

Republic of Lithuania: Second Review Under the Stand-By Arrangement—Staff Report; Staff Supplement; and News Brief on the Executive Board’s Decision

In the context of the second review under the Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the Second Review Under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **March 1, 2001**, with the officials of the Republic of Lithuania on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on April 4, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement updating information available as of **April 12, 2001.**
- a News Brief of **April 16, 2001**, on the IMF Executive Board’s decision completing the second review.

The document listed below has been separately released.

Letter of Intent by the authorities of the member country*

*May also be included in Staff Report.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Second Review Under the Stand-By Arrangement

Prepared by European II and Policy Development and Review Department

Approved by Mohammad Shadman-Valavi and Liam P. Ebrill

April 4, 2001

- Discussions were held in Vilnius during February 21- March 1, 2001. The Fund staff team comprised P. Alonso-Gamo (head), S. Fabrizio, S. George, V. Kramarenko (all EU2), and Q. Wang (PDR), and was assisted by M. Horton, the Fund's resident representative. Mr. A. Törnqvist, alternate Executive Director, attended some policy meetings.
- The mission met with President Adamkus, Prime Minister Paksas, Bank of Lithuania (BoL) Governor Šarkinas, Minister of Finance Lioginas, Minister of Labor and Social Protection Blinkeviciute, Seimas Budget and Finance Chairman Glaveckas, as well as other senior government officials, members of Parliament, and representatives of the banking and business communities.
- On March 8, 2000, the Executive Board approved a 15-month Stand-By Arrangement in an amount of SDR 61.8 million (equivalent to 42.6 percent of quota), and the first review was completed on January 10, 2001. The authorities confirmed their intention to make no purchases under the arrangement.
- In the attached letter dated April 2, 2001 (Attachment), the authorities request the completion of the second review and a waiver of applicability for end-March performance criteria.
- Lithuania has accepted the obligations of Article VIII of the Fund's Articles of Agreement and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

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EXECUTIVE SUMMARY

The program remains broadly on track. The macroeconomic situation in 2000 was better than expected and growth prospects for 2001 appear somewhat stronger than envisaged under the program, although the unemployment rate has continued to rise. All performance criteria for end-December 2000 were met, except for the elimination of expenditure arrears of the central government. The authorities committed to eliminate central government expenditure arrears by end-March 2001. Significant progress has been made in negotiations for EU accession. Finally, structural reforms advanced in the areas of banking privatization, labor, bankruptcy, and land legislation, while progress was mixed in the fiscal structural and energy sector areas.

Discussions focused on policies for 2001 and medium-term fiscal issues. The macroeconomic outlook for 2001 was updated. Real GDP is now expected to grow by at least 3.6 percent against the program target of 3.2 percent, and the current account deficit is projected to reach 6.5 percent of GDP, slightly less than initially projected.

The fiscal deficit target of 1.4 percent of GDP for 2001 remains appropriate. End-March targets under the program appear to be achievable and any revision of the budget in May would aim mainly at reallocating expenditures. In the staff's view, modest upward revisions of revenue and expenditure should only be considered at a later stage, once it becomes clear that the revenue performance during the first half of the year exceeds expectations.

The authorities intend to maintain the currency board arrangement in the runup to EU and EMU accession. In this regard, the preparations to a repegging of the litas from the dollar to the euro are under way. The monetary program has been revised to reflect a higher level of monetization of the economy.

The authorities indicated that they would move to regain momentum in the implementation of structural reforms in view of some delays experienced in late 2000–early 2001, in particular in the area of the energy sector and fiscal structural reforms.

Regarding medium-term policies, the government presented in February 2001 a tax reform program aiming at simplifying the tax system and reducing the tax burden, in order to stimulate investment, growth, and employment. The staff prepared with the authorities' assistance an illustrative medium-term fiscal scenario to highlight policy tradeoffs and their macroeconomic implications. The projected deficit of 1.4 percent of GDP for 2001 is close to a balanced position if cyclically adjusted. Therefore, the required reduction in the structural fiscal deficit, excluding the cost of the pension reform, to achieve a balanced position by the time of EU accession would be marginal. Consistent with this objective, the major tax and expenditure measures should be phased in gradually. Following the discussions, the authorities concurred that tax reforms should be more gradual than initially envisaged.

I. INTRODUCTION

1. During the discussions for the first program review and the 2000 Article IV Consultations on January 10, 2001, Directors commended Lithuania's progress in restoring macroeconomic stability and advancing structural reforms. They also noted that the currency board arrangement had constituted a linchpin of stability, and expressed support for the authorities' intention to maintain the currency board with a repegging to the euro in the coming year, with a view to achieving greater economic integration with the EU area. Given the need to preserve financial viability and the increasing expenditure commitments that Lithuania will face in the coming years, Directors welcomed the authorities' plan to prepare a comprehensive medium-term fiscal framework, in order to determine priorities, address future expenditure pressures, and seek ways to achieve the medium-term goal of a cyclically balanced budget.
2. Relations with the Fund and World Bank are summarized in Appendixes I and III, respectively. A US\$98.5 million Structural Adjustment Loan (SAL) was approved by the Executive Board of the World Bank in July 2000, and the first tranche of US\$50 million was disbursed in July. Technical assistance provided by the Fund is described in Appendix II. The periodicity and timeliness of the most important statistics are adequate and are presented in Appendix IV.¹ Appendix V describes an illustrative medium-term fiscal framework.

II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

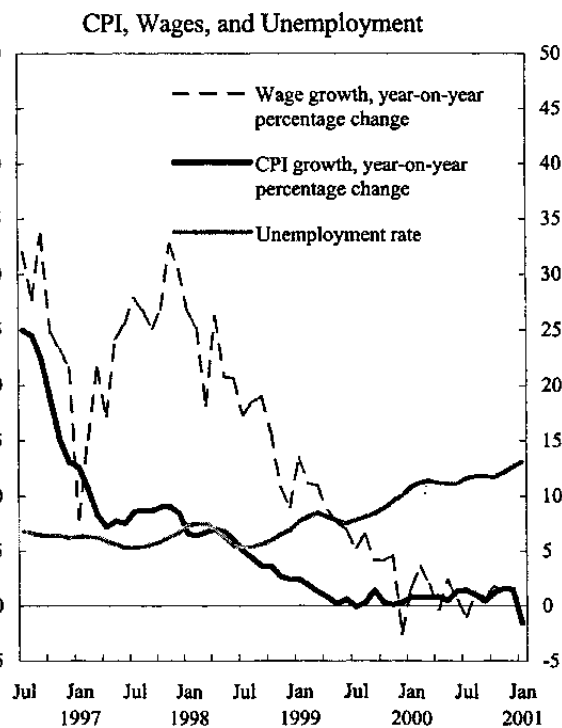
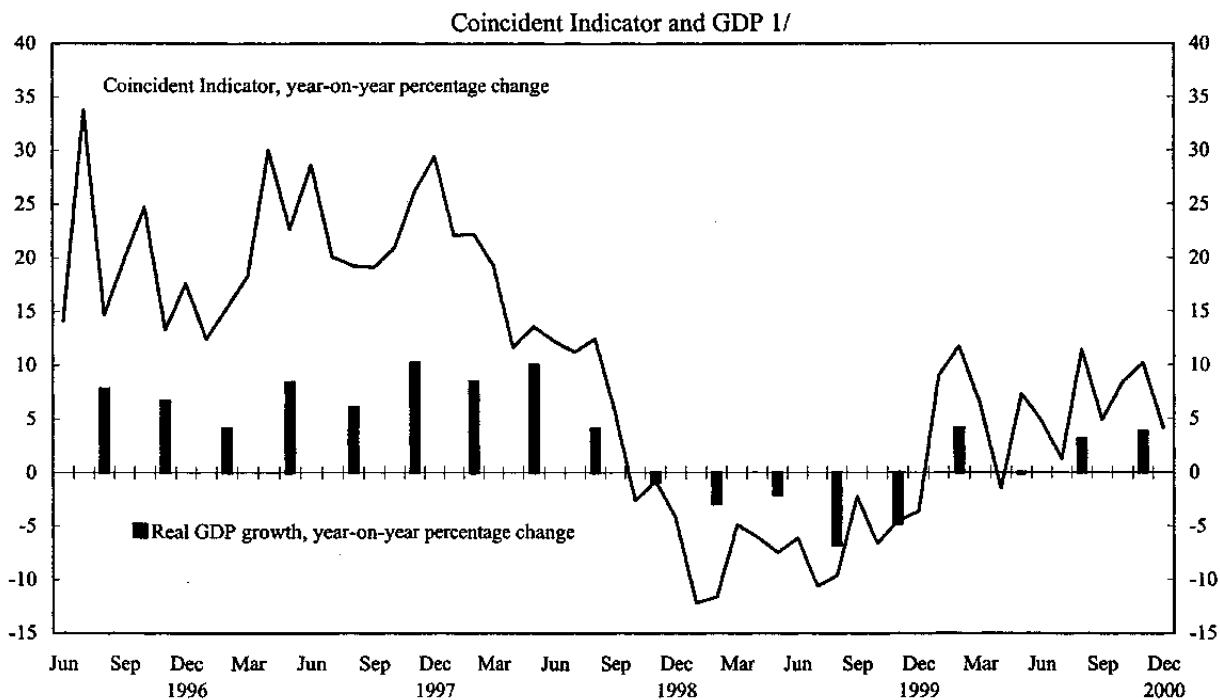
3. **The program supported by the standby arrangement remains broadly on track.** The macroeconomic situation in 2000 was better than expected and growth prospects for 2001 appear somewhat stronger than envisaged under the program, although the unemployment rate has continued to rise. All performance criteria for end-December 2000 were met, except for the elimination of expenditure arrears of the central government (Tables 1-8). Moreover, significant progress has been made in negotiations for EU accession. The authorities indicated that they would move to regain momentum in the implementation of structural reforms in view of some delays experienced in late 2000–early 2001.

A. Macroeconomic Developments

4. **Lithuania is slowly reemerging from the recession experienced in 1998-99, but the situation is still difficult.** The economic recovery, which gained momentum in the latter part of 2000, is stronger than expected, as real growth is estimated to have reached 2.7 percent in 2000, compared with the initial program projection of 2.3 percent (Table 1 and Figure 1). Exports continued to be the major engine of growth, while real domestic demand is estimated to have declined by 2 percent in 2000.

¹ Lithuania has subscribed to SDDS since May 1996. Information provided by the Lithuanian authorities meets the SDDS specifications for the coverage, periodicity and timeliness of data.

Figure 1. Lithuania: Selected Economic Indicators, 1996-2001



Sources: Lithuanian Department of Statistics; Bank of Lithuania; and Fund staff estimates.
1/ Real GDP growth is estimated for the fourth quarter of 2000.

5. **Inflation and wage growth remained subdued in 2000, while unemployment continued to rise.** The year-on-year average CPI and PPI increased by 1.5 percent in 2000, while average wages increased by 1.2 percent in nominal terms, all in line with program projections, and no inflation was registered as measured by the CPI in the 12 months to end-February 2001. The unemployment rate reached 13.1 percent in January 2001, with employment declining despite the recovery. The continued increase in unemployment is attributable to the ongoing restructuring, and to some extent, a higher level of registration, resulting from a tapering off of informal economic activity.

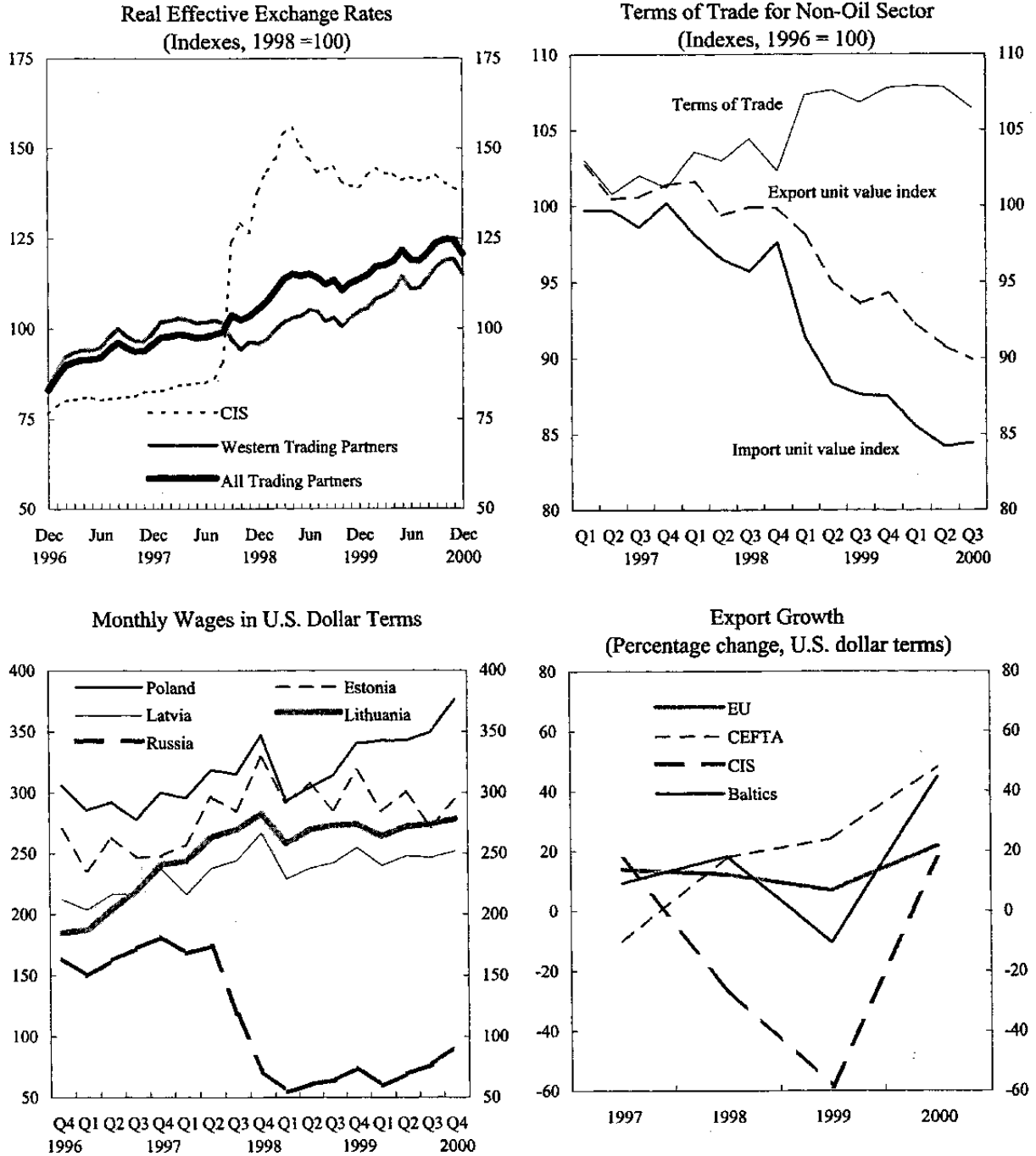
6. **The improvement in the external current account was faster than expected, driven mainly by strong export growth.** The current account deficit is estimated to have shrunk from 11.2 percent of GDP in 1999 to 5.4 percent in 2000, compared with a program target of 6.9 percent, reflecting mainly higher exports, the delay in the recovery of domestic demand, and lower-than-expected fuel imports owing to a mild winter. Exports of goods grew by 28 percent in U.S. dollar terms, while imports grew by 13 percent (Figure 2). The smaller current account deficit more than offset the lower-than-expected net capital inflows leading to an increase of US\$114 million in official reserves (Table 3). External debt at end-2000 stood at 43.3 percent of GDP, almost 1 percent of GDP below program projections, and external vulnerability indicators continued to improve (Table 9). The real effective exchange rate, after appreciating for most of the year, started to depreciate in November 2000, reflecting the recovery of the euro vis-à-vis the U.S. dollar. For the year as a whole, the real effective rate appreciated by 6.2 percent, but competitiveness was sustained by productivity and terms of trade gains (Figure 2).

7. **Despite somewhat lower-than-projected revenue, the general government deficit was 2.8 percent of GDP, 0.5 percent of GDP lower than targeted.** The general government cash expenditure was around 1 percent of GDP lower than expected. Compression of expenditure by the state budget, Social Insurance Fund (SoDra),² Health Insurance Fund (HIF) and extrabudgetary funds, more than offset minor expenditure overruns by municipalities and revenue shortfalls of the order of 0.5 percent of GDP (Table 2).³

² SoDra compressed expenditure on pensions by about 0.3 percent of GDP by forgoing pension indexation, while expenditure on work-related accident insurance was 0.1 percent of GDP below projections.

