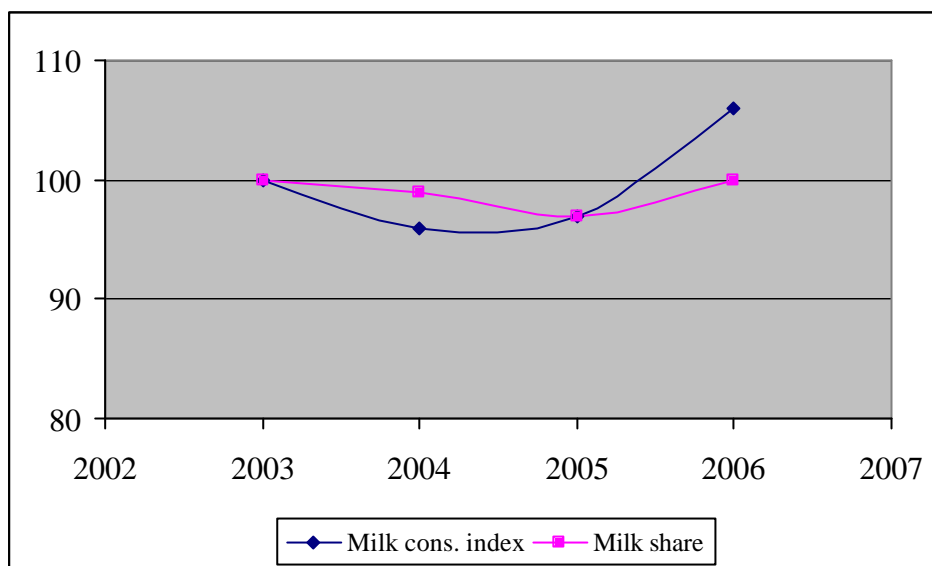


Figure 7. Share of Lithuanian dairies' sales (in %) in the total domestic consumption of milk, and development of consumption of this product (consumer index, 2001=100)

Source: Data of the Department of Statistics to the GovRL.

Data on market share for butter indicate that nearly all domestic consumption was from produce sold by Lithuanian dairies over the period 2003 to 2006 (see Figure 8). In 2006, in comparison with 2003, the consumption of butter declined by 40%. Over the period 2003 to 2006 the market share for butter declined from 99% to 96%.

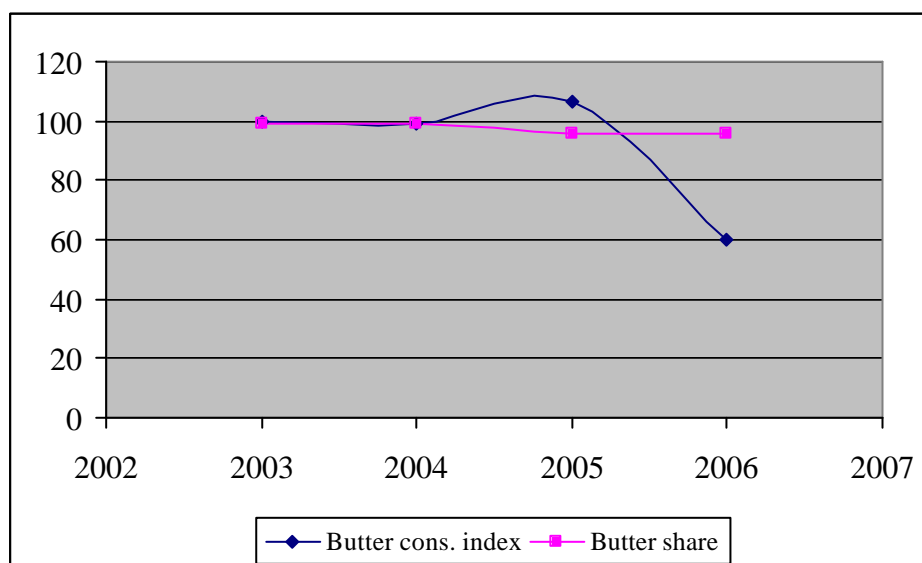


Figure 8. Share of Lithuanian dairies' sales (in %) in the total domestic consumption of butter, and development of consumption of this product (consumer index, 2001=100)

Source: Data of the Department of Statistics to the GovRL.

Data on market share for curd and cheese indicate that not all domestic consumption was from produce sold by Lithuanian dairies over the period from 2003 to 2006 (see Figure 9). The very small domestic consumption was from foreign competitors. Over the period 2003 to 2006 the consumption of curd and cheese gradually expanded by 25%. Meanwhile the market share for curd and cheese declined from 97% to 93%.

