January 2002
IMF Country Report No. 02/8

Republic of Lithuania: 2001 Article IV Consultation and First Review Under the Stand-By Arrangement—Staff Report; Public Information Notice and News Brief on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Lithuania

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2001 Article IV consultation with the Republic of Lithuania and first review under the Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation and first review under the stand-by arrangement, prepared by a staff team of the IMF, following discussions that ended on **November 15, 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 December 21, 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.

- the Public Information Notice (PIN) and a News Brief summarizing the **views of the Executive Board as expressed during its January 16, 2002 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for the Republic of Lithuania.

The document(s) listed below have been or will be separately released.

Letter of intent*

Statistical Appendix

* May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Staff Report for the 2001 Article IV Consultation and First Review Under the Stand-By Arrangement

Prepared by European II and Policy Development and Review Departments

Approved by Mohammad Shadman-Valavi and Liam P. Ebrill

December 21, 2001

- Discussions were held in Vilnius during November 6–15, 2001. The Fund staff team comprised P. Alonso-Gamo (head), R. Burgess, S. Fabrizio, V. Kramarenko (all EU2), and Q. Wang (PDR), and was assisted by M. Horton, the Fund's resident representative. Mr. A. Tornqvist, Alternate Executive Director, and Mr. S. Kropas, Advisor to the Executive Director, attended some policy meetings. The FSAP mission delivered its preliminary conclusions in the context of the Article IV consultation discussions.
- The mission met with President Adamkus, Seimas Chairman Paulauskas, Prime Minister Brazauskas, Bank of Lithuania (BoL) Governor Šarkinas, Seimas Budget and Finance Committee Chairman Butkevičius, Minister of Finance Grybauskaite, Minister of Economy Česna, Vice Minister of Labor and Social Protection Morkuniene, as well as other senior government officials, members of parliament, and representatives of the banking and business communities and trade unions.
- On August 30, 2001, the Executive Board approved a 19-month Stand-By Arrangement (SBA) for an amount equivalent to SDR 86.52 million (60 percent of quota).The authorities confirmed their intention to make no purchases under the arrangement.
- In the attached letter dated December 20, 2001, the authorities request the completion of the first review. The request is supported by the Supplementary Memorandum of Economic Policies (SMEP, Attachment I), which the authorities intend to publish.
- Lithuania has accepted the obligations of Article VIII of the Fund's Articles of Agreement and maintains an exchange system free of restrictions on payments and transfers for current international transactions.
- Relations with the Fund and the World Bank are summarized in Appendixes I and II, respectively; and periodicity and timeliness of the most important statistics are presented in Appendix III.
- As a background to the upcoming Board discussions, a Statistical Annex and "The Baltics—Medium-Term Fiscal Issues Related to EU and NATO Accession" will be forthcoming, while the papers on "Labor Market in Hard-Peg Accession Countries—The Baltics and Bulgaria" (SM/01/169) has been issued.

Contents

Appendices

Attachments

Lithuania: Basic Data

Social and demographic indicators (latest available data)	
Area (sq. km)	65,300
Population density (inhabitants per sq. km.)	56.6
Population (thousands)	3,692.6
Life expectancy at birth	72.8
Men	67.6
Women	77.9
Infant mortality rate (per 1,000 births)	8.5
Hospital beds (per 1,000 inhabitants)	9.3
Physicians (per 1,000 inhabitants)	3.8

	1996	1997	1998	1999	2000
			(In percent of GDP)		
National accounts					
Domestic demand	109.8	110.6	111.9	110.3	106.4
Consumption	85.3	84.0	87.5	87.7	85.7
Gross investment	24.5	26.5	24.4	22.7	20.7
External balance of goods and services	-9.8	-10.6	-11.9	-10.3	-6.4
			(Percentage change from previous period)		
Real GDP	4.7	7.3	5.1	-3.9	3.9
GDP (in millions of litai)	31,569	38,340	42,990	42,655	45,254
Consumer prices (end-period)	13.1	8.4	2.4	0.3	1.5
Real wages 1/	3.3	13.4	12.7	5.4	1.1
Labor market					
Total employment (thousands)	1,659	1,669	1,656	1,648	1,586
Of which: in state sector	585	542	528	512	495
Unemployment rate (in %) 2/	7.0	5.9	6.4	8.4	11.5
			(In millions of U.S. dollars)		
Balance of payments 3/					
Trade balance	-896	-1,147	-1,518	-1,405	-1,104
Current account balance	-723	-981	-1,298	-1,194	-675
			(Percentage change from previous period)		
Money and credit					
Broad money	-3.5	34.1	14.5	7.7	16.5
Credit to private sector	-4.4	18.9	16.9	13.8	-1.2
Interest rate (in percent) 4/	14.7	12.2	16.7	14.5	11.5
			(In percent of GDP)		
General government finances 5/					
Revenues	29.6	32.6	32.7	32.1	30.3
Expenditure and net lending	34.2	33.7	38.1	40.2	33.2
Financial balance 6/	-2.5	-1.5	-4.4	-6.2	-2.1
Fiscal balance 6/	-4.5	-1.8	-5.9	-8.5	-2.7

Sources: Lithuanian authorities; and Fund staff estimates.

1/ Average wage deflated by consumer price index.

2/ Calculated on the basis of registered unemployment; period average.

3/ Balance of payments prior to 1996 are not comparable data.

4/ Average annual interest rate on loans in domestic currency; end of year.

5/ There is a break in series beginning in 1998 when a new classification of fiscal account was implemented.

6/ Including the discrepancy between monetary and fiscal data.

Executive Summary

The macroeconomic objectives for 2001 are expected to be largely attained and all end-September performance criteria and structural benchmarks were met. Real GDP growth accelerated substantially, driven initially by strong export growth, complemented lately by a gradual recovery of domestic demand. The external current account declined further, largely due to rapid export growth. Inflation remained subdued. Fiscal adjustment continued despite revenue shortfalls, although small expenditure arrears persisted in some areas, resulting in the non-observance of the indicative target on central government expenditure arrears. Confidence in the currency board remained strong and access to international markets favorable. Good progress in structural reforms was registered in fiscal structural areas, energy restructuring, privatization, trade policy, and labor and social security system. EU accession negotiations have advanced rapidly.

The authorities' priority is to stabilize revenue, while creating a tax system consistent with EU requirements. To this end, the government has prepared an ambitious package of reforms covering the value-added tax (VAT), corporate income tax (CIT), and personal income tax (PIT), which aims at removing exemptions and broadening the tax bases. However, the reforms are likely to stabilize revenues only over the medium term.

The appropriate fiscal stance was at the core of the policy discussions with the authorities. The authorities agreed with the staff on an increase of the program budget deficit target to provide added flexibility, in view of possible further revenue shortfalls. For 2002, the staff and the authorities shared the view that a fiscal deficit target of 1.5 percent of GDP would be appropriate in light of the declining revenue-to-GDP ratio, the limited room for further expenditure cuts, and the better-than-originally-expected external current account prospects. To limit the decline in the revenue-to-GDP ratio, a number of revenue measures will be implemented starting in 2002. The authorities are committed to implement comprehensive measures to deal with the finances and arrears of municipalities and Health Insurance Fund.

Underpinned by the fiscal adjustment, the currency board arrangement continued to anchor macroeconomic policies. The authorities are confident that the repegging scheduled for February 2, 2002, will take place smoothly. Its announcement made in June 2001 was well-received by the markets, and the Bank of Lithuania has largely completed the preparation for the repegging. The main conclusion of the recent FSAP mission is that there are not major immediate risks to the stability of Lithuania's financial system.

The authorities remain committed to their ambitious structural reform agenda, which is driven in part by the requirements of EU accession. The agenda includes completing the banking privatization, strengthening corporate financial management, enhancing labor market flexibility, completing the large-scale privatization program, improving further the business environment, and implementing agriculture and land reform.

I. Introduction

1. The 2000 Article IV Consultation was concluded by the Executive Board on January 10, 2001 (EBS/00/286). Directors commended the progress made by Lithuania under the previous SBA. They emphasized the importance of preserving macroeconomic stability to maintain the credibility of the currency board arrangement (CBA), especially in the run-up to the repegging of the litas. Directors, however, expressed concern about the high level of unemployment and weak finances of municipalities. While recognizing that structural reforms had advanced significantly, they stressed the need for greater progress in the restructuring of the energy and agricultural sectors.

2. The political situation in Lithuania remains stable, under the dominant center-left coalition led by Prime Minister Brazauskas, the country's President during 1993-98. The continuing strong consensus on EU and NATO accession has played a major role in advancing reforms.

II. Recent Developments and Performance Under the Program

3. **Macroeconomic objectives for 2001 are expected to be largely attained and all end-September program performance criteria and structural benchmarks were met** (Tables 1-12). Real GDP growth accelerated substantially, the external current account deficit declined further, and inflation remained subdued. Fiscal adjustment continued, confidence in the currency board remained strong, and good progress was recorded in structural areas.

A. Macroeconomic Developments

4. **The economic recovery continued to gather pace.** Real GDP growth is expected to accelerate from 3.9 percent in 2000 to 4.5 percent in 2001 (Table 1 and Figure 1). The recovery was driven initially by strong export growth, but has since been complemented by a gradual increase in domestic demand. Real GDP growth amounted to 5.1 percent (year-on-year) for the first three quarters of 2001 but is expected to slow somewhat over the final quarter, as the recent deceleration in exports to the EU may be only partially offset by the gradual recovery of domestic demand and the strength of exports to CIS countries. Inflation remained relatively subdued, owing to flat wages in real terms, a decline in oil prices, and the lagged effects of the earlier appreciation of the litas against the euro. Registered unemployment has declined since its April 2001 peak, but remained at 12.5 percent in November.

5. **The external current account deficit is expected to narrow to 5.8 percent in 2001.** Non-oil exports expanded due to growing CIS markets and the consolidation of Lithuania's exporters' presence in EU markets, due in part to the positive impact of the litas depreciation in real effective terms on competitiveness (Box 1, Figure 2). Energy exports were boosted by larger imports of crude oil from Russia. Profits earned by foreign investors increased, and were mostly re-invested in Lithuania, contributing to sizable FDI inflows, already boosted by

Box 1: Lithuania: Indicators of External Competitiveness

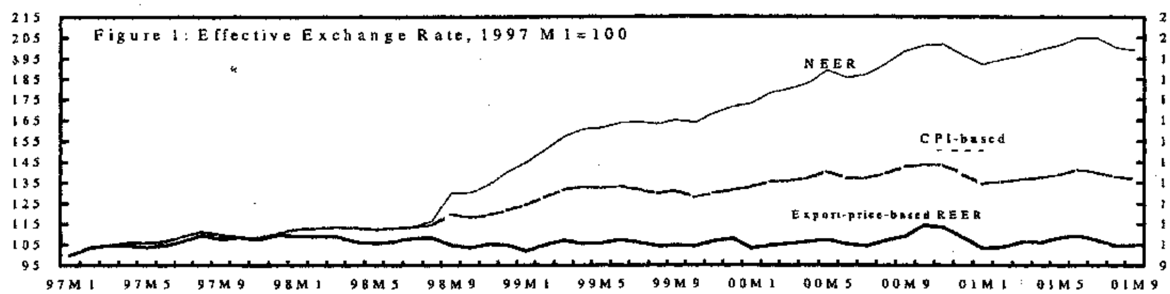
After a strong recovery in 1999-2000, Lithuania's exports continued to perform well during the first nine months of 2001, with exports of non-energy goods up by 16 percent (y-o-y) in U.S. dollar terms. Export growth, while reflecting in part favorable external conditions, clearly benefited from improved external competitiveness as shown by a number of different indicators.

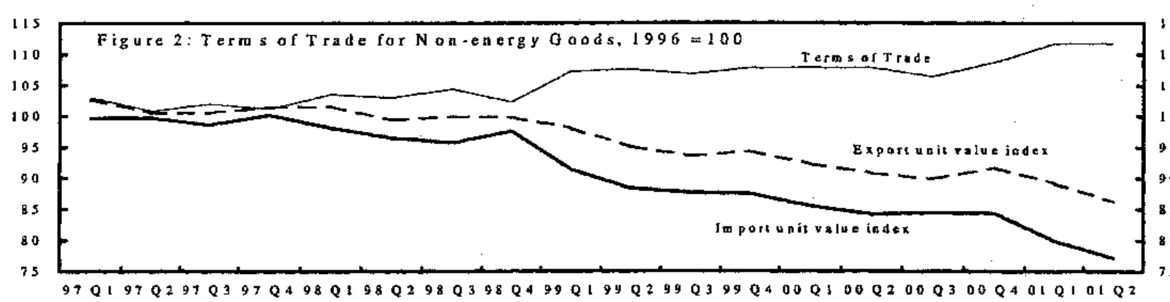
■ After appreciating by about 25 percent since 1998, the **CPI-based real effective exchange rate (REER)** depreciated by about 5 percent through September 2001 since its October 2000 peak (Figure 1).

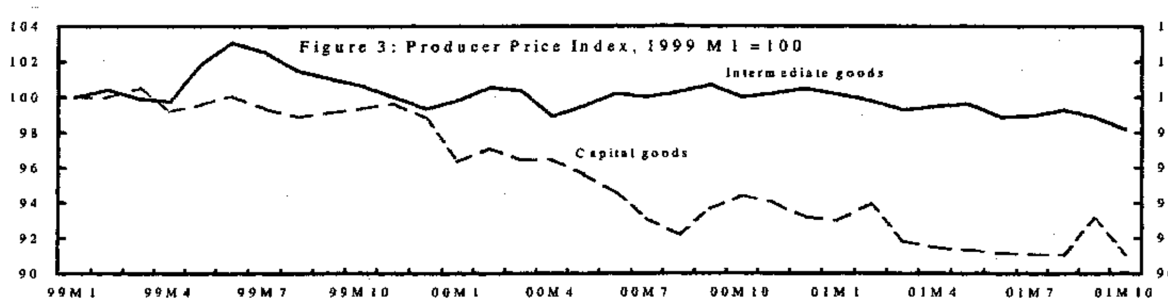
■ The **export-price-based REER**, in contrast to the CPI-based REER, has shown remarkable stability since 1997, indicating little loss of external competitiveness (Figure 1). The divergence between the two indicators could be explained by a widening gap between productivity growth in traded and non-traded goods sectors enabling Lithuania's exporters to maintain profitability while gaining a competitive edge through lowering their prices. Wage moderation helped maintain competitiveness.

■ Lithuania has enjoyed significant **terms of trade (ToT)** gains, as the decline in export prices, excluding the impact of oil prices, has been more than offset by an even faster decline in import prices (Figure 2).

■ Exporters have also benefited from cheaper domestic intermediate inputs and capital goods. The **producer price indices (PPI)** for intermediate and capital goods that are sold domestically declined by about 5 and 9 percent, respectively, during June 1999 - October 2001 (Figure 3).



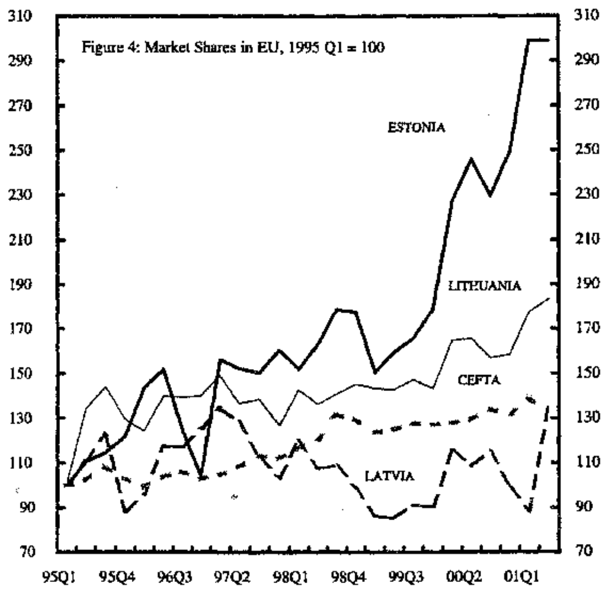


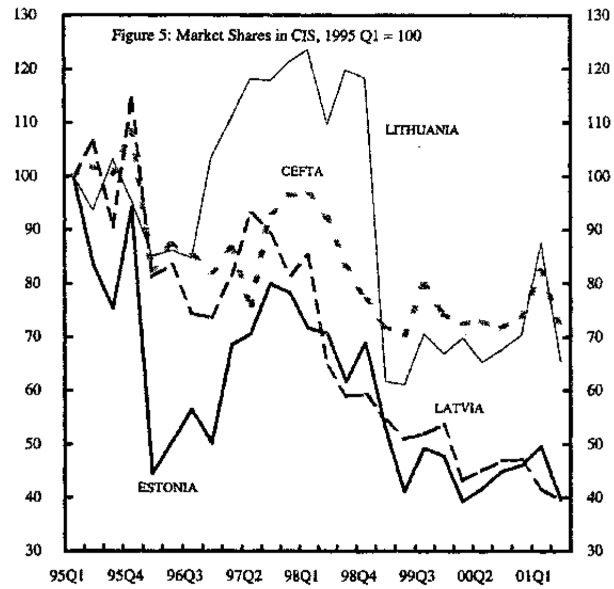


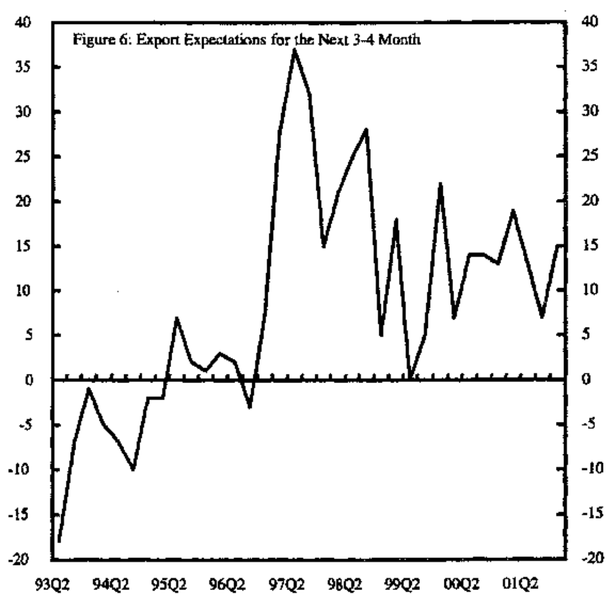
Source: Lithuania Department of Statistics and IMF Staff estimates

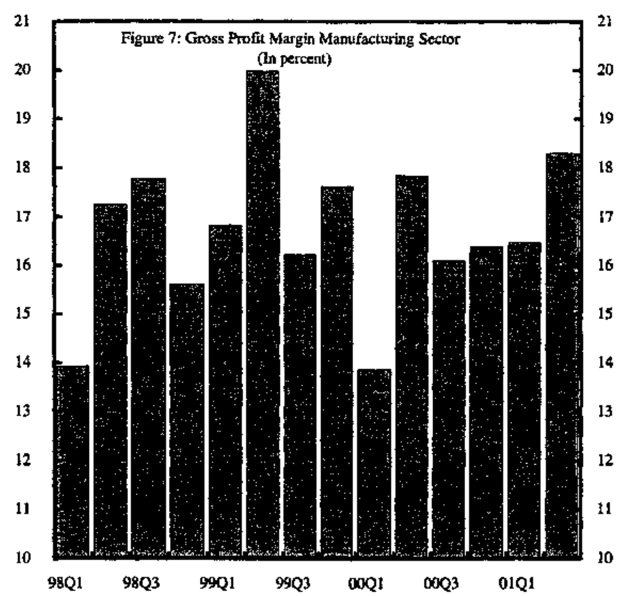
■ **Lithuania's exports have performed well relative to its major competitors.** The shares of Lithuania's exports are compared with those of its competitors in the import markets of its two largest trading partners—EU and CIS countries (Figure 4 and 5). To the extent that common factors affect the export performance of all competitors, the difference in export performance can be largely attributed to the relevant countries' competitiveness.

■ **Business confidence indicators** have pointed to a sustained optimism among exporters since early 1999, which coincided with a recovery of the profitability in the manufacture sector, the main exporting sector in Lithuania, during the same period of time (Figure 6 and 7).



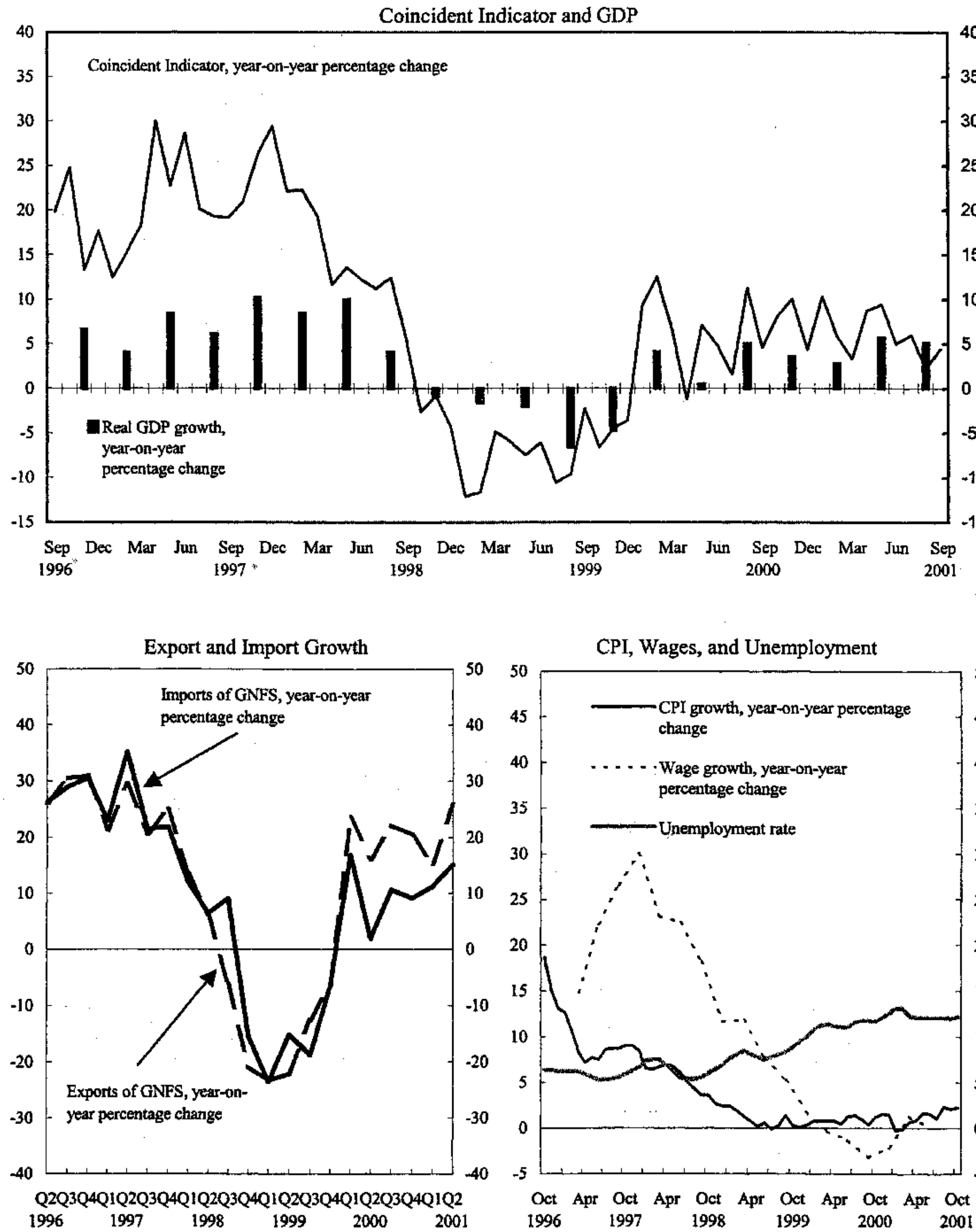






Source: Lithuania Department of Statistics and IMF EDDS database

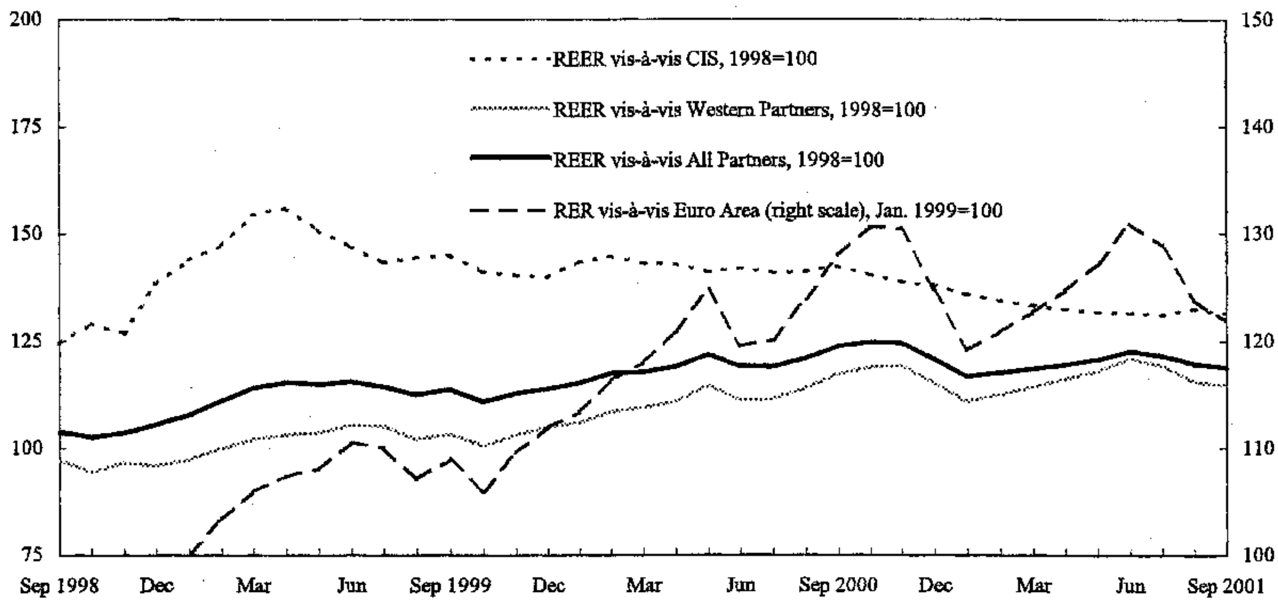
Figure 1. Lithuania: Selected Economic Indicators, 1996-2001



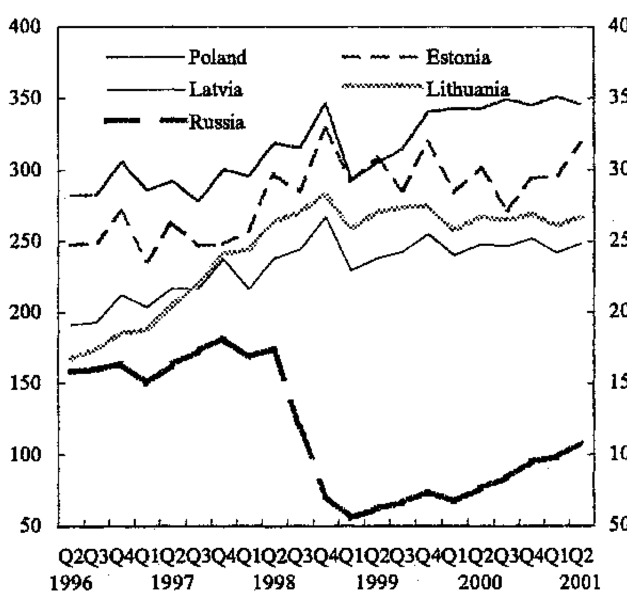
Sources: Lithuanian Department of Statistics; Bank of Lithuania; and Fund staff estimates.