³ A significant pick-up in exports led to a higher level of VAT refunds, contributing to shortfalls in VAT revenue of about 0.1 percent of GDP. The payroll tax yielded 0.2 percent of GDP less than expected, and the personal income tax 0.1 percent of GDP, reflecting a significant decline in employment in October-December 2000. Other tax and nontax revenues were broadly in line with program projections.

Figure 2. Lithuania: Indicators of External Competitiveness, 1996-2000



Sources: Lithuanian authorities; and Fund staff estimates.

8. **Expenditure arrears of the general government were cut from 1.4 percent of GDP at end-1999 to 0.5 percent at end-2000.** Arrears of the central government, however, were not fully cleared, contrary to the expectations under the program. While the arrears of the Road Fund (LTL 2 million) and the state budget (LTL 16 million) resulted from technical difficulties, the arrears of the HIF (LTL 22.6 million) were incurred because insufficient resources were allocated to reimburse pharmaceuticals. Municipal arrears increased by 0.1 percent of GDP (LTL 40 million) during 2000.⁴

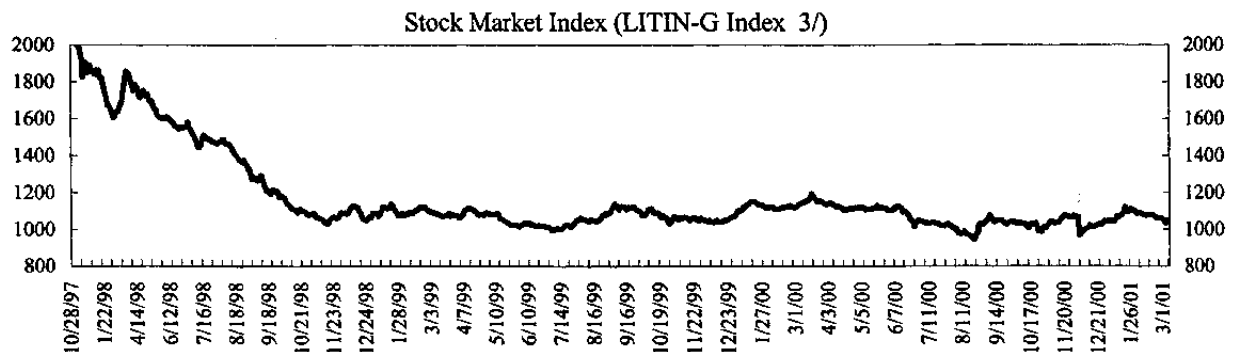
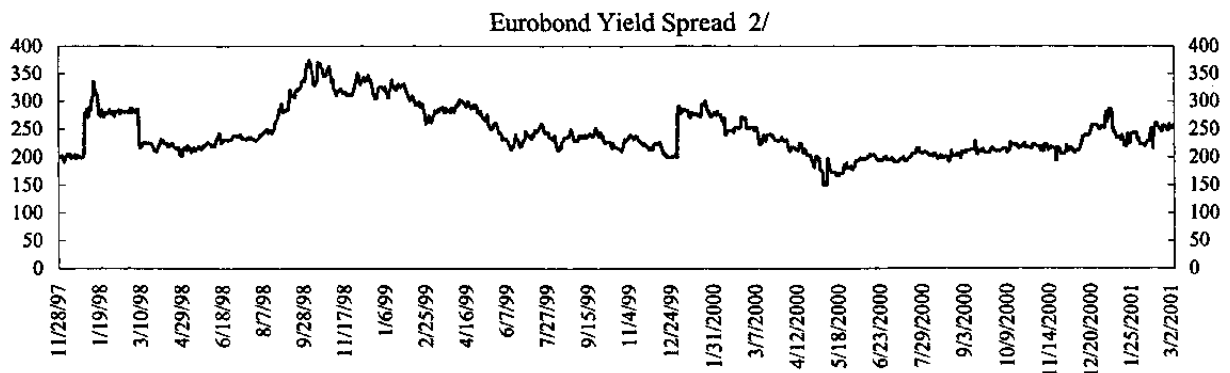
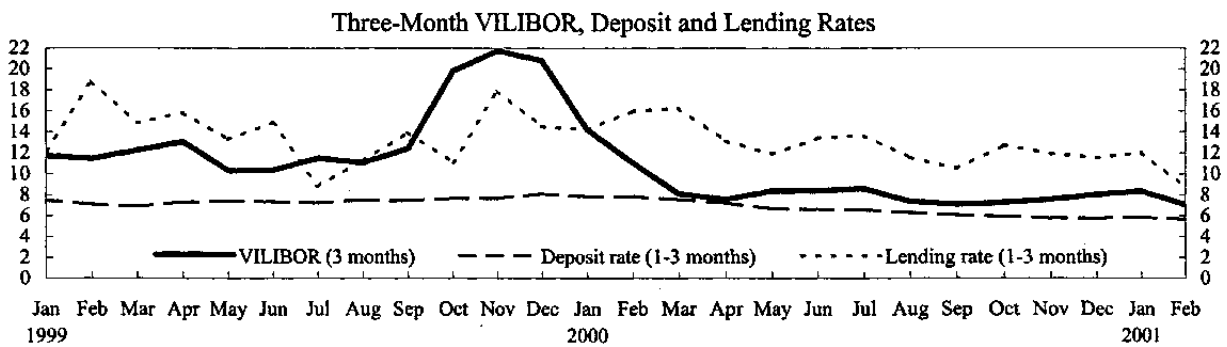
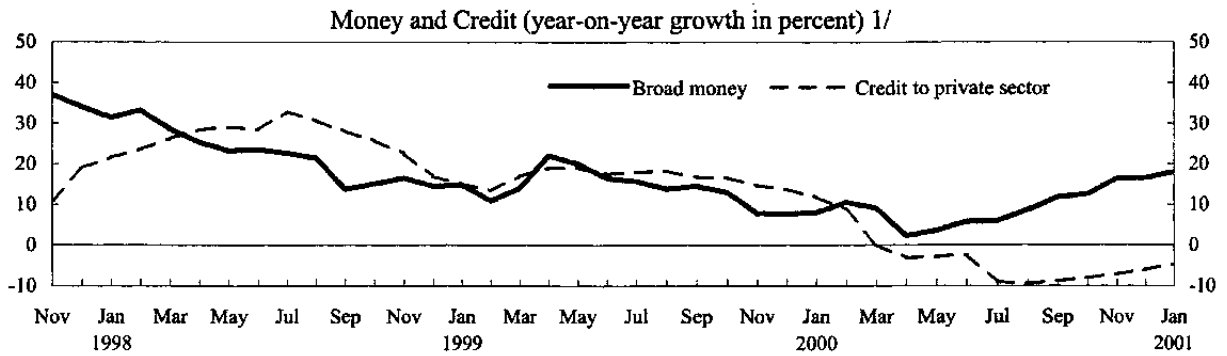
9. **The currency board arrangement continued to anchor macroeconomic policies.** The BoL has stated publicly its intention to switch the peg of the litas from the dollar to the euro in the next year. The amendments to the Law on the Stability of the Litas, which will allow the BoL to re-peg the currency in consultation with the government, were approved by the Seimas Finance and Budget Committee and are now being considered by Seimas. Market confidence continues to be strong, as reflected in the successful placement by the government of a €200 million Eurobond issue in February 2001, with a much lower spread (219 points) than the previous issue in August 2000 (246 points). The amendment to the BoL Law, which establishes its independence and creates a legal impediment for direct lending to the government, was approved by Seimas in March 2001.

10. **All end-December monetary performance criteria were met by large margins,** with official foreign reserves reaching US\$1,344 million (Tables 4 and 7). In 2000, broad money grew by 16.5 percent (compared with a program target of 9.5 percent) mainly reflecting increased monetization of the economy. The reduction in the reserve requirement from 10 to 8 percent in October 2000⁵ and increased deepening of the financial system, with a movement away from currency to other financial instruments in transactions, led to some increase in the multiplier. However, the limited resort of the budget to domestic financing and the increase in liquidity in the system did not lead to an expansion of credit to the private sector, mainly reflecting continued uncertainties in the economy and the banking system. Credit to the private sector remained below program projections (Figure 3), due both to the cautious behavior of bank managers, and the fact that the second and third largest banks were undergoing privatization, while the largest commercial bank was concluding a merger with another

⁴ The work of the government's commission on clearance of arrears by municipalities has not yielded immediate results. Revenue shortfalls persisted in 2000, with municipalities arguing that expenditure arrears stemmed from increased obligations (mainly increased teachers' salaries) imposed by the central government during 1997-2000 without matching transfers. At the same time, municipalities did not have binding budget constraints due to earlier bail-outs, which may have provided incentives for expenditure overruns.

⁵ The reduction in required reserves had a limited impact on credit to the economy, as most freed reserves were converted by banks into foreign assets, and credit continued to be weak.

Figure 3. Lithuania: Financial Indicators, 1997-2001



Sources: Bank of Lithuania; Bloomberg News; and National Stock Exchange of Lithuania.

1/ Included are reclassification of 270 million of DMB's claims on private sector to government lending funds, which were removed from banks' balance sheets in July, 2000.

2/ Yield spread between Lithuanian Eurobond and U.S. bond; Lithuanian Eurobond maturing July 2002.

3/ Calculated from all issues quoted in the current trading list, excluding treasury bills and investment companies.

medium-sized bank.⁶ With little credit expansion, commercial banks increased their net foreign assets to US\$190 million by year-end, significantly higher than expected. All banks complied with prudential ratios at end-December 2000.

B. Structural Reforms

11. **Structural reforms advanced in late 2000-early 2001.** However, results in the fiscal and energy areas were mixed. The completion of the treasury project was postponed until mid-2001 because of technical difficulties in implementing the software, and the draft Law on Budgetary Organizations and Appropriation Managers was somewhat delayed due to a crowded legislative agenda. The Reserve Stabilization Fund (RSF) is being set up in line with the commitments of the SMEP. Moreover, the Ministry of Labor and Social Protection is making preparations for the introduction of an ambitious pension reform (Box 1) with the legal framework to be put in place in 2001-2002, and the reform to be implemented from 2003. Finally, the debt management unit of the Ministry of Finance has been upgraded with a new software in the context of the SAL.

12. **Little progress was made in the restructuring of the energy and gas sectors,** owing first to the desire of the new government to review all plans and, second, to the replacement of the Minister of Economy. Nonetheless, the financial situation of energy public enterprises improved following tariff increases. The **Mazeikiu Nafta** oil company continues to encounter difficulties in reaching a long-term supply agreement with Russian oil companies. Without such an agreement, the company operates below capacity and cannot proceed with modernization and expansion plans, for which additional government guarantees of US\$118 million may be required.

13. **The government has made progress in the banking privatization program.** Negotiations with Hansabank for the privatization of the Savings Bank (LTB), which ceased making losses from the second half of 2000, are close to completion. Negotiations were complicated by the announcement by Swedbank, the owner of Hansabank, of a merger plan with SEB Bank, the owner of Vilnius Bank (VB), Lithuania's largest bank.⁷ Nevertheless, the authorities decided to go ahead with the sale of the Savings Bank (LTB), with the condition that, if the merger occurs, one of the two Lithuanian banks will have to be sold. A new tender for hiring advisors to privatize the Agricultural Bank was announced in February. Negotiations for the sale of the majority stake in the Lithuanian Shipping Company (LISCO) are close to completion.

⁶ Growth in private sector credit was essentially flat if the stock is adjusted for loan write-offs of LTL 270 million in July 2000 (when certain loans which had been financed by earmarked government deposits were transferred to the state debt recovery agency).

⁷ The combined LTB-VB-Hansabank would control approximately 80 percent of the market.

Box 1. Pension System and Prospective Reform

The new Pension Law took effect on January 1, 1995 and it is applicable to those retiring after this date. The Law is based on the principles of a contribution-defined pay-as-you-go (PAYG) system and provides for a gradual increase in the pension age and the contribution period, as well as the elimination of the Soviet-type early retirement privileged groups. The existing pension system is highly redistributive as it puts a strict limit on the maximum pension and guarantees a basic pension to all. The benefit package combines two components. The first is a years-of-service flat benefit—the basic pension—which effects substantial redistribution. The second is an earning-related benefit—the supplementary pension—which is proportional to life-time payroll contributions.

Social security employer contributions under labor contracts are 30 percent of gross wages, and employee contributions were increased from 1 to 4 percent of gross wages on January 1, 2000. Contributions explicitly assigned to pensions amounted to 22.5 percent before January 1, 2000 and 25 percent thereafter. Self-employed, employed under licenses, and farmers (about one third of employment) are required to pay mandatory contributions for a basic pension only which is equal to one half of the basic pension per month. Maximum payroll contributions were capped until end-1999. The state budget pays contributions for noncontributory periods of some groups, i.e., soldiers and maternity leave beneficiaries.

Noncontributory pensions include social pensions paid to uninsured elderly, disabled before age 18, and some other uninsured groups, as well as state pensions. In general, social pensions are equal to the basic pension with higher amounts for higher levels of disability. State pensions are paid to former Presidents, people making substantial social contributions (mainly artists), victims of the Soviet occupation, and scientists. These pensions could be as high as 1.8 times minimum living level for each year of service. Both types of noncontributory pensions are funded by the state budget.

Since the August 1998 Russian crisis the cash flow position of SoDra has deteriorated significantly. The tax base has shrunk as the number of employees under wage contracts has declined and wage growth has been weak. At the same time, the number of pension recipients has increased. As a result, the SoDra's deficit increased to 1 percent of GDP in 1999. Despite the increase in the payroll tax, the deficit is estimated at 0.4 percent in 2000. Recognizing the problems of the existing pension system, a package of expenditure measures for SoDra was approved in the context of the 2001 budget. Pension measures included a reduction in pensions of working pensioners and further acceleration of the increase in the retirement age from 2 to 6 months per year for men and from 4 to 6 months per year for women. Both measures would strengthen the medium-term position of the pension system, which is expected to generate surpluses by 2003-4 in the absence of pension reform.

To strengthen the incentives for retirement savings and promote the development of financial markets, Seimas instructed the government to prepare a plan for pension reform in 2000. A special committee of the government has prepared a *White Book* outlining various reform options. The government is considering a number of reform options involving a set up of a three-pillar pension system by 2003. The legislation for the voluntary third pillar has already been passed, and the government is preparing relevant legislation to set up a mandatory privately funded pension scheme (second pillar). The current plans are to limit the diversion of the payroll tax to the second pillar to 5 to 7 percentage points while making the second pillar mandatory for only the younger cohort of the population. The reform-related deficit of SoDra, ranging from 1.0 to 1.5 percent of GDP per year at an early stage depending on options, is envisaged to be financed by privatization proceeds during the first three to four years and later on by transfers from the state budget. Privatization proceeds earmarked for pension reform would be accumulated in the Reserve Stabilization Fund, which would be set up based on an amendment to the Law on Privatization.

14. **In order to facilitate private sector activity**, steps were taken to streamline procedures for the sale and purchase of land, and simplify the restitution of ownership rights. An amendment to the Constitution allowing foreigners to buy agricultural land (an EU requirement) has been submitted to Seimas. All parties in Seimas agreed to a resolution in January 2001 to support the passage of legislation needed to advance negotiations with the EU, as the authorities objective is to conclude negotiations in 2002, for accession in 2004. Reforms in the agriculture sector are broadly on track. Bankruptcy and company restructuring legislation was passed by Seimas in March. A set of amendments to the labor law to reduce restrictions on hiring and firing of labor was also passed in March.

III. POLICY DISCUSSIONS

A. Outlook for 2001

15. **The macroeconomic outlook for 2001 has been updated**, in light of recent developments. Real GDP is now expected to grow by at least 3.6 percent against the program target of 3.2 percent, reflecting continued export growth and some revival in domestic demand. End-of-year CPI inflation would be contained at 1.9 percent as initially envisaged (Table 1). The external current account deficit is projected to widen from 5.4 percent of GDP in 2000 to 6.5 percent, but still below the original program projection of 6.7 percent (Table 3). Slower economic growth in the major trading partners may well be offset by the positive impact of the recent favorable exchange rate developments⁸ if these were to persist. No major changes were made to the capital account projections. Foreign direct investment is projected to increase significantly in 2001, as several privatization projects are expected to be completed this year. The share of portfolio investment has been increased to reflect the issuance by the government of the Eurobond in February rather than the initial assumption of a syndicated bank loan. Gross official reserves are projected to reach US\$1,668 million at end-2001, slightly below earlier projections.