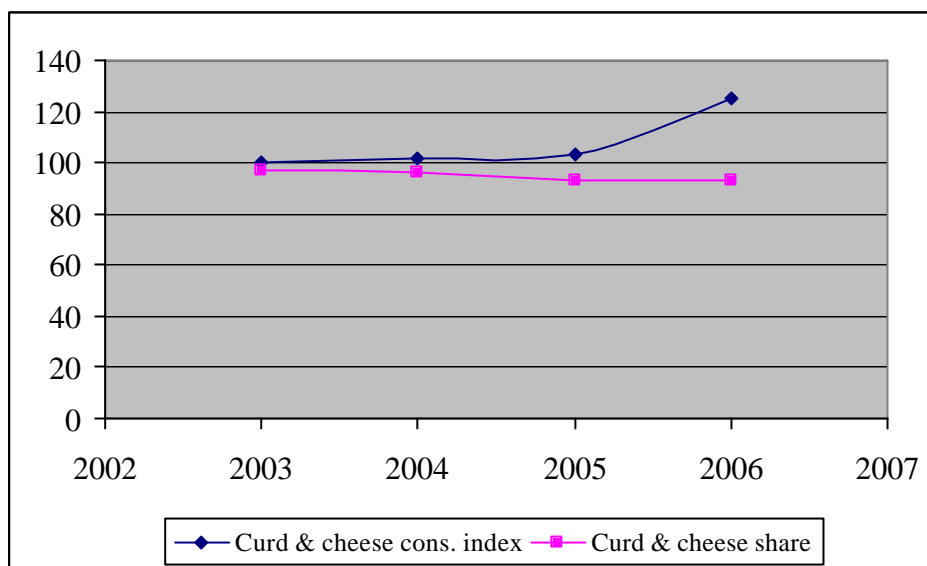


Figure 9. Share of Lithuanian dairies' sales (in %) in the total domestic consumption of curd & cheese, and development of consumption of these products (consumer index, 2001=100)

Source: Data of the Department of Statistics to the GovRL.

3.2.4 Competitiveness at retail level

In 2006 the Baltic International Centre for Economic Policy Studies carried out research on Competition in Baltic Grocery Retail Markets¹. The results of this research showed that the Lithuanian retail market developed as shown in the table 20 below.

Table 20. Market share development by turnover in Lithuania

	2003	2004	2005
VP Market (Maxima LT)	36,1	36,9	38,1
Iki	14,7	14,1	14,5
Norfa Retail	8,2	11,0	13,1
Rimi Lithuania	6,3	6,8	6,1
Total:	65,3	68,8	71,8

Source: Verslo Zinios (The largest Lithuanian companies by sales revenue).

In 2003–2005 the four largest retail networks occupied the major percentage of the retail market. The largest amounts of dairy products were sold in supermarkets that offer a rich assortment.

At the retail level a wide variety of products can be observed and comparisons are fraught with problems of different product specifications such as weight of product, fat content, additives, packaging, etc. A few observations are reported based on visits to supermarkets:

- In all categories of dairy products dominate products produced in Lithuania. They are well represented.
- The retail prices of dairy products produced by large milk processors do not differ from those produced by small milk processors.

¹ Competition in Baltic Grocery Retail Markets, Baltic International Centre for Economic Policy Studies, http://www.biceps.org/files/Competition_in_Baltic_Grocery_Retail_Markets.pdf

- Dairy products produced in Lithuania are known as products of high quality. The most of Lithuania's residents are of the opinion that dairy products of the Lithuanian origin are more natural than imported.
- In some supermarkets (eg. VP Market (Maxima LT)) dairy products are sold with a mark of retailer ("Optima linija") and are cheaper than those with the mark of milk processor.
- Among the imported dairy products dominate well-known products of the foreign producers Valio (Finland), President (France) and Danone (France). They are more expensive than those produced in Lithuania. (see Table 21). An element of these higher prices is due to the inherent quality of the product, but part of the price premium is due to the perceived value imparted to the products by their well-regarded brands.

Table 21. Retail prices of dairy products in a supermarket (Maxima LT), Lt

Product	Units	Foreign brands	Lithuanian
Yoghurt (2% fat with fruit or berries additives)	350 g	3,29 (Valio)	2,89
Butter (82% fat)	200 g	4,45 (President)	3,79
Cheese Gouda	1 kg	26,60	18,99
Cheese Mozzarella	130 g	3,63 (President)	3,25
Mouldy Cheese (55% fat)	1 kg	34,99 (President)	27,90

Source: Personal observation.

4 SWOT

4.1 Strengths and weaknesses

To evaluate the current situation in the dairy sector, a SWOT analysis was done; it shows that one of the most important agricultural sectors in Lithuania has not only strong advantages but also many weaknesses.

STRENGTHS

1. The experience and favourable conditions to develop dairy husbandry.
2. Profitable large-scale dairy farms during the last five years.
3. Modern dairy industry meets the EU food sanitary and hygiene requirements.
4. High concentration in the dairy industry.
5. The positive balance of foreign trade in dairy products.
6. The increasing volumes of production, sales and export of dairy products.
7. Low average purchase price of natural milk in comparison to other EU member states.
8. Strong positions of milk processing enterprises on the domestic market.
9. A wide assortment of Lithuanian dairy products on the retail market.

WEAKNESSES

1. Small-scale farms prevail in the milk production.
2. Low productivity of cows due to out-dated cow feeding and keeping technologies in small not specialised farms, insufficient genetic potential of cow herds and poor feedingstuffs in comparison to other EU member states.
3. A significant difference between the purchase price of natural milk in small-scale and large-scale dairy farms.
4. A low level of cooperation among milk producers.
5. High costs of milk collection from small-scale dairy farms.
6. The small value added created per employee in the dairy industry in comparison to other EU member states.