Figure 2. Lithuania: Indicators of External Competitiveness, 1996-2001

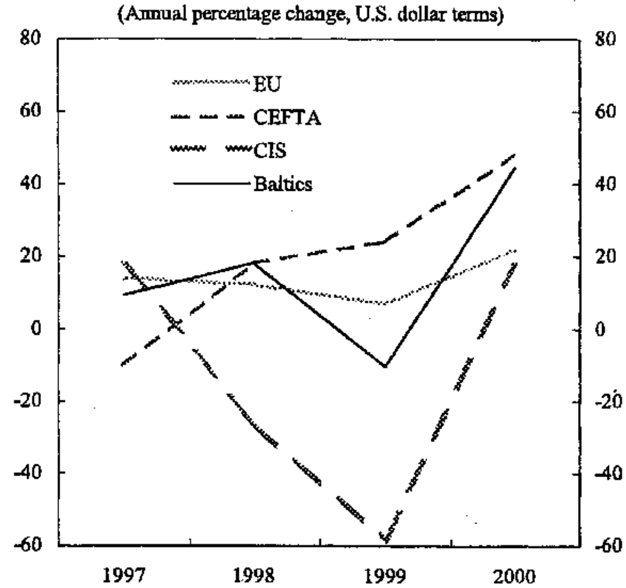
Real Exchange Rates



Monthly Wages in U.S. Dollar Terms



Export Growth
(Annual percentage change, U.S. dollar terms)



Sources: Lithuanian authorities; and Fund staff estimates.

large privatization receipts. Substantial bank amortization payments ahead of schedule were more than offset by portfolio investments, particularly through a government eurobond issue of €200 million in February, on favorable terms. Official foreign exchange reserves increased by US$180 million in the first nine months, and external debt and vulnerability indicators strengthened (Table 11).

6. **Fiscal adjustment continued in 2001, despite revenue shortfalls.** The general government deficit for the first nine months of 2001 declined to 1.2 percent of GDP—compared to 3.1 percent of GDP in the corresponding period of 2000—well under the program target of 1.7 percent (Table 3).[1] Nominal expenditure also were lower than in the same period in 2000. Revenue shortfalls (about 0.6 percent of GDP)[2] were offset through cuts in spending on goods and services, lower-than-projected SoDra outlays and lower capital expenditure, due to delays in approving the public investment program and, to some extent, to a lower-than-expected implementation rate. However, the problems of expenditure arrears persisted in the state budget (LTL 8 million) and the Health Insurance Fund (HIF) (LTL 29 million), resulting in the non-observance of the indicative target on central government expenditure arrears.[3]

7. **Confidence in the CBA remained strong,** with the foreign reserve coverage of reserve money reaching 165 percent at end-October. Monetization of the economy increased, although at a somewhat slower pace than in 2000, and broad money is expected to grow by 15.8 percent by year-end. Increased confidence of households and corporations in the banking system is expected to result in an increase in savings and foreign currency deposits of 40 percent and 22 percent, respectively, in 2001. The rapid growth of foreign currency deposits reflected a repatriation of deposits by enterprises and greater confidence of households in banks. At the same time, private sector credit is expected to increase by 9.8 percent in 2001, due to stronger competition in the banking sector and lower interest rates—stemming from declining interest rates in the United States and lower spreads (Figure 3)—improvements in the business environment, and, to some extent, incentives for

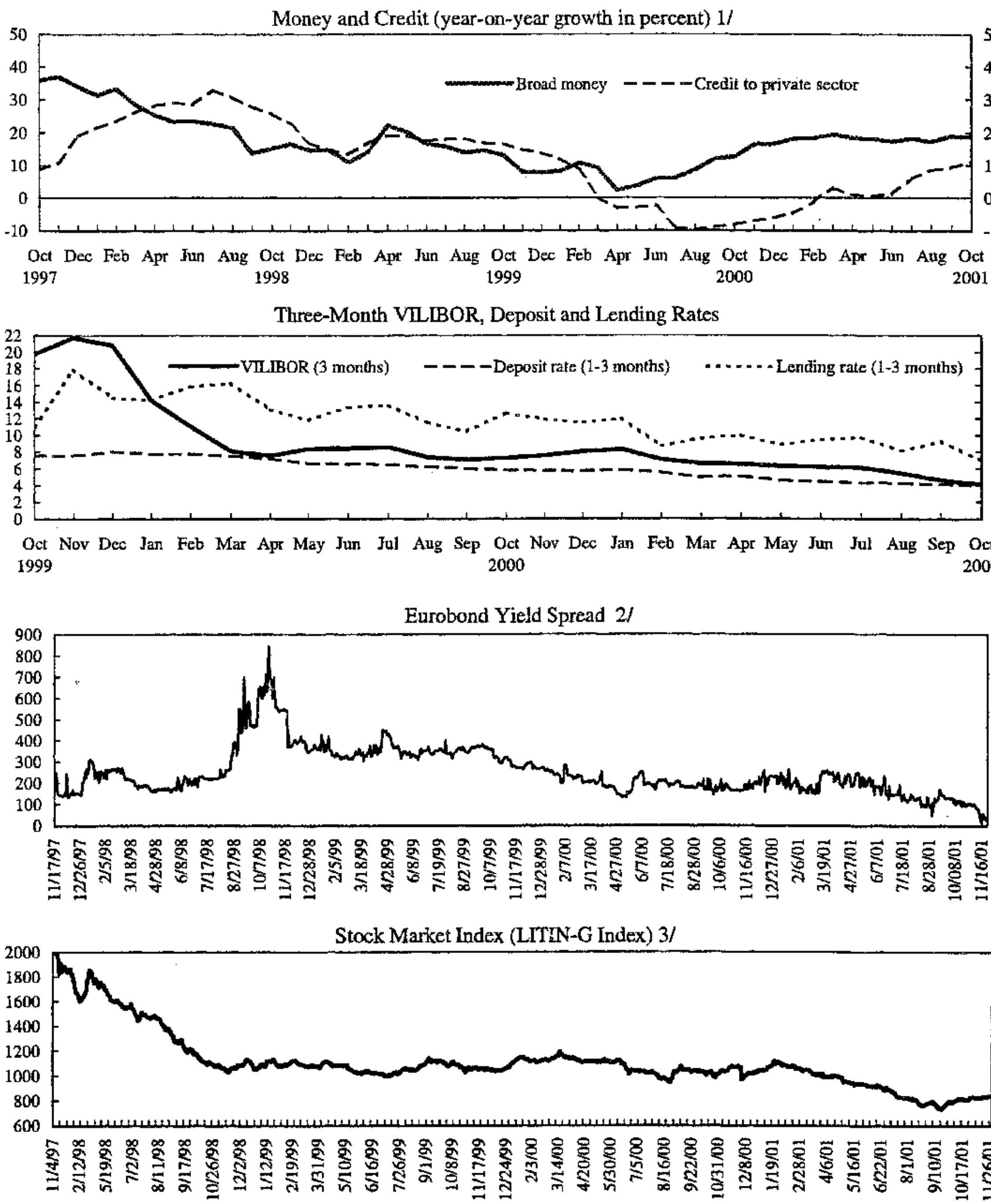
---

[1] All fiscal targets are on a cash basis.

[2] The changing structure of GDP, with an increasing shift toward lower-taxed exports, has led to an erosion of the tax base. Moreover, an expanding private sector has made increasing use of existing tax exemptions and loopholes, leading to larger-than-expected VAT refunds and deductions of life insurance premia and investment expenses from personal and corporate income taxes, respectively. Slow progress in VAT administration and the tax arrears of municipalities have also contributed to revenue shortfalls.

[3] Arrears of the HIF were due to continuing problems with pharmaceutical spending and procurement practices that will be addressed in December 2001-January 2002 (see SMEP, paragraph 20). Arrears at the state budget were quite small, resulting from technical expenditure coordination problems across hundreds of appropriation managers.

Figure 3. Lithuania: Financial Indicators, 1997-2001



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

1/ Included a reclassification of LTL 270 million of DMB's claims on private sector to government lending funds, which were removed from banks' balance sheets in July, 2000; also included a reclassification of LTL 785 million from the Turto Bank in July 2001, which is no longer a banking institution.

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

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

mortgage financing. Capital markets were not adversely affected by financial distress in some other emerging markets. All indicators of financial sector vulnerability improved during 2001 (Table 12).

8. The BoL has largely completed its preparations for the repegging of the litas from the U.S. dollar to the euro on February 2, 2002. The amendment to the Law on the Credibility of the Litas passed in March 2001 provides the legal basis for the repegging. The BoL has also approved new guidelines for official reserve management, allocating more than 90 percent to euro-denominated assets at the time of the repegging. Opinion polls indicate that the public is well informed about the details of the repegging, thanks to a BoL information campaign (SMEP, paragraph 8). Commercial banks have made available a wide range of hedging instruments, and indicated that large corporate customers were making increased use of them. However, most of the rebalancing of corporate and households' portfolios is not expected to take place until closer to the repegging date. The banks themselves had a small long open position in U.S. dollars as of end-September (Table 12).[4]

B. Structural Reforms

9. **The pace of structural reforms accelerated markedly in 2001** (see Box 2). The restructuring of the electricity and gas sectors has been largely completed. However, the Mažeikiu Nafta oil refinery continues to make losses,[5] and the conclusion of a deal with the Russian company Yukos for its participation, which would assure long-term oil supplies, was delayed, while the ambitious investment program is also being postponed. A large number of smaller residual state shareholdings and land plots were sold, following efforts to simplify the divestment process. In addition, a constitutional amendment to allow agricultural land sales to foreigners, in compliance with EU requirements, received preliminary parliamentary approval.

10. **In the fiscal area,** the Ministry of Finance established two new departments in April 2001 to coordinate and monitor financial issues related to EU accession, including mobilization of cofinancing. The law on the Methodology of Revenue Redistribution among Municipalities was passed by Seimas in October, and the draft 2002 budget incorporates the resulting definitions of state-mandated obligations and their costs. The State Control is conducting a performance audit of several municipalities. An amendment to the privatization

[4] The FSSA report provides an analysis of commercial banks' vulnerability to exchange rate and interest rate risk.

[5] In the event losses were to persist over the medium term, the company might not be able to pay interest of about 0.3 percent of GDP per year on government loans.

Box 2. Lithuania: Structural Reforms Implemented in 2001

During 2001, the Lithuanian authorities have undertaken a wide range of structural reforms, in connection with two Fund stand-by arrangements, a World Bank structural adjustment loan and the process of accession to the European Union. Key structural reforms implemented during the past year include the following.

Financial management and control:
- Completion of staged treasury modernization, involving single treasury account
- Reorganization of the customs department on the basis of EU best practices
- Approval of internal audit manual by MOF
- Creation of two departments at MOF to coordinate and monitor EU-related financial issues

Municipal finances:
- Monthly reporting and monitoring of arrears by a cabinet level commission*
- Approval of legislation to more clearly define municipal expenditure obligations related to state-delegated functions*
- Audit of 30 municipalities by State Controller*

Corporate governance:
- Approval of new laws on accounting, financial reporting and consolidated financial statements*
- Approval of new bankruptcy and enterprise restructuring laws, with more flexible and rapid procedures
- Entry into force of new law on companies, with greater protection of shareholders and creditors
- Approval of law on corporate registry, providing for publication of annual financial statements

Labor and social protection:
- Approval of amendments to labor legislation, providing for more flexibility in employment contracts and severance
- Approval of amendments to the law on civil service to ease dismissal/recruitment procedures
- Ratification of European Social Charter
- Establishment of a guarantee fund for employees of bankrupt companies, in line with EU directives and ILO conventions

Energy sector:
- Entry into force of new electricity and gas laws, providing for liberalization of markets and strengthening of regulatory independence
- Approval of Ignalina decommissioning program
- Framework agreement signed with EBRD on Ignalina decommissioning support fund

Foreign Trade:
- Accession to the WTO and reduction of conventional duties for 20 groups of imports
- Signing of free trade agreements with Bulgaria and Romania (remaining CEFTA countries)

Privatization:
- Sale of the Savings Bank*
- Sale of the Development Bank (end-Dec. 2000)*
- Sale of Lithuanian Shipping Company
- Conclusion of tender for sale of Lithuanian Agriculture Bank*
- Announcement of tender for sale of stake in Lithuanian Gas to strategic investor
- Approval of restructuring plan for Lithuanian Electric, a precondition for privatization
- Selection of advisors for restructuring and privatization of Lithuanian Airlines
- Approval of reorganization of Lithuanian Railways, with a view to restructuring and privatization
- Sale of 676 objects (through November 1, 2001) with receipts of LTL 440 million

Financial sector:
- Approval of amendments to the law on the BOL, strengthening central bank independence
- Amendment of the law on deposit insurance, in line with EU directives
- Amendment of the law on insurance to liberalize provisions for investment abroad and for access to transport insurance (WTO)

Other legislation/legal developments:
- Entry into force of the new civil code
- Adoption of amendments to the law on restitution to speed up completion of land restitution
- Commencement of operations of two-tier administrative court system
- [Approval by Seimas national anti-corruption program (strategy, law and action plan).]
- Entry into force of new legislation on trademark protection and intellectual property rights; ratification of WIPO copyright treaty
- Amendments to the laws on VAT and excise duties to harmonize treatment with EU
- Entry into force of amendments to the law on tax administration relating to audit, sanctions, enforcement and postponement of debts
- Entry into force of the law on consumer protection

*Covered by Fund conditionality.

law to authorize the Reserve Stabilization Fund (RSF) was approved by Seimas in November. The authorities also expressed interest in a Report on the Observance of Standards and Codes (ROSC) on fiscal transparency (SMEP, paragraph 22).

11. **In the financial sector, bank privatization is nearing completion.** The state-owned shares of the Savings Bank (LTB) were sold to Hansabank in September and the bank is being restructured. In November, Nord LB was selected as the winner of the tender for the Agricultural Bank, the last state-owned bank, and privatization negotiations are underway. Moreover, the BoL continued to improve the regulatory environment. A capital charge against market risks based on a value-at-risk approach will be introduced as of December 31, 2001, and the requirements on stress-testing of bank portfolios and due diligence of customers have been in effect since December 2001. The BoL also reduced its commissions on foreign exchange transactions and reduced the maximum permissible fees on foreign exchange transactions conducted by banks. The latter will limit the expenses of non-banks rebalancing their portfolios in the run-up to the repegging. Finally, the shift of Treasury accounts to the BoL did not create disruptions in the money markets, as cooperation between the Treasury and BoL was strengthened.

12. **EU accession negotiations have advanced rapidly**. At end-November 2001, agreement had been reached on 21 out of 31 chapters of the *acquis communautaire*, and the authorities aim at concluding the remaining chapters during the first half of 2002, paving the way for accession in 2004 (Box 3). The EU Commission's periodic report issued in November 2001 concluded that Lithuania was a functioning market economy, and should be able to cope in the near term with competitive pressures within the EU, a key requirement for EU accession. Moreover, the administrative capacity to absorb EU structural funds was strengthened significantly (paragraph 10), as a result of which around €15 million in SAPARD funds are expected to be disbursed by year-end.

III. Policies and Program for 2001-02

A. Macroeconomic and External Outlook

13. Policy discussions took place against the backdrop of a less favorable external environment, with a slowdown in trading partner countries, partly offset by lower oil prices and interest rates. GDP growth is expected to moderate somewhat in 2002 to 4.0 percent, reflecting some deceleration in external demand, especially from EU countries. Domestic demand will continue to be supported by the recent decline in interest rates which, together with greater competition in the banking sector, would lead to an acceleration of private sector credit growth. Inflation is expected to remain subdued at 2.8 percent in 2002, despite the impact of EU-related increases in excise duties.

Box 3. Lithuania: Progress in EU Accession Negotiations

In 2001, Lithuania made rapid progress in its EU accession negotiations, initiated in 2000. According to the 2001 Regular Report on Enlargement of the European Commission, Lithuania is among the ten candidate countries with target dates of accession compatible with the Göteborg timeframe, and the EU should be prepared to conclude accession negotiations by the end of the Danish Presidency in 2002, with a view to accession in 2004. By end-November 2001, the government had completed 21 of 31 chapters of the acquis communautaire, compared with only 7 one year earlier. The chapters closed in 2001 include some difficult ones, such as Environment, Free Movement of Persons, Customs Union, and Competition. Lithuania is thus well placed to achieve its ambitious timetable.

Lithuania is well-positioned to meet the two broad economic criteria for accession—the existence of a functioning market economy, and the capacity to withstand competitive pressure and market forces within the Union. The Commission found in its 2001 Regular Report that "Lithuania is a functioning market economy." Provided that it makes further substantial efforts to continue with the vigorous implementation of its structural reform program, it should be able to cope with the competitive pressure and market forces within the Union in the near term."

EU accession is a goal supported across the political spectrum, and in January 2001, all parties in Seimas agreed to put on the fast track the approval of all EU-related legislation. In this regard, progress was made in harmonizing Lithuanian legislations with EU standards. Three accounting laws were passed by Seimas on November 6, 2001. A package of legislative acts to amend the Constitution so as to allow the sale of agricultural land to foreigners went through the first reading in Seimas on November 15. A new labor code was submitted to Seimas in November 2001. An anti-corruption law is expected to be submitted to Seimas by end-2001. Finally, a comprehensive tax package is to be submitted by year-end, with a view to creating a tax system consistent with EU requirements.

Significant progress was made in improving the administrative capacity to administer and monitor the use of EU structural funds. A department specifically in charge of this operation was set up at the Ministry of Finance in April 2001. EC officials expressed recently their satisfaction with Lithuania's efforts to make efficient and timely use of resources under the PHARE program and indicated that Lithuania is on the list of top ten countries entitled to the European Commission national aid. Moreover, in November 2001, Lithuania became the fourth EU candidate country to be granted the right to independently administer Special Accession Program for Agriculture and Rural Development (SAPARD) funds after Bulgaria, Estonia and Slovenia.

A number of issues need to be resolved in 2002. First, in the energy area, Lithuania and the EU must reach agreement on a date for decommissioning the second reactor of the Chernobyl-like Ignalina nuclear power plant. According to the EU, it should be closed by 2009, and a decision to this end is a precondition to concluding negotiations in 2002. The Lithuanian authorities are concerned by the economic and social consequences of an early action, and would like the EU to share in the costs of decommissioning. Second, the difficult agricultural chapter is still pending. Third, Lithuania is concerned about the possible impact of sharp increases in excises on tobacco and alcohol, and eventual smuggling. In this regard, Lithuania is committed to improve customs administration. Other costs will have to be borne, for instance for the creation of an energy buffer stock. A detailed costing of EU accession obligations over the medium term was incorporated by Lithuania in its Pre-Accession Economic Program (PEP), presented to the Commission in October 2001.

14. **The external current account deficit is projected to remain at 5.8 percent of GDP in 2002. Lower growth of non-energy exports to the EU would be partly offset by the strength of exports to CIS markets, as Lithuanian exporters would further recoup some of the market share lost in the wake of the Russian crisis.** Given the high import content of exports and reflecting the reduced import bill due to a projected further decline in oil prices, import growth is projected to decelerate, albeit at a somewhat lower pace, due to the expected domestic demand recovery. The current account deficit would be financed by strong capital inflows, including a pick-up in foreign direct investment, a large part of which is privatization-related. Gross external debt as a percent of GDP will remain broadly unchanged from the level in 2001, while net external debt is likely to edge up, reflecting some repatriation of foreign assets by non-banks, as the average rate of return on foreign assets slackens with the global decline in interest rates.

15. **The main risk to the near-term outlook is a sharper than expected slowdown in Lithuania's main export markets, especially the EU.** A further significant fall in oil prices would also reduce growth in Lithuania's CIS trading partners. Despite the improvement in the terms of trade, the resulting slowdown in exports could reduce Lithuania's growth, increase the pressure on public finances, and lead to a wider current account deficit depending on the extent of the slowdown in private domestic demand.

B. The Currency Board Arrangement

16. **The CBA continues to anchor macroeconomic policies, and the authorities are confident that the repegging announced for February 2, 2002 will take place smoothly.**[6] Preparations have been characterized by transparency of the process, careful technical preparatory work by the BoL and a pro-active position of banks collaborating with their clients. Sustained fiscal discipline and macroeconomic stability, a strengthened financial sector, and good medium-term growth prospects have enhanced confidence in the economy and significantly reduced its vulnerability to contagion from instability in other emerging markets. These factors, together with the high level of liquidity of the government early in the year, should reduce the likelihood of interest rate increases around the repegging date. Finally, if the euro/dollar rate does not depreciate below its historic lows before February 2, the repegging will not create grounds for concern over the competitiveness of the economy in the medium term (Box 1). Even if the euro were to appreciate vis-à-vis the dollar in nominal terms by about 30 percent—reverting to its peak level in 1999—over the medium term, the litas would appreciate by around 10 percent in real effective terms, assuming that the share of EU and EU accession countries in Lithuania's trade remain unchanged. Such a real appreciation over a number of years would not undermine Lithuania's competitiveness, given

[6] At the time of the first review under the SBA, the repegging of the litas scheduled for February 2, 2002 will entail a modification of the continuous performance criterion under the SBA on maintaining the exchange rate under the currency board arrangement.

appreciation over a number of years would not undermine Lithuania's competitiveness, given its potential for faster productivity growth than in trading partners. Moreover, a likely further reorientation of trade towards the EU would reduce the impact of a possible appreciation of the euro on competitiveness.[7]

17. **A further increase in the monetization of the economy and an acceleration in growth of credit to the private sector are expected in 2002.** Broad money is projected to grow by 15 percent, consistent with a further decline in velocity to 4.0, in line with recent trends. Net bank financing of the government is projected at LTL 214 million, leaving enough room for credit to the private sector to grow by 16 percent from a relatively low base. In order to gradually align reserve requirements with those of the European Central Bank (ECB) area, the authorities will announce in the first quarter of 2002 the schedule of a further reduction in reserve requirements in consultation with Fund staff.

C. Fiscal Policy

18. **The government aims at achieving a structurally balanced budget in the medium term** (excluding the cost of pension reform), in order to ensure long-term fiscal sustainability, boost the credibility of the CBA, and underpin the projected current account deficit adjustment. The medium-term fiscal analysis presented in EBS/01/135 and the forthcoming companion paper highlighted the tradeoffs between revenue losses associated with the tax reform and the need to make room for EU and NATO accession-related expenditures, pension reform, and other social and environmental expenditures, while pursuing an orderly and gradual expenditure restructuring. In the run-up to the submission of the PEP to the EU, the government fostered a public debate on the major objectives of fiscal policy. A consensus emerged that the government needed to stabilize revenue so as to make expenditure plans realistic. A scenario reflecting this approach, incorporating detailed estimates of the costs of EU and NATO accession, is included in the companion paper.

19. **Thus, a comprehensive package of draft laws, covering the VAT, CIT, excises, and PIT, has been prepared, in order to stabilize revenue, improve tax administration, and create a tax system consistent with EU requirements** (SMEP paragraph 11). Instead of amending the existing laws and taking ad hoc measures, the government decided to submit to Seimas new draft laws, taking into considerations the recommendations of the FAD TA mission of June 2001. The legal framework for the VAT, in line with EU requirements, is expected to be in place by July 2002. Exemptions will be phased out gradually and eliminated

---

[7] Stress tests based on end-June 2001 balance sheets, which are described in the FSSA report, suggest that banks are sufficiently capitalized to withstand a sudden 20-percent appreciation of the euro after the repegging. Moreover, commercial banks indicated that borrowers intended to change the currency composition of their liabilities around the time of the repegging, thereby substantially reducing their exposure to the fluctuation of the euro/dollar rate.

by the time of EU accession. The CIT law, eliminating zero taxation of reinvested earnings and reducing the tax rate, would become effective in January 2002, but the positive impact on revenue will only materialize in 2003. The PIT law, which might reduce the marginal tax rate to the extent that there were revenue gains under the new CIT law, would become effective in 2003. In addition, the coverage of the real estate tax will be extended to residential property from January 2003.

20. **For 2001, the authorities continued to make best efforts to attain the original general government deficit target of 1.4 percent of GDP** (Table 3), despite expected general government revenue shortfalls of about 0.8 percent of the GDP, and did not intend to seek a budget revision in Seimas. To achieve the deficit target, VAT administration had been strengthened, especially at the customs level, and plans to cut expenditure and goods and services further were in place, making sure that new arrears would not emerge as a result. Lower-than-expected interest payments and expenditure of SoDra led to additional savings. Nonetheless, in view of increased uncertainty, the poor financial situation of the HIF, and possible further revenue shortfalls, the staff and the authorities agreed on a revision of the program target to 1.7 percent of GDP, to provide added flexibility, while remaining consistent with the attainment of macroeconomic objectives.

21. **The staff and the authorities shared the view that a general government deficit of 1.5 percent of GDP for 2002, implying a primary surplus, is appropriate and consistent with maintaining the credibility of the CBA.** Although it is 0.2 percent of GDP higher than originally envisaged, this slight revision is justified by a number of considerations. First, measures to stabilize revenue take time to bear fruit. Second, after the sharp adjustments in 2000-01, there is little room for further expenditure cuts. Finally, despite the global slowdown, Lithuania's external current account prospects are better than originally expected, reducing vulnerability risks.

22. **To limit the decline in the revenue-to-GDP ratio, a number of revenue measures will be implemented starting in 2002,** since the main elements of the tax reform package will become effective only from 2003. These measures, amounting to almost 0.3 percent of GDP (SMEP, paragraph 15), include reductions in VAT exemptions, higher excises, the postponement of the increase in the tax exempt minimum (TEM) of the PIT from January to April,[8] and improvements in tax administration. Finally, amendments to the law on Social Security, extending mandatory full pension insurance to certain groups of self-employed, was approved by Seimas in November 2001. Overall, general government revenue is projected to decline from 29.4 percent of GDP in 2001 to 29 percent in 2002.