16. **The fiscal deficit of 1.4 percent of GDP for 2001 remains appropriate and end-March targets under the program appear to be achievable.** According to the authorities, the planned revision of the budget in May would aim mainly at reallocating expenditure. In the staff's view, modest upward revisions of revenue and expenditure should only be considered at a later stage if it becomes clear that the revenue performance during the first half of the year exceeds expectations. The authorities remain committed to the deficit target, but would want to use any additional revenue beyond program projections to revise expenditure or reduce taxes. The authorities are committed to eliminating central government expenditure arrears by end-March 2001. A lasting solution to the arrears of the HIF would require a revision of the regulations for reimbursing pharmaceuticals.

⁸ The current euro/dollar rate (US\$0.88-0.89 per €1) is more favorable than the program assumption of US\$0.85 per €1.

17. **The authorities intend to maintain the currency board arrangement in the run-up to EU and EMU accession.** Regarding the re-pegging strategy, the BoL underscored the need for providing market participants with sufficient lead time to adjust their financial portfolios. A multi-topic MAE mission visited Vilnius in March 2001 for consultations regarding the technical preparations for the switch, including legal and practical steps to be taken by the BoL and commercial banks, issues of reserve management, and the needed public information campaign. The BoL will announce the final decision on dates and exact technical modalities of the switch in the second half of 2001, in consultation with Fund staff.

18. **The monetary program for 2001 was revised to reflect the impact of a substantially higher-than-expected level of monetization registered in 2000.** The program for 2001 projects a further reduction in velocity consistent with the ongoing deepening of financial intermediation, resulting in broad money growth of 6.9 percent at end-2001. The combination of the higher level of monetization and unchanged assumptions on the financing of the budget would leave room for 11.3 percent growth in credit to the private sector, to support small and medium-sized business activities, fostering growth and employment creation in the medium term. However, for this credit growth to materialize, increased competition in the banking system would be desirable, with banks becoming more active in identifying good prospective borrowers. No further decreases in reserve requirements would be appropriate at this stage, given prudential considerations under the CBA and ample liquidity in the banking system.

19. **The authorities intend to accelerate structural reforms in the near future,** with the appointment of a new Minister of Economy in early March. The approval of the restructuring plan for the Lithuanian Power Company (LPC), scheduled for January 2001, was expected in March-April, and the announcement of the tender for the privatization of the distribution network is now slated for August 2001. The approval of the plan for the evaluation of the assets of the gas company should take place in April, while the announcement of a tender for privatization should take place by May 2001. The initiation of the privatization of the electrical utilities grid and the gas company is a condition for the disbursement of the second tranche of the World Bank's SAL. The authorities are determined to complete the privatization of the two state-owned banks in the near future, which would promote competition and efficiency in the banking system and investment and growth in the medium term.

20. **To promote private activity and streamline government operations,** several specialized commissions will replace the Sunset and Sunrise commissions. The main priorities for foreign investors include measures to render labor markets more flexible, and new rules for initiating bankruptcy proceedings and satisfying creditors' claims. In this regard, newly passed legislative acts to reform the labor market and streamline the bankruptcy procedures are expected to make Lithuania more attractive to foreign investors and to facilitate employment creation. Regarding the new bankruptcy legislation, the authorities are concerned that the easing of the stringent current requirements may increase the number of bankruptcies and layoffs in the short term, leading to a further increase in the unemployment rate. To cushion the vulnerable segments of population, the staff advised the authorities to improve the design

of social safety nets. Legal steps to simplify the restitution of land ownership rights are currently under discussion within the government.

B. Medium-Term Fiscal Strategy

21. **The authorities are developing a medium-term fiscal strategy that would be incorporated into the Pre-accession Economic Policy paper**, which is to be submitted to the European Commission by October 1, 2001. In formulating such a strategy, the authorities' objective is to achieve a cyclically balanced budget by 2003, while making provisions for new expenditure commitments, such as the costs of EU accession, the pension reform, social safety nets, the elimination of arrears, and environmental clean-up.⁹

22. **The government presented in February 2001 a tax reform program aiming at simplifying the tax system and reducing the tax burden** in order to stimulate investment, growth, and employment. The main elements of the original proposal included the elimination of the corporate income tax (CIT) beginning in 2002,¹⁰ a significant gradual reduction in the personal income tax beginning in 2003, and the re-alignment of indirect taxation to conform to EU requirements.¹¹ The government expects that the tax rate cuts would have a positive effect on economic growth and tax compliance, so as to generate sufficient revenue to finance essential and new expenditure commitments. However, even after allowing for this positive impact, in the staff's view, if all measures were to be introduced according to the proposed schedule, the fiscal deficit would likely be higher, unless expenditures are significantly cut.

23. **The staff prepared with the authorities' assistance an illustrative medium-term fiscal scenario to highlight policy tradeoffs and their macroeconomic implications.** The major tax and expenditure measures contained in the government program were phased in such a way that the medium-term fiscal deficit, excluding the cost of the pension reform, would be reduced gradually from a projected 1.4 percent of GDP in 2001 to a balanced position in 2005 (Appendix V). Expenditure would be maintained at 31-32 percent of GDP. Taxes on labor were assumed to be reduced at an early stage, while the corporate income tax would be phased out in stages. New taxes were proposed by the staff to compensate for revenue losses (Appendix V). The impact of EU-related tax changes was considered to be positive over the medium term. Finally, substantial post-accession EU transfers would help

⁹ The focus is on the deficit which excludes the cost of the pension reform (Appendix V).

¹⁰ At present, reinvested earnings are deducted from taxable profits, while dividends are taxed at 29 percent. The proposed tax reform will involve the elimination of the CIT, but dividends will still be taxable.

¹¹ Accession to the EU would require tax harmonization, so that excises on certain goods (sugar, perfumes, electricity) and VAT exemptions would have to be abolished, while excises on cigarettes and petroleum products would be gradually brought to EU minimum levels.

finance post-accession costs. The staff emphasized that a number of different tax packages would be consistent with the expenditure and fiscal balance objectives.

24. The staff pointed out that a number of considerations should be taken into account in assessing different tax reform options. First, the speed of the tax reform should be consistent with the authorities' objective of achieving a cyclically balanced budget by the time of EU accession to anchor expectations under the CBA. To this end, a marginal reduction of the structural budget deficit,¹² excluding the cost of the pension reform, would be necessary. Second, there appears to be little scope for compressing expenditure further, given the need to cofinance EU accession costs, finance the pension reform starting in 2003, comply with the Seimas decision setting binding expenditure floors on education and defense, and ensure the delivery of basic government services. Third, in the case of Lithuania, a reduction of taxation on labor should be given priority over cuts in taxation of capital, given the high level of unemployment. Fourth, the impact of a reduction in taxes on capital on growth is likely to be small in the short term. While such a reduction could result in long-term efficiency gains, the immediate impact of lower capital taxation—without any decrease in labor taxation—could well be higher savings and capital-intensive growth, leading to a persistence of high unemployment. Finally, tax collection under the personal income tax could be adversely affected if employee compensation were to shift from wages to capital income, especially since capital gains are not taxed.

25. The authorities agreed that tax reforms should be more gradual than initially envisaged, while expressing their intention to finish the tax reform by 2004, before the next parliamentary elections. The authorities also indicated that they were working on their own macro-fiscal scenario, and a tax reform package will be presented to Seimas for discussion.¹³

26. The authorities are also examining options to address the problem of expenditure arrears of municipalities. The staff underscored a strategy for helping municipalities clear arrears should minimize moral hazards associated with bail-outs. Transfer schemes should be linked to concrete measures to be undertaken by the municipalities, and be part of a comprehensive overhaul of municipal finances, with a view to aligning resources and

¹² The fiscal position is already estimated to be close to balance for 2001 on a cyclically adjusted basis. However, estimates for potential output should be treated cautiously.

¹³ The initial government proposal (paragraph 22) has evolved as follows: the elimination of the CIT in 2002, the re-establishment of the capital gains tax in 2002, a gradual reduction in the PIT rate and a gradual increase in the exempt minimum beginning in the second half of 2001, a gradual elimination of the gross sales tax over 2002-3, a realignment of excises in accordance with EU requirements, and the establishment of a real estate tax by municipalities. This tax reform plan, if endorsed by the government, would be presented to Seimas in April, but is likely to run into difficulties, given strong opposition, including within the government coalition, to the elimination of the CIT.

responsibilities, identifying possible new sources of revenue (e.g., real estate or enhanced property taxes) and further expenditure rationalization. In any event, municipalities should comply with the 2001 budget law and clear all arrears by end-2001 independently of the timing of additional transfers from the central government.

IV. STAFF APPRAISAL

27. **The Lithuanian authorities managed to restore macroeconomic stability in 2000 and give new impetus to structural reforms.** Macroeconomic stability needs to be preserved if credibility is to be maintained, and structural reforms must be accelerated if private activity is to be promoted, leading to higher growth and employment creation. This is especially important given that Lithuania might be able to conclude accession negotiations with the EU in 2002, and to join in the first wave of enlargement.

28. **The authorities should be commended for their efforts to achieve the fiscal targets.** The prospect for an accelerated recovery in 2001 might result in better than expected revenue performance, thus enabling the authorities to achieve their ambitious targets while at the same time addressing critical expenditure needs. However, the staff recommends caution, and urges the authorities to proceed with supplementary spending only after additional revenue has been collected. Maintaining a prudent fiscal stance in advance of the repegging of the litas would enhance confidence in economic policies and help maintain the momentum for further reforms over the medium term.

29. **The staff endorses the authorities' intention to switch the peg of the litas to the euro,** with a view to moving smoothly toward greater economic integration with the EU area, while preserving the credibility of the currency board, which has anchored macroeconomic policies and provided price stability. In order to minimize uncertainties, the staff welcomes the authorities' plans to make the process as transparent as possible, and would also caution against any further reduction of reserve requirements in the period prior to the repegging.

30. **The staff welcomes the authorities' ongoing work on the preparation of a comprehensive medium-term fiscal framework,** which will provide an opportunity to determine priorities, address future expenditure pressures, and seek ways to achieve the medium-term goal of a cyclically balanced budget. Fiscal policy should preserve the consolidation achieved in 2000, with some modest further adjustment. This would send a signal to financial markets regarding the irreversibility of fiscal adjustment in the context of the currency board arrangement. On the expenditure side, there might be little room for further cuts if essential services and social expenditures are to remain adequate; the authorities are encouraged, however, to pursue expenditure rationalization.

31. **The staff welcomes the objective of simplifying and making the tax system more transparent,** bringing it in line with the EU. Regarding the government's tax reform plans, the staff believes there is limited scope for measures that would entail sudden and large losses of revenue. In the staff's view, a gradual phasing of tax reforms over several years, would be consistent with the government's program of easing the tax burden to promote economic

growth and with the expenditure and fiscal balance objectives. Moreover, there is a need to preserve a balance between the taxation of capital and labor, if employment-creating growth is to be promoted. In this connection, the staff would caution against the immediate abolition of the CIT, and would favor some easing of the tax burden on labor, in particular by reducing the PIT.

32. **A number of structural problems need to be addressed.** While macroeconomic performance appears to be better than expected and progress in structural reforms was registered in several areas, the staff urges the authorities to move ahead clearly and concretely in the coming months with planned reforms in the fiscal area, banking privatization, the energy sector, and measures to facilitate private sector activity. First, in the fiscal area, the staff is concerned that the position of municipalities, the HIF and the Road Fund would deteriorate sharply in the medium term, unless steps are taken to improve their financial situation in a sustainable manner and to prevent the re-emergence of arrears. The authorities are urged to proceed with caution in providing additional transfers to the municipalities to help them clear arrears. Any transfers should be part of a comprehensive change package of measures to address financial imbalances of municipalities. The staff welcomes the progress in preparing for the pension system reform, to be implemented as of 2003, and supports the authorities' view that it should be financed by privatization proceeds at an early stage.

33. **The authorities are encouraged to complete the privatization of the two remaining state-controlled banks as soon as possible.** Bank privatization and strengthened banking supervision should enhance the efficiency of financial intermediation and increase confidence in the domestic financial system.

34. **The staff urges the government to proceed swiftly with the implementation of the recommendations of the sunset and sunrise commissions so as to address a wide range of structural and strategic issues.** The new bankruptcy and labor legislation would stimulate further restructuring, promoting private investment and employment over the medium term. At the same time, the reforms planned in the energy and agricultural sectors should help boost efficiency and reduce the scope of government support. In this connection, the staff urges the authorities to limit the provision of new government guarantees. Deregulation is also crucial to improving Lithuania's business environment and competitiveness. Social concerns should be addressed through improved social safety nets.

35. **In the staff's view, the program remains broadly on track,** and the end-March targets can be achieved. The staff considers that the authorities' program is strong, supports the authorities' request for a waiver of applicability for end-March performance criteria, and recommends the completion of the second program review, taking into account that the authorities have taken the necessary steps to clear the remaining arrears of the central government.

V. PROPOSED DECISION

The following draft decision is proposed for adoption by the Executive Board:

1. The Republic of Lithuania has consulted with the Fund in accordance with paragraph 3(c) of the Stand-By Arrangement for the Republic of Lithuania (EBS/00/28, Sup. 1) and paragraph 2 of the letter from the Prime Minister of the Republic of Lithuania and the Governor of the Bank of Lithuania dated February 22, 2000.

2. The letter from the Prime Minister of the Republic of Lithuania and the Governor of the Bank of Lithuania dated April 2, 2001 shall be attached to the Stand-By Arrangement, and the letters dated February 22 and December 13, 2000 shall be read as supplemented by the letter dated April 2, 2001.

3. The Fund decides that the second review contemplated in paragraph 3(c) of the Stand-By Arrangement is completed, and that the Republic of Lithuania may make purchases up to a cumulative amount of the equivalent of SDR 51.5 million under the arrangement through April 20, 2001, and thereafter in accordance with the provisions of the arrangement, notwithstanding the non-availability of data to assess the observance of end-March 2001 performance criteria specified in paragraph 3(a) of the Stand-By Arrangement, on condition that, with respect to the purchase subject to the performance criteria specified above, (i) the Republic of Lithuania has accurately represented that such information is unavailable, and (ii) the information provided by the Republic of Lithuania on performance under end-December 2000 performance criteria specified in paragraph 3(a) of the Stand-By Arrangement is accurate.

Table 1. Lithuania: Selected Macroeconomic Indicators, 1996-2001

	1996	1997	1998	1999	2000		2001 Proj.
					Prog.	Est.	
National income, prices, and wages							
Nominal GDP (in millions of litai) 1/	31,569	38,340	42,990	42,535	44,530	44,808	47,400
GDP (in millions of U.S. dollars) 1/	7,892	9,585	10,748	10,634	11,133	11,202	11,850
Real GDP growth (year-on-year, in percent) 1/	4.7	7.3	5.1	-4.2	2.3	2.7	3.6
Average CPI (year-on-year change, in percent)	24.7	8.8	5.1	0.8	1.0	1.0 8/	1.0
End-of-period CPI (year-on-year, in percent)	13.1	8.4	2.4	0.3	1.6	1.5 8/	1.9
GDP deflator (year-on-year, in percent)	25.1	13.2	6.7	3.3	2.2	2.6	2.1
Average monthly wage (in U.S. dollars)	155	196	232	253	...	...	...
Unemployment rate (in percent) 2/	6.2	6.7	6.9	10.0	...	11.5 8/	...
Saving-investment balance (in percent of GDP)							
Gross national saving	15.3	16.3	12.3	11.7	17.2	15.1	14.9
General government	0.2	1.7	-0.7	-4.0	-0.9	-0.5	0.5
Non-government	15.2	14.6	13.0	15.7	18.2	15.7	14.5
Gross national investment	24.5	26.5	24.4	22.9	21.9	20.5	21.4
Foreign saving	9.2	10.2	12.1	11.2	6.9	5.4	6.5
General government (in percent of GDP)							
Financial balance	-2.5	-1.5	-4.4	-6.2	-2.8	-2.1	-1.3
Net lending 3/	2.0	0.3	1.5	2.4	0.5	0.7	0.1
Fiscal balance 3/	-4.5	-1.8	-5.9	-8.5	-3.3	-2.8	-1.4
External sector							
Current account balance							
in percent of GDP	-9.2	-10.2	-12.1	-11.2	-6.9	-5.4	-6.5
in millions of U.S. dollars	-723	-981	-1,298	-1,194	-768	-602	-771
Gross official reserves (in millions of U.S. dollars) 4/	834	1,063	1,460	1,242	1,297	1,356 8/	1,668
External debt (in percent of GDP) 5/	30.2	34.0	34.8	42.6	44.2	43.3	43.2
Debt service (in percent of exports of GNFS)	6.8	10.7	18.3	20.0	15.2	14.7	13.3
Exchange rate (litai/euro, period average)	...	...	...	4.18	...	3.70	...
Real effective exchange rate (1995=100, "+"=appreciation) 6/	114	132	142	160	...	171	...
Money and credit							
Reserve money (year-on-year change, in percent)	2.2	32.4	28.8	-4.0	-9.3	-3.0 8/	0.2
Broad money (year-on-year change, in percent)	-3.5	34.1	14.5	7.7	9.5	16.5 8/	6.9
Private sector credit (year-on-year change, in percent) 7/	-4.4	18.9	16.9	13.8	7.5	-1.2 8/	11.3
Money multiplier	2.2	2.2	2.0	2.2	2.6	2.6 8/	2.8
Currency/deposits, in percent	53.9	53.5	50.7	43.9	37.6	34.1 8/	32.5
Foreign currency deposits/ litai deposits, in percent	60.3	48.1	57.0	77.7	80.9	83.8 8/	80.9

Sources: Lithuanian authorities; and Fund staff estimates and projections.