4.2 Opportunities and Threats

OPPORTUNITIES

1. The enlargement of dairy farms.
2. The increase of cow productivity.
3. Development of cooperation among milk producers.
4. Financial support from the European Agricultural Fund for Rural Development (EAFRD) for the strengthening of technical basis of cooperatives and farms.
5. Improvement of milk collection system.
6. Development of production of higher value-added dairy products.
7. Good opportunities for the development of foreign trade in dairy products on the EU common market.
8. Search and introduction of new markets.

THREATS

1. The enlargement of farms might increase the average purchase price of natural milk.
2. The increasing import of dairy products.
3. Rather large share of dairy products export to the hardly predictable and risky Russian market.

5 Suggestions for policy recommendations

In the future the dairy cattle breeding will remain the main branch of animal husbandry, but the processes of convergence among the EU member states bring many tasks, the implementation of which anticipates positive results of the development.

The main development trends for milk farm should be as follows:

1. The enlargement of dairy farms and development of cooperation. It would decrease costs of milk collection for milk processing enterprises and increase milk purchase price for milk farm. In order to implement this task the financial support from the European Agricultural Fund for Rural Development (EAFRD) is needed. This support will be used for modernization of farms and cooperatives joining small milk farms for development of raw milk logistic centers.

2. The increase of cow productivity. In order to implement this task the support from state is needed. This support will be used for the purchase of productive pedigree heifers and cows.
3. The production of fodder in farms, using new technologies.

The main development trends for milk processing industry should be as follows:

1. The increase of labour productivity and exploitation of productive capacities as well as decrease of expenditure. In order to implement this task the financial support from the European Agricultural Fund for Rural Development (EAFRD) could be used.
2. The development of higher value-added dairy products export. These dairy products are exported to Russian market meanwhile the processed semimanufactures are exported to the EU common market.
3. Search and introduction of new export markets.

Annex I

Exports and imports of dairy products, 1999 - 2007

	1999	2000	2001	2002	2003	2004	2005	2006	2007
Milk and cream, not concentrated									
Export, thou. Litas	985,9	14426,9	8401,2	6421,4	30739,2	105156,7	137012,9	146948,5	275327,0
Import, thou. Lt	933,2	1169,5	1197,7	1717,7	1989,7	2126,1	40193,8	119796,9	156676,5
Milk and cream, concentrated									
Export, thou. Litas	149514,1	151815,7	158976,6	78100,4	93959,26	110266,0	105281,0	110261,7	233070,4
Import, thou. Lt	19087,1	119235,0	108123,1	26409,7	6243,1	1795,8	8147,6	8478,4	17121,9
Buttermilk, curdled milk and cream, yogurt and other fermented or acidified milk and cream									
Export, thou. Litas	1072,3	895,7	3365,8	5160,9	6164,3	11024,4	8042,5	9880,7	13800,4
Import, thou. Lt	13110,4	11362,5	8651,6	13231,4	12945,8	17505,7	28784,0	35415,9	47625,0
Whey and products consisting of natural milk constituents									
Export, thou. Litas	10184,9	23915,5	39098,7	15786,5	17495,1	40720,7	53903,0	58136,2	90641,0
Import, thou. Lt	470,6	481,1	4570,9	441,1	5041,8	9474,5	13682,0	7452,3	11178,7
Butter and other fats and oils derived from milk, dairy spreads									
Export, thou. Litas	77678,5	57784,6	48184,6	39395,6	34621,7	50875,3	66353,0	86127,2	75764,7
Import, thou. Lt	1076,9	618,5	1213,4	983,8	1105,2	1533,6	4244,8	4567,7	8665,0
Cheese and curd									
Export, thou. Litas	199676,4	289503,7	345674,6	378628,9	342465,0	440852,0	477700,2	570921,0	645810,6
Import, thou. Lt	5077,7	3227,0	4413,2	5944,7	8942,1	12454,1	24177,7	27319,3	40670,4
Milk sugar									
Export, thou. Litas	110,8	4003,8	11365,7	7069,2	7221,7	6329,2	8966,4	15738,0	29074,3
Import, thou. Lt	225,8	198,4	23,8	7,7	23,2	55,1	17,3	52,6	140,8
Ice cream									
Export, thou. Litas	15449,5	13229,0	18093,8	24620,4	25075,1	19157,3	22947,0	26244,2	30062,0
Import, thou. Lt	1958,6	1943,8	2285,5	4782,8	5305,1	11178,5	14459,0	20950,0	22094,5
Casein									
Export, thou. Litas	23966,0	26883,5	29438,1	3983,2	6768,0	12277,5	8345,2	3261,0	856,0
Import, thou. Lt	4172,7	15552,1	7364,2	528,5	754,0	122,4	308,2	383,8	532,1

Source: MoA Foreign trade data base (Data of the Department of Statistics to the GovRL).