23. **Given the projected decline in the revenue-to-GDP ratio and the need for fiscal consolidation, some expenditure cuts will be necessary, although expenditure will grow**

[8] Together with the increase in the TEM, the PIT rate on second job wages will be reduced from 35 percent to the standard rate of 33 percent.

in real terms. The consolidated expenditure of the national budget and the road program[9] is expected to be cut by 0.3 percent of GDP, while ensuring that priority social spending and investment needed for NATO and EU accession are adequately provided for.[10] In fact, the proposed Public Investment Program (PIP) for 2002 gives priority to EU-related investment. The staff expressed concern about the low implementation rate of the PIP in 2001; the authorities shared this concern and are addressing the problem. In addition, HIF expenditure is expected to be reduced by almost 0.2 percent of GDP, as measures to limit spending on pharmaceuticals are implemented (SMEP, paragraph 20). The latter measures together with the rescheduling of arrears on pharmaceuticals, should eliminate HIF arrears and improve its medium-term financial position. The expenditure of SoDra would decline relative to GDP, given the current indexation procedure. Investment by the Privatization Fund will remain at the 2001 nominal level, and expenditure for savings and land restitution will be limited to 0.1 percent of GDP. The authorities indicated that strong pressures to increase expenditure would emerge during Seimas discussions, and the staff urged them to resist such pressures.

24. **The targeted deficit can be readily financed.** Gross financing needs (around 7 percent of GDP) would be almost equally split between domestic and foreign sources. The authorities' financing strategy is geared toward diversifying and lengthening maturities of treasury securities, and tapping the eurobond market, in particular to refinance the US$200 million maturing 1997 eurobond (Box 4). A decline of 0.6 percent of GDP of public and publicly guaranteed debt in 2002 would reflect a primary surplus, low interest rates, and rapid growth. In order to deal with possible defaults on direct and guaranteed loans to domestic enterprises, the government is committed to strengthening collection efforts and has made sufficient provisions for covering them. In addition, steps have been taken to limit strictly such loans in the future.[11]

25. **Contingency plans in response to a more pronounced external economic slowdown and/or less favorable emerging market conditions were discussed with the authorities.** In response to a larger than expected global slowdown (Box 5), the government's strategy would be, in the first instance, to let the automatic stabilizers operate to support economic activity. A moderate increase in the fiscal deficit could be financed using a combination of the government's liquid resources and a slightly higher issuance of domestic securities. However, the scope for allowing the automatic stabilizers operate fully is limited by the government's substantial gross financing requirements and the need to maintain the credibility of the CBA. If, for instance, the economic slowdown were also

---

[9] From 2002, the Road Fund will be incorporated in the state budget.

[10] The government initiated a debate on the constitutional validity of laws imposing binding expenditure floors in certain areas, which limits the flexibility of the budgetary process.

[11] The existing direct and guaranteed loans to domestic enterprises were granted mainly before 1999.

Box 4. Lithuania: Public Debt and Asset Management

The government strategy in managing public debt and assets consists of consolidating debt and deposit management of the central government, shifting more borrowing to the domestic market, limiting unhedged foreign currency exposure to euro-denominated instruments, reducing its exposure to contingent liabilities and maintaining a highly liquid position. Sustainability of public and publicly guaranteed debt is expected to improve over the medium-term, given the low level of gross debt of 28 percent of GDP at end-September 2001 (Table 13), projected primary surpluses in the medium term, and a conservative debt management strategy.

In the government's borrowing strategy, the domestic treasury security market is given priority. **Local currency denominated government securities** (discounted or fixed coupon) issued domestically amounted to 3.1 percent of GDP as of end-September 2001. The maturity ranges from 6 months to 7 years. Residents dominate this segment of the market. The secondary market for these securities is fairly illiquid with sporadic transactions occurring from time to time, mainly between resident banks for liquidity management purposes. To address this problem, the government in cooperation with the BoL plans to improve technical aspects of the market infrastructure, including through standardization of maturities (1, 2, 5, and 10 years). **Foreign currency denominated eurobonds,** with a face value of about 9 percent of GDP and a remaining maturity ranging from 5 months to more than 6 years as of end-September 2001, will gradually decline in importance, as the currency risk premia of domestic securities decline. This market is fairly liquid, as spreads between ask and bid prices have recently hovered around 0.2 percent. Resident banks hold approximately 13 percent of the market capitalization, while nonresidents are mainly represented by retail investors. The government also sees some potential in **eurobonds denominated in local currency,** currently amounting to 0.2 percent of GDP.

The central government took active part in the management of liabilities of **SoDra** to limit interest costs. SoDra's financing needs in 2001 were largely met through state budget financing, and onerous short-term borrowing by SoDra was virtually discontinued in 2001. The government plans to continue with this strategy in 2002. **Municipalities** are subject to borrowing ceilings set in annual national budget laws relative to their revenue. The credit standing of municipalities is extremely low given the accumulated overdue payable accounts of around 0.5 percent of GDP. As a result, their borrowing is largely limited to IFIs with state guarantees, small credit lines from domestic commercial banks, and borrowing from the state budget. The current strategy of the government is to strictly limit municipalities' borrowing domestically or abroad.

The focus of **asset management** is on keeping a highly liquid position, partially pre-funding the pension reform, and reducing contingent liabilities and net lending. Holding a large amount of investable resources (deposits, liquidity funds, and accumulated privatization proceeds, 2.7 percent of GDP at end-September) represents an opportunity cost of 0.2 percent of GDP per year. However, the government considers this cost worth paying for two reasons. First, the government sees a need for a liquidity cushion in case of a lack of favorable access to borrowing. Second, the accumulated privatization proceeds allows the government to partially pre-fund the pension reform and remove populist pressures for additional public spending financed by a one-off receipt. At least two thirds of privatization proceeds will be accumulated in the RSF subject to strict accountability and transparency requirements. Regarding less liquid assets, the government has recently stepped up efforts to collect repayments due on net lending and defaulted guarantees; although recent legal issues with the Mazeikiu Oil Company cast some doubts over claims amounting to 2.5 percent of GDP. The recovery rate of nonperforming loans parked at the Turto Bankas remains very low. Residual shareholdings and real estate objects of the central and local governments would be substantially reduced after the privatization in the banking and energy sectors have been completed.

Box 5. Lithuania: Potential Impact of a Global Economic Slowdown

The staff's baseline scenario is predicated on the assumption that the recent deterioration in the external environment continues into the first half of 2002. It assumes that growth in the EU, which accounts for roughly half of Lithuania's exports, slows from 1.7 percent in 2001 to 1.4 percent in 2002 (Table). Under these conditions, Lithuania's growth rate is expected to decelerate from around 4.5 percent in 2001 to 4.0 percent in 2002, with a continued recovery in domestic demand and the strength of exports to eastern Europe partly offsetting the weakness of exports to the EU. Consumer price inflation is forecast to remain moderate—although somewhat higher than 2001 following EU-related increases in excise duties—at 2.8 percent in 2002.

The possibility of a sharper slowdown in the world economy poses a substantial downside risk, especially if accompanied by a further significant fall in oil prices.[1] The latter would have a negative impact on Russia and other CIS markets which, hitherto, have continued to grow relatively strongly and thus provided something of a safety valve for Lithuanian exporters. The resulting reduction in exports to both eastern and western Europe would directly reduce real GDP growth and lead to a wider current account deficit. The eventual reduction in growth would be somewhat larger if consumer and investor confidence were also adversely affected, although this would also tend to reduce imports and thus offset some of the deterioration in the current account deficit. Lower oil prices would also directly reduce the nominal import bill given Lithuania's position as a (small) net importer of petroleum products.

Staff estimate that, taken together, a reduction in EU growth to ½ percent in 2002 together with a fall in oil prices to US$18 per barrel, could reduce real GDP growth in Lithuania to 2.0 percent in 2002, with the current account deficit widening to around 6.3 percent of GDP. Lower oil prices would also lead to lower domestic inflation, although the GDP deflator would remain broadly unchanged following the improvement in the terms of trade. In the absence of any policy response, this would, in turn, reduce the growth in government revenues and, pari passu, lead to a deterioration in the fiscal balance of around 0.5 percent of GDP compared to the baseline.

Table. Lithuania: Macroeconomic Scenarios, 2000-2002
(In percent of GDP; unless otherwise indicated)

	Baseline Scenario			"Lower world growth" Scenario
	2000	2001	2002	2002
External assumptions				
EU real GDP growth rate	3.4	1.7	1.4	0.5
Oil price (US dollars per barrel)	28.2	25.0	21.0	18.0
Lithuanian Macroeconomic indicators				
Real GDP growth rate	3.9	4.5	4.0	2.0
GDP deflator	2.1	2.0	3.0	3.2
Domestic savings	14.8	13.9	14.1	13.3
Private	14.9	14.0	14.1	13.5
Public	-0.2	-0.1	0.3	-0.2
Domestic investment	20.7	19.7	19.9	19.6
Private	18.8	18.1	18.5	18.2
Public	1.9	1.6	1.4	1.4
Current account balance	-6.0	-5.8	-5.8	-6.3
Fiscal balance	-2.7	-1.7	-1.5	-2.0
Memorandum items:				
Exports of GNFS (in millions of US$)	5,109	5,912	6,108	5,823
Imports of GNFS (in millions of US$)	5,832	6,521	6,779	6,538
Government revenues (in millions of litai)	13,707	14,136	14,763	14,526
Government expenditures (in millions of litai)	15,011	14,861	15,539	15,539

Source: Staff estimates and projections.

[1] Oil prices have fallen further since the mission. The latest WEO oil price assumption for 2002 is $18.5 per barrel, only slightly above the assumption in staff's lower world growth scenario. A significant fall below this level, despite leading to an improvement in the terms of trade, would therefore pose an additional risk to the macroeconomic outlook given its impact on Russia and other CIS export markets, as outlined above.

accompanied by a significant increase in the costs of financing, the authorities agreed that additional revenue-raising and expenditure-cutting measures may be necessary to ensure fiscal and external sustainability.

D. Structural Issues

26. **Structural reform efforts will continue in 2002.** In addition to the measures in the SMEP, and recommendations of the FSAP mission, the authorities will undertake further reforms and strengthen implementation in a number of areas, including in connection with the World Bank Structural Adjustment Loan (SAL) and EU accession (Box 6).

Fiscal Structural Reforms

27. **Comprehensive measures have been prepared to deal with municipal finances and arrears** (SMEP, paragraph 19). Based on the new legislation, which defines municipal functions and methodologies for establishing their costs, the amount of earmarked transfers for state-delegated functions and education expenditures calculated on a per-student basis will be guaranteed. Municipalities will be required to take adequate revenue/expenditure measures in other areas in the event of shortfalls in their other revenue. Legislation giving more discretion in setting tax rates and fees accruing to local budgets, including a real estate tax, was recently submitted to Seimas. To assist municipalities in reducing the stock of expenditure arrears, the government will allocate LTL 200 million over the next three years, of which LTL 64 million in 2002. Disbursements will be linked to clearance of arrears following a schedule that municipalities will prepare together with their 2002 budget.[12] In addition to continued monthly monitoring of municipal arrears by a cabinet-level commission, the State Control will conduct further audits of municipalities in 2002, with penalties for municipal appropriation managers found not to be in observance of the new legislation.

28. **The government is preparing revised legislation for the pension reform introducing a three-pillar system** (SMEP, paragraph 21). The main principles of the reform remain unchanged, but the new system would be in place from 2004, a year later than originally planned, to allow for a smoother transition. By then, SoDra is expected to generate surpluses, while the State Tax Inspectorate will have gained sufficient operational experience after taking over the payroll tax collection unit of SoDra. To complete the merger, the government has submitted to Seimas amendments to the laws on Social Security and Tax administration. In addition, legislative acts to reduce expenditure on generous state pension benefits paid outside the system of the mandatory pension insurance will be submitted to Seimas in 2002.

[12] By law, municipalities submit their budget two months after approval of the state budget.

Box 6. Lithuania: Agenda for Further Structural Reforms in 2002

In addition to reforms to be implemented under the stand-by arrangement program and described in the SMEP, the authorities will undertake further reforms and strengthen implementation in a number of areas, including in connection with the World Bank SAL and EU accession.

Financial management and control:

- Strengthen multi-year budgeting and execution, in particular for investment and program planning, evaluation and reporting
- Introduce financial statements according to ESA-95; prepare for shift to accrual accounting
- Approve new law on tax administration to strengthen taxpayer rights, equity among taxpayers and efficiency of administration
- Complete unification of state tax inspectorate (STI) and tax collection activities of SoDra
- Introduce EU-compliant and harmonized IT systems for STI and customs
- Harmonize procurement legislation with EU; strengthen capacity of public procurement office
- Strengthen internal audit and financial management and control; strengthen legal framework and independence of the state auditor

Business environment:

- Introduce legal provisions for new corporate registry to ensure information management, modern IT system and staff training
- Enact statutes of the product standards association; complete adoption of EU product standards; strengthen administrative capacities for market surveillance, especially at borders
- Amend patent legislation to meet EU requirements and those of international treaties.
- Approve secondary legislation in intellectual property rights; strengthen administrative capacity in enforcement of copyrights
- Harmonize legislation on e-commerce with EU; strengthen capacity and independence of data protection inspectorate

Agriculture/land reform:

- End regulation of grain and sugar pricing via approval of new law on agriculture and rural development
- Separate state agriculture market operations from export promotion and information dissemination
- Abolish constitutional restrictions on acquisition of agriculture land by foreigners and foreign legal entities and authorization procedures for acquisition of non-agricultural land by foreigners
- Further complete land restitution and farm titling
- Strengthen agriculture inspection arrangements and upgrade inspection and testing facilities

Statistics:

Improve regional statistics

Transportation/communications:

- Align vehicle taxation and user charges with EU
- Pursue restructuring of railways, (management independence, separation of infrastructure management from transportation operations, strengthen administration); introduce regulatory framework for infrastructure charges
- Strengthen capacity of communications regulatory authority

Labor, social protection and state pensions:

- Adopt new labor code; strengthen labor health and safety inspection institutions
- Adopt new public health law
- Approve new civil service law to ensure financing for early retirement and supplementary state pensions and to facilitate creation of privately funded pensions

Financial sector: [1]

- Approve new law on securities markets to strengthen authority and independence of securities commission
- Amend civil code and companies law to provide more strict liability for contract fraud and corporate misrepresentation
- Strengthen supervision of insurance services and of auditors and audit companies
- Improve implementation of anti-money laundering measures and strengthen independence of monitors

Energy/environment:

- Agree pricing of electricity transmission and distribution; finalize power purchase agreements
- Conclude sale of at least 51 percent of distribution assets of LPC through an open tender to international strategic investors
- Conclude sale of least 34 percent of LG through an open tender to international strategic investors
- Approve law on energy to extend regulatory commission authority over licensing, trading, supervision, service quality and consumer protection; strengthen commission capacity
- Approve new district heating law
- Set precise date for closure of Ignalina Unit #2
- Strengthen implementation of EU standards for water and air quality, waste management

Enterprise restructuring/bankruptcy:

- Increase staffing and training of the judiciary, bankruptcy administrators and the competition council

[1] Some of these measures are part of the FSAP recommendations.

Financial Sector Reforms

29. **The authorities broadly agreed with the thrust of assessments and most recommendations of the FSAP mission** (Box 7). The main conclusion of the FSAP mission is that there are no major immediate risks to the stability of the Lithuanian financial system. Stress-testing shows that banks would be able to withstand a wide range of shocks. Even so, continued strengthening of the institutional underpinnings of financial stability, and implementation of prudent macroeconomic policies along with a fiscal policy that supports the credibility of the CBA, will be important to limit the risks in future years. The BoL and the government will implement a number of recommendations of the FSAP mission related to cooperation with foreign supervisory authorities, leasing and mortgage financing, and supervision of insurance companies (SMEP, paragraph 23). At the same time, the BoL believes that the current system of liquidity risk management and loan provisioning are adequate, whereas the FSAP mission saw some room for improvement. The BoL and the FSAP mission agreed that some changes in the legal framework for bank failure resolution might be worth considering. The FSAP mission also noted that the authorities could consider creating a unified supervisory authority to deal with the expected integration of financial markets and rise of financial conglomerates. The authorities were of the view that such a move was not strongly indicated at the present stage of institutional and market development, but agreed with the mission that such a reform could be envisaged in the longer term. The authorities also decided to participate in the pilot project for the assessment of anti-money laundering policies, and consider implementing recommendations in this area.

30. **The overall findings of the Stage One safeguards assessment of the BoL indicated that the BoL's safeguards appear generally adequate and a Stage Two (on-site) assessment was not considered necessary at this juncture.** However, the safeguards assessment report recommended that: (i) the BoL establish procedures to ensure an action plan for the implementation of the external and internal audit recommendations; (ii) strengthen its overall governance in the financial reporting, audit, and internal controls areas by establishing an oversight body, such as an audit committee; (iii) strengthen compliance with International Accounting Standards (IAS) and ECB accounting standards, and disclose differences, if any, between BoL's accounting principles and IAS and the ECB in its financial statements; and (iv) improve accounting practices and disclosures for IMF transactions. Finally, staff also recommend that the BoL be monitored during the duration of the arrangement and, therefore, request that the central bank provide IMF staff with copies of the year 2001 and year 2002 audited financial statements and related audit reports. These weaknesses will be discussed with the authorities in the context of the second review of the program.

Other Areas

31. **Despite economic growth, unemployment has fallen only gradually in recent months, as it is largely structural in nature, reflecting skills mismatches and limited geographical mobility.** The authorities expressed their determination to bring about a further reduction in unemployment through enhanced labor market flexibility, and the provision of well-targeted training opportunities. The new labor code, which was submitted to Seimas in

Box 7. Lithuania: Conclusions of the FSSA Report

There appear to be no immediate threats to financial system soundness in Lithuania. Both domestic and foreign indebtedness are low, with the current account deficit financed largely by private foreign direct investment inflows. Banks have adopted a conservative approach to lending and risk management, and their capitalization and loan quality are generally adequate. Securities and insurance markets are not large enough to pose a significant systemic risk in the near term. The payment and settlement system handles only a limited number of transactions and has shown itself to be robust in previous periods of stress. Regulation and supervision of banking and securities markets are well-developed, and there is a high degree of transparency in monetary and financial policies. There are, however, significant weaknesses in insurance regulation and supervision, which the authorities are working to remedy.

Stress-tests indicate that the Lithuanian financial system should be able to cope with a wide range of shocks. Shocks considered in the stress-testing exercise, both individually and in combination, included swings in interest rates and exchange rates (such as the euro-dollar cross rate), declines in interest margins, and a downturn in real economic activity. In particular, absent unusually and unexpectedly large movements in the euro-dollar rate between now and the repegging date, there appear to be no significant risks to financial system stability from the repegging of the litas. Only a very major shock, such as a banking crisis in the countries of origin of the major bank shareholders, might materially affect the solvency of the Lithuanian banks through foreign bank ownership linkages.

The assessment of **anti-money laundering policies** found the legal and regulatory framework to be largely in line with international standards, but it also identified areas for improvement in the examination and cooperation practices of supervisory agencies involved in preventing money laundering.

Key recommendations of the FSAP mission include:

- expanding the legal powers of the BOL to intervene in and quickly resolve the failure of banks experiencing financial distress or insolvency;
- strengthening supervisory cooperation with the home country supervisors of Lithuanian banks' parent institutions, and establishing sufficiently stringent limits on domestic banks' exposures to their parent institutions;
- improving the quality of borrower and bank financial statements, strengthening accountability of bank directors for risk management, and revising loan classification and provisioning rules to better reflect borrower creditworthiness and the fair value of collateral;
- reconsidering the present arrangements for the management of the assets of failed banks;
- unifying financial sector supervision in the longer term;
- publicizing activities of the Deposit Insurance Fund (DIF); disclosing a possibility of a back-up line of credit from the Ministry of Finance; and limiting moral hazard of DIF operations;
- improving consumer protection for insurance policyholders and strengthening the independence and the capacity of the State Insurance Supervisory Agency;
- limit the government program of subsidized mortgage financing and provide incentives for leasing;
- strengthening anti-money laundering procedures, including through: giving the State Insurance Supervisory Agency and Lithuanian Securities Commission clear responsibility for enforcing anti-money laundering regulations and extending their controls over internal control procedures of companies under their supervision, introducing a new system of information sharing on money laundering, and providing the Tax Police department with adequate resources.

November 2001, is expected to introduce more flexibility by allowing lower minimum wages for specific groups, including certain classes of unskilled workers and, possibly, certain regions. In addition, the authorities remain committed to the maintenance of social cohesion, through the provision of well-targeted support to the most vulnerable sections of society. The Unemployment Insurance Law, which will be submitted to Seimas in 2002, is expected to strengthen the insurance element in the payment of unemployment assistance.

32. **The remaining structural reform agenda, which is driven in part by the requirements of EU accession,** includes the completion of the large-scale privatization program and the identification and implementation of measures to further enhance competitiveness. The authorities re-iterated their intention to privatize Lithuanian Gas and the Lithuanian Power Company in 2002,[13] and to press ahead with the eventual privatization of the last few remaining major state-owned enterprises, including Lithuanian Airlines and Lithuanian Railways (SMEP paragraphs 26 and 27). The authorities are implementing measures to streamline company registration and liquidation, and will continue to follow the recommendations of the sunrise commission regarding the streamlining of business regulation (SMEP paragraph 24).

33. **The authorities are committed to take further steps to rationalize support for the agricultural sector, with a view to EU accession.** The introduction in September 2001 of minimum prices for grain and sugar was a step backward, but the authorities would terminate the government's authority to regulate agricultural prices, consistent with commitments under the World Bank SAL. The government also indicated their intention to facilitate the use of the financing available through the EU SAPARD program to leverage its efforts to foster rural development and investments in rural infrastructure.

IV. Medium-Term Objectives and Strategy

34. **The medium-term macroeconomic framework envisages a gradual acceleration in GDP growth, combined with continued low inflation and a reduction in the current account deficit.** Real GDP growth is projected to accelerate gradually to around 6 percent over the medium-term, driven initially by a continued recovery in domestic demand and subsequently by an acceleration of export growth. Export growth is expected to pick up significantly in 2003 and to stay strong beyond Lithuania's EU accession in 2004. As a result, the current account deficit will be gradually reduced to around 5 percent of GDP by 2005, and is expected to be largely financed by non-debt creating inflows. FDI inflows are projected to moderate as the privatization process draws to a close, but remain substantial at around 2.5-3.5 percent of GDP per annum. This would contribute to a further strengthening of external viability as reflected in a gradual decline of the gross external debt ratio to below 40 percent of GDP by 2005. Lithuania's ability to attract significant inflows on favorable terms is dependent on the continuation of sound macroeconomic management, and is also

[13] Energy sector issues were discussed in detail in EBS/01/135 (Box 3).

supported by favorable prospects for early EU accession (which is expected to take place in 2004).

35. **Further fiscal consolidation, together with sustained implementation of structural reforms, will further buttress investors' confidence in the economy.** Unemployment should decline further, albeit slowly, reflecting the strengthening recovery, more flexible labor laws and, to some extent, the planned reduction in labor taxation. Having fallen for the last two years, real wages appear to have stabilized and are expected to grow moderately over the medium-term. Inflation is expected to remain at around 3.0 percent, slightly above likely average inflation in the euro area, reflecting relatively faster productivity growth in Lithuania's tradable sector.

V. Staff Appraisal

36. **Over the last year, Lithuania has made remarkable progress,** maintaining macroeconomic stability, accelerating growth, reducing vulnerabilities and implementing an impressive package of structural reforms. The authorities should be commended for their successful implementation of the program, preserving continuity despite political changes, and the staff encourages them to persevere in their efforts. These successes, however, should not lead to complacency, as structural reforms must continue, and recent policy changes need to be effectively implemented. Vulnerability to potential exogenous shocks, although reduced, still calls for the continuation of strict financial policies.

37. **Although areas of weakness remain, the authorities' efforts have left Lithuania better placed to face the challenges of 2002.** These challenges include managing successfully the repegging of the litas in a complex international financial environment; keeping fiscal discipline to buttress credibility; maintaining the momentum for the structural reforms needed over the medium term, so as to create the conditions for sustained growth and competitiveness in the face of what could be a more adverse external environment; and concluding accession negotiations with the EU, in order to be able to join in the first wave of enlargement in 2004. These are not easy challenges, and there is little room for policy or implementation slippages.

38. **The staff endorses the authorities' plans for the repegging of the litas to the euro in February 2002,** with a view to moving smoothly toward greater economic integration with the EU, while preserving the credibility of the CBA, which has anchored macroeconomic stability, while competitiveness has been maintained. The staff considers that the BoL's strategy to make the process as transparent as possible, in order to minimize uncertainties, inform the population, and make extensive technical preparations, has been appropriate. The authorities are encouraged to continue with their technical preparations and plans to ensure a smooth transition.

39. **The credibility of the CBA hinges crucially on a supportive fiscal stance.** The budget target for 2002 aims at consolidating the hard-won adjustment achieved in 2000-01, with a modest further adjustment. The 2002 budget seeks to limit the erosion of tax revenue,

allocate expenditure in line with medium-term priorities to promote growth, and remain consistent with the medium-term goal of achieving a cyclically balanced budget. The staff urges the authorities to adhere to the target, resisting pressures to increase expenditures without accompanying revenue measures.

40. **Given the persistent shortfalls, measures to stabilize revenues constitute an urgent priority,** and the staff welcomes the comprehensive tax package prepared by the government. Eliminating exemptions and loopholes would allow for a reduction of rates while preserving tax revenue, promoting fairness and transparency and fostering private activity. The staff urges the authorities to resist pressures to maintain or award preferential treatments to particular groups or sectors, which would jeopardize the tax reform objectives, generally without stimulating growth. The staff would also encourage the authorities to accelerate the implementation of revenue-raising measures, particularly if the attainment of fiscal objectives were under threat.

41. **On the expenditure side, it is important to set clear priorities in the context of the annual budget process.** In this regard, binding floors on certain expenditure categories reduce flexibility and may lead to suboptimal allocations. Careful prioritization is required given that new EU and NATO-related commitments will have to be faced and that there is little room for further cuts if essential services and social expenditures are to remain adequate. There also would appear to be little scope for large payments in connection with the savings and land restitution plans in the near future. The public investment program has to be geared toward preparing the economy for EU accession. While the staff welcomes the improved administrative framework, allowing Lithuania to make effective use of EU structural funds, implementation capacity needs to increase. Moreover, there is room to pursue expenditure rationalization and efficiency gains across the board.

42. **Urgent steps were called for to improve the financial situation of the HIF and municipalities** and prevent the accumulation of arrears. The steps to limit HIF expenditures are significant and deserving of support. Regarding municipalities, new legislation allocating expenditure responsibilities and the concomitant resources, as well as regular audits and monitoring are important steps in the right direction. The proposed real estate tax will help by providing a more stable source of own revenue. However, the staff urges the authorities to ensure that additional transfers to the municipalities are clearly linked to concrete measures and arrears reduction by them. In addition, expenditure rationalization is needed. Finally, in the staff's view, municipal finance reform will only bring positive results if the government uses all possible legal means and moral authority to oblige the municipalities to follow the new principles of financial relations between the state and municipal budgets.

43. **The staff welcomes the progress in preparing for a reform of the pension system** to be implemented as of 2004. Given the importance of garnering public support for the process and the logistical complexity of its implementation, this delay appears justified. The staff also understands the cost considerations that led the government to opt for a less costly second pillar. The staff supports the authorities' intention to bring certain groups of self

employed into the full pension insurance scheme and to reduce state pensions. It is essential that adequate resources for the financing of this reform be provided.