1/ GDP for 1999 has been substantially revised by the Statistical Office since EBS/00/28 has been published.

2/ Registered unemployment, end-of-period.

3/ The program adjuster was 0.2 percent of GDP for 2000.

4/ Including valuation changes. Gross official reserves reported here differ from the monetary survey because here reverse repos involving major currencies in both legs are included.

5/ External liabilities minus equity investment in Lithuania.

6/ CPI-based, trade-weighted real exchange rate against 21 major trading partners in 1999.

7/ Dec. 2000 is adjusted for LTL 270 million of DMB's reclassified loans. If included, private sector credit would fall by 6.1 percent.

8/ Actual figure.

Table 2. Lithuania: Summary of Consolidated General Government Operations, 1998-2001

	1998	1999 Prel.	2000		2001 Budget 1/
			Prog.	Est.	
(In millions of litai)					
Revenue and grants	14,036	13,687	13,643	13,532	14,525
Grants	0	0	0	0	0
Revenue	14,036	13,687	13,643	13,532	14,525
Tax revenue	13,433	12,955	12,980	12,829	13,553
Taxes on income and profits	4,017	3,971	3,885	3,836	4,009
Payroll tax (social security tax)	3,063	2,891	3,262	3,194	3,333
Taxes on goods and services	5,596	5,385	5,173	5,141	5,582
Other tax revenue	756	709	660	657	630
Non tax Revenue	603	732	663	703	972
Expenditure and net lending	16,362	17,351	15,209	14,777	15,204
Expenditure	15,734	16,345	14,965	14,478	15,141
Current expenditure	14,326	15,389	14,065	13,763	14,311
Wages and salaries, excl. contributions to SoDra	3,290	3,513	3,471	3,450	3,498
Goods and services	4,899	4,624	4,154	4,012	4,341
Transfers to EU	0	0	0	0	0
Transfers to households	4,977	5,244	5,493	5,401	5,502
Subsidies	202	150	137	103	100
Interest payments 2/	507	650	800	782	845
Savings restitution program	450	1,207	10	15	25
Capital expenditure	1,408	956	900	715	830
Discrepancy	190	-29	-91	-1	0
Financial balance	-1,888	-2,629	-1,231	-944	-616
Net lending 3/	628	1,006	244	300	63
Lending	1,017	1,381	475	529	353
of which: Mazeikiiai Oil Company	240	800	88	88	0
Repayments	389	-375	-231	-230	-290
Fiscal balance (deficit (-)) 3/	-2,516	-3,635	-1,475	-1,244	-679
Financing	2,516	3,635	1,475	1,244	679
Net domestic	-286	392	-164	-225	-1,089
Bank financing	-666	326	-520	-422	-1,108
Monetary Authorities	-635	602	-622	-480	-1,339
Commercial Banks	-31	-276	102	58	231
Non-bank financing	380	66	357	197	19
Net foreign	535	2,762	739	665	467
Privatization proceeds	2,267	481	900	803	1,300
(In percent of GDP)					
Revenue and grants	32.7	32.2	30.6	30.2	30.8
Grants	0.0	0.0	0.0	0.0	0.0
Revenue	32.7	32.2	30.6	30.2	30.8
Tax revenue	31.2	30.5	29.1	28.6	28.8
Taxes on income and profits	9.3	9.3	8.7	8.6	8.5
Payroll tax (social security tax)	7.1	6.8	7.3	7.1	7.1
Taxes on goods and services	13.0	12.7	11.6	11.5	11.8
Other tax revenue	1.8	1.7	1.5	1.5	1.3
Non tax Revenue	1.4	1.7	1.5	1.6	2.1
Expenditure and net lending	38.1	40.8	34.2	33.0	32.3
Expenditure	36.6	38.4	33.6	32.3	32.1
Current expenditure	33.3	36.2	31.6	30.7	30.4
Wages and salaries, excl. contributions to SoDra	7.7	8.3	7.8	7.7	7.4
Goods and services	11.4	10.9	9.3	9.0	9.2
Transfers to EU	0.0	0.0	0.0	0.0	0.0
Transfers to households	11.6	12.3	12.3	12.1	11.7
Subsidies	0.5	0.4	0.3	0.2	0.2
Interest payments 2/	1.2	1.5	1.8	1.7	1.8
Savings restitution program	1.0	2.8	0.0	0.0	0.1
Capital expenditure	3.3	2.2	2.0	1.6	1.8
Discrepancy	0.4	-0.1	-0.2	0.0	0.0
Financial balance	-4.4	-6.2	-2.8	-2.1	-1.3
Net lending 3/	1.5	2.4	0.5	0.7	0.1
Lending	2.4	3.2	1.1	1.2	0.7
of which: Mazeikiiai Oil Company	0.6	1.9	0.2	0.2	0.0
Repayments	0.9	-0.9	-0.5	-0.5	-0.6
Fiscal balance (deficit (-)) 3/	-5.9	-8.5	-3.3	-2.8	-1.4
Financing	5.9	8.5	3.3	2.8	1.4
Net domestic	-0.7	0.9	-0.4	-0.5	-2.3
Bank financing	-1.5	0.8	-1.2	-0.9	-2.3
Non-bank financing	0.9	0.2	0.8	0.4	0.0
Net foreign	1.2	6.5	1.7	1.5	1.0
Privatization proceeds	5.3	1.1	2.0	1.8	2.8
Memorandum Items:					
Public and publicly guaranteed debt, mln. LTL	9,614	12,069	12,855	12,651	14,036
In percent of GDP	22.4	28.4	28.9	28.2	29.8
Public and publicly guaranteed net debt, mln. LTL	7,629	10,694	10,941	10,812	11,030
In percent of GDP	17.7	25.1	25	24.1	23.4
GDP, in mln. LTL 4/	42,990	42,535	44,530	44,808	47,135

Sources: Ministry of Finance, Ministry of Social Security; and Fund staff estimates.

1/ Revenue and expenditure numbers reported in EBS/00/286 were adjusted to reflect the incorporation in the general government budget of fees paid to educational establishments and their spending (LTL 128 million).

2/ Interest payments do not include provisioning of defaults, which are reflected under "net lending".

3/ Program numbers for 2000 are reported without the program adjuster to net lending and deficit for higher-than-expected project lending. The adjuster for 2000 is LTL 81 million. The budgeted amount of provisioning of defaults of LTL 102 million is included for the program numbers and estimates for 2000.

4/ Budget GDP for 2001.

Table 3. Lithuania: Balance of Payments, 1997-2001

	1997	1998	1999	2000		2001 Proj.
				Prog.	Est.	
(In millions of U.S. dollars)						
Current account	-981	-1,298	-1,194	-768	-602	-771
Trade balance	-1,147	-1,518	-1,405	-1,009	-971	-1,116
Exports (f.o.b.)	4,192	3,962	3,147	4,033	4,191	4,448
Imports (f.o.b.)	5,340	5,480	4,551	5,043	5,163	5,565
Non-factor services, net	134	241	305	381	423	436
Credits	1,032	1,109	1,092	1,148	1,084	1,137
Debits	897	868	786	767	660	701
Factor income, net	-198	-255	-258	-265	-241	-297
Current transfers, net	230	235	163	126	187	207
Capital and financial account	1,080	1,442	1,057	749	636	1,118
Capital transfers, net	4	-2	-3	4	3	6
Financial account	1,076	1,444	1,061	745	633	1,112
Direct investment, net	328	921	478	355	322	650
Portfolio investment, net	188	-53	506	429	369	282
Other investment, net	560	575	77	-39	-58	180
Net errors and omissions	170	285	-42	83	94	0
Financing	-269	-429	179	-64	-129	-347
Fund financing	-31	-30	-17	-12	-15	-35
Change in official reserves (- = increase)	-238	-399	196	-52	-114	-312
Official reserves and external debt						
Gross official reserves 1/	1,063	1,460	1,242	1,297	1,356	1,668
External debt 2/	3,258	3,739	4,525	4,924	4,846	5,117
Public and publicly guaranteed	1,483	1,670	2,383	2,583	2,394	2,632
Private	1,881	2,069	2,142	2,341	2,451	2,485
Short-term debt						
On a remaining maturity basis	1,796	1,730	1,581	1,564	1,519	1,767
On an original maturity basis	1,030	1,040	1,066	1,091	1,016	1,091
Of which:						
Trade credit	670.9	571.9	692	769	739	769
Currency and deposit	149	145	189	...	208	230
Debt service 3/	561	925	846	786	776	745
Amortization	427	765	688	597	564	502
Interest payment	156	160	158	189	212	242
(In percent of GDP, unless otherwise indicated)						
Current account	-10.2	-12.1	-11.2	-6.9	-5.4	-6.5
Trade balance of goods and services	-10.6	-11.9	-10.3	-5.6	-4.9	-5.7
Trade balance, goods	-12.0	-14.1	-13.2	-9.1	-8.7	-9.4
Of which:						
Non-energy trade balance	-4.4	-8.2	-6.6	...	-2.1	-2.4
Trade balance, services	1.4	2.2	2.9	3.4	3.8	3.7
Financial account	11.2	13.4	10.0	6.7	5.7	9.4
Direct investment, net	3.4	8.6	4.5	3.2	2.9	5.5
Portfolio investment, net	2.0	-0.5	4.8	3.9	3.3	2.4
Other investment, net	5.8	5.4	0.7	-0.4	-0.5	1.5
External debt 2/	34.0	34.8	42.6	44.2	43.3	43.2
Public and publicly guaranteed	15.5	15.5	22.4	23.2	21.4	22.2
Private	19.6	19.3	20.1	21.0	21.9	21.0
Short-term external debt						
On a remaining maturity basis	18.7	16.1	14.9	14.1	13.6	14.9
On an original maturity basis	10.7	9.7	10.0	9.8	9.1	9.2
Of which:						
Trade credit	7.00	5.32	6.5	6.9	6.6	6.5
Currency and deposit	1.55	1.35	1.78	...	1.85	1.94
Debt service, in percent of exports of GNFS 3/	10.7	18.3	20.0	15.2	14.7	13.3
Amortization	8.2	15.1	16.2	11.5	10.7	9.0
Interest payment	3.0	3.2	3.7	3.7	4.0	4.3
Memorandum items:						
Nominal GDP (millions of U.S. dollars)	9,585	10,748	10,634	11,133	11,202	11,850
Exports of GNFS (yearly percent change)	24.1	-2.9	-16.4	22.3	24.5	5.9
Imports of GNFS (yearly percent change)	25.1	1.8	-15.9	8.9	9.1	7.6

Sources: Lithuanian authorities; and Fund staff estimates and projections.

1/ Including valuation changes. Gross official reserves reported here differ from the monetary survey because reverse repos involving major currencies in both legs are included.

2/ External liabilities minus equity investment.

3/ Debt service comprises interest and gross repayment on external loans, and interest and net repayment on debt securities.

Table 4. Lithuania: Summary Monetary Accounts, 1998-2001

	1998	1999	2000				2001	
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec. Prog. Act.	Dec. Proj.	
(In millions of litai, unless otherwise indicated)								
Monetary Authority								
Net Foreign Assets	4,836	4,054	4,292	4,722	4,538	4,385	4,607	5,947
Net Domestic Assets	-575	35	-596	-979	-763	-676	-643	-1,974
Net credit to government	-947	-326	-951	-1,269	-1,015	-948	-804	-2,144
Credit to banks	52	30	29	28	23	24	24	24
Credit to private sector	7	6	6	6	6	6	6	6
Credit to nonbank financial institutions	7	20	20	20	20	20	0	20
Other items, net	305	305	300	237	203	222	120	120
Reserve Money	4,260	4,088	3,696	3,743	3,774	3,709	3,964	3,973
Currency outside the central bank	3,036	2,972	2,723	2,810	2,785	2,883	2,904	2,939
Currency outside banks	2,800	2,739	2,552	2,644	2,637	2,683	2,658	2,739
Cash in vaults of banks	236	233	170	167	149	200	246	200
Deposit money banks' deposits	1,212	1,109	965	923	978	818	1,048	1,022
Reserves in litai	868	445	508	477	516	413	621	607
Required reserves in foreign currency	344	436	457	445	462	397	416	415
Private and non monetary financial institutions	13	7	8	10	10	8	12	12
Monetary Survey								
Net Foreign Assets	4,292	3,656	4,494	4,906	5,202	4,674	5,368	6,327
Monetary authority	4,836	4,054	4,292	4,722	4,538	4,385	4,607	5,947
Banks and other banking institutions	-544	-398	202	184	665	289	761	380
Net Domestic Assets	4,035	5,316	4,391	4,429	4,652	5,149	5,087	4,852
Net claims on government 1/	-505	39	-598	-737	-145	-482	299	-810
Monetary authority	-947	-326	-951	-1,269	-1,015	-948	-804	-2,144
Banks and other banking institutions 2/	441	365	353	532	870	466	1,103	1,334
Credit to non financial public enterprises	352	437	508	476	485	470	575	608
Credit to private sector 2/	4,874	5,545	5,239	5,410	5,108	5,958	5,209	5,799
Credit to nonbank financial institutions	470	468	452	487	493	480	514	543
Other items, net	-1,155	-1,168	-1,206	-1,202	-1,289	-1,277	-1,512	-1,288
Broad Money	8,327	8,972	8,885	9,335	9,854	9,823	10,456	11,179
Currency outside banks	2,800	2,739	2,552	2,644	2,637	2,683	2,658	2,739
Deposits	5,527	6,233	6,333	6,691	7,218	7,140	7,797	8,440
In national currency	3,520	3,509	3,471	3,666	3,959	3,948	4,243	4,667
In foreign currency	2,007	2,725	2,862	3,025	3,259	3,192	3,554	3,773
Memorandum items:								
Reserve money (yearly percent change)	28.8	-4.0	-2.8	-6.5	-2.0	-9.3	-3.0	0.2
Broad money (yearly percent change)	14.5	7.7	9.1	5.8	11.8	9.5	16.5	6.9
Private sector credit (yearly percent change) 2/	16.9	13.8	0.0	-2.4	-8.8	7.5	-1.2	11.3
Money multiplier	2.0	2.2	2.4	2.5	2.6	2.6	2.6	2.8
Currency/deposits, in percent	50.7	43.9	40.3	39.5	36.5	37.6	34.1	32.5
Foreign currency deposits/ litai deposits, in percent	57.0	77.7	82.5	82.5	82.3	80.9	83.8	80.9
Velocity of broad money 3/	6.0	4.9	...	...	...	4.7	4.6	4.4
Gross official reserves, in US\$ mln. 4/	1,462	1,244	1,295	1,391	1,337	1,297	1,344	1,668
GDP, mln. LTL	42,990	42,535	...	...	...	44,530	44,808	47,400

Sources: Bank of Lithuania; and Fund staff estimates and projections.

1/ Excludes local government deposits; includes counterpart funds.