44. **A significant acceleration in structural reforms took place in 2001.** In particular, the completion of the restructuring of the energy sector paved the way for privatization in 2002, while bank privatization led to efficiency gains and greater competition. The staff encourages the authorities to complete rapidly the privatization of the Agricultural Bank. Bank privatization, together with a strengthened banking system, following the recommendations of the FSAP mission, should enhance the efficiency of financial intermediation and increase confidence in the domestic financial system. The staff encourages the authorities to take steps, along the lines of the FSAP recommendations, to strengthen the financial system further and adapt to the evolving environment. In this regard, the staff welcomes the authorities' decision to participate in the pilot project to assess anti-money laundering policies and practices.

45. **Nonetheless, the staff would urge the authorities not to lose momentum in the coming months,** and continue to implement steps critical for investment, growth, and reducing unemployment, in particular measures to facilitate private activity and deregulation, which are key to improving Lithuania's business environment and competitiveness. Recent initiatives to set indicative prices in agriculture are regrettable, and the staff urges the authorities to reverse them and to implement the reforms contained in the World Bank's SAL, aimed at boosting efficiency and reducing the scope of government support. The judicious use of SAPARD structural funds should help prepare Lithuania's agricultural sector for EU accession.

46. **The authorities' strategy has risks.** First, it relies heavily on the maintenance of fiscal discipline. Resisting calls for increased expenditure will need strong resolve by the government, especially in the face of high unemployment and sectoral pressures. The government will have to secure political support for a rapid approval of the ambitious tax package by Seimas and pursue steadfastly the elimination of exemptions. Second, while the repegging strategy seems appropriate and the risk of disruption appears small, the authorities need to ensure the continued credibility of the CBA after the repegging, maintaining fiscal restraint and competitiveness. Third, the current global slowdown might be deeper or longer than envisaged, while lower oil prices could also adversely affect Russia and other CIS export markets. Growth could therefore be lower than projected, putting additional pressure on the budget. The government should be ready to take the necessary measures to preserve a sound fiscal position. Fourth, gross financing needs in 2002 are large. While Lithuania should be able to cover them, even if access to international financial markets were to become difficult, further adjustment might be needed in the event of sharp increases in interest rates, which would also adversely impact private sector activity. Fifth, the authorities' strategy of strict financial discipline and rapid EU accession places much of the impetus for growth on the private sector, and the state must promote a supportive business environment via effective implementation of the legal framework put in place over the last several years. In addition, a large number of laws need to be approved by Seimas, and the government will have to forge

consensus across the political spectrum, particularly on sensitive decisions that may impact EU accession.

47. **Despite these concerns, the staff would like to reiterate its overall assessment that the authorities' strong program remains on track and deserves support.** The timely passage of the 2002 budget demonstrates the authorities' commitment to the program. Overall, the stance of macroeconomic policies remains appropriate, and the staff is confident that the authorities would modify polices quickly and appropriately in response to adverse external or domestic shocks. Thus, the staff supports the completion of the first review under the stand-by arrangement.

48. **Lithuania's statistical base is generally adequate, and the quality and timeliness of data allow effective surveillance and macroeconomic analysis.** The authorities have subscribed to Standard Data Dissemination System since May 1996. Further improvements in the consolidation of general government operations statistics remain a priority, and progress in this regard is expected to be made in 2002. The staff supports the authorities' interest in a fiscal ROSC, which would provide recommendations for improving transparency and data quality in the budget process. In addition, the staff urges the authorities to follow the recommendations of the safeguards assessment and achieve compliance in the near future.

49. **The staff welcomes Lithuania's decision to publish this Article IV staff report.**

50. **The staff recommends that Lithuania remain on the standard 12-month consultation cycle.**

Table 1. Lithuania: Selected Macroeconomic Indicators, 1998-2002

	1998	1999	2000	2001					2002	
				Q1	Q2	Q3	Year			
				Act.			Prog.	Proj.	Prev. Proj.	Proj.
National income, prices, and wages										
Nominal GDP (in millions of litai)	42,990	42,655	45,254	10,684	12,093	12,726	47,012	48,087	50,509	51,531
GDP (in millions of U.S. dollars)	10,748	10,664	11,314	2,671	3,023	3,182	11,753	12,022	12,627	12,883
Real GDP growth (year-on-year, in percent)	5.1	-3.9	3.9	4.4	5.7	5.2	3.6	4.5	4.7	4.0
Average CPI (year-on-year change, in percent)	5.1	0.8	1.0	0.1	0.5	1.8	0.6	1.4	2.8	2.8
End-of-period CPI (year-on-year change, in percent)	2.4	0.3	1.5	0.7	1.5	2.1	2.0	2.0	3.0	2.8
GDP deflator (year-on-year change, in percent)	6.7	3.2	2.1	1.4	1.0	-0.9	1.0	1.6	2.6	3.0
Average monthly wage (in U.S. dollars)	232	247	252	260	267	267	...	...	...	...
Unemployment rate (in percent) 1/	6.9	10.0	11.5	13.2	12.1	12.0	...	...	...	...
Saving-investment balance (in percent of GDP)										
Gross national saving	12.3	11.5	14.8	11.6	13.6	...	15.2	13.9	15.4	14.1
General government	-1.1	-3.9	-0.2	-0.3	-0.5	...	0.7	-0.1	0.8	0.3
Non-government	13.4	15.4	14.9	11.9	14.1	...	14.6	14.0	14.6	13.9
Gross national investment	24.4	22.7	20.7	17.0	18.1	...	21.9	19.7	22.0	19.9
Foreign saving	12.1	11.2	6.0	5.4	4.6	...	6.7	5.8	6.6	5.8
General government (in percent of GDP)										
Financial balance	-4.4	-6.2	-2.1	-1.0	-2.0	-0.3	-1.3	-1.7	-0.9	-1.1
Net lending	1.5	2.4	0.7	-0.1	-0.1	0.7	0.1	0.1	0.4	0.4
Fiscal balance	-5.9	-8.5	-2.7	-0.9	-1.9	-1.0	-1.4	-1.7	-1.3	-1.5
External sector										
Current account balance										
in percent of GDP	-12.1	-11.2	-6.0	-5.4	-4.6	...	-6.7	-5.8	-6.6	-5.8
in millions of U.S. dollars	-1,298	-1,194	-675	-145	-138	...	-786	-695	-836	-741
Gross official reserves (in millions of U.S. dollars) 2/	1,460	1,242	1,359	1,287	1,455	1,598	1,790	1,565	1,986	1,944
Gross external debt (in percent of GDP) 3/	34.8	42.5	42.9	44.5	41.8	...	44.8	43.6	44.5	43.8
Debt service (in percent of exports of GNFS)	18.3	20.0	20.9	61.0	28.0	...	13.5	28.9	16.4	14.0
Exchange rate (litai/euro, period average)	...	4.18	3.70	3.69	3.49	3.56	...	...	...	...
Real effective exchange rate (1998=100, "+"=appreciation) 4/	100.0	112.9	120.2	117.5	119.5	119.9	...	...	...	...
Money and credit										
Reserve money (year-on-year change, in percent)	28.8	-4.0	-3.3	-0.4	2.2	0.1	2.3	5.5	4.4	13.4
Broad money (year-on-year change, in percent)	14.5	7.7	16.5	19.4	17.2	18.9	8.9	15.8	8.5	15.0
Private sector credit (year-on-year change, in percent) 5/	16.9	13.8	-1.2	3.0	1.2	9.5	9.7	9.8	10.2	15.9
Money multiplier	2.0	2.2	2.6	2.9	2.9	3.1	2.8	2.9	2.9	2.9
Currency/deposits, in percent	50.7	43.9	34.1	31.0	31.3	29.9	32.5	31.3	31.6	31.6
Foreign currency deposits/ litai deposits, in percent	57.0	77.7	83.8	90.4	88.6	86.6	80.9	88.6	80.9	88.6

Sources: Lithuanian authorities; and Fund staff estimates and projections.
1/ Registered unemployment, end-of-period.
2/ Gross official reserves reported here differ from the monetary survey because they include reverse repos involving major currencies in both legs.
3/ External liabilities minus foreign equity investment in Lithuania.
4/ CPI-based, trade-weighted real effective exchange rate against 21 major trading partners in 1999.
5/ December 2000 is adjusted for reclassification of LTL 270 million of DMB's claims on private sector which were removed from balance sheets in July 2000.
Also, August 2001 numbers have been adjusted by LTL 785 million of reclassified assets.

Table 2: Lithuania: Balance of Payments, 2000-2006

	2000	2001				2002		2003	2004	2005	2006
		H1	H2	Year							
				Prog.	Proj.	Prev. Proj.	Proj.	Projections			
	(In millions of US dollars, unless otherwise indicated)										
Current account	-675	-283	-412	-786	-695	-836	-741	-760	-793	-827	-859
Trade balance	-1,104	-387	-649	-1,197	-1,036	-1,214	-1,108	-1,136	-1,400	-1,432	-1,466
Exports (f.o.b.)	4,050	2,417	2,383	4,335	4,800	4,549	4,961	5,613	6,025	6,612	7,337
Imports (f.o.b.)	5,154	2,804	3,032	5,532	5,835	5,763	6,068	6,750	7,425	8,044	8,803
Non-factor services, net	380	205	221	400	426	420	437	459	476	494	512
Credits	1,059	535	577	1,118	1,112	1,162	1,147	1,194	1,240	1,288	1,338
Debits	679	330	356	719	686	743	710	734	764	795	827
Factor income, net	-194	-216	-119	-246	-335	-311	-340	-367	-394	-461	-478
Current transfers, net	243	114	136	258	250	270	269	284	524	573	573
Capital and financial account	705	433	552	1,236	985	1,072	1,160	779	821	840	862
Capital transfers, net	2	1	5	6	6	5	5	5	5	5	5
Financial account	702	432	547	1,230	979	1,067	1,155	774	816	835	857
Direct investment, net	375	318	115	530	433	475	545	465	460	460	460
Portfolio investment, net	265	235	83	242	318	375	235	170	20	154	154
Other investment, net	63	-121	348	458	228	217	375	139	336	221	243
Net errors and omissions	127	-32	0	0	-32	0	0	0	0	0	0
Financing	-157	-118	-140	-451	-259	-236	-419	-19	-28	-14	-2
Fund financing	-26	0	-30	-36	-30	-40	-40	-40	-32	-25	-13
Change in official reserves (-=increase)	-131	-118	-110	-414	-229	-196	-379	21	4	11	11
Official reserves and external debt											
Gross official reserves 1/	1,359	1,455	1,565	1,790	1,565	1,986	1,944	1,923	1,919	1,908	1,897
Gross external debt 2/	4,856	4,867	5,236	5,261	5,236	5,615	5,647	5,871	6,139	6,410	6,681
Public and publicly guaranteed	2,364	2,389	2,489	2,603	2,489	2,637	2,662	2,688	2,574	2,568	2,561
Private	2,493	2,479	2,747	2,657	2,747	2,978	2,985	3,183	3,565	3,843	4,120
Net external debt 3/	2,948	2,850	3,205	3,733	3,205	4,285	3,726	3,945	4,219	4,520	4,854
Public and publicly guaranteed	2,364	2,389	2,489	2,603	2,489	2,637	2,662	2,688	2,574	2,568	2,561
Private	584	461	716	1,130	716	1,648	1,064	1,257	1,645	1,952	2,292
Short-term gross external debt											
On a remaining maturity basis	2,600	1,777	1,888	1,908	1,888	2,146	1,954	1,958	1,993	2,122	...
On an original maturity basis	1,114	1,143	1,278	1,239	1,278	1,465	1,355	1,360	1,378	1,507	1,636
Of which:											
Trade credit	732	717	691	782	691	832	741	791	841	891	941
Currency and deposits at banks	247	241	269	269	269	322	315	342	361	418	476
Short-term net external debt 4/	-59	-141	88	102	88	196	261	283	395	447	524
Debt service 5/	1,066	1,282	428	736	1,709	936	858	892	904	932	946
Amortization	854	1,157	329	491	1,486	669	610	598	599	615	615
Interest payments	212	125	99	245	224	266	248	293	305	317	331
	(In percent of GDP, unless otherwise indicated)										
Current account	-6.0	-5.0	-6.5	-6.7	-5.8	-6.6	-5.8	-5.5	-5.3	-5.1	-4.8
Trade balance of goods and services	-6.4	-3.2	-6.8	-6.8	-5.1	-6.3	-5.2	-4.9	-6.2	-5.8	-5.4
Trade balance, goods	-9.8	-6.8	-10.3	-10.2	-8.6	-9.6	-8.6	-8.3	-9.4	-8.8	-8.3
Of which:											
Non-energy trade balance	-3.1	-1.8	-6.0	-3.3	-4.0	-3.5	-5.0	-4.8	-6.0	-5.5	-5.0
Trade balance, services	3.4	3.6	3.5	3.4	3.5	3.3	3.4	3.3	3.2	3.0	2.9
Factor income, net	-1.7	-3.8	-1.9	-2.1	-2.8	-2.5	-2.6	-2.7	-2.6	-2.8	-2.7
Current transfers, net	2.1	2.0	2.1	2.2	2.1	2.1	2.1	2.1	3.5	3.5	3.2
Financial account	6.2	7.6	8.6	10.5	8.1	8.4	9.0	5.6	5.5	5.1	4.8
Direct investment, net	3.3	5.6	1.8	4.5	3.6	3.8	4.2	3.4	3.1	2.8	2.6
Portfolio investment, net	2.3	4.1	1.3	2.1	2.6	3.0	1.8	1.2	0.1	0.9	0.9
Other investment, net	0.6	-2.1	5.5	3.9	1.9	1.7	2.9	1.0	2.2	1.4	1.4
Gross external debt 2/	42.9	41.8	43.6	44.8	43.6	44.5	43.8	42.6	41.1	39.4	37.6
Public and publicly guaranteed	20.9	20.5	20.7	22.1	20.7	20.9	20.7	19.5	17.2	15.8	14.4
Private	22.0	21.3	22.8	22.6	22.8	23.6	23.2	23.1	23.9	23.6	23.2
Net external debt 3/	26.1	24.5	26.7	31.8	26.7	33.9	28.9	28.7	28.2	27.8	27.3
Public and publicly guaranteed	20.9	20.5	20.7	22.1	20.7	20.9	20.7	19.5	17.2	15.8	14.4
Private	5.2	4.0	6.0	9.6	6.0	13.1	8.3	9.1	11.0	12.0	12.9
Short-term gross external debt											
On a remaining maturity basis	23.0	15.3	15.7	16.2	15.7	17.0	15.2	14.2	13.3	13.0	...
On an original maturity basis	9.8	9.8	10.6	10.5	10.6	11.6	10.5	9.9	9.2	9.3	9.2
Of which:											
Trade credit	6.47	6.15	5.75	6.66	5.75	6.59	5.75	5.75	5.63	5.48	5.30
Currency and deposits at banks	2.18	2.07	2.24	2.29	2.24	2.55	2.44	2.48	2.41	2.57	2.68
Debt service, in percent of exports of GNFS 5/	20.9	43.4	14.4	13.5	28.9	16.4	14.0	13.1	12.4	11.8	10.9
Amortization	16.7	39.2	11.1	9.0	25.1	11.7	10.0	8.8	8.2	7.8	7.1
Interest payments	4.1	4.2	3.3	4.5	3.8	4.7	4.1	4.3	4.2	4.0	3.8
Memorandum items:											
Nominal GDP (millions of U.S. dollars)	11,314	5,694	6,328	11,753	12,022	12,627	12,883	13,765	14,944	16,266	17,759
Exports of GNFS (percent change, y-o-y)	20.6	20.6	11.2	6.7	15.7	4.7	3.3	11.4	6.7	8.7	9.8
of which: non-energy exports of GNFS	13.6	13.4	11.7	8.7	12.5	7.7	4.9	8.8	10.5	12.0	12.1
Imports of GNFS (percent change, y-o-y)	9.3	13.2	10.5	7.2	11.8	4.1	3.9	10.4	9.4	7.9	8.9
of which: non-energy imports of GNFS	1.9	10.5	18.4	8.9	14.6	8.4	7.9	8.3	14.2	10.9	11.0

Source: Data provided by the Lithuanian authorities; and staff estimates and projections.

1/ 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 foreign equity investment.

3/ Total external liabilities minus total external assets, excluding foreign direct investment, equity investment and reserve assets.

4/ Total short-term liabilities minus total short-term assets, on an original maturity basis.

5/ Debt service comprises interest and repayment on external loans, and interest and repayment on debt securities. A large debt service ratio for Q1 2001 and 2001 reflects a repayment of large liabilities by commercial banks undertaken ahead of schedule in Q1 2001.

Table 3. Lithuania: Summary of Consolidated General Government Operations, 1998-2002

	1998	1999	2000 1/	2001				2002	
				Prog. 2/	Proj.	Jan.-Sept.		Prev. Proj.	Proj. 3/
						Prog.	Act.		
	(In millions of litai)								
Revenue	14,036	13,687	13,707	14,546	14,122	10,668	10,426	14,775	14,950
Tax revenue	13,433	12,955	12,841	13,489	12,997	9,851	9,522	13,756	13,901
Taxes on income and profits	4,017	3,971	3,835	4,000	3,808	2,899	2,785	4,000	3,956
Payroll tax (social security tax)	3,063	2,891	3,194	3,290	3,193	2,392	2,416	3,445	3,407
Taxes on goods and services	5,596	5,385	5,157	5,583	5,380	4,088	3,880	5,555	5,749
Other tax revenue	756	709	655	615	616	472	442	757	789
Non-tax Revenue	603	732	866	1,057	1,125	817	904	1,019	1,049
Expenditure and net lending	16,362	17,152	15,011	15,160	14,853	11,215	10,759	15,433	15,727
Expenditure	15,734	16,146	14,711	15,097	14,820	11,172	10,703	15,246	15,529
Current expenditure	14,326	15,190	13,839	14,235	14,073	10,618	10,312	14,389	14,811
Wages and salaries, excl. contributions to SoDra	3,290	3,513	3,450	3,499	3,524	2,644	2,553	3,535	3,554
Goods and services	4,899	4,425	4,088	4,258	4,009	3,088	2,904	4,274	4,526
Transfers to households	4,977	5,244	5,401	5,475	5,646	4,144	4,160	5,602	5,783
Subsidies	202	150	103	82	93	39	48	84	66
Interest payments	507	650	782	902	781	690	636	870	834
Savings restitution program	450	1,207	15	20	19	14	10	25	48
Capital expenditure	1,408	956	872	862	747	555	392	857	718
Discrepancy	190	170	-59	64	110	64	110	0	0
Financial balance	-1,888	-2,629	-944	-616	-808	-568	-388	-471	-579
Net lending	628	1,006	300	63	33	43	56	187	198
Lending	1,017	1,381	529	353	337	248	246	379	365
of which: Mazeikiai Oil Company	240	800	88	0	0	0	0	0	0
Repayments	389	-375	-230	-290	-304	-205	-190	-192	-167
Fiscal balance (deficit (-))	-2,516	-3,635	-1,244	-679	-841	-611	-444	-658	-776
Financing	2,516	3,635	1,244	679	841	611	444	658	776
Net domestic	-286	392	-61	-982	118	-400	-288	-192	-583
Bank financing	-666	337	-109	-1,094	-24	-434	-285	-292	-683
Monetary Authorities	-635	602	-480	-1,711	-689	-1,065	-679	-585	-897
Commercial Banks	-31	-265	371	617	665	631	394	293	214
Non-bank financing	380	55	47	113	142	35	-4	100	100
Net foreign	535	2,762	502	371	145	422	231	150	160
Privatization proceeds	2,267	481	803	1,289	579	589	502	700	1,200

Table 3. Lithuania: Summary of Consolidated General Government Operations, 1998-2002 (concluded)

	1998	1999	2000 1/	2001 Prog. 2/	2001 Proj.	2001 Jan.-Sept. Prog.	2001 Jan.-Sept. Act.	2002 Prev. Proj.	2002 Proj. 3/
				(In percent of GDP)					
Revenue	32.7	32.1	30.3	30.9	29.4	30.5	27.9	29.3	29.0
Tax revenue	31.2	30.4	28.4	28.7	27.0	28.2	25.5	27.2	27.0
Taxes on income and profits	9.3	9.3	8.5	8.5	7.9	8.3	7.4	7.9	7.7
Payroll tax (social security tax)	7.1	6.8	7.1	7.0	6.6	6.8	6.5	6.8	6.6
Taxes on goods and services	13.0	12.6	11.4	11.9	11.2	11.7	10.4	11.0	11.2
Other tax revenue	1.8	1.7	1.4	1.3	1.3	1.3	1.2	1.5	1.5
Non-tax Revenue	1.4	1.7	1.9	2.2	2.3	2.3	2.4	2.0	2.0
Expenditure and net lending	38.1	40.2	33.2	32.2	30.9	32.1	28.8	30.6	30.5
Expenditure	36.6	37.9	32.5	32.1	30.8	31.9	28.6	30.2	30.1
Current expenditure	33.3	35.6	30.6	30.3	29.3	30.4	27.6	28.5	28.7
Wages and salaries, excl. contributions to SoDra	7.7	8.2	7.6	7.4	7.3	7.6	6.8	7.0	6.9
Goods and services	11.4	10.4	9.0	9.1	8.3	8.8	7.8	8.5	8.8
Transfers to households	11.6	12.3	11.9	11.6	11.7	11.8	11.1	11.1	11.2
Subsidies	0.5	0.4	0.2	0.2	0.2	0.1	0.1	0.2	0.1
Interest payments	1.2	1.5	1.7	1.9	1.6	2.0	1.7	1.7	1.6
Savings restitution program	1.0	2.8	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Capital expenditure	3.3	2.2	1.9	1.8	1.6	1.6	1.0	1.7	1.4
Discrepancy	0.4	0.4	-0.1	0.1	0.2	0.2	0.3	0.0	0.0
Financial balance	-4.4	-6.2	-2.1	-1.3	-1.7	-1.6	-1.0	-0.9	-1.1
Net lending	1.5	2.4	0.7	0.1	0.1	0.1	0.1	0.4	0.4
Lending	2.4	3.2	1.2	0.8	0.7	0.7	0.7	0.8	0.7
of which: Mažeikiai Oil Company	0.6	1.9	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Repayments	0.9	-0.9	-0.5	-0.6	-0.6	-0.6	-0.5	-0.4	-0.3
Fiscal balance (deficit (-))	-5.9	-8.5	-2.7	-1.4	-1.7	-1.7	-1.2	-1.3	-1.5
Financing	5.9	8.5	2.7	1.4	1.7	1.7	1.2	1.3	1.5
Net domestic	-0.7	0.9	-0.1	-2.1	0.2	-1.1	-0.8	-0.4	-1.1
Bank financing	-1.5	0.8	-0.2	-2.3	-0.1	-1.2	-0.8	-0.6	-1.3
Monetary Authorities	-1.5	1.4	-1.1	-3.6	-1.4	-3.0	-1.8	-1.2	-1.7
Commercial Banks	-0.1	-0.6	0.8	1.3	1.4	1.8	1.1	0.6	0.4
Non-bank financing	0.9	0.1	0.1	0.2	0.3	0.1	0.0	0.2	0.2
Net foreign	1.2	6.5	1.1	0.8	0.3	1.2	0.6	0.3	0.3
Privatization proceeds	5.3	1.1	1.8	2.7	1.2	1.7	1.3	1.4	2.3
Memorandum Items:									
Public and publicly guaranteed debt, mln. LTL	9,817	12,371	13,028	13,938	13,924	...	...	14,602	14,617
In percent of GDP	22.83	29.00	28.79	29.65	28.96	...	...	28.91	28.37
GDP, in mln. LTL	42,990	42,655	45,254	47,012	48,087	34,979	37,403	50,509	51,531

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

1/ From 2000 onward, 5 new extra-budgetary funds, which had not been reported before, were added.

2/ Fees paid to educational establishments and their spending (LTL 128 million) were added to general government operations from 2001 onward.

3/ Fees paid by trucks crossing the borders of the country were added from 2002 onward. In addition, following the new organic budget law, revenue of state institutions for provided services was included in municipal budget from 2002 onward.

Table 4. Lithuania: Summary Monetary Accounts, 1998-2002

	1998	1999	2000	2001					2002	
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.		Dec.	
							Prev. Proj.	Proj.	Prog.	Proj.
	(In millions of litai, unless otherwise indicated)									
Monetary Authority										
Net Foreign Assets	4,836	4,054	4,607	4,381	5,027	5,254	6,503	5,602	7,467	7,278
Net Domestic Assets	-575	35	-655	-700	-1,203	-1,477	-2,459	-1,431	-3,244	-2,549
Net credit to government	-947	-326	-804	-854	-1,296	-1,483	-2,515	-1,493	-3,100	-2,390
Credit to banks	52	30	24	23	16	17	24	24	24	24
Credit to private sector	7	6	6	5	5	5	6	6	6	6
Credit to non-bank financial institutions	7	20	0	0	0	0	10	10	10	10
Other items, net	305	305	120	125	72	-16	16	22	-185	-198
Reserve Money	4,260	4,088	3,953	3,681	3,824	3,777	4,044	4,171	4,222	4,729
Currency outside the central bank	3,036	2,972	2,904	2,714	2,845	2,907	2,989	3,087	3,164	3,543
Currency outside banks	2,800	2,739	2,658	2,511	2,607	2,693	2,789	2,887	2,964	3,343
Cash in vaults of banks	236	233	246	202	237	214	200	200	200	200
Deposit money banks' deposits	1,212	1,109	1,037	949	965	854	1,040	1,069	1,042	1,171
Reserves in litai	868	445	621	553	580	465	618	642	623	673
Required reserves in foreign currency	344	436	416	396	386	389	423	427	420	497
Private and non monetary financial institutions	13	7	12	18	14	16	15	15	16	16
Banking Survey										
Net Foreign Assets	4,292	3,656	5,368	5,370	5,680	6,420	6,869	6,452	7,687	8,358
Monetary authority	4,836	4,054	4,607	4,381	5,027	5,254	6,503	5,602	7,467	7,278
Banks and other banking institutions	-544	-398	761	989	653	1,166	366	850	220	1,080
Net Domestic Assets	4,035	5,316	5,087	5,242	5,258	5,292	4,515	5,660	4,663	5,570
Net claims on government 1/	-505	39	299	303	232	342	-795	546	-1,087	-138
Monetary authority 2/	-947	-326	-804	-854	-1,296	-1,483	-2,515	-1,493	-3,100	-2,390
Banks and other banking institutions 3/	441	365	1,103	1,156	1,528	1,826	1,720	2,040	2,013	2,253
Credit to non-financial public enterprises	352	437	575	578	485	497	598	611	642	655
Credit to private sector 3/	4,874	5,545	5,209	5,396	5,476	4,808	5,714	4,933	6,294	5,718
Credit to non-bank financial institutions	470	468	514	539	626	693	533	546	573	585
Other items, net	-1,155	-1,168	-1,512	-1,574	-1,561	-1,048	-1,535	-976	-1,760	-1,250
Broad Money	8,327	8,972	10,456	10,612	10,938	11,712	11,383	12,113	12,349	13,927
Currency outside banks	2,800	2,739	2,658	2,511	2,607	2,693	2,789	2,887	2,964	3,343
Deposits	5,527	6,233	7,797	8,101	8,331	9,019	8,594	9,225	9,386	10,585
Memorandum items:										
Reserve money (yearly percent change)	28.8	-4.0	-3.3	-0.4	2.2	0.1	2.3	5.5	4.4	13.4
Broad money (yearly percent change)	14.5	7.7	16.5	19.4	17.2	18.9	8.9	15.8	8.5	15.0
Private sector credit (yearly percent change) 3/	16.9	13.8	-1.2	3.0	1.2	9.5	9.7	9.8	10.2	15.9
Money multiplier	2.0	2.2	2.6	2.9	2.9	3.1	2.8	2.9	2.9	2.9
Currency / deposits, in percent	50.7	43.9	34.1	31.0	31.3	29.9	32.5	31.3	31.6	31.6
Foreign currency / litai deposits, in percent	57.0	77.7	83.8	90.4	88.6	86.6	80.9	88.6	80.9	88.6
End-period velocity	...	...	4.00	...	...	...	4.13	3.97	4.09	3.70
Velocity of broad money 4/	6.0	4.9	4.7	...	...	...	4.31	4.26	4.3	4.0
Gross official reserves, in US$ mln. 5/	1,462	1,244	1,344	1,278	1,426	1,484	1,790	1,565	1,986	1,944
GDP, mln. LTL	42,990	42,655	45,254	...	...	...	47,012	48,087	50,509	51,531

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

1/ Excludes local government deposits; includes counterpart funds.