2/ December 2000 is adjusted for reclassification of LTL 270 million of DMB's claims on private sector to government lending funds, which were removed from balance sheets in July, 2000. If included, private sector credit would fall by 6.1 percent in 2000.

3/ Only annual average velocity is reported at year-end.

4/ Gross official reserves for historic data differ between Tables 1 and 3 because the exposure under reverse repos was not reflected either in foreign assets or liabilities at the time of the program design. For projections, assumption is that all reverse repo transactions are unwound.

Table 5. Lithuania: Schedule of Available Purchases Under the Stand-By Arrangement, 2000-2001

Amount of Purchase	Availability	Contingent On
SDR 51.5 million (35.5 percent of quota)	April 20, 2001	Completion of second review
SDR 10.3 million (7.1 percent of quota)	May 15, 2001	Observance of end-March 2001 performance criteria and completion of second review 1/

Source: Fund staff calculations.

1/ In addition to other clauses in the arrangement.

Table 6. Lithuania: Indicators of Financial Obligations to the Fund, 2001-2008

	2001	2002	2003	2004	2005	2006	2007	2008
	Projections							
<i>Obligations from existing drawings 1/</i>								
Debt Service to the Fund (in millions of SDRs)	34.1	36.9	35.3	27.2	20.5	11.0	4.4	0.0
Repurchases (in millions of SDRs)	26.7	31.1	31.1	24.6	19.0	10.4	4.3	0.0
Charges (in millions of SDRs)	7.4	5.8	4.2	2.6	1.5	0.6	0.1	0.0
In percent of exports GNFS	0.8	0.8	0.8	0.5	0.4	0.2	0.1	0.0
In percent of external debt service	6.1	5.2	4.8	4.1	3.1	1.6	0.6	0.0
In percent of gross official reserves	2.7	2.7	2.6	2.0	1.5	0.8	0.3	0.0
Exports GNFS, in millions of US\$	5,585	5,925	6,275	6,822	7,491	8,090	8,738	9,437
External debt service, in millions of US\$	745	936	987	895	889	960	1,037	1,120
Gross official reserves, in millions of US\$	1,668	1,836	1,815	1,811	1,800	1,944	2,100	2,267
US\$/SDR exchange rate	1.3	1.3	1.3	1.3	1.4	1.4	1.4	1.353
Quota, in millions of SDR	144	144	144	144	144	144	144	144
External debt, in millions of US\$	5,117	5,450	5,737	6,033	6,331	6,838	7,385	7,976
GDP, in millions of US\$	11,850	12,798	13,841	15,160	16,571	17,897	19,329	20,875
<i>Obligations from existing and prospective drawings 2/</i>								
Debt Service to the Fund (in millions of SDRs)	36.8	41.1	39.3	44.6	42.0	16.2	4.4	0.0
Repurchases (in millions of SDRs)	26.7	31.1	31.1	40.0	39.6	15.5	4.3	0.0
Charges (in millions of SDRs)	10.1	10.0	8.2	4.6	2.4	0.7	0.1	0.0
In percent of exports GNFS	0.9	0.9	0.8	0.9	0.8	0.3	0.1	0.0
In percent of external debt service	6.5	5.8	5.3	6.7	6.4	2.3	0.6	0.0
In percent of gross official reserves	2.9	3.0	2.9	3.3	3.2	1.1	0.3	0.0
<i>Memorandum items:</i>								
<i>Fund credit outstanding</i>								
<i>Without drawings under the stand-by arrangement</i>								
In millions of SDRs	120.3	89.2	58.1	33.5	14.5	4.1	0.0	0.0
In millions of US\$	159.1	118.7	77.8	45.1	19.6	5.6	0.0	0.0
In percent of quota	83.4	61.9	40.3	23.2	10.1	2.9	0.0	0.0
In percent of external debt	3.1	2.2	1.4	0.7	0.3	0.1	0.0	0.0
In percent of GDP	1.3	0.9	0.6	0.3	0.1	0.0	0.0	0.0
Exchange rate US\$/SDR	1.3	1.3	1.3	1.3	1.4	1.4	1.4	1.4
<i>With drawings under the stand-by arrangement</i>								
In millions of SDRs	161.5	130.4	99.3	59.3	19.7	4.2	0.0	0.0
In millions of US\$	213.5	173.5	132.9	79.8	26.7	5.7	0.0	0.0
In percent of quota	112.0	90.4	68.9	41.1	13.7	2.9	0.0	0.0
In percent of external debt	4.2	3.2	2.3	1.3	0.4	0.1	0.0	0.0
In percent of GDP	1.8	1.4	1.0	0.5	0.2	0.0	0.0	0.0

Sources: Lithuanian authorities, and Fund staff estimates and projections.

1/ Assuming no drawings under the stand-by arrangement.

2/ Assuming all drawings are made under the stand-by arrangement.

Table 7. Lithuania: Performance Criteria, Benchmarks and Indicative Targets Under Stand-By Arrangement, January 2000 - March 2001 1/

Variables and Periods	Performance Criteria/ Indicative Targets		Outcomes	
	Unadjusted	Adjusted		
I. Maintenance of exchange rate under currency board arrangement			Observed	
Duration of the stand-by arrangement				
II. Full foreign exchange cover for currency board liabilities (in percent of reserve money)				
Duration of the stand-by arrangement				
March 31, 2000	100	...	156	
June 30, 2000	100	...	165	
September 30, 2000	100	...	142	
December 31, 2000	100	...	136	
March 31, 2001	100	...	...
III. Minimum level for total reserve deposits of banks with the Bank of Lithuania, calculated as for the reserve maintenance period and expressed as a percentage of eligible commercial bank liabilities:				
Through October 13	8	...	Observed	
From October 14	6	...	Observed	
Through January 13	6	...	Observed	
Through February 13	6	...	Observed	
IV. No accumulation of external payments arrears by the Government	...	...	Observed
V. Ceilings on general government fiscal balance; 2/ 3/ cumulative from January 1, 2000 to:		(In millions of Litas)		
March 31, 2000	426	441	467	
June 30, 2000	746	791	708	
September 30, 2000	992	1069	905	
December 31, 2000	1475	1556	1244	
March 31, 2001	1746	...	...
Rebased, cumulative from January 1, 2001				
March 31, 2001	271	...	...
VI. Ceilings on general government net lending; 2/ cumulative from January 1, 2000 to:				
March 31, 2000	72	87	111	
June 30, 2000	58	103	118	
September 30, 2000	44	121	293 4/	
December 31, 2000	243	324	297	
March 31, 2001	262	...	...
Rebased, cumulative from January 1, 2001				
March 31, 2001	19	...	...
VII. Ceilings on stock of general government guarantees for domestic borrowing:				
December 31, 1999 (actual)	593	...	593	
March 31, 2000	547	...	565	
June 30, 2000	527	...	499	
September 30, 2000	487	...	451	
December 31, 2000	489	...	433	
March 31, 2001	489	...	...
VIII. Ceilings on stock of outstanding general government payment obligations:				
December 31, 1999 (actual)	590	...	593	
March 31, 2000	443	...	470	
June 30, 2000	295	...	443	
September 30, 2000	148	...	317	
December 31, 2000 5/	0	...	41	
March 31, 2001 5/	0	...	...
		(In millions of U.S. Dollars)		
IX. Floors on net foreign exchange coverage of the currency board arrangement:				
March 31, 2000	-127	...	-85	
June 30, 2000	-127	...	-69	
September 30, 2000	-127	...	-60	
December 31, 2000	-127	...	-36	
March 31, 2001	-127	...	...
X. Ceilings on contracted public and publicly guaranteed medium- and long-term external debt; cumulative from January 1, 2000, until:	All maturities	1-5 yr maturity	All maturities	1-5 yr maturity
March 31, 2000	359	288	282	261
June 30, 2000	429	308	300	277
September 30, 2000	594	327	528	357
December 31, 2000 6/	703	470	558	362
March 31, 2001 6/	996	670
XI. Ceilings on the outstanding stock of external government debt with maturity of less than one year: 7/ duration of the standby arrangement	0		0	

Sources: Lithuanian authorities; and Fund staff estimates and projections.

1/ Initial targets for end-March, end-June and end-September, and revised targets for end-December and end-March under items III, V, VII, VIII, IX, X and XI are performance criteria, and item VI is a benchmark.

2/ Ceilings will be increased by the amounts that actual on-lending of already committed project loans from IFIs exceed the programmed amounts (with a maximum adjustment of LTL 193 million based on a quarterly project-by-project list for 2000).

3/ The end-March ceilings will be increased by the amount that the actual investment projects included in the attached quarterly list exceeds the program target of LTL 27 million for end-March

(with a maximum adjustment of LTL 27 million on a project-by-project basis for end-March.

4/ Of which: not initially budgeted defaults LTL 146 million.

5/ Applies to the central government.

6/ The term debt has the meaning set forth in point No.9 of the Guidelines on Performance criteria with Respect to Foreign Debt, adopted August 24, 2000.

7/ Excluding import-related credits and short-term credit lines of municipalities with resident banks.

Table 8. Lithuania: Structural Benchmarks Under Stand-By Arrangement

Action	Timing	Status
1. Take legal steps required for the establishment of Reserve Stabilization Fund	End-March, 2001	Draft amendment to the Privatization Law and draft regulation are with the Ministry of Justice
2. Present draft Organic Budget Law to Seimas	March 31, 2000	Adopted by Seimas at end July
3. Engage advisors for privatization of Lithuanian Power Company	April 1, 2000	Done
4. Bring Agricultural Bank to the point of sale	April 30, 2000	Done
5. Bring Savings Bank to the point of sale	September 30, 2000	Done
6. Abolish all remaining export taxes	January 1, 2001	Done
7. Reverse the temporary anti-crisis measures provided for in Government Resolution No. 1122, 1998	November 1, 2000	Done
8. Bring an electricity distribution company to the point of sale	March 31, 2001	To be delayed to the second half of 2001

Table 9. Lithuania: Indicators of External and Financial Vulnerability, 1998-2001

	1998	1999					2000			Latest	Date
		Mar.	Jun.	Sep.	Dec.	Year	Mar.	Jun.	Sep.		
Financial indicators											
State debt (domestic and foreign, in percent of GDP) 1/	22.4	24.4	25.1	25.3	28.4	28.4	30.5	29.1	28.6	28.6	Q3/2000
Broad money (year-on-year change in percent)	14.5	14.0	16.5	14.5	7.7	7.7	9.1	5.8	11.8	16.5	12/31/00
Broad money in percent of gross official reserves	142.6	138.8	164.5	170.8	180.6	180.6	160.7	163.8	182.7	192.8	12/31/00
Private sector credit (year-on-year change in percent) 2/	16.9	17.0	17.5	16.8	13.8	13.8	0.0	-2.4	-8.8	-6.1	12/31/00
External indicators											
Current account balance in percent of GDP	-12.1	-8.0	-13.6	-8.7	-14.2	-11.2	-2.8	-5.6	-3.5	-3.5	Q3/2000
Exports of GNFS (year-on-year change in percent)	-2.9	-23.4	-22.0	-12.6	-6.2	-16.4	29.0	19.7	24.6	24.6	Q3/2000
Imports of GNFS (year-on-year change in percent)	1.8	-23.6	-15.1	-18.7	-6.4	-15.9	16.5	1.8	10.7	10.7	Q3/2000
Capital and financial account balance in percent of GDP	13.4	10.6	7.6	7.4	14.4	9.9	7.0	5.8	2.1	2.1	Q3/2000
Gross official reserves (in millions of U.S. dollars) 3/	1,460	1,467	1,342	1,290	1,242	1,242	1,382	1,424	1,349	1,356	12/31/00
Gross official reserves/short-term debt 4/	0.84	0.91	0.87	0.78	0.79	0.79	0.80	0.80	0.89	0.89	Q3/2000
Gross official reserves/short-term debt corrected for current account deficit net of FDI	0.69	0.86	0.76	0.71	0.67	0.54	0.78	0.91	0.89	0.89	Q3/2000
Gross official reserves/reserve money	1.37	1.54	1.34	1.34	1.22	1.22	1.50	1.52	1.43	1.37	12/31/00
Gross official reserves in months of imports of GNFS over the following year	3.3	3.2	2.9	2.7	2.6	2.6	2.7	2.8	2.6	2.6	12/31/00
Net foreign assets of financial sector (in millions of U.S. dollars) 5/	-120	-91	-125	-145	-79	-79	69	66	163	187	12/31/00
Total external debt (in millions of U.S. dollars) 6/	3,739	3,833	3,869	4,036	4,525	4,525	4,741	4,845	4,668	4,668	Q3/2000
in percent of GDP	34.8	35.7	35.8	37.7	42.6	42.6	43.9	44.7	42.5	42.5	Q3/2000
in percent of exports GNFS (over the last four quarters)	73.7	80.4	86.5	93.7	106.8	106.8	104.8	98.6	93.2	93.2	Q3/2000
of which: Public sector debt (in millions of U.S. dollars)	1,670	1,881	1,884	1,920	2,383	2,383	2,552	2,527	2,364	2,364	Q3/2000
in percent of GDP	15.5	17.5	17.4	17.9	22.4	22.4	23.6	23.3	21.5	21.5	Q3/2000
of which: Short-term external debt (in millions of U.S. dollars) 4/	1,730	1,618	1,543	1,660	1,581	1,581	1,719	1,779	1,522	1,522	Q3/2000
in percent of gross international reserves	118.5	110.3	115.0	128.7	127.3	127.3	124.4	124.9	112.9	112.9	Q3/2000
in percent of GDP	16.1	15.1	14.3	15.5	14.9	14.9	15.9	16.4	13.9	13.9	Q3/2000
External interest payments in percent of exports GNFS	3.2	4.1	3.5	3.8	3.6	3.7	4.9	4.0	4.0	4.0	Q3/2000
External amortization payments in percent of exports GNFS	15.1	15.7	17.1	16.9	15.1	16.2	6.0	10.3	17.6	17.6	Q3/2000
Debt service as percent of tax revenue	29.1	26.1	26.6	27.8	24.0	26.1	24.4	22.1	37.9	17.9	Q4/2000
Debt service as percent of exports of GNFS	18.3	19.8	20.6	20.7	18.7	20.0	14.0	14.3	21.6	21.6	Q3/2000
Real effective exchange rate (year-on-year change in percent, "+" = appreciation) 7/	9.6	13.6	14.2	6.3	4.2	4.2	3.3	3.2	9.0	6.2	12/31/00
Financial market indicators											
Stock market index, end of period 8/	1,089	1,067	1,014	1,079	1,089	1,089	1,137	1,046	1,036	1,105	1/30/01
Market capitalization (listed shares, percent of GDP)	10.0	10.7	10.0	10.6	10.7	10.7	10.3	14.4	14.1	14.1	Q3/2000
Foreign currency debt rating 9/	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	12/1/00
Spread of benchmark bonds (basis points, end of period) 10/	331	279	227	239	210	239	229	194	210	240	3/19/01
Memorandum items:											
GDP (in millions of U.S. dollars)	10,748	2,333	2,772	2,850	2,679	10,634	2,499	2,805	3,007	3,007	Q3/2000
Nominal exchange rate (litai/U.S. dollar, end-of-period)	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	Q4/2000
Nominal exchange rate (litai/euro, end-of-period)	...	4.3	4.1	4.3	4.0	4.0	3.8	3.8	3.5	3.7	Q4/2000

Sources: Bank of Lithuania, Ministry of Finance, Department of Statistics, National Stock Exchange of Lithuania, Bloomberg, Baltic News Service, and Information Notice System.

1/ Public and publicly guaranteed debt.

2/ Includes reduction of claims on private sector of LTL270 million in July, 2000.

3/ Gross official reserves reported here differ from the monetary survey because here reverse repos involving major currencies in both legs are included.

4/ On a remaining maturity basis.

5/ Deposit money banks.

6/ External liabilities minus equity investment in Lithuania.

7/ CPI-based REER against the 21 major trading partners in 1999.

8/ LITIN-G price index, calculated for all issues that have been quoted in the current trading list in the past three months, excluding treasury bills and shares of investment companies.

9/ S&P investment grade rating.

10/ Monthly average spread of 5-year Eurobond (US\$200 million) issued in July 1997 above the rate on U.S. treasury bills maturing July 31, 2002.