2/ Projections for 2001 onwards include Treasury accounts, which were moved from commercial banks to the BoL at end-June, 2001.

3/ December 2000 is adjusted for LTL 270 million of DMB's claims on private sector, which were removed from balance sheets in July, 2000. Also, August 2001 numbers have been adjusted by LTL 785 million of reclassified assets.

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

5/ Gross official reserves for historic data differ from the BOP table because exposure under reverse repo liabilities were deducted from foreign assets, and differences in valuation. For projections, assumption is that all reverse repo liabilities are unwound.

Table 5. Lithuania: Macroeconomic Framework, 1998-2006

	1998	1999	2000	2001 Prog.	2001 Proj.	2002 Prev. Proj.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.
	(In percent of GDP, unless otherwise indicated)										
Gross national saving	12.3	11.5	14.8	15.2	13.9	15.4	14.1	14.4	15.9	16.2	16.5
General government	-1.1	-3.9	-0.2	0.7	-0.1	0.8	0.3	1.0	2.3	2.8	2.8
Non-government	13.4	15.4	14.9	14.6	14.0	14.6	13.9	13.4	13.6	13.4	13.6
Gross national investment	24.4	22.7	20.7	21.9	19.7	22.0	19.9	19.9	21.2	21.3	21.3
General government	3.3	2.2	1.9	1.8	1.6	1.7	1.4	1.8	2.9	3.3	3.3
Non-government	21.1	20.4	18.8	20.1	18.1	20.3	18.5	18.2	18.3	18.0	18.0
Foreign saving 1/	12.1	11.2	6.0	6.7	5.8	6.6	5.8	5.5	5.3	5.1	4.8
General government financial balance 2/	-4.4	-6.2	-2.1	-1.3	-1.7	-0.9	-1.1	-0.8	-0.6	-0.5	-0.5
General government net lending	1.5	2.4	0.7	0.1	0.1	0.4	0.4	0.0	0.0	0.0	0.0
Consolidated general government fiscal balance 2/	-5.9	-8.5	-2.7	-1.4	-1.7	-1.3	-1.5	-0.8	-0.6	-0.5	-0.5
Current account balance	-12.1	-11.2	-6.0	-6.7	-5.8	-6.6	-5.8	-5.5	-5.3	-5.1	-4.8
External debt 3/	34.8	42.4	42.9	44.8	43.6	44.5	43.8	42.6	41.1	39.4	37.6
Debt service (in percent of exports of GNFS)	18.3	20.0	20.9	13.5	28.9	16.4	14.0	13.1	12.4	11.8	10.9
Nominal GDP (in millions of Litai)	42,990	42,655	45,254	47,012	48,087	50,509	51,531	55,060	59,774	65,065	71,038
Real GDP growth (annual percentage change)	5.1	-3.9	3.9	3.6	4.5	4.7	4.0	4.8	5.3	6.0	6.0
Average CPI inflation (annual percentage change)	5.1	0.8	1.0	0.6	1.4	2.8	2.8	3.0	3.0	3.0	3.0
End-of-period CPI inflation (annual percentage change)	2.4	0.3	1.5	2.0	2.0	3.0	2.8	3.0	3.0	3.0	3.0

Sources: Lithuanian authorities; and Fund staff calculations.

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.

Table 6. Lithuania: Schedule of Available Purchases under the Stand-By Arrangement, 2001-2003

Amount of Purchase	Availability	Contingent On
SDR 12.36 million (8.57 percent of quota)	August 30, 2001	Undrawn
SDR 12.36 million (8.57 percent of quota)	December 1, 2001	Observance of end-Sept. 2001 performance criteria, and completion of first review 1/
SDR 12.36 million (8.57 percent of quota)	March 1, 2002	Observance of end-Dec. 2001 performance criteria.
SDR 12.36 million (8.57 percent of quota)	June 1, 2002	Observance of end-March 2002 performance criteria, and completion of second review 1/
SDR 12.36 million (8.57 percent of quota)	September 1, 2002	Observance of end-June 2002 performance criteria
SDR 12.36 million (8.57 percent of quota)	December 1, 2002	Observance of end-Sept. 2002 performance criteria, and completion of third review 1/
SDR 12.36 million (8.57 percent of quota)	March 1, 2003	Observance of end-Dec. 2002 performance criteria.

Source: Fund staff calculations.

1/ In addition to other clauses in the arrangement.

Table 7. Lithuania: Indicators of Financial Obligations to the Fund, 2002-2008

	2002	2003	2004	2005	2006	2007	2008
				Projections			
Obligations from existing drawings 1/							
Debt Service to the Fund (in millions of SDRs)	34.50	33.60	26.20	19.90	10.80	4.40	0.00
Repurchases (in millions of SDRs)	31.10	31.10	24.60	19.00	10.40	4.30	0.00
Charges (in millions of SDRs)	3.40	2.50	1.60	0.90	0.40	0.10	0.00
In percent of exports GNFS	0.73	0.63	0.46	0.33	0.16	0.06	0.00
In percent of external debt service	5.17	4.85	3.73	2.76	1.39	0.52	0.00
In percent of gross official reserves	2.28	2.25	1.76	1.35	0.68	0.26	0.00
Exports GNFS, in millions of US$	6,108	6,807	7,265	7,900	8,532	9,215	9,952
External debt service, in millions of US$	858	892	904	932	1,006	1,087	1,174
Gross official reserves, in millions of US$	1,944	1,923	1,919	1,908	2,061	2,225	2,404
US$/SDR exchange rate	1.28	1.29	1.29	1.29	1.29	1.29	1.29
Quota, in millions of SDR	144.20	144.20	144.20	144.20	144.20	144.20	144.20
External debt, in millions of US$	5,647	5,871	6,139	6,410	6,923	7,477	8,075
GDP, in millions of US$	12,883	13,765	14,944	16,266	17,567	18,973	20,491
Obligations from existing and prospective drawings 2/							
Debt Service to the Fund (in millions of SDRs)	35.9	36.2	50.3	63.2	32.9	6.0	0.0
Repurchases (in millions of SDRs)	31.1	31.1	46.2	60.7	32.0	5.9	0.0
Charges (in millions of SDRs)	4.8	5.1	4.1	2.5	0.9	0.1	0.0
In percent of exports GNFS	0.8	0.7	0.9	1.0	0.5	0.1	0.0
In percent of external debt service	5.4	5.2	7.2	8.8	4.2	0.7	0.0
In percent of gross official reserves	2.4	2.4	3.4	4.3	2.1	0.3	0.0
Memorandum items:							
Fund credit outstanding							
Without drawings under the stand-by arrangement							
In millions of SDRs	89.3	58.2	33.6	14.7	4.3	0.0	0.0
In millions of US$	114.7	74.9	43.3	18.9	5.6	0.0	0.0
In percent of quota	61.9	40.4	23.3	10.2	3.0	0.0	0.0
In percent of external debt	2.0	1.3	0.7	0.3	0.1	0.0	0.0
In percent of GDP	0.9	0.5	0.3	0.1	0.0	0.0	0.0
Exchange rate US$/SDR	1.3	1.3	1.3	1.3	1.3	1.3	1.3
With drawings under the perspective stand-by arrangement							
In millions of SDRs	163.4	144.7	98.5	37.8	5.9	0.0	0.0
In millions of US$	209.9	186.1	126.9	48.9	7.6	0.0	0.0
In percent of quota	113.3	100.3	68.3	26.2	4.1	0.0	0.0
In percent of external debt	3.7	3.2	2.1	0.8	0.1	0.0	0.0
In percent of GDP	1.6	1.4	0.8	0.3	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 prospective stand-by arrangement.

Table 8. Lithuania: Performance Criteria for Stand-By Arrangement, 2001-2002 1/

	Target	Adjusted Target	Outcome 2/
Continuous performance criteria			
I. Exchange rate			
LTL 4 per US$1 3/	...	...	Observed through end-September
II. 100-percent coverage of currency board liabilities, in percent	100	...	Observed through end-September
III. Reserve requirements, in percent 4/	6	...	Observed through end-September
IV. Non-accumulation of new external payments arrears	...	...	Observed through end-September
Quantitative performance criteria			
I. Ceiling on the general government deficit, mln. LTL			
Cumulative from January 1, 2001			
March 31, 2001 (previous arrangement)	271	287	94
June 30, 2001	460	496	322
September 30, 2001	600	704	444
December 31, 2001	841	...	...
Cumulative from January 1, 2002			
March 31, 2002	383	...	...
June 30, 2002	576	...	...
December 31, 2002	776	...	...
II. Floors on net foreign exchange coverage of the currency board arrangement, mln. US$			
Stocks			
March 31, 2001 (previous arrangement)	-127	...	-39
June 30, 2001	-127	...	-24
September 30, 2001	-127	...	-2
December 31, 2001	-127	...	...
March 31, 2002	-127	...	...
June 30, 2002	-127	...	...
December 31, 2002	-127	...	...

III. Ceilings on contracted public and publicly guaranteed medium- and long-term external debt; mln. US$	All maturities	1-5 year maturity (medium- and long-term)	All maturities	1-5 year maturity
Cumulative from January 1, 2001				
March 31, 2001 (previous arrangement)	293	200	183	0
June 30, 2001	433	200	194	0
September 30, 2001	648	200	194	0
December 31, 2001	683	200	...	...
Cumulative from January 1, 2002				
March 31, 2002	450	200	...	...
June 30, 2002	610	200	...	...
December 31, 2002	640	200	...	...

IV. Ceilings on the outstanding stock of public and publicly guaranteed short-term external debt; mln. US$	Target	Adjusted Target	Outcome 2/
Maximum stock during the period			
March 31, 2001 (previous arrangement)	0	...	0
June 30, 2001	50	...	0
September 30, 2001	50	...	0
December 31, 2001	50	...	...
March 31, 2002	200	...	...
June 30, 2002	200	...	...
December 31, 2002	200	...	...

Source: Lithuanian authorities; and Fund staff estimates.

1/ Definitions and exclusions are presented in the Technical Memorandum of Understanding.
Numbers for end-June 2001 are indicative targets, numbers for end-September 2001, end-December 2001, end-March 2002, and end-June 2002 are performance criteria, and numbers for end-December 2002 are indicative targets.

2/ Based on latest available data.

3/ This performance criterion will be modified on February 2, 2002 consistent with SMEP paragraph 8.

4/ This is consistent with the required reserve ratio of 8 percent.

Table 9. Lithuania: Quantitative Benchmarks for Stand-By Arrangement, 2001-2002

	Ceiling	Outcome
I. Domestic guarantees, mln. LTL		
Outstanding stock		
March 31, 2001 (previous arrangement)	319	217
September 30, 2001	314	232
December 31, 2001	312	...
March 31, 2002	315	...
June 30, 2002	312	...
December 31, 2002	312	...
II. Central government arrears, mln. LTL		
Outstanding stock		
March 31, 2001 (previous arrangement)	0	19
September 30, 2001	0	37
December 31, 2001 1/	0	...
March 31, 2002	0	...
June 30, 2002	0	...
December 31, 2002	0	...

Source: Ministry of Finance; and Fund staff estimates.

1/ A government decision to clear pharmaceutical arrears will be considered as clearance of arrears under the program.

Table 10. Lithuania: Structural Benchmarks for Stand-By Arrangement, 2001-2002

Measure	Date	Status
Submit to Seimas draft amendments to the Law on Revenue Redistribution of Municipalities	end-September 2001	Done
Submit to Seimas draft amendments to the Privatization Law for establishing the Reserve Stabilization Fund	end-September 2001	Done
Tender for privatizing the Agricultural Bank	end-September 2001	Done
Government's decision on a set of measures to overhaul municipal finances	end-December 2001	Done
Submit to Seimas draft amendments to the Law on Social Security needed for the pension reform	end-December 2001	Replaced with another benchmark (Pension reform concept)
Submit to Seimas legal amendments on accounting standards	end-December 2001	Done
Submit to Seimas a new labor code	end-December 2001	Done
Submit to Seimas a Pension Reform Concept	end-December 2001	
Submit to Seimas draft CIT an VAT laws	end-December 2001	Done
Submit to Seimas draft PIT law	end-January 2002	
Submit to Seimas amendments to the law on Tax Administration and law on Social Security on the merger of the SoDra's payroll tax collection unit with STI	end-January 2002	Done
Finalize quarterly plan for arrears reduction of municipalities	end-March 2002	
Submit to Seimas the draft unemployment insurance law	end-June 2002	

Source: Lithuanian authorities.

Table 11. Lithuania: Indicators of External and Financial Vulnerability, 1998-2001

	1998	1999	2000					2001			
			Mar.	Jun.	Sep.	Dec.	Year	Mar.	June	Latest	Date
Financial indicators											
State debt (domestic and foreign, in percent of GDP) 1/	22.4	28.4	30.4	30.0	28.9	28.1	28.1	28.7	27.8	28.1	Q3/2001
Broad money (year-on-year change in percent)	14.5	7.7	9.1	5.8	11.8	16.5	16.5	19.4	17.2	18.9	Q3/2001
Broad money in percent of gross official reserves	142.6	180.6	160.7	163.8	182.7	192.4	192.4	206.2	188.0	168.8	Q3/2001
Private sector credit (year-on-year change in percent) 2/	16.9	13.8	0.0	-2.4	-8.8	-6.1	-6.1	3.0	1.2	9.5	Q3/2001
External indicators											
Current account balance in percent of GDP	-12.1	-11.2	-5.7	-6.1	-3.4	-8.7	-6.0	-5.4	-4.6	-4.6	Q2/2001
Exports of GNFS (year-on-year change in percent)	-2.9	-16.4	23.5	16.1	22.2	20.5	20.6	15.3	25.8	25.8	Q2/2001
Imports of GNFS (year-on-year change in percent)	1.8	-15.9	16.9	1.9	10.6	9.1	9.3	11.2	15.2	15.2	Q2/2001
Capital and financial account balance in percent of GDP	13.4	9.9	8.9	6.6	0.4	9.6	6.2	8.9	6.4	6.4	Q2/2001
Gross official reserves (in millions of U.S. dollars) 3/	1,460	1,242	1,382	1,424	1,349	1,359	1,359	1,287	1,455	1,735	10/30/01
Gross official reserves/short-term debt 4/	0.84	0.65	0.52	0.48	0.48	0.52	0.52	0.63	0.82	0.82	Q2/2001
Gross official reserves/reserve money	1.37	1.22	1.50	1.52	1.43	1.37	1.37	1.40	153.4	183.0	Q3/2001
Gross official reserves in months of imports of GNFS over the following year	3.3	2.6	2.7	2.7	2.5	2.5	2.5	2.3	2.6	2.6	Q2/2001
Net foreign assets of financial sector (in millions of U.S. dollars) 5/	-120	-79	69	66	163	187	187	244	160	291	Q2/2001
Total gross external debt (in millions of U.S. dollars) 6/	3,739	4,525	4,741	4,845	4,729	4,856	4,856	5106	4867	4,867	Q2/2001
in percent of GDP	34.8	42.4	43.8	44.5	42.7	42.9	42.9	44.5	41.8	41.8	Q2/2001
in percent of exports GNFS (over the last four quarters)	73.7	106.8	106.1	110.0	96.7	95.1	95.1	96.4	86.7	86.7	Q2/2001
of which: Public sector debt (in millions of U.S. dollars)	1,670	2,383	2,552	2,527	2,364	2,364	2,364	2,461	2,389	2,389	Q2/2001
in percent of GDP	15.5	22.3	23.6	23.2	21.3	20.9	20.9	21.5	20.5	20.5	Q2/2001
of which: Short-term external debt (in millions of U.S. dollars) 4/	1,730	1,899	2,674	2,988	2,798	2,600	2,600	2,053	1,777	1,777	Q2/2001
in percent of GDP	16.1	17.8	24.7	27.5	25.2	23.0	23.0	17.9	15.3	15.3	Q2/2001
Total net external debt (in millions of U.S. dollars) 7/	2,243	2,818	2,944	2,890	2,767	2,948	2,948	2,982	2,850	2,850	Q2/2001
in percent of GDP	20.9	26.4	27.2	26.6	25.0	26.1	26.1	26.0	24.5	24.5	Q2/2001
in percent of exports GNFS (over the last four quarters)	...	66	66	64	57	58	58	56.3	50.8	50.8	Q2/2001
of which: Public sector debt (in millions of U.S. dollars)	1,687	2,392	2,631	2,527	2,364	2,364	2,364	2,461	2,389	2,389	Q2/2001
in percent of GDP	16	22	24	23	21	21	21	21	20	20	Q2/2001
of which: Private sector debt (in millions of U.S. dollars)	556	426	313	363	403	584	584	522	461	461	Q2/2001
in percent of GDP	5.2	4.0	2.9	3.3	3.6	5.2	5.2	4.6	4.0	4.0	Q2/2001
Total net external short-term debt (in millions of U.S. dollars)	88	-78	-116	-137	-206	-59	-59	-194	-141	-141	Q2/2001
in percent of GDP	0.8	-0.7	-1.1	-1.3	-1.9	-0.5	-0.5	-1.7	-1.2	-1.2	Q2/2001
External interest payments in percent of exports GNFS	3.2	3.7	5.2	4.2	4.5	2.8	4.1	4.2	4.3	4.3	Q2/2001
External amortization payments in percent of exports GNFS	15.1	16.2	6.7	9.2	18.1	31.8	16.7	56.8	23.3	23.3	Q2/2001
Public and publicly guaranteed debt service as percent of tax revenue	16.1	13.0	7.7	9.3	25.4	8.7	12.7	8.2	8.6	8.6	Q2/2001
Debt service as percent of exports of GNFS	22.6	20.0	15.0	13.4	22.6	34.6	20.9	61.0	27.6	27.6	Q2/2001
Real effective exchange rate (year-on-year change in percent, "+" = appreciation) 9/	9.6	4.2	3.3	3.2	9.00	1.62	6.55	0.01	1.19	-0.04	9/30/01
Financial market indicators											
Stock market index, end of period 10/	1,089	1,089	1,137	1,046	1,036	1,047	1,047	1,007	910	855	12/18/01
Foreign currency debt rating 11/	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	7/20/01
Spread of benchmark bonds (basis points, end of period) 12/	359	268	230	197	187	228	228	253	148	52	11/30/01
Memorandum items:											
GDP (in millions of U.S. dollars)	10,748	10,664	2,522	2,832	3,053	2,907	11,314	2,671	3,023	3,182	Q3/2001
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	11/27/01
Nominal exchange rate (litai/euro, end-of-period)	...	4.0	3.8	3.8	3.5	3.6	3.7	3.4	3.6	3.5	11/27/01

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, excluding short-term debt of SoDra and nonguaranteed debt of municipalities.

2/ Includes reduction of claims on private sector of LTL 270 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/ Total external liabilities minus total external assets, excluding foreign direct investment, equity investment and reserve assets.

8/ Debt service comprises interest and repayment on external loans, and interest and repayment on debt securities. A large debt service ratio for Q1 2001 and 2001 reflects a rollover of a large liability by commercial banks undertaken in Q1 2001.

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

10/ 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.

11/ S&P investment grade rating.

12/ Monthly average spread of 5-year Eurobond (US$200 million) issued in July 1997 above the rate on a synthetic U.S. treasury bond with same maturity, reported by *DataStream*.

Table 12. Lithuania: Indicators of Financial Sector Vulnerability, 1997-2001

(In percent, unless otherwise indicated)

	1997	1998	1999				2000				2001		
			Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sept.
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	3.0	1.2	9.5
Loans to private enterprises	3,167	3,493	3,625	3,892	3,927	3,858	3,573	3,714	3,629	3,715	3,792	3,855	3,927
Loans to private enterprises (percentage change, year-on-year)	...	10.3	...	...	...	10.4	-1.4	-4.6	-7.6	-3.7	6.1	3.8	8.2
Share of loans to private enterprises in total lending	76.3	67.8	67.0	66.7	65.5	65.3	62.7	63.4	63.8	62.8	62.2	62.5	61.2
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	16.4	14.2	14.4	12.6
Cash	4.0	4.3	3.8	3.4	3.1	3.7	2.7	2.5	2.1	3.1	2.5	2.8	3.0
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	11.7	11.6	9.6
Required reserves (in percent of total reserves)	70.7	59.9	75.2	88.0	83.0	69.8	85.7	85.4	85.5	71.6	76.1	78.9	85.0
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	11.3	12.0	10.0	9.9
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	16.3	16.4	16.5	16.8
Leverage ratio 6/	5.9	14.9	14.8	15.2	14.7	11.1	11.1	10.3	10.4	10.2	10.5	11.0	10.7
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	9.0	8.9	8.6
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	64.4	66.2	63.8
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	48.7	49.1	49.2
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	36.0	33.2	33.2
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	46.6	45.5	45.9
Market assessment													
Share price of Vilniaus Banka (in LTL, end of period)	229	29	28	27	23	26	31	30	40	50	50	51	51
Spread between VILIBID and VILIBOR 7/ 8/	500	268	232	202	239	296	296	254	264	233	199	191	176
Open position in foreign exchange 9/ 10/	...	...	...	...	-3.3	6.0	12.4	7.9	4.4	3.8	4.1	3.8	8.6
Total loans (in millions)	4,150	5,150	5,412	5,834	5,997	5,911	5,695	5,860	5,686	5,916	6,093	6,167	6,416
Total deposits (in millions)	6,006	6,670	6,702	7,019	7,296	7,450	7,638	8,136	8,858	9,176	9,653	9,755	10,442

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

1/ December 2000 is adjusted for LTL 270 million of DMB's claims on private sector, which were removed from balance sheets in July, 2000. Also, August 2001 numbers have been adjusted by LTL 785 million of reclassified assets.

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/ Interbank rates; basis points.

8/ As of January 1, 1999, the spread between the average overnight Vilnius Interbank Offered rate (VILIBOR) and the average overnight Vilnius Interbank Bid rate (VILIBID) during the respective month; before January 1, 1999, the spread between the average of the highest and lowest VILBOR and the average between the highest and lowest VILIBID.

9/ Open position includes off-balance exposure.

10/ 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.

Table 13. Lithuania--General Government Debt, 1998-2001

	1998	1999	2000	Sep. 2001
		(In millions of litai)		
Public and publicly guaranteed debt	9,816.6	12,371.3	13,028.3	13,422.1
Public foreign debt	4,755.8	7,415.4	7,779.8	8,261.1
Of which eurobonds	3,200.0	2,893.5	3,944.4	4,647.3
Guaranteed foreign debt	1,981.6	2,299.9	2,117.5	2,087.6
Domestic public debt	2,535.2	2,080.8	2,688.5	2,687.6
Of which: treasury securities	1,584.9	1,101.1	1,549.0	1,601.0
Domestic guarantees	340.9	203.0	65.4	97.8
Municipal nonguranteed debt 1/	123.8	212.3	273.5	282.1
SoDra nonguaranteed debt1/	79.2	159.9	103.6	5.9
		(In percent of GDP)		
Public and publicly guaranteed debt	22.8	29.0	28.8	27.9
Public foreign debt	11.1	17.4	17.2	17.2
Of which eurobonds	7.4	6.8	8.7	9.7
Guaranteed foreign debt	4.6	5.4	4.7	4.3
Domestic public debt	5.9	4.9	5.9	5.6
Of which: treasury securities	3.7	2.6	3.4	3.3
Domestic guarantees	0.8	0.5	0.1	0.2
Municipal nonguranteed debt 1/	0.3	0.5	0.6	0.6
SoDra nonguaranteed debt 1/	0.2	0.4	0.2	0.0
Memorandum items:				
GDP, in mln. LTL	42,990	42,655	45,254	48,087

Sources: Ministry of Finance; and Fund staff estimates.

1/ As reported in the banking survey.

LITHUANIA: FUND RELATIONS
(As of November 30, 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	267.96	185.8
Reserve position in Fund	0.02	0.0

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Holdings	4.95	N.A.

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
Extended arrangements	104.36	72.4
Systemic Transformation	19.41	13.5

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	8/30/2001	3/29/2003	86.52	0.00
Stand-by	3/8/2000	6/7/2001	61.80	0.00
EFF	10/24/1994	10/23/1997	134.55	134.55

VI. Projected Obligations to Fund: (SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	10/31/2001	2001	2002	2003	2004	2005
Principal		3.5	31.1	31.1	24.6	19.0
Charges/Interest		0.0	3.2	2.3	1.4	0.8
Total		3.5	34.3	33.4	26.0	19.8

VII. Implementation of HIPC Initiative:

N/A

VIII. Current Status of Safeguards Assessments:

Under the safeguards assessment policy, the Bank of Lithuania (BOL) is subject to a full Stage One safeguards assessment with respect to the stand-by arrangement, which is scheduled to expire on March 29, 2003. A Stage One safeguards assessment of the BOL was completed on December 10, 2001. The assessment concluded that a Stage Two (on-site) visit was unnecessary, but identified certain weaknesses and appropriate recommendations.

IX. Exchange Arrangements:

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. Lithuania has accepted the obligations of Article VIII of the Fund's Article of Agreement and maintains an exchange system free of restrictions on the making of payment and transfers for current international transactions.

X. Article IV Consultation:

Lithuania is on the 12-month consultation cycle.

XI. FSAP Participation and ROSCs:

FSAP work program is underway.