Table 10. Lithuania: Indicators of Financial Sector Vulnerability, 1997-2000
(In percent, unless otherwise indicated)

	1997	1998	1999				2000			
			Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Private sector credit (percentage change, year-on-year) 1/	18.9	16.9	17.0	17.5	16.8	13.8	0.0	-2.4	-8.8	-1.2
Share of loans to enterprises in total lending	...	...	-8.6	5.8	5.4	6.0	5.7	6.1	4.6	7.4
Commercial bank reserves (in percent of deposits) 2/	15.7	26.2	20.5	17.9	18.2	21.5	17.9	16.3	15.6	14.5
Cash	4.0	4.3	3.8	3.4	3.1	3.7	2.7	2.5	2.1	3.1
Reserves held at the BOL	11.6	21.9	16.6	14.5	15.1	17.8	15.2	13.8	13.6	13.3
<i>Of which: Excess reserves (in percent of total reserves)</i>	29.3	40.1	24.8	12.0	17.0	30.2	14.3	14.6	14.5	28.4
Official risk indicators 3/										
Share of non-performing loans in total loans 4/	28.3	12.9	12.2	10.9	9.1	12.5	15.1	16.5	14.0	11.2
Risk-weighted capital asset ratio (capital over risk-weighted assets) 5/	10.8	23.8	22.7	22.6	22.1	17.4	18.0	16.4	16.7	16.4
Leverage ratio 6/	5.9	14.9	14.8	15.2	14.7	11.1	11.1	10.3	10.4	10.3
Share of private sector credit collateralized by real estate	12.9	12.0	11.5	11.2	11.3	10.3	10.7	10.5	9.3	9.7
Financial sector risk factors of DMB's										
Share of foreign currency loans in total lending	39.7	55.9	57.5	59.3	58.7	61.6	63.7	64.1	66.9	66.8
Share of foreign currency deposits in total deposits	38.9	41.9	41.1	43.2	46.4	48.8	48.9	48.4	48.0	49.5
Short-term loans in percent of total loans	61.1	45.9	44.7	42.7	43.4	41.0	42.2	39.7	37.6	37.9
Demand deposits in percent of total deposits	66.8	62.3	58.2	55.1	51.8	51.4	50.0	49.1	49.9	48.9
Open position in foreign exchange 7/ 8/	...	...	...	...	-3.3	6.0	12.4	7.9	4.4	3.8

Sources: Bank of Lithuania and National Stock Exchange of Lithuania.

1/ End-year private sector credit growth excludes reclassified loans of LTL 270 million, which were removed from banks' books in July, 2000. If this amount is included, private sector credit falls by 6.1 percent in December, 2000.

2/ Excludes central government deposits.

3/ Prudential standards are broadly at international levels, and there is a full program of on-site and off-site supervision. Foreign bank branches are not included.

4/ Includes loans overdue for 31 days. The classification of loans may be adjusted according to the borrower's standing, loan restructuring and refinancing

(Resolution on the Board of the Bank of Lithuania on the Approval of the Regulations for Classification of Doubtful Assets, April 24, 1997 No. 87).

5/ The compilation of the minimum capital adequacy ratio was aligned with the Basle methodology on January 1, 1997.

6/ Defined as the ratio of total capital to total liabilities.

7/ Open position includes off-balance exposure.

8/ Maximum open position requirements have been reduced as of June 1, 2000. Maximum in foreign currency and precious metals is 25 percent of a bank's capital, while earlier it was 30 percent. Maximum in each currency is 15 percent, while earlier it was 20 percent.

FUND RELATIONS
(As of February 28, 2001)

- I. **Membership Status:** Joined: 04/29/1992; Article VIII.
- II. **General Resources Account:**
- | | SDR Million | Percent of Quota |
|---------------------------|-------------|------------------|
| Quota | 144.20 | 100.0 |
| Fund holdings of currency | 288.66 | 200.2 |
| Reserve position in Fund | 0.02 | 0.0 |
- III. **SDR Department:**
- | | SDR Million | Percent of Allocation |
|----------|-------------|-----------------------|
| Holdings | 0.57 | N.A. |
- IV. **Outstanding Purchases and Loans:**
- | | SDR Million | Percent of Quota |
|-------------------------|-------------|------------------|
| Extended arrangements | 116.44 | 80.7 |
| Systemic Transformation | 28.03 | 19.4 |
- V. **Latest Financial Arrangements:**
- | Type | Approval Date | Expiration Date | Amount Approved (SDR Million) | Amount Drawn (SDR Million) |
|----------|---------------|-----------------|-------------------------------|----------------------------|
| Stand-by | 03/08/2000 | 06/07/2001 | 61.80 | 0.00 |
| EFF | 10/24/1994 | 10/23/1997 | 134.55 | 134.55 |
| Stand-by | 10/22/1993 | 10/24/1994 | 25.88 | 5.18 |
- VI. **Projected Obligations to Fund:** (SDR Million; based on existing use of resources and present holdings of SDRs):
- | | Overdue | Forthcoming | | | | |
|------------------|------------|-------------|------------|------------|------------|------------|
| | 02/28/2001 | 2001 | 2002 | 2003 | 2004 | 2005 |
| Principal | | 24.2 | 31.1 | 31.1 | 24.6 | 19.0 |
| Charges/Interest | | <u>5.3</u> | <u>5.7</u> | <u>4.1</u> | <u>2.6</u> | <u>1.4</u> |
| Total | | 29.5 | 36.8 | 35.2 | 27.2 | 20.4 |
- VII. **Exchange Arrangement:**
- The currency of Lithuania is the litas. Since April 1, 1994, the litas has been pegged to the U.S. dollar at LTL 4 per U.S. dollar under a currency board arrangement.
- VIII. **Resident Representative:**
- The resident representative of the Fund in Lithuania is Mr. Mark Horton, who took up his post in October 1999.
- IX. **Consultation Cycle:**
- Lithuania is on the 12-month consultation cycle.

LITHUANIA: TECHNICAL ASSISTANCE FROM THE FUND, 1997-2001

Department	Issue	Action	Date	Counterpart
FAD	Treasury operations	Mr. Ramachandran	Feb/Mar. 1997	Ministry of Finance
FAD	Treasury operations	Mr. Ramachandran	Jun. 1997	Ministry of Finance
FAD	Treasury operations	Mr. Ramachandran	Aug/Sep. 1997	Ministry of Finance
STA	Balance of payments statistics	Mr. Allen	Aug/Sep. 1997	Department of Statistics
FAD	Treasury operations	Mr. Ramachandran	Nov/Dec. 1997	Ministry of Finance
MAE	Monetary policy and banking supervision	Mission	Dec. 1997	Bank of Lithuania
STA	National accounts and balance of payments	Mr. Gschwindt de Gyor	Dec. 1997	Department of Statistics
FAD	Treasury operations	Mr. Ramachandran	Jan. and April 1998	Ministry of Finance
STA	Multipurpose statistics	Mr. Allen	Resident Advisor, 1997-98	Department of Statistics, Bank of Lithuania, and Ministry of Finance
STA	Balance of payments	Mr. Gschwindt de Gyor	April 1999	Department of Statistics and Bank of Lithuania
FAD	Expenditure policy	Mission	June/July 99	Ministry of Finance
FAD	Treasury operations	Mission	November 1999	Ministry of Finance
MAE	Monetary policy	Mr. Ketterer	Resident Advisor, May 1997-November 1999	Bank of Lithuania
STA	Balance of payments statistics (also covering Latvia)	Mr. Buxton	Resident Advisor, October 1999-October 2000	Bank of Lithuania
LEG	Bankruptcy legislation	Mr. Dimitrachkov	March 2000	Ministry of Economy
FAD	Establishment of Fiscal Reserve Fund	Mission	July 2000	State Privatization Fund
MAE	Multi-topic	Mission	March 2001	Bank of Lithuania

LITHUANIA: WORLD BANK RELATIONS

1. Since Lithuania joined the World Bank in 1992, the Bank's assistance to the country has concentrated on reforms in key areas such as preserving macroeconomic stabilization to build and maintain investor confidence, reducing government involvement in business activities, and enforcing the basic legal tenets necessary for private activity. Moreover, the Bank is assisting in reorienting the social safety net, public services, infrastructure, and the energy sector to the needs of a market economy.
2. The table below provides a summary of IBRD loans as of March 8, 2001. It includes 15 projects and SALs with commitments totaling US\$448.36 million equivalent and disbursements on all Bank projects in Lithuania amounting to US\$234.15 million and €54.88 million. A Structural Adjustment Loan II for the period July 1, 2000-June 30, 2001 in the amount of US\$98.5 million was approved in July 2000. Preparation of other operations is proceeding in the areas of infrastructure, education, and municipal services.
3. Projects approved by IFC amount to US\$104.5 million as of December 2000. The portfolio consists of the following projects: (i) modernization and expansion of a privatized, export-oriented wool mill (US\$11.6 million); (ii) modernization of a color picture tubes factory (US\$15 million); (iii and iv) construction of a margarine production plant (US\$1.025 million) and an asphalt production plant (US\$1.7 million) (both are sub-projects of a line of credit to support SMEs); (v) upgrading of fabric forming and finishing operations of a wool worsted fabric producer (US\$6.6 million); and (vi) subordinated loan to strengthen the capital basis of a bank (US\$20 million). The following projects have been approved by the Board: (i) modernization of production facility and financial restructuring of a plywood and particleboard manufacturer (US\$2.75 million);¹ and (ii) expansion, modernization and financial restructuring of a paperboard mill (US\$2 million).
4. Lithuania is a member of MIGA, which has so far not issued any guarantees, but has four applications pending. Government representatives have participated in MIGA-sponsored meetings on investment promotion, and Lithuania is an active user of MIGA's Internet-based information dissemination facilities. FIAS has completed a study of administrative barriers to investment.
5. The first World Bank Country Economic Memorandum was published in April 1993. A Public Expenditure Review was conducted in 1993/94 and was the basis for a donor meeting on public investments in May 1995. The Bank also has prepared an informal enterprise and financial sector study, a private sector assessment, a comprehensive energy sector review, a study of nuclear energy alternatives commissioned by the G-7, an agricultural review, a municipal finance study, a social insurance/social policy note, and an informal note on transport. In 1998, the Bank completed a multi-sectoral collection of policy notes, and a Country Assistance Strategy for 1999-2001, which were discussed by the Board on May 11, 1999. A Macro Financial Vulnerability Study was completed in 1999.

¹ Likely to be canceled.

World Bank Loans Approved by the Board
(As of March 8, 2001, in millions of U.S. dollars)

	Commitments	Disbursements
Rehabilitation Loan 1/ (effective October 1992)	60.0	58.8
SAL I (effective October 1996) 2/	80.0	80.0
Highway Project (effective September 1996) 3/	19.0	19.0
Power Rehabilitation and Restructuring (effective November 1995)	26.4	17.87
Environment (Klaipeda) (effective May 1995)	7.0	3.94
EFSAP (effective December 1995)	25.0	21.00
Environment (Siauliai) (effective December 1996)	6.2	5.99
Agricultural Development Project (effective August 1996)	30.0	7.98
Klaipeda Geothermal (effective October 1996)	5.9	4.41
Energy/Housing Pilot (effective November 1996)	10.0	8.18
Social Policy (effective January 1998)	3.7	2.22
Municipal Development (effective October 2000)	20.1	0.19 (€)
Health Project (effective May 2000)	21.2	0.91
SAL II (effective July 2000)	98.5	54.69 (€)
Klaipeda Port (effective October 2000)	35.36	3.85
Total	448.36	US\$234.15 €54.88

Source: The World Bank.

1/ Loan closed in December 1995; US\$1.2 million canceled.

2/ Loan closed in June 1998

3/ Loan closed in April 2000

**Survey of Reporting of Main Statistical Indicators
(As of March 12, 2001)**

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	Public External Debt
Date of latest observation	3/12/01	2/28/01	1/31/01	1/31/01	1/31/01	1/31/01	Jan. 2001	Dec. 2000	Q3 2000	Q4 2000	Q3 2000	Q4 2000
Date received	3/13/01	3/1/01	3/01	3/01	3/01	3/01	02/01/01	03/01/01	1/29/01	02/21/01	1/30/01	2/21/01
Frequency of data	D	M	M	M	M	M	M	M	Q	M	Q	M
Frequency of reporting	D	M	M	M	M	M	M	M	Q	M	Q	M
Source of data	C	A 1/	A 1/	A 1/	A 1/	A 1/, C	C	A 1/, C	A 1/ C	A 1/	A, N 1/	A
Mode of reporting	E	C,E	C,E	C,E	C,E	C,E	E	C,E	C,E	C	C	V
Confidentiality	C	C	C	B	C	C	C	C	C	C	C	C
Frequency of publication	D	M	M	M	M	M	M	M	Q	M	Q	M

1/ Through the resident representative office.

Notes:

Frequency of data: D-daily, W-weekly, M-Monthly, Q-Quarterly.

LITHUANIA—ILLUSTRATIVE MEDIUM-TERM FISCAL SCENARIO

1. The staff prepared a stylized macroeconomic scenario for 2001-5 with a focus on public finances. Table 11 shows the summary of major macroeconomic indicators, which reflect the staff's judgment on the impact of tax measures, changes in the composition of expenditure, and external developments on major GDP expenditure components. Tables 12 and 13 present the general government operations and balance of payments, respectively.

A. Medium-Term Framework

2. Real GDP growth is expected to accelerate from 3.6 percent in 2001 to 5-6 percent a year over the medium term. Growth would be underpinned primarily by the recovery of domestic demand and continued good export performance during 2002-3, and subsequently, EU accession would give an additional impetus to growth acceleration.

3. In 2002-03, internal demand would be stimulated by the ongoing cyclical recovery, structural reforms, changes to the tax system (see below), and strengthened investors' and consumers' confidence in the run-up to EU accession. Consumption and investment would be further boosted by EU accession, which is assumed to happen in this scenario in 2004. Moreover, the full impact of gradual tax reforms would bear fruits in terms of growth and employment after its completion in 2004 and beyond.

4. During 2001-5, wages are projected to increase by 3 to 4 percent in real terms and unemployment is projected to decline, as a result of the strengthening of the recovery and, to some extent, the projected reduction in labor taxation. These labor market developments would contribute to the strengthening of the tax bases for the payroll and personal income taxes. Inflation would remain around 2-3 percent, reflecting faster productivity growth than in trading partners.

5. Gross national saving would increase from 14.9 percent of GDP in 2001 to 16.6 percent of GDP in 2005, owing to cyclical factors, a reduction in the taxation of capital, and rising wages, whose growth was negative in real terms in 1999-2000. A drop of public saving in 2003 would reflect the projected reduction in payroll tax revenue due to the pension reform. This decline would be offset by an increase in private saving, as a large portion of consumers are likely to be myopic and liquidity constrained, implying that they would have a relatively stable marginal propensity to save outside the pension system irrespective of policy change at least in the medium term.

6. Over the medium term, a sustained growth path is projected for the period of 2002-03 for both exports and imports, with the former growing at a slightly faster pace, leading to a steady shrinking of the current account deficit. Export growth would be driven by a further penetration to EU markets and a continued expansion of services. The EU accession would have a major impact on the current account. Lithuania is projected to receive net transfers in the amount of about LTL 900 per annum (1¼ percent of GDP) from 2004 onwards, and consequently, imports would increase significantly on account of a pick-up in EU-related

investment. As the stage of large-scale privatization comes to an end after 2001, privatization-related FDI inflows would start to diminish. FDI inflows over the medium term are projected to be maintained at a stable albeit lower level, as non-privatization related FDI inflows would increase, owing to an improved business environment, sustained economic growth, and EU accession (Box 2). Portfolio and other investment inflows, which would be underpinned by full access to international capital market by the private sector, as well as the government, are projected to grow steadily. Overall external debt would decline gradually in terms of GDP, with the private sector overtaking the public sector as the major borrower. Official reserves would reflect the projected development of money demand and government deposits, including the RSF, at the Central Bank.

B. Fiscal Policy

7. The pace of the tax reform is adjusted in light of the feasible path of expenditure consolidation and its re-orientation toward EU accession, and the need to continue a gradual adjustment of the fiscal deficit. It is projected that the cyclically adjusted fiscal deficit, excluding the cost of the pension reform,¹ would be gradually eliminated by the time of EU accession. At the same time, expenditure would stay at around 31-32 percent of GDP to meet various government's expenditure obligations,² relating to EU and NATO accession,^{3,4} the

¹ It is assumed that the cost of the pension reform would be 1 percent of GDP and would be financed by privatization proceeds during 2003-5.