XII. Technical Assistance:

The following table summarizes the technical assistance missions provided by the Fund to Lithuania since February 1977.[1]

[1] For technical assistance before 1997, see previous reports.

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
FAD	Tax policy issues	Mission	June 13-26	Ministry of Finance
MAE/WB	FSAP	Mission	July 2-13	Bank of Lithuania and Ministry of Finance
MAE/WB	FSAP	Mission	September 10-21	Bank of Lithuania and Ministry of Finance

XIII. Resident Representative:

The resident representative of the Fund in Lithuania is Mr. Mark Horton, who took up his post in October 1999.

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 October 1, 2001. It includes 16 projects and SALs with commitments totaling US$465.4 million equivalent and disbursements on all Bank projects in Lithuania amounting to US$244.27 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 October 1, 2001, in millions of U.S. dollars)

	Commitments	Disbursements
Rehabilitation Loan (effective October 1992) 1/	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	20.99
Environment (Klaipeda) (effective May 1995)	7.0	4.89
EFSAP (effective December 1995) 4/	25.0	21.80
Environment (Siauliai) (effective December 1996)	6.2	5.96
Agricultural Development Project (effective August 1996) 5/	30.0	9.50
Klaipeda Geothermal (effective October 1996)	5.9	5.27
Energy Efficiency/Housing Pilot (effective November 1996) 6/	10.0	9.89
Social Policy (effective January 1998)	3.7	2.31
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)	35.3	4.95
Vinius District Heating	17.1	-
Total	465.4	US$244.27 €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
4/ Loan closed in June 2001
5/ Loan closed in June 2001
6/ Loan closed in June 2001

LITHUANIA: STATUS OF STATISTICAL DATABASE

1. Over the past several years, Lithuania has made good progress in establishing a macroeconomic database. Official data for all sectors are generally of sufficiently good quality to support economic analysis. However, frequent and large revisions of national accounts data, though necessary for improving the accuracy and reliability of the data, tend to complicate the analysis of economic developments.

2. In general, the data are available on a timely basis, and the authorities have given the staff ready access to all available data (see the attached matrix). An IFS page for Lithuania was introduced in December 1995. In May 1996, the Lithuanian authorities subscribed to the Special Data Dissemination Standard, and its metadata have been posted on the Fund's Dissemination Standards Bulletin Board (DSBB) on the Internet since April 1997. A significant amount of information is now available on various websites through the Internet (see section on Dissemination of Statistics, below).

National accounts

3. National accounts at current and constant prices are compiled quarterly by the Department of Statistics (DOS). Revised estimates were prepared with technical assistance from the World Bank and were published on March 30, 1998. The revised estimates attempted to address existing problems, including the size of the hidden economy and estimates of the GDP deflator. These revisions also corrected for conceptual and computational errors existing in the series for the years 1990–96. Two types of corrections were made to the baseline national accounts data processed by the DOS. The first was in respect of under-reporting by firms officially registered with the DOS. The second concerned firms and individuals not in the official register and which could be assumed to be "hidden." The adjustment for under-reporting was obtained by comparing the value of reported production with employment indicators from social security records and other sources. Corrections for firms not presently in the DOS register were made on an ad-hoc basis and restricted to output generated in industry and retail trade. With regard to the GDP deflator, the DOS does not publish investment or tradeable goods price indices, although work is underway to prepare estimates of real GDP by expenditure on a quarterly and annual basis, along with estimates of export and import prices. The constant price estimates are mainly compiled using production volume indicators. Analysis of the implicit GDP deflator in light of plausible price estimates derived from expenditure data and the consumer price index cast some doubts on the accuracy of the GDP deflator.

Price data

4. Since December 1998, the CPI weights for the national level market basket have been updated each year. The last update was undertaken in December 2000 and based on the Household Budget Survey (HSB) covering the period October 1999 to September 2000. The monthly CPI is available in the second week of the following month. The producer price

index is calculated according to the chain-linked Laspeyres formula. Data on investment or tradable goods price indices are not yet available.

Public finance

5. Data on the central government budget execution are available quarterly in the standard GFS format, although these data are subject to frequent revisions. The ongoing treasury project is expected to improve data quality substantially. The budget data are only compiled on a cash basis; compilation of the budget data on an accrual basis would allow monitoring of arrears and facilitate forecasting of future budgetary flows. In January 1999, the Ministry of Finance began publishing data on monthly consolidated general government operations, which include the national government (state and municipalities) and some extrabudgetary funds. Further work is needed to include all extrabudgetary funds and eliminate intra-government transfers in the consolidation of general government operations.

Money and banking

6. The accounts of the BoL for the end of each month are available in the second week of the following month, while the consolidated accounts of banking institutions are available within the month following the month of reference. The sectorization and classification of the accounts follow the methodology of the *Monetary and Financial Statistics Manual.*

External sector

7. The BoL is responsible for compiling the balance of payments, the international investment position and the international reserves statistics. The BoL compiles balance of payments statistics on a quarterly basis using the format recommended in the *Balance of Payments Manual*, fifth edition (BPM5). In 1999, BoL set in motion plans to develop and produce monthly balance of payments statistics to meet the requirements of the EU following Lithuania's application for membership of the EU.

8. STA assigned a balance of payments statistics advisor to Lithuania during the period October 1999-October 2000, who also covered Latvia. The mission concluded that the methodology used to compile Lithuanian balance of payments statistics is, for the most part, sound and that the BoL has made progress in developing a monthly balance of payments series and in its compilation of travel and transfers. It also found that it has significantly reduced the errors and omissions item, to less than 2 percent of GDP for the second quarter of 2000. During that period BoL made improvements in several areas, most notably in refining its technique for estimating travel expenditures, drawing upon additional data sources for private transfers and further developing its methodology for adjusting the value of exports from warehouses. As a result of work undertaken to produce monthly statistics, the BoL has also developed the methodology and data sources needed for compiling monthly balance of payments series. The new monthly surveys draw heavily on existing sources (available survey, administrative and other), as well as new monthly surveys of banks and a sample of nonfinancial enterprises. In addition, it has incorporated an additional source, by

setting a new monthly international transactions reporting system. The new framework was set up on a pilot basis in November 2000 and should reach an acceptable level in 2001.

9. However, some problems remain in the estimation of merchandise trade transiting through Customs-bonded warehouses, regarding the value between the reception and shipment of the merchandise. The scope of smuggling and shuttle trade is also deemed underestimated in trade data. The current transfers do still underestimate the private transfer due to lack of appropriate sources. In the financial flows accounts, existing estimation methods also misstate several key components of other investment flows, especially for banks. This should be corrected by the new banking report, which will be used for estimating all current and financial account items for the banking sector, including the direct investment flows of the sector. The authorities should give priority to implementing the mission's recommendations in a timely and effective manner.

10. Lithuania meets the Special Data Dissemination Standard (SDDS) specifications for coverage, periodicity and timeliness of the data, and for the dissemination of the advance release calendars, and the metadata have been posted on the Fund's Dissemination Standards Bulletin Board (DSBB). The Data Template on International Reserves and Foreign Currency Liquidity is disseminated according to the operational guidelines and is hyperlinked to the Fund's DSBB.

Dissemination of statistics

11. The Lithuanian authorities publish a range of economic statistics through a number of publications, including the DOS's monthly publication, *Economic and Social Developments*, and the BoL's monthly *Bulletin*. A significant amount of data are available on the Internet:

- Lithuania's metadata for data categories defined by the Special Data Dissemination Standard are posted on the IMF's DSBB;
- The BoL website (http://www.lbank.lt) provides data on monetary statistics, treasury bill auction results, balance of payments, the international investment position, and main economic indicators;
- The DOS website (http://www.std.lt) provides quarterly information on economic and social development indicators;
- The Ministry of Finance (http://www.finmin.lt) home page includes data on the national budget, as well as information on laws and privatization; and
- The National Stock Exchange website (http://www.nse.lt) has information on stock trading.

Core Statistical Indicators
(As of November 30, 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	11/29/01	10/31/01	10/31/01	10/31/01	10/31/01	10/31/01	Oct. 2001	Sep. 2001	Q3 2001	Q3 2001	Q3 2001	9/2001
Date received	11/29/01	11/5/01	11/14/01	11/14/01	11/25/01	11/25/01	11/8/01	11/16/01	11/15/01	10/29/01	10/8/01	10/31/01
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.

Vilnius

December 20, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

1. The overarching objective of Lithuania's economic policies is to promote sustained economic growth and improved living standards through continued macroeconomic stability and further implementation of structural reforms necessary for an efficiently functioning of market economy and enhancement of competitiveness. Early accession to the EU and NATO is our main policy goal. The key elements of our economic policy strategy will be to maintain the currency board arrangement as the cornerstone of macroeconomic stability; to further fiscal consolidation in order to support external viability; and to advance the remaining key structural reforms at a fast pace. The attached Supplemental Memorandum of Economic Policies (SMEP) lays out the concrete policy measures to be taken during December 2001 and 2002.

2. In support of the policies detailed in the SMEP, we request approval of the first review of the stand-by arrangement with the International Monetary Fund (IMF) that was approved by the IMF Executive Board on August 30, 2001 in an amount equivalent to SDR 86.52 million. We do not envisage at this time making purchases under the arrangement, but could do so if economic circumstances were to be worse than expected. We understand that the Fund will continue to monitor the program on the basis of quarterly performance criteria, and two more program reviews will be conducted, as described in the original Memorandum of Economic Policies signed on July 26, 2001 and the SMEP. As a demonstration of our commitment, Seimas passed on December 13, 2001 the budget for 2002, comprising the national budget and the budgets of the Social Insurance, Health Insurance and Privatization funds, in line with paragraph 29 of the SMEP.

3. We believe that the policies described in the SMEP are adequate to achieve the objectives of the program, but will stand ready to take additional measures as necessary to achieve those objectives. During the period of the arrangement we will consult with the IMF on the adoption of any such measures that may be appropriate, in line with the Fund's policies on such consultations.

4. We are committed to transparency in our economic policies, and we authorize the Fund to publish this letter and the SMEP following Executive Board consideration of the first program review and 2001 Article IV consultation discussions.

Yours sincerely,

//s//
Algirdas Brazauskas
Prime Minister

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

Republic of Lithuania

Supplementary Memorandum of Economic Policies of the Government and the Bank of Lithuania for the Period December 2001-02

I. Introduction

1. **The economic program supported by the Stand-by Arrangement (SBA) with the IMF is being implemented with positive results.** In 2001, growth accelerated, the external position of the economy strengthened, spreads on government securities fell to their historic lows, and structural reforms generally advanced. Confidence in Lithuania's policy-making remains strong in the run-up to the repegging. The economic program is on track and the main objectives of the program described in the Memorandum of Economic Policies (MEP) of July 26, 2001 remain valid. However, certain adjustments to program targets and the timing of some measures are needed in response to changing circumstances and to address weaknesses which program implementation has made apparent.

2. **The macroeconomic situation continued to improve in the first nine months of 2001, with a gradual recovery in domestic demand now complementing export-led growth.** Real GDP growth (year-on-year) amounted to 5.1 percent for the first half of the year and, according to preliminary estimates, output continued to grow at around this rate in the third quarter. After having fallen by nearly 10 percent last year, investment increased by 8.3 percent (year-on-year) in the first half of 2001. Inflation remained relatively subdued, consistent with wage moderation and with the lagged effects of the earlier appreciation of the litas against the euro. The unemployment rate has declined by around 1 percentage point since its April 2001 peak, but remained at 12.2 percent in October.

3. **All program performance criteria and structural benchmarks for end-September were met, despite revenue shortfalls.** However, the problem of expenditure arrears persisted in the state budget and the Health Insurance Fund, resulting in the non-observance of the indicative target on central government expenditure arrears. Further progress was made in the fiscal structural area. The draft law on the Methodology of Revenue Redistribution among Municipalities was passed by Seimas on October 23, 2001, and the pricing and definitions of state-mandated obligations were included in the draft 2002 budget law. Moreover, preparation for extending the real estate tax to residential property in 2003 is ongoing. Finally, Seimas has approved an amendment to the Privatization Law, authorizing the establishment of a Reserve Stabilization Fund (RSF). The government established the RSF by a resolution approved on December 18, 2001 and will, by March 2002, submit regulations on RSF operations to Seimas for approval.

4. **Other structural reforms continued to advance.** The government has announced its plan for the privatization of the Lithuanian Gas Company (LG), under which a 34 percent stake will be offered to a strategic foreign investor, followed by another 34 percent stake to a

gas supplier. A tender for the privatization was announced in November 2001. The Lithuanian Power Company (LPC) is being restructured into 5 new utilities covering power generation, distribution, and transmission, with a view to eventual privatization. The distribution of authorized capital and liabilities among the new successor companies has been approved by Seimas. The privatization of the banking sector is nearing completion following the submission of a bid for the purchase of the Lithuanian Agricultural Bank (LZUB). An advisor for the restructuring and privatization of Lithuanian Airlines (LA) was selected at end-October. Recent measures requiring company shareholders with controlling stakes to make a buy-out offer to minority shareholders, and allowing sales at market value rather than book value, have helped to accelerate the sale of small residual state shareholdings and land plots, raising an average of some LTL 50 million per month through 2001. In agriculture, a revised draft constitutional amendment to allow agricultural land sales to foreigners, in compliance with EU requirements, is expected to be passed by Seimas shortly. Legislation to introduce national accounting standards that are compatible with EU regulations, and a new labor code governing the relationship between employees and employers, have been submitted to Seimas. Significant progress has been made on accession negotiations with the EU. The government has completed 18 of 31 chapters so far, and aims to close a further 3-4 by year-end, and the remaining chapters in 2002, paving the way for Lithuania's accession to the EU in 2004.

5. **Regarding program implementation, good progress has been made so far.** In addition, the government is committed to intensifying its efforts in a number of areas. The government sees an urgent need to speed up the reform of the tax system, to finalize the set of reform measures of municipal finances, to restructure the operations of the Health Insurance Fund, and to continue its efforts to improve the business environment and reduce unemployment.

II. THE GOVERNMENT'S PROGRAM

A. Macroeconomic outlook

6. **The macroeconomic outlook for 2001-02 envisages continued growth, low inflation, and the maintenance of the external current account deficit at a sustainable level.** Real GDP is expected to grow by 4.5 percent in 2001 and 4.0 percent in 2002. A gradual recovery of both private consumption and investment is projected to be the main contributor to growth in the second half of 2001 and the first half of 2002, as the ongoing slowdown in the EU and other trading partners is likely to have a negative impact on export performance. The recovery in domestic demand will be supported by the recent decline in interest rates which is expected to lead to an acceleration of credit growth to the private sector. The external current account deficit is projected to reach 5.8 percent in 2001—a deterioration relative to the first half of 2001, but better than originally expected—and to remain broadly unchanged in 2002, as lower growth of non-energy exports to the EU would be offset by the strength of exports to CIS markets and a reduced import bill due to a projected further decline in oil prices. The reduction in the current account deficit would be

supported by the continuation of fiscal restraint in 2002. The current account deficit would be financed by strong capital inflows, including a pick-up in foreign direct investment.

7. **Average inflation is projected to remain subdued at 1.4 and 2.8 percent in 2001 and 2002, respectively.** Continued growth is expected to facilitate a further gradual decline in unemployment and a resumption of modest growth in real wages, over the second half of 2001 and through 2002.

B. The currency board arrangement

8. **The currency board arrangement continues to be the main anchor of economic policies.** The repegging of the litas from the U.S. dollar to the euro will take place on February 2, 2002 at 4.0000 times the reference exchange rate of the U.S. dollar vis-à-vis the euro announced by the European Central Bank on February 1, 2002. New guidelines for the management of gross official reserves consistent with the new reserve currency have been adopted, timely provisions of euro coins and banknotes have been ensured, and technical aspects of the interbank and foreign exchange markets on the day of the repegging have been fine-tuned. The BoL is intensifying the public information campaign on the repegging. The BoL and the government are confident that they have taken all necessary steps to ensure that economic agents are prepared for the repegging.

9. **The strong balance of payments position and sustained confidence in the banking system would lead to a further monetization of the economy.** Broad money is expected to grow by 15 percent in 2002. Credit growth would accelerate to 16 percent, as recent privatizations in the banking sector lead to greater competition and interest rates decline further, reflecting strong confidence and low interest rates in the euro area. Further reduction of the required reserve ratio is envisaged for 2002, with the timing announced early in the year in consultation with IMF staff.

C. Fiscal policy and fiscal structural reforms

10. **Under the CBA, fiscal policy is the major instrument of macroeconomic management.** The achievement of a credible budget deficit reduction path through the maintenance of fiscal consolidation continues to be at the core of the authorities' strategy. Continued fiscal adjustment will underpin the credibility of the CBA and lead to further reductions in borrowing costs for the public and the private sectors. To help ensure long-term fiscal sustainability, the government is committed to achieving a structurally balanced budget in the medium term (excluding the cost of the pension reform).

11. **Stabilizing the revenue-to-GDP ratio has become a government priority in order to ensure medium-term fiscal sustainability.** The continued decline in the revenue-to-GDP ratio in 2000-01 is in part attributable to the changing structure of GDP and in part to wider use of loopholes and inconsistencies in existing tax legislation. The government has decided to tackle this problem by overhauling the entire tax system instead of amending current tax

legislation. The need to put in place a more comprehensive, internally consistent and stable tax system requires careful technical consideration and political consensus. This will take time to achieve and thus the reforms will mostly be implemented from 2003. A new law on excises consistent with EU requirements has already been passed by Seimas, and new laws on value added tax (VAT) and corporate income tax (CIT) were submitted to Seimas in December. A new personal income tax (PIT) law will be submitted to Seimas by end-January 2002. The new legislation will remove exemptions and broaden tax bases in accordance with EU requirements and taking into consideration the recommendations of the June 2001 mission of the IMF Fiscal Affairs Department. Specifically, the tax reform is intended to be revenue neutral. The new VAT law will eliminate exemptions in stages, starting with the service sector in 2002, by the time of EU accession, and the new CIT law will eliminate exemptions for reinvested earnings and lower the tax rate. To the extent that the revised CIT law raises additional revenues, the PIT rate would be further reduced while ensuring it is consistent with the medium-term fiscal objectives. Subject to Seimas' approval, the law on the CIT would become effective in January 2002, the law on the VAT would become effective in July 2002, and the law on PIT in January 2003. In addition, the government intends to extend the coverage of the real estate tax to residential property from January 2003.

12. **On the expenditure side, there are a number of priorities and obligations to which the government is committed:** the costs of EU and NATO accession, the closure of the Ignalina nuclear power station, environmental remediation, pension reform, improvements to social expenditure, and the clearance of remaining expenditure arrears. The savings and land restitution programs represent additional substantial obligations that could only be fulfilled over a long period of time, given other pressing expenditure needs. The public investment program will be geared towards infrastructure, environmental and other projects necessary for EU accession, and towards further improvements in health and education.

13. **For 2001, a revenue shortfall of the general government estimated at 0.8 percent of GDP would be largely offset by lower-than-estimated expenditure in some areas and expenditure cuts.** Fiscal performance remains in line with program commitments (MEP paragraph 12), and the government will strive to attain its 1.4 percent of GDP deficit target. However, in view of heightened uncertainty and possible further revenue shortfalls, for added flexibility, the program ceiling has been revised to 1.7 percent of GDP, which is still consistent with the attainment of macroeconomic objectives. To limit revenue shortfalls, VAT administration has been strengthened, especially by the customs department. Lower state budget expenditure on interest and savings on provisioning for defaults on guaranteed debt, together with lower than estimated expenditure of the Social Insurance Fund (SoDra) and other expenditure cuts of the state budget will ensure the achievement of the deficit target.

14. **For 2002, a draft budget with a general government deficit of 1.5 percent of GDP was submitted to Seimas.** The initial program deficit target was increased by 0.2 percent for a number of reasons. First, the revenue-to-GDP ratio is declining due to the erosion of the

base of the corporate, personal, and value added taxes under the current legislation. Second, given the expenditure obligations related to NATO and EU accession, there is not much room for further expenditure cuts, in particular in investment spending. Third, despite the global economic slowdown, Lithuania's macroeconomic conditions are favorable and external current account prospects are better than originally expected, reducing external vulnerability risks. Finally, the increase in the budget deficit would be consistent with the credibility of the CBA, while additional financing could be readily mobilized.

15. **A number of tax measures will be implemented in 2002 to limit the decline in the revenue-to-GDP ratio before the main elements of the tax reform package become effective from 2003**. These measures include: (i) higher excises on diesel fuel, other fuels such as liquid gas and gasoline, and cigarettes; (ii) conversion of some EU-incompatible excise taxes into specific taxes; (iii) the elimination of some VAT exemptions and introduction of restrictions for VAT deductions on passenger cars; (iv) the extension of full pension insurance to certain groups of self-employed; and (v) improvements in tax administration targeting VAT collections and customs. At the same time, the tax exempt minimum of the PIT will be increased from LTL 214 to LTL 250 from April 1, 2002.

16. **Expenditure would decline by 0.4 percent of GDP, but it would grow in real terms.** Consolidated expenditure of the national budget and the road program will be cut by 0.3 percent of GDP, while ensuring that priority social spending and investment needed for EU and NATO accession are adequately provided for. Further, measures to limit expenditure of the HIF on pharmaceuticals will yield additional savings (paragraph 20). The expenditure of SoDra would decline relative to GDP, given the current indexation procedure. Nominal expenditure on investment projects by the Privatization Fund will remain unchanged compared with 2001. Finally, expenditure for savings and land restitution will be limited to 0.1 percent of GDP.

17. **The current global slowdown would adversely affect Lithuania's growth prospects.** In the event of a larger than expected slowdown, the government will, in the first instance, let the automatic stabilizers operate to support economic activity. In the event of a severe or protracted slowdown, however, resulting in a substantial loss of revenue, or sharp increase in the cost of financing, the government will take, in consultation with IMF staff, appropriate revenue and expenditure measures necessary to ensure fiscal sustainability. The cautious fiscal stance planned for 2002 would place Lithuania in a strong position to cope with the adverse impacts of potentially more difficult external economic developments.

18. **In 2002, the financing strategy of the government will be geared toward** diversifying and lengthening maturities of treasury securities, and tapping the eurobond market. Gross financing needs of the government of around 7 percent of GDP would be almost equally split between domestic and foreign sources. Should access to international financial markets become less favorable due to global emerging market conditions, a combination of the use of liquid resources of the government and a slightly higher issuance of domestic securities would allow for covering financing needs in 2002. The medium-term

sustainability of public debt is expected to improve in 2002, as public and publicly guaranteed debt is expected to decline from 28.9 percent of GDP in 2001 to 28.4 percent in 2002. In light of possible defaults on direct and guaranteed loans to domestic enterprises, the government is committed to strengthening its collection efforts, further limiting the concession of such guarantees and tightening the conditions for eligibility.

19. **Having clearly defined the expenditure functions of municipalities, the efforts to strengthen their finances will focus on enhancing expenditure management and finding new sources of revenue.** These measures would address the structural causes of municipal expenditure arrears, thereby helping to clear the outstanding stock. Based on the new legislation, which defines methodologies for establishing costs of service provision, about 55 percent of municipal revenues will be earmarked to finance the functions delegated by the state and the student's basket. Regardless of revenue performance, the amount of earmarked transfers for the above two purposes is guaranteed. By contrast, in the event of a shortfall in PIT revenue and other taxes commissioned to municipalities earmarked for financing other municipal functions, municipalities will be required to take revenue and/or expenditure measures in other areas to maintain strict financial balance. Legislation giving municipalities more discretion in setting tax rates and fees accruing to local budgets—including a real estate tax of up to 1.5 percent of assessed property values will be submitted to Seimas by end-January 2002. This would lead to greater predictability in revenue and flexibility in the financial management of municipalities. In line with its commitment not to undertake any unconditional bail-outs, the central government will assist municipalities in reducing the stock of expenditure arrears by allocating LTL 200 million worth of additional transfers over the next three years, of which LTL 64 million would be made available in 2002 in equal quarterly installments. The municipalities will submit schedules for the corresponding reduction of arrears, and disbursements will be linked to their fulfillment. Compliance with the quarterly schedules by the municipalities will be a structural benchmark as of the second half of 2002. To further strengthen financial control, the Cabinet-level commission on expenditure arrears will continue its monthly monitoring of the clearance of municipal arrears and the State Control will conduct audits of another 30 municipalities in 2002, with penalties for municipalities found not to be in observance of the new legislation. Moreover, in order to enhance transparency the authorities will continue to publish quarterly municipal financial statements. As a general principle, the general government will strictly refrain from recourse to mutual debt cancellation or other netting or offset schemes, including with suppliers and tax payers. Finally, as part of the municipal finance reform, municipal borrowing limits have been lowered to correspond to municipalities' own resources. Moreover, in view of the weaknesses of municipal finances, the central government will not support external borrowing by municipalities aside from projects covered by the state public investment program and/or borrowing from international financial organizations.

20. **The government has undertaken a number of significant steps to eliminate the arrears of the HIF and substantially improve its medium-term financial position.** The government approved a decision on the rescheduling of the arrears on pharmaceuticals on December 18, 2001 and will start negotiations on its terms. These steps would effectively

lead to the elimination of the stock of pharmaceutical arrears. In order to strengthen the HIF's financial situation, the current system of reimbursements for pharmaceuticals will be changed on January 1, 2002. First, the list of pharmaceuticals subject to reimbursement will be reduced by 130 items. Second, cases in which pharmaceuticals are subject to 100 percent reimbursement will be substantially reduced. Third, tighter regulation of prescription of the most expensive pharmaceuticals will be adopted. Fourth, financial incentives for controlling pharmaceutical costs by physicians will be introduced. These measures will help save about LTL 100 million already in 2002. The government will also submit amendments to the law on Mandatory Health Insurance by January 2002 establishing more effective reimbursement procedures.

21. **The government will submit to Seimas a revised Concept of the Pension Reform by end-December 2001**. The main principles of the pension reform outlined in the MEP (paragraph 17) remain unchanged. The cost of the pension reform is currently estimated at 0.6 percent of GDP per year, at the initial stage of the reform, given the decision of the government to reduce the maximum mandatory age for the participation in the pension reform to 30 years. The government plans to finance the transition cost of the pension reform, partly by privatization proceeds. The new system would be in place from 2004 when SoDra is expected to start generating surpluses (before the remittance of 5 percentage points of the payroll tax to the second pillar) and when the State Tax Inspectorate will have gained sufficient operational experience after merging with the payroll tax collection unit of SoDra. To this end, the government has submitted to Seimas amendments to the laws on Social Security and on Tax Administration necessary to complete the merger. In addition, legislative acts necessary to limit expenditure on state pensions through tighter eligibility requirements and revised calculations of benefits will be submitted to Seimas in the course of 2002. Finally, Seimas approved on November 20, 2001 amendments to the law on Social Security to extend the requirement of mandatory full pension insurance to certain groups of self-employed. This measure will yield LTL 20 million in additional revenue in 2002. Other legislative acts pertaining to the pension reform (MEP, paragraph 17) will be submitted to Seimas following the passage of the pension reform concept in 2002.

22. **The government intends to request from the IMF a Report on the Observance of Standards and Codes (ROSC) on fiscal transparency** for 2002. The report will assess fiscal transparency practices in Lithuania following the requirements of the IMF Code of Good Practices on Fiscal Transparency—Declaration of Principles. The government will review the current practices in the areas identified as needing improvement by the report.

D. Other structural policies

23. Financial sector reforms will draw on recommendations from the reports and assessments of the joint missions of the World Bank-IMF Financial Sector Assessment Program (FSAP). Reforms will aim to further enhance the resilience of the financial system and to foster a broadening and deepening of the range of financial products and services available. Specific areas of attention in the banking system will include enhancing the use of

risk assessment and management techniques, improving disclosure by banks, enhancing the quality of borrower financial statements, including via adoption of national accounting standards (MEP paragraph 20), and continuing cross-border supervisory cooperation. In housing finance, policies will aim to better target public support and to focus on the development of instruments, rather than new institutions. In leasing, consideration will be given to regulatory and tax changes to remove conditions that presently discourage leasing vis-à-vis bank finance. Finally, in insurance, efforts will target improvements of corporate governance and market oversight, including by strengthening the independence and capacity of the insurance supervisory agency.

24. **The government believes that improvements to the business environment remain the key to enhancing the climate for investment, attracting foreign direct investment, and strengthening competitiveness.** The government is putting in place measures to streamline company registration and liquidation procedures, including through the establishment of a new company registry by January 2002. The government will also use support available through the EU PHARE program to: (i) ensure the effective implementation of new insolvency laws adopted in July 2001, through the provision of formal training for administrators and judges on new bankruptcy procedures, and preparation of a manual on bankruptcy and restructuring procedures; and (ii) assess the competitiveness of Lithuanian businesses. In addition, the government will continue to follow the recommendations of the sunrise commission regarding the streamlining of business regulation.

25. **The government remains committed to further reducing unemployment, through enhanced labor market flexibility and the provision of well-targeted training opportunities, while at the same time protecting the most vulnerable sections of society.** The government is continuing to provide job training programs that are targeted towards the projected future employment needs of the private sector. The new labor code is expected to introduce flexibility in the setting of the minimum wage, with provisions for lower minimum wages for specific groups, certain classes of unskilled workers and possibly certain regions. With passage of the new labor code, expected in the first half of 2002, laws on Works' Councils and on Lockouts will be proposed to Seimas in the second half of 2002. The Unemployment Insurance Law, which strengthens the insurance element in the payment of unemployment assistance, will be submitted to Seimas by end-June 2002. In addition, the government is committed to maintaining social cohesion by ensuring that the social safety net provides the necessary support to the most vulnerable groups, and will seek to improve the targeting of social assistance programs in this regard. The law on Social Assistance in Cash, which will be submitted to Seimas by end-June 2002, will change eligibility norms and replace the current general reduction in housing bills with cash payments targeted to the long-term unemployed.

26. **The development of an efficient and competitive energy sector remains a key policy objective, and the government is proceeding with plans to restructure and privatize the Lithuanian Power Company (LPC) and Lithuanian Gas (LG).** Registration of the restructured LPC successor companies—a precursor to privatization—is expected to be

completed by the beginning of 2002 together with the settlement of a remaining US$45 million of outstanding claims on Belarus for electricity deliveries through the sale of debt to third parties. It is expected that the successor companies will be offered for sale in the second half of 2002. The staged privatization of LG will take place in 2002, with the initial sale of a 34 percent stake to a strategic foreign investor likely to be completed by May 2002, followed by the sale of the second 34 percent stake to a gas supplier in the second half of the year. The government will limit its further financial involvement in Mazeikiu Nafta's investment plan and operations to the US$118 million in guarantees already committed.

27. **More generally, the privatization program, which has been a key part of efforts to increase efficiency and promote the overall restructuring of the economy, is nearing completion**. Lithuanian Airlines is expected to be restructured and ready for privatization by April 2002. The cargo business of Lithuanian Shipping Company (LISCO, the rest of which was privatized in early 2001) will be offered for sale in the second half of 2002. The government is also committed to the privatization of Lithuanian Railways (LRR), following a comprehensive reorganization of the company over the next two years along the lines approved by the government in May 2001. The government plans to continue with the rapid sale of over 3,000 small residual state shareholdings and land plots, and the State Property Fund is preparing an inventory of such assets to facilitate this process.

28. **The government remains committed to rationalizing its support for the agricultural sector, with a view to EU accession.** The government will draw on the expertise of the World Bank in aiming to reduce the losses of the Agricultural and Food Products Market Regulation Agency (AFMRA) stemming from market support, procurement, and storage operations, including through the adoption of legislation in the first half of 2002 that would terminate the government's authority to regulate the prices of primary and processed agricultural products. The government will continue to foster rural development and investments in rural infrastructure through its efforts to facilitate the implementation of EU SAPARD programs, and through its own development program.

III. PROGRAM MONITORING

29. Passage of the budget for 2002 by Seimas, comprising the national budget, and the budgets of SoDra, the HIF, and the Privatization Fund, consistent with program commitments, will constitute a prior action for the completion of the first review. The program is monitored on the basis of quarterly quantitative performance criteria and benchmarks and a set of structural policy benchmarks for end-December 2001, end-March 2002, and end-June 2002 consistent with the revised economic program (specified in the attached tables), and the second review by the IMF Executive Board. The definitions of program targets are provided in the Technical Memorandum of Understanding (Annex).

30. The second review will be based on end-March 2002 outcomes and is expected to be completed by end-June 2002. The review will focus on the design of a set of measures

following the recommendations of the FSAP and ROSC missions, and further progress in tax reforms and municipal finances.

Table 1. Lithuania: Performance Criteria for Stand-By Arrangement, 2001-2002 1/

	Target	Adjusted Target	Outcome 2/
Continuous performance criteria			
I. Exchange rate			
LTL 4 per US$1 3/	...	...	Observed through end-September
II. 100-percent coverage of currency board liabilities, in percent	100	...	Observed through end-September
III. Reserve requirements, in percent 4/	6	...	Observed through end-September
IV. Non-accumulation of new external payments arrears	...	...	Observed through end-September
Quantitative performance criteria			
I. Ceiling on the general government deficit, mln. LTL			
Cumulative from January 1, 2001			
March 31, 2001 (previous arrangement)	271	287	94
June 30, 2001	460	496	322
September 30, 2001	600	704	444
December 31, 2001	841	...	...
Cumulative from January 1, 2002			
March 31, 2002	383	...	...
June 30, 2002	576	...	...
December 31, 2002	776	...	...
II. Floors on net foreign exchange coverage of the currency board arrangement, mln. US$			
Stocks			
March 31, 2001 (previous arrangement)	-127	...	-39
June 30, 2001	-127	...	-24
September 30, 2001	-127	...	-2
December 31, 2001	-127	...	...
March 31, 2002	-127	...	...
June 30, 2002	-127	...	...
December 31, 2002	-127	...	...

III. Ceilings on contracted public and publicly guaranteed medium- and long-term external debt; mln. US$	All maturities	1-5 year maturity	All maturities	1-5 year maturity
		(medium- and long-term)		
Cumulative from January 1, 2001				
March 31, 2001 (previous arrangement)	293	200	183	0
June 30, 2001	433	200	194	0
September 30, 2001	648	200	194	0
December 31, 2001	683	200	...	...
Cumulative from January 1, 2002				
March 31, 2002	450	200	...	...
June 30, 2002	610	200	...	...
December 31, 2002	640	200	...	...

IV. Ceilings on the outstanding stock of public and publicly guaranteed short-term external debt; mln. US$	Target	Adjusted Target	Outcome 2/
Maximum stock during the period			
March 31, 2001 (previous arrangement)	0	...	0
June 30, 2001	50	...	0
September 30, 2001	50	...	0
December 31, 2001	50	...	...
March 31, 2002	200	...	...
June 30, 2002	200	...	...
December 31, 2002	200	...	...

Source: Lithuanian authorities; and Fund staff estimates.

1/ Definitions and exclusions are presented in the Technical Memorandum of Understanding.
Numbers for end-June 2001 are indicative targets, numbers for end-September 2001, end-December 2001, end-March 2002, and end-June 2002 are performance criteria, and numbers for end-December 2002 are indicative targets.

2/ Based on latest available data.

3/ This performance criterion will be modified on February 2, 2002 consistent with SMEP paragraph 8.

4/ This is consistent with the required reserve ratio of 8 percent.

Table 2. Lithuania: Quantitative Benchmarks for Stand-By Arrangement, 2001-2002

	Ceiling	Outcome
I. Domestic guarantees, mln. LTL		
Outstanding stock		
March 31, 2001 (previous arrangement)	319	217
September 30, 2001	314	232
December 31, 2001	312	...
March 31, 2002	315	...
June 30, 2002	312	...
December 31, 2002	312	...
II. Central government arrears, mln. LTL		
Outstanding stock		
March 31, 2001 (previous arrangement)	0	19
September 30, 2001	0	37
December 31, 2001 1/	0	...
March 31, 2002	0	...
June 30, 2002	0	...
December 31, 2002	0	...

Source: Ministry of Finance; and Fund staff estimates.

1/ A government decision to clear pharmaceutical arrears will be considered as clearance of arrears under the program.

Table 3. Lithuania: Structural Benchmarks for Stand-By Arrangement, 2001-2002

Measure	Date	Status
Submit to Seimas draft amendments to the Law on Revenue Redistribution of Municipalities	end-September 2001	Done
Submit to Seimas draft amendments to the Privatization Law for establishing the Reserve Stabilization Fund	end-September 2001	Done
Tender for privatizing the Agricultural Bank	end-September 2001	Done
Government's decision on a set of measures to overhaul municipal finances	end-December 2001	Done
Submit to Seimas draft amendments to the Law on Social Security needed for the pension reform	end-December 2001	Replaced with another benchmark (Pension reform concept)
Submit to Seimas legal amendments on accounting standards	end-December 2001	Done
Submit to Seimas a new labor code	end-December 2001	Done
Submit to Seimas a Pension Reform Concept	end-December 2001	
Submit to Seimas draft CIT and VAT	end-December 2001	Done
Submit to Seimas draft PIT law	end-January 2002	
Submit to Seimas amendments to the law on Tax Administration and law on Social Security on the merger of the SoDra's payroll tax collection unit with STI	end-January 2002	Done
Finalize quarterly plan for arrears reduction of municipalities	end-March 2002	
Submit to Seimas the draft unemployment insurance law	end-June 2002	

Source: Lithuanian authorities.

REPUBLIC OF LITHUANIA

TECHNICAL MEMORANDUM OF UNDERSTANDING FOR THE 2001/2002 STAND-BY ARRANGEMENT

1. This Memorandum defines variables that constitute quantitative performance criteria and benchmarks for the stand-by arrangement and sets out the reporting requirements for the government and the Bank of Lithuania.

I. PERFORMANCE CRITERIA ON THE OPERATION OF THE CURRENCY BOARD ARRANGEMENT

Maintenance of exchange rate under currency arrangement

2. The present exchange rate of LTL 4 per $1 will be maintained throughout the period of the program. The currency of the peg will be changed at the time of the repegging. In this connection, all performance criteria related to the currency board arrangement will be adjusted accordingly at the time of the repegging.

Cover for currency board arrangement

3. The Bank of Lithuania will ensure the maintenance of not less than 100 percent foreign reserve backing for the Bank of Lithuania's liabilities, as defined in paragraph 4 below under the currency board arrangement for the duration of the stand-by arrangement.

4. Foreign reserves backing will consist of the gross foreign reserves of the Bank of Lithuania, as defined in paragraph 10, expressed in Litai at the official exchange rates of the Bank of Lithuania. The Bank of Lithuania's Litai liabilities under the currency board arrangement comprise:

(i) Litas notes and coins in circulation

(ii) correspondent accounts of and certificates of deposit and other Litas liabilities to commercial banks and nonbank financial institutions;

(iii) government deposits;

(iv) staff and other private sector deposits;

(v) correspondent accounts of foreign central banks.

Required reserves of the banking system

5. Average reserve deposits of the banking system over each required reserve holding period established by the Bank of Lithuania (running from the 13th of one month to the 12th of the next month) shall not be permitted to be below required reserve deposits of the banking system, as defined in paragraph 6, by more than 2 percentage points of eligible liabilities, as defined in paragraph 6.

6. All banks will be required to hold reserve deposits on account with the Bank of Lithuania of not less than 8 percent of their domestic and foreign currency deposit liabilities. Together, these shall constitute the required reserve deposits of the banking system. The deposit aggregates against which required reserves of the banking system shall be calculated will be referred to as "eligible liabilities," as defined in the 28. December 1993 Resolution No. 52 of the Board of the Bank of Lithuania ("On Confirmation of the Rules for Required Reserves for Commercial Banks"). Average reserve deposits of the banking system for each reserve maintenance period will be calculated at the end of each holding period as a percentage of eligible commercial bank liabilities.

7. The Bank of Lithuania will extend new credits to banks only and in amounts that do not violate (i) the performance criterion requiring full foreign currency backing for currency board liabilities or (ii) the performance criterion specifying the minimum targets for net international reserves.

Performance criterion on floor on net foreign exchange coverage of the currency board arrangement

8. International reserve assets and liabilities shall be valued in U.S. dollars using the Bank of Lithuania's official rates prevailing at each test date. For the period of the program, monetary gold will be valued at market prices according to BoL internal guidelines.

9. Net foreign exchange coverage of the currency board arrangement is defined as:

   (i) gross foreign reserves of the Bank of Lithuania, less foreign reserve liabilities;

less

   (i) foreign currency-denominated liabilities of the Bank of Lithuania to domestic residents and privatization proceeds of the government held in the Bank of Lithuania; and

(ii) Litai liabilities of the Bank of Lithuania, as defined in paragraph 4, under the currency board arrangement, less deposits withdrawn through deposit auctions and any central bank bills.[1]

10. Gross foreign reserves of the Bank of Lithuania shall be defined as:

(i) monetary gold holdings;

(ii) holdings of SDRs;

(iii) reserve position in the IMF; and

(iv) holdings of foreign exchange in convertible currencies by the Bank of Lithuania.

11. Excluded from gross foreign reserves are:

(i) capital subscriptions to foreign financial institutions;

(ii) long-term nonfinancial assets of the Bank of Lithuania;

(iii) convertible currency-denominated claims on domestic banks;

(iv) assets in nonconvertible currencies; and

(v) foreign assets pledged as collateral or otherwise encumbered.

12. Fund staff will be informed of details of any gold sales, purchases, or swap and derivative operations during the program period, and any resulting changes in the level of gross foreign reserves that arise from revaluation of gold carried out according to the accounting practice of the Bank of Lithuania will be excluded from gross reserves as measured herein.

13. Foreign currency-denominated reserve liabilities of the Bank of Lithuania shall be defined as:

(i) the Bank of Lithuania's convertible foreign currency liabilities to nonresidents, with an original maturity of up to and including one year;

(ii) the outstanding use of Fund credit.

[1] The Single Treasury System will remain outside the Bank of Lithuania during the program period.

14. Excluded from foreign reserve liabilities are any liabilities arising from balance of payments support loans of maturity longer than one year, including such loans from the EU, the BIS or other international financial institutions, foreign governments or foreign banks.

15. Foreign currency-denominated liabilities to domestic residents shall include convertible currency deposits of the general government, and liabilities to banks and non-bank financial institutions, including deposits under the reserve requirement. Bank of Lithuania Litai liabilities under the currency board arrangement are defined in paragraph 4.

II. Performance Criteria on General Government Fiscal Balance, Guarantees for Domestic Borrowing, and Arrears

16. The general government encompasses the national government (comprising the state and municipal governments) and the extrabudgetary funds. The extrabudgetary funds include the Social Insurance Fund (SoDra), Health Insurance Fund, Privatization Fund, Road Fund, Ignalina Closure and Decommissioning Fund, and any other extra-budgetary operations. The central government is defined as the general government excluding municipalities.

17. The general government deficit is determined on a cash basis.

- The overall deficit is the excess of total expenditure plus net lending over total revenue and grants. For the purpose of program monitoring, it is defined as the negative sum of (i) net domestic financing; (ii) net external financing and (iii) net privatization receipts (Table 1).

- Net external financing is the sum in national currency of (i) the disbursements of external loans (to the entities covered above the line or on-lent by the general government, including but not limited to budgetary organization and appropriation managers); (ii) exceptional financing (rescheduled principal plus interest if any); (iii) proceeds from bonds or other debt-related instruments issued abroad; less: (iv) amortization due (including but not limited to amortization payments of appropriation managers and budgetary organizations); and (v) changes in assets held for liquidity and/ or investment purposes outside the domestic banking system.

- Net domestic financing is the sum of net bank financing and net nonbank financing.

    - Net bank financing is defined as the change in the banking system's claims on the general government in domestic and foreign currency, including the change in the holdings of government securities by the banking system; minus the change in balances held in the central bank and the commercial banks and other banking institutions.

- Net nonbank domestic financing is defined as the sum of: (i) the change in the holdings of government securities by nonbanks, calculated as the difference between the change in the stock of government securities and the change in the holdings of government securities by the banking system; (ii) any net direct borrowing from nonbank institutions, including by budgetary organization and appropriation managers.

- Net privatization proceeds are defined as the cash receipts from asset sales by the general government from abroad or domestically minus privatization-related expenditure. Expenditures necessary for, and directly related to, the privatization of state-owned enterprises shall be deducted from gross privatization proceeds and will not be classified as expenditure above the line in the fiscal accounts. These are limited to (i) outlays for consultants and advisers, (ii) increases in authorized capital prior to the sale of an enterprise, and (iii) outlays due to assuming the clean-up of environmental damages as identified in specific privatization agreements.

18. The ceiling on the general government deficit is subject to two adjusters: for faster-than-projected implementation of net lending operations and for faster-than-projected implementation of investment projects by budgetary organizations and appropriation managers.

19. For the purpose of assessing the observance of the ceilings on the general government fiscal balance, the program targets will be adjusted upwards by the amount actually disbursed and on-lent under already committed foreign loans from International Financial Institutions (including the World Bank, the EBRD, the EIB, and the NIB) and other sources of financing as specified in Table 2 are higher than the amounts assumed under the program with a 50 percent implementation rate of the total annual commitment.

20. The implementation of general government investment projects carried out by budgetary organizations and appropriation managers, including but not limited to the Ministry of Defense, is specified in Table 3 on a quarterly institution-by-institution basis. The performance criterion on the fiscal deficit will be adjusted by the amount equal to the excess of the actual appropriations over the programmed cumulative quarterly amount for every project, assuming a 50 percent implementation rate of the total annual commitment. The adjusted amount for every project for each test date shall not exceed the annual appropriation for each project based on a 100 percent implementation rate.

21. General government guarantees on domestic borrowing include all guarantee commitments for (i) borrowing in domestic currency from residents and nonresidents and (ii) borrowing in foreign currency issued for the Agricultural Marketing Agency and the Export and Import Credit Insurance Agency (Table 4).

22. Outstanding payment obligations of the general government include all identified obligations incurred by the state government, municipalities, SoDra, the Health Insurance Fund, and other extrabudgetary funds as covered by the definition of general government provided above. Outstanding payment obligations are defined as delayed payments for deliveries of goods and services when a bill has been received but not paid after 45 days. For wages and salaries, and pensions, outstanding payment obligations are defined to exist when payments are delayed by more than 7 days. Outstanding payments obligations of the central government are defined as outstanding payments obligations of the general government minus outstanding payments obligations of the municipalities outside the general government (Table 5).

III. Performance Criteria on External Debt

Ceiling on contracting or guaranteeing of external debt (i.e., debt denominated in foreign currency) with original maturities of more than one year by the public sector with a sub-ceiling on external debt with original maturities of longer than one year and including five years.

23. For purposes of this performance criterion, the public sector comprises: (i) general government (as defined in paragraph 16), (ii) the Bank of Lithuania, and (iii) other agencies on behalf of the general government (Table 6). This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted by the Executive Board on August 24, 2000 (Decision No. 12274-(00/85) but also to commitments contracted or guaranteed for which value has not been received. Excluded from the limits are use of IMF resources, guarantees of foreign currency-denominated borrowing of the Agricultural Marketing Agency and the Export and Import Credit Insurance Agency covered in paragraph 21, and foreign currency direct borrowing and guarantee by the municipalities from resident banks which are not guaranteed by the central government. Included are other than IMF balance of payments support from official creditors.

Ceiling on the outstanding stock of external debt (i.e., debt denominated in foreign currency) with original maturities of up to and including one year owed or guaranteed by the public sector.

24. For purposes of this performance criterion, the public sector excludes the Bank of Lithuania. The term debt has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 by the Executive Board (Decision No. 12274-(00/85). Excluded are normal import-related credits, liabilities on the correspondent accounts with central banks of the BRO (Baltics, Russia, and other countries of the former Soviet Union) countries, guarantees of foreign currency-denominated borrowing of the Agricultural Marketing Agency and the Export and Import Credit Insurance Agency covered under paragraph 21, and foreign currency direct borrowing and guarantee by the municipalities from resident banks which are not guaranteed by the central government.

25. The general government will not accumulate external payments arrears on any expenditure item or external debt as defined paragraph 23-24. Transactions subject to the ceilings specified in Section III shall be valued in the contracted currency and converted into U.S. dollars at the time the loan agreement is entered into at the exchange rate for the end of the month.

IV. Reporting

26. The authorities will provide the IMF with information needed to monitor the implementation of the program on a regular basis and in accordance with the timetable indicated below. Fund staff will review together with the authorities the data reporting on an ongoing basis and revise the reporting whenever necessary.

Information on money and banking

27. *On a monthly* basis, the Bank of Lithuania will provide information on:

- international reserves;
- the balance sheet of the Bank of Lithuania, deposit money banks, other banking institutions, and the consolidated banking survey;
- the structure of bank assets and liabilities;
- the currency exchange between the Bank of Lithuania, commercial banks, and the general government.

28. In line with SDDS requirements, the data on international reserves of the Bank of Lithuania will be provided to the Fund on the 5th working day after the end of the month at the latest; the balance sheet of the Bank of Lithuania will be provided to the Fund on the 10th working day after the end of the month at the latest throughout the program period in the agreed format. The other data referred to in paragraph 27 will be provided to the Fund on the 18th working day after the end of each month at the latest throughout the program period in the agreed format.

General government budget implementation and financing

29. On a *monthly basis*, the Ministry of Finance will provide information on:

- below the line financing of the consolidated general government;
- revenue of the national government (state government and municipalities);
- on-lending operations of the general government to the nongovernment sector;

- revenue and expenditure of all extrabudgetary funds included in the calculation of the general government financial balance;
- outstanding domestic government debt broken down by maturity and type of debt (direct and guaranteed), including disbursements and redemption;
- domestic debt service;
- use of resources borrowed abroad;
- general government deposits held abroad;
- disbursements and repayments of foreign loans;
- borrowing by municipal governments;
- domestic guarantees issued during the month and the stock of outstanding domestic guarantees at the end of the month (Table 3); and
- the stock of outstanding payment obligations of the general government, broken down by state government, municipalities, the Social Insurance Fund, the Health Insurance Fund, and each of the other extrabudgetary funds (Table 4).[2]

30. These data will be reported to the Fund within 30 days after the end of each month throughout the program period in the agreed format.

31. *On a quarterly basis*, the Ministry of Finance will provide information on:

- state government revenues and expenditures in terms of both economic and functional classification; and
- local government revenues and expenditures in terms of both economic and functional classification.

32. For the state government, these data will be reported to the Fund within 30 days after the end of the quarter throughout the program period in the agreed format. Data for municipalities will be reported to the Fund within 90 days after the end of the quarter throughout the program period in the agreed format.

[2] Outstanding payment obligations of municipalities will be reported on a quarterly basis.

Information on the External Sector

33. *On an monthly basis*, the Ministry of Finance and the Bank of Lithuania will provide information on:[3]

- short-term and long-term external debt stock of the public and private sector[4] including non-concessional loans from multilateral organizations; and
- external debt service for short-term and long-term external debt of the public sector.

34. These data will be reported to the Fund within 30 days after the end of each month throughout the program period in the agreed format.

35. The above reporting requirements will be assessed on an ongoing basis, and may be revised at the initiative of the Fund and with the consent of the government and the Bank of Lithuania.

December 19, 2001

//s//	//s//
Ms. Ungulaitiene Vice Minister of Finance Ministry of Finance	Mr. A. Kregzde Vice Governor Bank of Lithuania

[3] The Ministry of Finance will provide data on public debt and the Bank of Lithuania will report data on private debt.

[4] Information on registered private sector loans will be provided on a monthly basis, actual figures for the external debt stock of the private sector will be reported on a quarterly basis.

Table 1. Lithuania: General Government Financing, 2000-01

		2000				2001		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
		Stocks, millions of litai (end of period)						
	Domestic credit to government							
1	Short term loans & advances to central government (DMBs)	41.5	41.5	7.6	8.0	0.0	0.0	0.0
2	Long term loans & advances to central government (DMBs)	121.6	118.0	135.0	95.6	126.7	157.7	167.7
3	Claims on municipal governments (DMBs)	214.2	203.1	239.4	273.5	271.8	277.6	282.1
4	Claims on social insurance fund (DMBs)	231.6	243.4	234.6	267.6	281.6	243.6	253.8
5	Savings bonds	75.6	87.3	113.8	130.1	149.4	135.3	144.3
6	Recapitalization bonds	634.0	634.0	634.0	514.2	514.2	514.2	514.2
7	Treasury securities (at issue value)	1,220.3	1,327.1	1,463.0	1,549.0	1,573.5	1,609.6	1,601.0
7.1	Held by DMBs	530.2	640.0	775.2	892.4	995.0	1,013.7	993.0
7.2	Held by OBIs	18.7	23.1	28.1	31.2	29.7	26.0	0.3
7.3	Held by Nonbanks	671.4	664.0	659.8	625.5	548.8	569.9	607.7
8	Total adjusted credit to government (sum of lines 1-8)	2,538.7	2,654.4	2,827.4	2,838.0	2,917.2	2,938.0	2,963.0
	Government deposits							
9	Central government deposits (BOL)	927.9	1,246.9	994.4	781.7	832.7	1,275.7	1,460.8
10	Central government deposits (DMBs)	672.6	723.4	906.3	576.7	807.0	666.7	539.2
11	Central government deposits (OBIs)	132.7	104.6	105.6	105.6	110.7	116.5	0.0
12	Municipal government deposits (DMBs)	108.0	119.6	194.9	135.8	115.0	124.9	154.3
13	Privatization funds (DMBs)	225.3	174.6	151.9	149.2	219.8	33.2	59.4
14	Social insurance fund (DMBs)	26.2	30.1	35.8	58.4	39.0	55.9	45.0
15	General government deposits (sum of lines 9-14)	2,092.8	2,399.2	2,388.9	1,807.4	2,124.2	2,272.9	2,258.6
		Flows, in millions of litai						
16	Changes in domestic credit (change in line 8)	210.6	115.7	173.0	10.6	79.2	20.8	25.0
17	Changes in domestic deposits (change in line 15)	-717.2	-306.4	10.3	581.5	-316.8	-148.7	14.3
18	Float between government deposits noncaptured through monetary accounts	0.0	0.0	0.0	-73.5	73.5	-16.5	-19.2
19	Net domestic repayments to nonbanks	0.0	-43.5	0.0	-22.5	0.0	0.0	0.0
20	Net domestic Financing (sum of lines 16-19)	-506.6	-234.2	183.3	496.1	-164.1	-144.4	20.1
21	Foreign Borrowing	992.4	61.3	535.4	35.7	760.8	14.8	80.6
22	Amortization by the central budget	41.0	127.0	571.1	220.3	41.5	111.9	164.0
23	Amortization by appropriation managers	23.5	61.1	23.0	55.7	20.0	50.2	58.6
24	Change in the government deposit abroad					526.7	-153.6	-193.7
25	Net flows of funds from abroad (line 21-line 22-line 23-line 24)	927.9	-126.8	-58.7	-240.3	172.6	6.3	51.7
26	Net privatization proceeds	45.6	602.0	72.4	83.3	85.6	365.5	50.4
27	General government fiscal balance (line 20+line 25+line 26)	466.9	241.0	197.0	339.1	94.1	227.4	122.2
28	Cumulative fiscal deficit	466.9	707.9	904.9	1,244.0	94.1	321.5	443.7

Sources: Ministry of Finance; and staff estimates.