² Assumptions on expenditure do not include cash payments for savings or land restitution of which the combined amount is around LTL 5 billion (10.5 percent of 2001 GDP), as they could not be afforded in this framework. Some noncash compensations could take place or small payments could be made over a long period if other expenditures were cut.

³ The cost of EU accession is reflected in cofinancing for investment and other projects (around 0.3 percent of GDP, depending on the implementation rate) under the three programs—SAPARD, ISPA, and PHARE—under the relevant expenditure categories and guaranteed borrowing for 2001-3. EU grants which are allocated under the above mentioned programs have an upper limit of around €130 million in 1999 prices (1.1 percent of GDP), and the actual amount of grants depends on the available amount of cofinancing. The financing of government's commitments under the Acquis Communautaire during the post accession period would be facilitated by membership grants from the EU. This scenario draws on the preliminary quantification of Lithuania's contributions to the EU and prospective grants for 2003-4, which is presented in a joint study of independent experts financed by the EU and the Ministry of Finance ("Support for Policy Impact Analysis/Budgetary Impact").

⁴ The cost of NATO accession is incorporated in the binding floor on defense expenditure of 2 percent of GDP.

pension reform, and the binding floor for expenditure on education of 7 percent of GDP. Given all these considerations, the proposed tax reform would be basically revenue neutral, provided EU grants are included as revenue and the impact of a diversion of 1 percent of GDP of the payroll tax to the mandatory privately funded pension scheme is excluded.

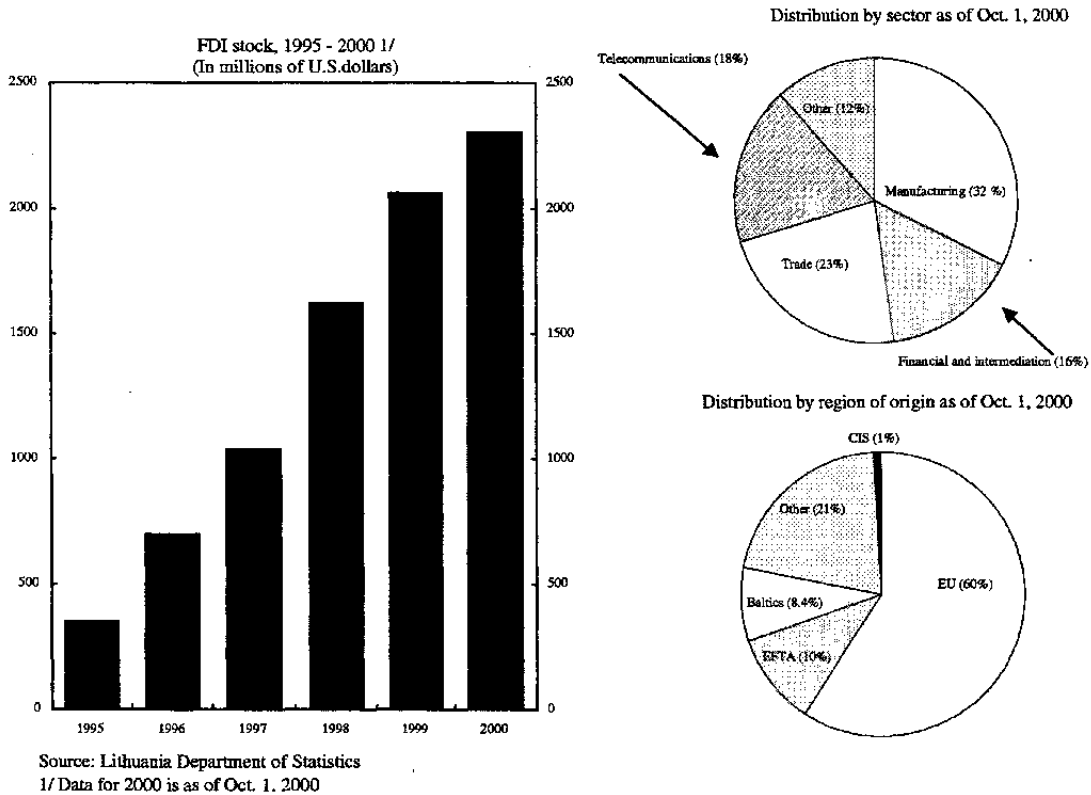
8. A number of tax measures are recommended to be implemented in a gradual manner,⁵ because of uncertainties related to the impact of tax measures, expenditure restructuring, and pension reform on the consumption/saving behavior of households and investment decisions of corporations, as well as growth. These uncertainties would possibly imply wide margins of error in the projections of tax bases. A gradualist approach would leave the government enough flexibility to react to unexpected developments and adapt policies if needed.

⁵ All CIT exemptions and deductions would be abolished and the rate would be reduced from 24 percent to 15 in 2002, 10 in 2003, 5 in 2004, and 0 in 2005. Excises on cigarettes, selected petroleum products, and beer would be gradually increased. Excises on remaining nonexcisable goods in the EU would be abolished in 2002. Special levies on previously excisable goods would be introduced in 2002. VAT exemptions would be abolished and selected reduced rates would be increased to 18 percent in 2004. The personal income tax rate would be decreased to 32 percent in 2002, 30 percent in 2003, 27 in 2004, and 24 from 2005 onwards. The tax exempt minimum would be gradually increased. The taxation of author's rights would be revised. The gross sale tax, financing the road fund, would be abolished in 2003. A car property tax would be introduced in 2004, generating 0.1 percent of GDP. Taxes on pollution would be increased in 2004.

Box 2. Foreign Direct Investment in Lithuania

Foreign direct investment in Lithuania has accelerated since 1995 when the second phase of privatization was started, which involved the sale of large state-owned enterprises. As of end-October 2000, about 60 percent of the cumulative FDI inflows originated from the EU countries and close to 20 percent from the other two Baltic states and EFTA countries. FDI has concentrated primarily in four economic sectors—manufacturing, wholesale and retail trade, post and telecommunications, and financial intermediation.

Lithuania: Cumulative FDI



The near-term outlook for FDI in Lithuania appears to be quite positive on account of a number of factors such as privatization projects in the pipeline, existing foreign investors' expansion plans and an increased likelihood of early EU accession. Currently, there are almost 3,000 entities on the privatization list owned by the state, whose book value amounts to LTL 2.8 billion. Also on the list are share-holdings in more than 200 enterprises controlled by the state, with the nominal value of the shares owned by the state amounting to LTL 2.0 billion. In addition, there are about 500 real estate entities on the list. While it remains unclear how many firms on the list will be eventually bought by foreign investors, it is certain that several large state-owned enterprises that are to be privatized in the next 1-2 years should attract a large amount of FDI, including Lithuanian Gas, Lithuanian Power, Agricultural Bank, the Savings Bank, Lithuanian Shipping Company, Lithuanian Airlines, and Lithuanian Railways.

Representatives from several large existing foreign investors expressed satisfaction with their experience in Lithuania and indicated plans to expand their operation in the near future.

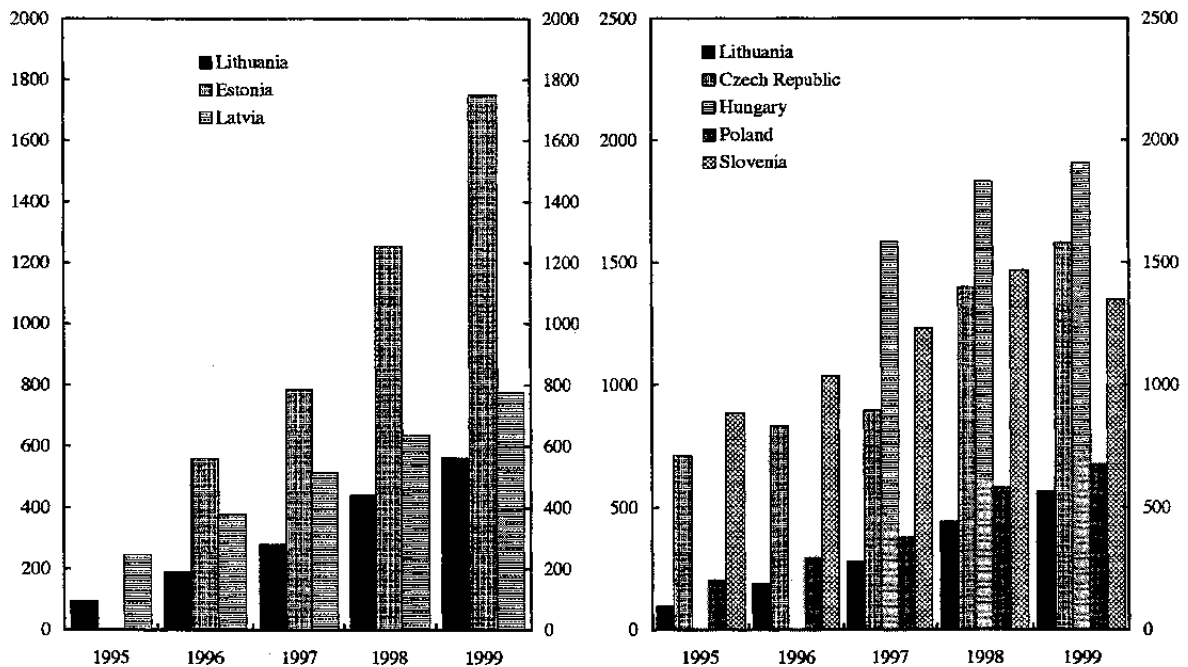
The prospect of an early EU accession will speed up the harmonization of Lithuania's legal, tax, and customs systems with EU directives, and also contribute to attracting more FDI, as investing in Lithuania becomes an integral part of foreign investors' EU-wide business development strategies.

Box 2. Foreign Direct Investment in Lithuania (continued)

Cross-country comparisons show that the amount of FDI inflows in Lithuania has yet to reach its full potential, despite the recent significant increase. According to the results of a survey presented by The Wall Street Journal Europe's Central European Economic Review (CEER) in December 1999, among the 27 Central European countries, Lithuania ranked seventh overall as to the preferred country to invest after Hungary, Slovenia, Poland, Czech Republic, Estonia and Latvia. Lithuania's ranking is relatively high, but its per capita FDI is well below the front runners (see chart below). Lithuania registered the lowest level of per capita FDI stock in the Baltic region, which, by end-1999, was only about one-third of the level of Estonia, two-thirds of the level of Latvia, and well below the levels registered by the Czech Republic, Hungary, and Slovenia in 1997. These numbers show that there is a considerable scope for an increase in FDI in Lithuania, if favorable conditions are created.

The main challenge facing Lithuania is to continue to attract a high level of FDI in the medium term, particularly in greenfield projects not directly related to the privatization process. Maintaining macroeconomic stability and deepening structural reforms remain essential to meet this challenge. Prudent macroeconomic policies help maintain a stable economic and financial environment that is conducive to attracting FDI. While the recently proposed amendment to the Constitution to allow foreigners to buy farmland was well received by the foreign investor community, the authorities should continue to carry out structural reforms in order to establish a more business-friendly regulatory framework. In this regard, more concrete measures and coordinated efforts by various government agencies are needed to address systematically the administration barriers to investment in Lithuania, especially those identified in the 1999 Foreign Investment Advisory Service (FIAS) Report by the World Bank.

Cumulative per capita FDI by country as of end-1999
(In U.S. dollars)



Source: EDSS

Table 11. Lithuania: Macroeconomic Framework, 1998-2005

	1998	1999	2000	2001	2002	2003	2004	2005
			Est.			Proj.		
(In percent of GDP, unless otherwise indicated)								
Gross national saving	12.3	11.7	15.1	14.9	15.1	15.4	16.2	16.6
General government	-0.7	-4.0	-0.5	0.5	0.6	-0.1	0.9	0.9
Non-government	13.0	15.7	15.7	14.5	14.5	15.6	15.3	15.7
Gross national investment	24.4	22.9	20.5	21.4	21.5	21.6	21.9	22.2
Foreign saving 1/	12.1	11.2	5.4	6.5	6.4	6.2	5.7	5.5
General government financial balance 2/	-4.4	-6.2	-2.1	-1.3	-1.3	-1.8	-1.2	-1.1
General government net lending	1.5	2.4	0.7	0.1	0.0	0.0	0.0	0.0
Consolidated general government fiscal balance 2/	-5.9	-8.5	-2.8	-1.4	-1.3	-1.8	-1.2	-1.1
Current account balance	-12.1	-11.2	-5.4	-6.5	-6.4	-6.2	-5.7	-5.5
External debt 3/	34.8	42.6	43.3	43.2	42.6	41.5	39.8	38.2
Debt service (in percent of exports of GNFS)	18.3	20.0	14.7	13.3	15.8	15.7	13.1	11.9
Nominal GDP (in millions of Litai)	42,990	42,535	44,808	47,400	51,191	55,363	60,640	66,285
Real GDP growth (annual percentage change)	5.1	-4.2	2.7	3.6	4.6	5.2	5.5	6.0
Average CPI inflation (annual percentage change)	5.1	0.8	1.0 4/	1.0	2.8	3.0	3.0	3.0
End-of-period CPI inflation (annual percentage change)	2.4	0.3	1.5 4/	1.9	3.0	3.0	3.0	3.0

Sources: Lithuanian authorities; and Fund staff estimates and projections.

1/ Negative current account balance.

2/ Includes discrepancy between above and below the line estimates of the financial balance and balances of budgetary organizations not recorded in the above the line number. Also includes savings restitution payments in 1998-99.

3/ External liabilities minus equity investment in Lithuania. Includes public, publicly guaranteed and private external debt.

4/ Actual data.

Table 12. Lithuania: Summary of Consolidated General Government Operations, 1998-2005

	1998	1999 Prel.	2000		2001 Budget 1/	2002	2003	2004	2005
			Prog.	Est.					
(In millions of Lita)									
Revenue and grants	14,036	13,687	13,643	13,532	14,525	15,613	15,832	18,922	20,061
Grants	0	0	0	0	0	0	0	1,685	1,742
Revenue	14,036	13,687	13,643	13,532	14,525	15,613	15,832	17,237	18,319
Tax revenue	13,433	12,955	12,980	12,829	13,553	14,564	14,714	16,055	17,069
Taxes on income and profits	4,017	3,971	3,885	3,836	4,009	4,218	4,248	3,897	3,764
Payroll tax (social security tax)	3,063	2,891	3,262	3,194	3,333	3,607	3,395	3,698	4,084
Taxes on goods and services	5,596	5,385	5,173	5,141	5,582	5,974	6,174	6,949	7,605
Other tax revenue	756	709	660	657	630	766	897	1,510	1,616
Non tax Revenue	603	732	663	703	972	1,049	1,117	1,182	1,250
Expenditure and net lending	16,362	17,351	15,209	14,777	15,204	16,262	16,839	19,671	20,808
Expenditure	15,734	16,345	14,965	14,478	15,141	16,262	16,839	19,671	20,808
Current expenditure	14,326	15,389	14,065	13,763	14,311	15,310	15,912	18,392	19,471
Wages and salaries, excl. contributions to SoDra	3,290	3,513	3,471	3,450	3,498	3,602	3,710	3,949	4,205
Goods and services	4,899	4,624	4,154	4,012	4,341	4,861	4,995	5,882	6,206
Transfers to EU	0	0	0	0	0	0	0	675	736
Transfers to households	4,977	5,244	5,493	5,401	5,502	5,875	6,226	6,581	6,981
Subsidies	202	150	137	103	100	103	106	446	461
Interest payments 2/	507	650	800	782	845	845	850	833	856
Savings restitution program	450	1,207	10	15	25	25	25	25	25
Capital expenditure	1,408	956	900	715	830	952	928	1,279	1,337
Discrepancy	190	-29	-91	-1	0	0	0	0	0
Financial balance	-1,888	-2,629	-1,231	-944	-616	-649	-1,008	-749	-746
Net lending 3/	628	1,006	244	300	63	0	0	0	0
Lending	1,017	1,381	475	529	353	300	300	300	300
of which: Mazeikiiai Oil Company	240	800	88	88	0	0	0	0	0
Repayments	389	-375	-231	-230	-290	-300	-300	-300	-300
Fiscal balance (deficit (-)) 3/	-2,516	-3,635	-1,475	-1,244	-679	-649	-1,008	-749	-746
Fiscal balance, excluding the cost of pension reform	-2,516	-3,635	-1,475	-1,244	-679	-649	-454	-143	-84
Financing	2,516	3,635	1,475	1,244	679	649	1,008	749	746
Net domestic	-286	392	-164	-225	-1,089	-51	808	649	721
Bank financing	-666	326	-520	-422	-1,108	-151	708	549	621
Monetary Authorities	-635	602	-622	-480	-1,339	-533	306	385	448
Commercial Banks	-31	-276	102	58	231	383	401	164	174
Non-bank financing	380	66	357	197	19	100	100	100	100
Net foreign	535	2,762	739	665	467	0	0	0	0
Privatization proceeds	2,267	481	900	803	1,300	700	200	100	25
(In percent of GDP)									
Revenue and grants	32.7	32.2	30.6	30.2	30.8	30.5	28.6	31.2	30.3
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.8	2.6
Revenue	32.7	32.2	30.6	30.2	30.8	30.5	28.6	28.4	27.6
Tax revenue	31.2	30.5	29.1	28.6	28.8	28.5	26.6	26.5	25.8
Taxes on income and profits	9.3	9.3	8.7	8.6	8.5	8.2	7.7	6.4	5.7
Payroll tax (social security tax)	7.1	6.8	7.3	7.1	7.1	7.0	6.1	6.1	6.2
Taxes on goods and services	13.0	12.7	11.6	11.5	11.8	11.7	11.2	11.5	11.5
Other tax revenue	1.8	1.7	1.5	1.5	1.3	1.5	1.6	2.5	2.4
Non tax Revenue	1.4	1.7	1.5	1.6	2.1	2.0	2.0	1.9	1.9
Expenditure and net lending	38.1	40.8	34.2	33.0	32.3	31.8	30.4	32.4	31.4
Expenditure	36.6	38.4	33.6	32.3	32.1	31.8	30.4	32.4	31.4
Current expenditure	33.3	36.2	31.6	30.7	30.4	29.9	28.7	30.3	29.4
Wages and salaries, excl. contributions to SoDra	7.7	8.3	7.8	7.7	7.4	7.0	6.7	6.5	6.3
Goods and services	11.4	10.9	9.3	9.0	9.2	9.5	9.0	9.7	9.4
Transfers to EU	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.1	1.1
Transfers to households	11.6	12.3	12.3	12.1	11.7	11.5	11.2	10.9	10.5
Subsidies	0.5	0.4	0.3	0.2	0.2	0.2	0.2	0.7	0.7
Interest payments 2/	1.2	1.5	1.8	1.7	1.8	1.7	1.5	1.4	1.3
Savings restitution program	1.0	2.8	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Capital expenditure	3.3	2.2	2.0	1.6	1.8	1.9	1.7	2.1	2.0
Discrepancy	0.4	-0.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financial balance	-4.4	-6.2	-2.8	-2.1	-1.3	-1.3	-1.8	-1.2	-1.1
Net lending 3/	1.5	2.4	0.5	0.7	0.1	0.0	0.0	0.0	0.0
Lending	2.4	3.2	1.1	1.2	0.7	0.6	0.5	0.5	0.5
of which: Mazeikiiai Oil Company	0.6	1.9	0.2	0.2	0.0	0.0	0.0	0.0	0.0
Repayments	0.9	-0.9	-0.5	-0.5	-0.6	-0.6	-0.5	-0.5	-0.5
Fiscal balance (deficit (-)) 3/	-5.9	-8.5	-3.3	-2.8	-1.4	-1.3	-1.8	-1.2	-1.1
Fiscal balance, excluding the cost of pension reform	-5.9	-8.5	-3.3	-2.8	-1.4	-1.3	-0.8	-0.2	-0.1
Financing	5.9	8.5	3.3	2.8	1.4	1.3	1.8	1.2	1.1
Net domestic	-0.7	0.9	-0.4	-0.5	-2.3	-0.1	1.5	1.1	1.1
Bank financing	-1.5	0.8	-1.2	-0.9	-2.3	-0.3	1.3	0.9	0.9
Non-bank financing	0.9	0.2	0.8	0.4	0.0	0.2	0.2	0.2	0.2
Net foreign	1.2	6.5	1.7	1.5	1.0	0.0	0.0	0.0	0.0
Privatization proceeds	5.3	1.1	2.0	1.8	2.8	1.4	0.4	0.2	0.0
Memorandum Items:									
Public and publicly guaranteed debt, mln. LTL	9,614	12,069	12,855	12,651	14,036	14,690	15,421	16,869	17,843
In percent of GDP	22.4	28.4	28.9	28.2	29.8	28.7	27.9	27.8	26.9
Public and publicly guaranteed net debt, mln. LTL	7,629	10,694	10,941	10,812	11,030	11,151	12,189	14,021	15,443
In percent of GDP	17.7	25.1	25	24.1	23.4	21.8	22.0	23.1	23.3
GDP, in mln. LTL 4/	42,990	42,535	44,530	44,808	47,135	51,191	55,363	60,640	66,285

Sources: Ministry of Finance, Ministry of Social Security, and Fund staff estimates and projections.

1/ Revenue and expenditure numbers reported in EBS/00/286 were adjusted to reflect the incorporation in the general government budget of fees paid to educational establishments and their spending (LTL 128 million).

2/ Interest payments do not include provisioning of defaults, which are reflected under "net lending".

3/ Program numbers for 2000 are reported without the program adjuster to net lending and deficit for higher-than-expected project lending. The adjuster for 2000 is LTL 81 million. The budgeted amount of provisioning of defaults of LTL 102 million is included for the program numbers and estimates for 2000.

4/ Budget GDP for 2001.

Table 13. Lithuania: Medium-term Balance of Payments, 1998-2005

	1998	1999	2000		2001	2002	2003	2004	2005
			Prog.	Est.					
(In millions of U.S. dollars)									
Current account	-1,298	-1,194	-768	-602	-771	-821	-859	-861	-919
Trade balance	-1,518	-1,405	-1,009	-971	-1,116	-1,176	-1,235	-1,437	-1,527
Exports (f.o.b.)	3,962	3,147	4,033	4,191	4,448	4,730	5,021	5,477	6,037
Imports (f.o.b.)	5,480	4,551	5,043	5,163	5,565	5,906	6,257	6,915	7,564
Non-factor services, net	241	305	381	423	436	459	483	509	556
Credits	1,109	1,092	1,148	1,084	1,137	1,195	1,253	1,344	1,454
Debits	868	786	767	660	701	736	771	836	898
Factor income, net	-255	-258	-265	-241	-297	-344	-390	-439	-487
Current transfers, net	235	163	126	187	207	241	284	507	539
Capital and financial account	1,442	1,057	749	636	1,118	1,030	880	890	934
Capital transfers, net	-2	-3	4	3	6	5	5	5	5
Financial account	1,444	1,061	745	633	1,112	1,025	875	885	929
Direct investment, net	921	478	355	322	650	475	450	425	450
Portfolio investment, net	-53	506	429	369	282	275	277	273	299
Other investment, net	575	77	-39	-58	180	275	148	187	180
Net errors and omissions	285	-42	83	94	0	0	0	0	0
Financing	-429	179	-64	-129	-347	-209	-21	-29	-15
Fund financing	-30	-17	-12	-15	-35	-41	-42	-33	-26
Change in official reserves (- =increase)	-399	196	-52	-114	-312	-168	21	4	11
Official reserves and external debt									
Gross official reserves 1/	1,460	1,242	1,297	1,356	1,668	1,836	1,815	1,811	1,800
External debt 2/	3,739	4,525	4,924	4,846	5,117	5,450	5,737	6,033	6,331
Public and publicly guaranteed	1,670	2,383	2,583	2,394	2,632	2,637	2,550	2,811	3,096
Private	2,069	2,142	2,341	2,451	2,485	2,813	3,187	3,222	3,236
Short-term debt									
On a remaining maturity basis	1,730	1,581	1,564	1,519	1,767	2,013	2,107	2,167	...
On an original maturity basis	1,040	1,066	1,091	1,016	1,091	1,305	1,509	1,594	1,698
Of which:									
Trade credit	571.9	692	769	739	769	819	869	919	969
Currency and deposit	145	189	...	208	230	283	335	370	406
Debt service 3/	925	846	786	776	745	936	987	895	889
Amortization	765	688	597	564	502	675	709	597	573
Interest payment	160	158	189	212	242	260	278	298	316
(In percent of GDP, unless otherwise indicated)									
Current account	-12.1	-11.2	-6.9	-5.4	-6.5	-6.4	-6.2	-5.7	-5.5
Trade balance of goods and services	-11.9	-10.3	-5.6	-4.9	-5.7	-5.6	-5.4	-6.1	-5.9
Trade balance, goods	-14.1	-13.2	-9.1	-8.7	-9.4	-9.2	-8.9	-9.5	-9.2
Of which:									
Non-energy trade balance	-8.2	-6.6	...	-2.1	-2.4	-2.9	-3.2	-3.8	-3.6
Trade balance, services	2.2	2.9	3.4	3.8	3.7	3.6	3.5	3.4	3.4
Financial account	13.4	10.0	6.7	5.7	9.4	8.0	6.3	5.8	5.6
Direct investment, net	8.6	4.5	3.2	2.9	5.5	3.7	3.3	2.8	2.7
Portfolio investment, net	-0.5	4.8	3.9	3.3	2.4	2.2	2.0	1.8	1.8
Other investment, net	5.4	0.7	-0.4	-0.5	1.5	2.1	1.1	1.2	1.1
External debt 2/	34.8	42.6	44.2	43.3	43.2	42.6	41.5	39.8	38.2
Public and publicly guaranteed	15.5	22.4	23.2	21.4	22.2	20.6	18.4	18.5	18.7
Private	19.3	20.1	21.0	21.9	21.0	22.0	23.0	21.3	19.5
Short-term external debt									
On a remaining maturity basis	16.1	14.9	14.1	13.6	14.9	15.7	15.2	14.3	...
On an original maturity basis	9.7	10.0	9.8	9.1	9.2	10.2	10.9	10.5	10.2
Of which:									
Trade credit	5.32	6.5	6.9	6.6	6.5	6.4	6.3	6.1	5.9
Currency and deposit	1.35	1.78	...	1.85	1.94	2.21	2.42	2.44	2.45
Debt service, in percent of exports of GNFS 3/	18.3	20.0	15.2	14.7	13.3	15.8	15.7	13.1	11.9
Amortization	15.1	16.2	11.5	10.7	9.0	11.4	11.3	8.8	7.7
Interest payment	3.15	3.7	3.7	4.0	4.3	4.4	4.4	4.4	4.2
<i>Memorandum items:</i>									
Nominal GDP (millions of U.S. dollars)	10,748	10,634	11,133	11,202	11,850	12,798	13,841	15,160	16,571
Exports of GNFS (yearly percent change)	-2.9	-16.4	22.3	24.5	5.9	6.1	5.9	8.7	9.8
Imports of GNFS (yearly percent change)	1.8	-15.9	8.9	9.1	7.6	6.0	5.8	10.3	9.2

Sources: Lithuanian authorities; and Fund staff estimates and projections.

1/ Including valuation changes. Gross official reserves reported here differ from the monetary survey because reverse repos involving major currencies in both legs are included.

2/ External liabilities minus equity investment.

3/ Debt service comprises interest and gross repayment on external loans, and interest and net repayment on debt securities.

April 2, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
700 19th Street NW
Washington, D.C. 20431

Dear Mr. Köhler:

1. The key objective of Lithuania's economic policy is to promote sustained economic growth through continued macroeconomic stability and an acceleration of structural reforms, with membership in the European Union and NATO being our central policy goals. Our economic program is supported by the stand-by arrangement (SBA) that was approved by the Fund's Executive Board in March 2000. Implementation of the program has brought significant positive results, as confirmed at the time of the Executive Board's completion of the first program review on January 10, 2001.

2. Despite our best efforts, a single performance criterion for end-December 2000 was not observed—the elimination of central government expenditure arrears. At that time, LTL 41 million worth of arrears were recorded, due to technical difficulties related to clearing all payments at end-year. We regret that these arrears persisted and wish to inform you that all central government expenditure arrears have now been cleared. As such, we are now in a position to request the completion of the second review under the stand-by arrangement, in support of implementation of policies detailed in the Supplementary Memorandum on Economic Policies (SMEP) for the remainder of the term of the SBA. We also believe that we have met in full the final set of performance criteria under the SBA for end-March 2001. However, reliable data on the observance of these performance criteria will become available after April 15, 2001.

3. As before, we do not envisage making purchases under the arrangement, and we believe that the policies described in the SMEP are adequate to achieve our program objectives. However, we stand ready to take additional measures as necessary, in consultation with the Fund staff. We hope to initiate discussions with the Fund staff in May on a possible follow-up arrangement for the period from July 1, 2001-December 31, 2002, again to be treated on a precautionary basis and with a focus on continued fiscal consolidation, support of the currency board arrangement, and completion of remaining structural reforms, with a view to improving the business environment, targeting a reduction of the high rate of unemployment and early EU accession.

4. In line with our commitment to transparency in economic policies, we authorize the Fund to publish this letter following Executive Board approval of the second program review. We will publish this letter in Lithuania.

Sincerely yours,

//s//
Rolandas Paksas
Prime Minister
Republic of Lithuania

//s//
Reinoldijus Šarkinas
Chairman of the Board
Bank of Lithuania

INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Second Review Under the Stand-By Arrangement—Staff Supplement

Prepared by Legal, European II, and Policy Development and Review Departments

Approved by Francois Gianviti, Mohammad Shadman-Valavi, and Liam P. Ebrill

April 12, 2001

1. In response to an inquiry from an Executive Director—who is not raising an objection to the lapse of time completion of this review—the following clarifies some technical issues concerning the waiver of applicability of end-March 2001 performance criteria.
2. Under the stand-by arrangement for Lithuania (EBS/00/28, Supplement 1) purchases after March 31, 2001 are, among other conditions, subject to the observance of end-March 2001 performance criteria. Since the second review under the arrangement will be completed after March 31, 2001 but official data are not yet available on the observance of end-March 2001 performance criteria, the draft Board decision circulated on a lapse of time basis provides for a waiver of applicability of end-March 2001 performance criteria. This decision allows Lithuania to make purchases of up to the amount that would have been available on the basis of end-December 2000 performance criteria until April 20, 2001. End-March 2001 performance criteria will apply to purchases after April 20, 2001. A waiver for the non-observance of the end-December 2000 performance criterion on the stock of general government payment arrears was not proposed because end-December 2000 performance criteria do not apply to purchases requested after March 31, 2001.
3. The Fund often grants a waiver of applicability of performance criteria when a review is completed shortly after a new test date becomes applicable but official information is not yet available on the observance of performance criteria for this test date. Staff would not support waivers of applicability if there were concerns that the program was not broadly on-track, and in the case of Lithuania, staff considers that all end-March 2001 performance criteria can be met.

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 01/37
FOR IMMEDIATE RELEASE
April 16, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Completes the Second Review Under the Stand-by Arrangement for Lithuania

The Executive Board of the International Monetary Fund (IMF) today completed the second (and last) review of Lithuania's performance under a 15-month, SDR 61.8 million (about US\$78 million) stand-by arrangement. This opens the way for a release of SDR 51.5 million (about US\$65 million) from the arrangement, which the authorities, however, are not expected to request as they have treated the arrangement as precautionary so far.

In commenting on the Executive Board's decision to complete the review of Lithuania's economic program, Shigemitsu Sugisaki, Deputy Managing Director, stated:

"The Lithuanian authorities are to be commended for the successful implementation of their macroeconomic program that helped restore macroeconomic stability in 2000. The economic recovery is stronger than expected, although rising unemployment continues to pose concerns. In recent months, structural reforms have advanced in the areas of banking privatization, bankruptcy, and labor legislation, although progress has been mixed in the fiscal structural and energy sector areas. Significant progress has been made in negotiations for EU accession.

"The budget deficit target for 2001 approved by parliament in December of last year remains appropriate. The authorities' ongoing work on the preparation of a comprehensive medium-term fiscal framework is welcome. The effort to simplify and make the tax system more transparent is also an important positive step and will facilitate EU accession. The

EXTERNAL RELATIONS DEPARTMENT

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authorities need to coordinate tax and expenditure measures in such a way as to achieve their medium-term goal of a cyclically adjusted balanced budget. The authorities' intention to switch the peg of the litas to the euro, with a view to moving smoothly toward greater economic integration with the EU is also welcome. The authorities are urged to move ahead with structural reforms in the fiscal area, banking sector, energy sector, and measures to facilitate private activity," Sugisaki said.