Table 2. Lithuania: Investment Projects from On-Lent Resources, 2001-02

Nr.	Creditor	Reg. Nr.	2001													
			year	Q1		Q2		Q1-Q2			Q3		Q1-Q3			Q4
				Prog.	Act.	Prog.	Act.	Prog.	Act.	Adjustor	Prog.	Act.	Prog.	Act.	Adjustor	Prog.
	I. Nonbudgetary organizations															
1	World Bank (Lithuanian Energy)	0019	28,000	8,970	8,970	6,500	5,141	15,470	14,111	6,376	6,500	6,650	21,970	20,611	9,626	6,030
2	World Bank (Klaipėda Water)	0020	12,480	0	0	4,160	1,051	4,160	1,051	0	4,160	2,751	8,320	5,211	1,051	4,160
3	World Bank (Šiauliai Water)	0032	840	0	0	840	0	840	0	0	0	112	840	0	0	0
4	World Bank (CJSC "Geoterma")	0033	6,300	2,126	2,126	4,174	1,202	6,300	3,328	178	0	553	6,300	3,328	178	0
5	World Bank (The Housing Credit Foundation)	0034	10,700	4,650	4,650	6,050	1,014	10,700	5,664	314	0	5,492	10,700	5,664	314	0
6	World Bank (Agriculture Sector)	0035	6,000	520	520	1,500	6,067	2,020	6,587	3,000	1,500	0	3,520	8,087	6,327	2,480
7	European Investment Bank (Lithuanian Railways)	0046.1	26,440	8,963	8,963	0	0	8,963	8,963	4,482	0	17,496	8,963	8,963	4,482	0
8	European Investment Bank (Lithuanian Railways)	0046.2	12,904	0	0	0	0	0	0	0	6,452		6,452	6,452	3,226	6,452
9	NIB (municipality 20 mln. EUR)	0052	73,442	736	736	0	0	736	736	368	24,311	44,974	25,047	25,047	12,524	48,395
10	European Investment Bank (municipality 15 mln. EUR)	0059	6,940	0	0	0	0	0	0	0	3,470	0	3,470	3,470	1,735	3,470
11	European Investment Bank (Panevėžio municipality - 6 mln. EUR)	0060	1,000	0	0	0	0	0	0	0	500	0	500	500	250	500
12	World Bank (municipality - 18,89 mln.EUR)	0066	31,120	0	0	15,050	0	15,050	0	0	0	0	15,050	0	0	16,070
13	World Bank (energy saving project - 8 mln. USD)	...	2,000	0	0	0	0	0	0	0	0	0	0	0	0	2,000
	Total (1-13)		218,166	25,965	25,965	38,274	14,474	64,239	40,440	14,718	46,893	78,028	111,132	87,333	39,712	89,557
	II. Budgetary organizations															
1	World Bank (Ministry of Social Security and Labor)	0042	4,661	0	0	1,550	0	1,550	0	0	1,550	0	3,100	1,550	0	1,561
2	Europe Social Development Fund (Ministry of Social Security and Labor)	0043	1,000	0	0	0	0	0	0	0	0	0	0	0	0	1,000
3	Europe Social Development Fund (Ministry of Social Security and Labor)	0058	5,459	0	0	1,700	0	1,700	0	0	1,900	2,556	3,600	1,900	100	1,859
4	World Bank (health project -21 mln. USD)	0069	20,000	0	0	6,500	0	6,500	0	0	6,500	0	13,000	6,500	0	7,000
5	World Bank (education project - 25 mln. USD)	...	2,000	0	0	0	0	0	0	0	2,000	0	2,000	2,000	1,000	0
6. I	Soc. Development fund (School renovation project - 2,5 mln. USD)	...	10,000	0	0	0	0	0	0	0	10,000	0	10,000	10,000	5,000	0
6. II	GS(High school renovation project)	...	10,000	0	0	10,000	0	10,000	0	0	0	0	10,000	0	0	0
7	GS Courts	...	2,000	0	0	0	0	0	0	0	2,000	542	2,000	2,000	1,000	0
8	GS Ministry of health	...	29,000	0	0	29,000	0	29,000	0	0	0	0	29,000	0	0	0
9	GS Ministry of internal affairs	...	10,884	0	0	0	0	0	0	0	5,884	0	5,884	5,884	2,942	5,000
10	GS Custom	...	6,830	0	0	6,830	0	6,830	0	0	0	0	6,830	0	0	0
	Total (1-10)		101,834	0	0	55,580	0	55,580	0	0	29,834	3,098	85,414	29,834	10,042	16,420
	Total (1-II)		320,000	25,965	25,965	93,854	14,474	119,819	40,440	14,718	76,727	81,126	196,546	117,167	49,754	105,977

Source: Ministry of Finance.

Table 2. Lithuania: Investment Projects from On-Lent Resources, 2001-02 (continued)

Nr.	Creditor	Reg. Nr.	2002 year Prog.	Q1 Prog.	Q2 Prog.	Q3 Prog.	Q4 Prog.
	I. Nonbudgetary organisations						
1	World Bank (Lithuanian Energy)	0019	11,388	11,388	0	0	0
2	World Bank (Klaipėda Water)	0020	2,000	2,000	0	0	0
3	World Bank (Šiauliai Water)	0032	0	0	0	0	0
4	World Bank (CJSC "Geoterma")	0033	0	0	0	0	0
5	World Bank (The Housing Credit Foundation)	0034	0	0	0	0	0
6	World Bank (Agriculture Sector)	0035	0	0	0	0	0
7	European Investment Bank (Lithuanian Railways)	0046.1	0	0	0	0	0
8	European Investment Bank (Lithuanian Railways)	0046.2	41,882	12,695	6,795	12,695	9,697
9	NIB (municipality 20 mln. EUR)	0052	0	0	0	0	0
10	European Investment Bank(municipality 15 mln. EUR)	0059	23,840	5,960	5,960	5,960	5,960
11	European Investment Bank (Panevėžio municipality - 6 mln. EUR)	0060	7,000	1,500	1,500	1,500	2,500
12	World Bank(municipality - 18,89 mln.EUR)	0066	6,385	1,500	1,500	1,885	1,500
		...					
13	World Bank (energy saving project - 20 mln. USD)	...	2,000	500	500	500	500
14	Lithuanian Railway (Pauostis)	...	0	0	0	0	0
15	EBRD (energy saving project for institutions 20 mln. USD)	...	8,000	2,000	2,000	2,000	2,000
	Total (1-13)		102,495	37,543	18,255	24,540	22,157
	II. Budgetary organisations						
1	World Bank (Ministry of Social Security and Labour)	0042	5,260	2,630	2,630	0	0
2	Europe Social Development Fund (Ministry of Social Security and Labour)	0043	1,500		1,500	0	0
3	Europe Social Development Fund (Ministry of Social Security and Labour)	0058	0	0	0	0	0
4	World Bank(health project -21 mln. USD)	0069	23,040	5,760	5,760	5,760	5,760
5	World Bank(education project - 25 mln. USD)	...	10,000	2,500	2,500	2,500	2,500
6. I	European Development Bank (School renovation project - 2,5 mln. USD)	...	5,900		5,900		
6. II	GS(High school renovation project)	...	0	0	0	0	0
7	GS Courts	...	0	0	0	0	0
8	GS Ministry of Health	...	0	0	0	0	0
9	GS Ministry of Health (health care)	...	0	0	0	0	0
10	GS Ministry of Internal affairs	...	0	0	0	0	0
11	GS Custom	...	0	0	0	0	0
	Total (1-10)		45,700	10,890	18,290	8,260	8,260
	TOTAL (I+II)		148,195	48,433	36,545	32,800	30,417

Source: Ministry of Finance.

Table 3. Lithuania: State Budget Expenditures on Investment Projects Financed from Borrowed Resources, 2001-02

(In millions of Litai)

	2001												2002
	Year	Q1	Q2	Q1-Q2			Q3		Q1-Q3			Q4	Year
		Prog.	Prog.	Prog.	Act.	Adjustor	Prog.	Act.	Prog.	Act.	Adjustor	Prog.	
Total	229.7	51.9	73.9	125.9	77.8	21.1	51.9	61.8	177.8	139.7	54.3	51.9	444.1
Ministries	162.0	35.0	57.0	92.0	48.5	7.1	35.0	37.4	127.0	85.9	23.9	35.0	173.2
Ministry of National Defense	75.8	13.4	35.4	48.9	22.3	0.0	13.4	18.7	62.3	41.0	9.8	13.4	77.8
Ministry of Culture	8.3	2.1	2.1	4.2	2.0	0.0	2.1	2.0	6.2	4.0	0.9	2.1	13.4
Ministry of Social Security and Labor	9.7	2.4	2.4	4.9	1.2	0.0	2.4	0.9	7.3	2.1	0.0	2.4	5.5
Ministry of Health	39.5	9.9	9.9	19.7	17.0	7.1	9.9	9.9	29.6	26.9	12.1	9.9	21.6
Ministry of Education and Science	28.8	7.2	7.2	14.4	6.0	0.0	7.2	5.9	21.6	11.9	1.1	7.2	8.6
Ministry of Environment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3
Ministry of Finance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.1
Ministry of Interior Affairs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.1
Ministry of Agriculture	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	12.9
Ministry of Communications	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3
Ministry of Justice	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.4
Ministry of Economy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.4
Ministry of Foreign Affairs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.8
Government Bodies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	5.0
Projects of Municipalities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	53.2
Regions	40.0	10.0	10.0	20.0	18.5	8.5	10.0	15.6	30.0	34.1	19.1	10.0	51.7
Departments, Services, and Inspectorates	8.2	2.1	2.1	4.1	0.6	0.0	2.1	0.6	6.2	1.2	0.0	2.1	30.4
Department of Sciences and Studies under the Ministry of Education and Science	8.2	2.1	2.1	4.1	0.6	0.0	2.1	0.6	6.2	1.2	0.0	2.1	...
Enterprises and Organizations	0.4	0.1	0.1	0.2	0.0	0.0	0.1	0.0	0.3	0.0	0.0	0.1	92.4
Education, culture and other institutions and organizations	19.2	4.8	4.8	9.6	10.2	5.4	4.8	8.2	14.4	18.5	11.3	4.8	38.2
Science and studies	19.1	4.8	4.8	9.6	10.2	5.4	4.8	8.2	14.3	18.4	11.2	4.8	34.4
Public enterprises: translation, documentation and information center	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	3.8

Source: Ministry of Finance.

Table 4. Lithuania: Ceilings on Stock of General Government Guarantees for Domestic Borrowing, 2000-02
(In millions of Litai)

	2000							2001							2002			
	Q1	Limit	Q2	Limit	Q3	Limit	Q4 Limit	Q1 Limit	Act.	Q2	Act.	Q3	Act.	Q4	Q1	Q2	Q3	Q4
Total	565	547	499	527	451	487	489	489	376	315	214	314	232	312	315	312	312	312
Special agencies	252	290	228	290	243	270	283	270	178	255	162	252	169	250	250	250	250	250
Agricultural marketing agency	240	260	215	255	230	225	233	230	165	230	147	230	154	230	220	220	220	220
of which: SAPARD program cofinancing	...	...	...	...	...	...	...	20	0	20	0	20	0	30	30	30	30	30
Export and import credit insurance agency	11	30	13	35	12	45	50	40	14	25	15	22	15	20	15	15	15	15
SoDra	177	177	175	177	175	177	177	177	159	...	-	...	-	...	15	15	15	15
Other	136	80	95	60	33	40	29	42	39	60	52	62	63	62	65	62	62	62

Source: Ministry of Finance.

Table 5. Lithuania: Stock of General Government Outstanding Payment Obligations, 1999-2001
(In millions of Litai, unless otherwise indicated)

	1999	2000				2001		
	Dec. 31	Apr. 1	Jul. 1	Oct. 1	Dec. 31	Apr. 1	Jul. 1	Oct. 1
Total outstanding payment obligations	594	470	443	317	236	264	238	224
(in percent of annual GDP)	1.4	1.0	1.0	0.7	0.5	0.5	0.5	0.5
State government	125	81	86	65	17	18	15	8
Wages and salaries	8	5	7	3	2	3	3	0
Other expenditure	118	77	80	62	15	15	12	8
Municipalities	155	233	237	183	195	245	218	188
Wages and salaries	14	21	11	7	10	12	11	10
Other expenditure	140	212	225	176	185	233	206	178
SoDra	0	0	0	0	0	0	0	0
Pensions, wages and salaries	0	0	0	0	0	0	0	0
Other expenditure	0	0	0	0	0	0	0	0
Health Insurance Fund	0	14	55	23	23	0	5	29
Payments to health care providers	0	0	0	0	0	0	0	0
Wages and salaries	0	0	0	0	0	0	0	0
Other expenditure	0	14	55	23	23	0	5	29
Privatization Fund	0	3	0	0	0	1	0	0
Wages and salaries	0	0	0	0	0	0	0	0
Other expenditures	0	3	0	0	0	1	0	0
Rural Support Fund	231	129	62	19	0	0	0	0
Wages and salaries	0	0	0	0	0	0	0	0
Other expenditure	231	129	62	19	0	0	0	0
Road Fund	83	10	4	28	2	0	0	0
Wages and salaries	0	0	0	0	0	0	0	0
Other expenditure	83	10	4	28	2	0	0	0
Memorandum item:								
Nominal GDP	42,655	45,254	45,254	45,254	45,254	48,087	48,087	48,087

Sources: Ministry of Finance; municipalities; and extrabudgetary funds.

Table 6. Lithuania: Newly Contracted Public and Publicly Guaranteed Debt, 2001-02

Name of the Project	Spending Agency	Source of Financing	Amount	
			in LTU mn.	in US$ mn.
2001				
Q1				
Eurobonds	Ministry of Finance	...	732	183
Q2				
Lithuanian Road project	Lithuanian Road Administration Agency	EIB and NIB	42	11
Q3	...	...	0	0
Q4				
Lithuanian Rail Road project	Lithuanian Railways	Kena	10	3
Lithuanian Rail Road project	Lithuanian Railways	EBRD	216	54
Vilnius Heating project	Vilnius Municipality	World Bank	120	30
School Renovation project	Municipalities	Social Development Fund	10	3
2002				
Q1				
Education project	Ministry of Education	World Bank	100	25
Mazeikiu Nafta	Mazeikiu Nafta	...	472	118
Energy Saving project	Municipalities	EBRD	80	20
Q2				
Eurobonds	Ministry of Finance	...	1500	375
Energy Saving project	Municipalities	World Bank	100	25
Q3				
New projects	Various agencies	...	100	25

Source: Ministry of Finance.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 02/4
FOR IMMEDIATE RELEASE
January 24, 2002

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

IMF Concludes 2001 Article IV Consultation with the Republic of Lithuania

On January 16, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Lithuania.[1]

Background

Lithuania has firmly implemented its adjustment and reform program in 2001 with impressive results. The external current account deficit declined sharply and external vulnerability decreased; real GDP growth resumed and inflation remained subdued. Confidence in the currency board and in Lithuania's policy making in general was restored, allowing for favorable access to domestic and international capital markets. The pace of structural reforms accelerated markedly in energy restructuring, fiscal structural areas, privatization particularly in the banking sector, trade policy, labor and in the social security system. Significant progress has also been made in the overarching objectives of EU and NATO accession, which are widely supported across the political spectrum.

Real GDP grew by 5.1 percent year-on-year for the first three quarters of 2001, and it is expected to grow by 4.5 percent for the whole year, driven initially by strong export growth, which has been complemented lately by a gradual recovery of domestic demand. The latter was supported by a resumption in credit growth to the private sector, following stronger competition in the banking sector, lower interest rates, and improvements in the business environment. The external current account deficit is expected to narrow to 5.8 percent in 2001 from 6.0 percent in 2000, mainly because of rapid export growth. Fiscal adjustment continued in 2001, despite

---

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

revenue shortfalls. The general government fiscal deficit for the first nine months of 2001 declined to 1.2 percent of GDP compared to 3.1 percent in the corresponding period of 2000. In order to stabilize revenue and create a tax system consistent with EU requirements, the government prepared and submitted to Seimas an ambitious tax package of laws on value-added tax, and corporate and personal income taxes, which aims at removing exemptions and broadening the tax bases.

Underpinned by fiscal adjustment, the currency board continued to provide a sound anchor for credible macroeconomic policy in Lithuania. In view of the progressive orientation of trade toward the euro area and greater economic integration in the region, the authorities announced in mid-2001 the repegging of the anchor currency from the dollar to the euro, which will take place on February 2, 2002, based on the European Central Bank reference exchange rate of the euro for the dollar of February 1, 2002. The announcement on June 28 was well-received by the markets and the Bank of Lithuania has largely completed the preparations for the repegging. Financial sector vulnerability indicators improved over 2001.

The pace of structural reforms accelerated markedly in 2001 in several areas. To coordinate and monitor financial issues related to EU accession, two new departments at the Ministry of Finance were established. To strengthen municipal finances, new legislation allocating expenditure responsibilities to municipalities and the concomitant resources was passed by Seimas, and a set of measures have been prepared to deal with municipal arrears. Important reforms of the Treasury system have been implemented. The restructuring of the energy sector was completed, paving the way for privatization in 2002. Bank privatization increased efficiency and competition. A number of measures have been undertaken to improve labor market flexibility and enhance the business environment. Labor laws were amended to reduce restrictions on hiring and firing of workers, and new solvency laws were adopted.

EU accession negotiations have advanced rapidly, with agreement reached on 21 chapters (out of 31) of the *acquis communautaire*. Lithuania submitted its preaccession economic program to the EU commission in October 2001. The EU accession report of November 2001 concludes that Lithuania is a functioning market economy, and should be able to cope with competitive pressures within the EU in the near term.

Executive Board Assessment

Executive Directors commended the authorities for maintaining macroeconomic stability, continuing the strong growth performance, and implementing important structural reforms. While progress has also been made in reducing vulnerability, Lithuania nevertheless remains exposed to the risk of exogenous shocks, which Directors agreed, highlights the importance of continuing with sound financial policies and structural reforms aimed at creating conditions for sustained growth, foreign direct investment, and enhanced competitiveness.

Directors noted the important role that the determined implementation of an ambitious fiscal adjustment has played in improving macroeconomic conditions and in underpinning the credibility of the currency board arrangement. They considered that the 2002 budget appropriately aims at consolidating the recent adjustment, while seeking to limit the erosion of tax revenue and addressing expenditure needs in line with medium-term priorities. They urged the authorities to adhere to the 2002 deficit target, resisting pressures to increase expenditures without accompanying revenue measures.

Directors considered that, given persistent shortfalls, measures to stabilize tax revenue constitute an urgent priority. In this context, they welcomed the comprehensive tax package prepared by the government, which would eliminate exemptions, and thereby allow to reduce rates, while preserving tax revenue. They cautioned against the preferential treatment of particular groups and sectors, which would jeopardize the tax reform objectives and the ultimate goal of stimulating growth.

In light of new EU accession-related expenditure commitments, Directors emphasized the importance of careful prioritization, rationalization of expenditure and strengthening of budgetary control. They welcomed improvements in the administrative framework, allowing Lithuania to make effective use of EU structural funds, and encouraged the authorities to further increase implementation capacity in this area.

Directors supported the measures taken to improve the financial situation of the Health Insurance Fund and municipalities and prevent the accumulation of arrears. Regarding the latter, they underscored the importance for the government of using all legal means to oblige municipalities to follow the new principles of financial relations between the state and municipal budgets. They also looked forward to the new pension system which will put Lithuania's social security system on a sound financial footing.

Directors endorsed the plan to switch the peg of the litas from the dollar to the euro, consistent with greater economic integration with the EU. They welcomed the authorities' strategy to make the process transparent and looked forward to a smooth transition. Directors underscored the need to maintain macroeconomic discipline, including prudent debt management policies, and to continue structural reform efforts aimed at ensuring competitiveness over the medium term.

Directors welcomed the significant acceleration in structural reforms in 2001, in particular the progress made in restructuring the energy sector and in bank privatization. They urged the authorities to reverse recent initiatives to set indicative prices in agriculture, and encouraged them to continue to implement structural reforms critical for investment, growth, and reducing unemployment. In this regard, they looked forward to the early implementation of measures to enhance labor market flexibility and training opportunities.

Directors welcomed the authorities' participation in the Financial Sector Assessment Program (FSAP). They encouraged the authorities to continue efforts to strengthen the banking system, following the FSAP recommendations, which, together with bank privatization, will enhance the efficiency of financial intermediation and further improve confidence in the domestic financial system. They also welcomed the authorities' participation in the pilot project to assess anti-money laundering policies and practices.

Directors commended the authorities' commitment to transparency in the conduct of economic policies and in data provision.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2001 Article IV Consultation with Lithuania is also available.

Republic of Lithuania: Selected Economic Indicators

	1997	1998	1999	2000
Real Economy	*Changes in percent*			
Real GDP	7.3	5.1	-3.9	3.9
CPI (period average)	8.8	5.1	0.8	1.0
Unemployment rate (in percent) 1/	14.1	13.3	14.1	15.9
National saving (in percent of GDP)	16.6	12.3	11.5	14.8
National investment (in percent of GDP)	26.5	24.4	22.7	20.7
Public Finance	*In percent of GDP*			
General government balance	-1.8	-5.9	-8.5	-2.7
General government external debt	14.1	15.7	22.4	20.9
Money and Credit	*Changes in percent*			
Base money	32.4	28.8	-4.0	-3.0
Broad money	34.1	14.5	7.7	16.5
Domestic credit to nongovernment	21.7	16.9	13.8	-1.2
Balance of Payments	*In percent of GDP*			
Trade balance	-10.6	-11.9	-10.3	-6.4
Current account	-10.2	-12.1	-11.2	-6.0
Gross international reserves (in millions of U.S. dollars)	1,063	1,460	1,242	1,359
Exchange Rate				
Exchange rate regime	*Currency Board Arrangement*			
Present	LTL 4 =US$1			
Real effective exchange rate (1998=100) 2/	93	100	113	120

Sources: Data provided by the Lithuanian authorities, and IMF staff estimates and projections.

1/ Based on the definition of the International Labor Organization (ILO).

2/ Export-share weighted real exchange rate (CPI-based) against 21 major trading partners in 1999.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 02/4
FOR IMMEDIATE RELEASE
January 16, 2002

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

IMF Approves US$15 Million Tranche Under Stand-By Credit for Lithuania

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Lithuania's economic performance under the 19-month stand-by credit. This decision makes another disbursement of SDR 12.4 million (about US$15 million) available to Lithuania, bringing the total available IMF resources to SDR 24.7 million (about US$30 million).

The stand-by credit was approved on August 30, 2001 (see Press Release No. 36) for a total of SDR 86.5 million (about US$108 million). So far, Lithuania has not drawn from the available IMF resources.

Following the Executive Board discussion on Lithuania, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, said:

"The Lithuanian authorities are to be commended for the continued successful implementation of their economic program, which has contributed substantially to the economy's progress over the last year. Growth was strong, the current account deficit declined further, and inflation remained subdued, although unemployment continues to be high. Structural reforms advanced across a range of areas, including energy sector restructuring, privatization, and fiscal management. Preparations for EU accession have also proceeded at a fast pace.

"Fiscal adjustment over the last two years has been impressive, and the recently approved budget for 2002 appropriately seeks to consolidate these hard-won gains. The authorities' tax reform package represents an important step towards the establishment of a more transparent and efficient tax system that will help to stabilize revenues over the medium term. The recent measures to address the financial weaknesses of the health insurance fund and municipalities are welcome, and the authorities are urged to implement them rigorously.

"The planned repegging of the litas to the euro, with a view to greater economic integration with the EU, is welcome, and preparations for the repegging have proceeded smoothly. While there are no major risks to the stability of Lithuania's financial system, the authorities will continue their efforts to further strengthen the institutional underpinnings of the financial sector, in line with the recommendations of a recent joint IMF-World Bank Financial Sector Assessment Program mission. Looking ahead, it will be important to maintain macroeconomic discipline and the momentum of structural reform to ensure that the economy remains competitive and continues to perform well, even in a potentially more difficult external environment," Mr. Sugisaki said.

Statement by Åke Törnqvist and Stasys Kropas, Advisors to the Executive Director for the Republic of Lithuania
January 16, 2002

First, I would like to thank the staff on behalf of my authorities and myself for a very comprehensive and thorough report and an excellent set of supporting documents on economic developments in Lithuania. My authorities would like to see all of them published.

Recent Economic Developments and Outlook

In economic terms the year 2001 was one of the most successful years since Lithuania gained independence. Macroeconomic conditions were substantially improved: the external position of the economy strengthened and interest rates approached EU levels. The country experienced accelerating economic growth in a low inflation environment.

GDP grew by 5.1 percent in the third quarter last year. This growth stems from the rise in the value added in the manufacturing, energy, construction and trade sectors. Exports of goods and services increased by 14.6 percent in the third quarter while investments for capital formation increased by 7.3 percent. The current account deficit stayed at a record low 0.4 percent of GDP level. Despite the higher growth rate, inflation stayed at 2 percent in 2001.

Notwithstanding the rapid economic growth, unemployment remains at a high level. As it is largely structural in nature, reflecting skills mismatches and limited mobility, the Government will continue to implement measures further to enhance labor market flexibility and conduct targeted training programs. A new labor code has already been submitted to the Seimas (Parliament) and the new Unemployment Insurance Law is expected to introduce more flexibility in wage bargains and strengthen the insurance element in the maintenance of social cohesion.

EU Accession

Lithuania has made substantial progress towards the important goal of EU accession. The European Commission's 2001 Regular Report on Progress Toward EU Accession concluded that Lithuania is a functioning market economy and should be able to cope in the near term with the competitive pressures within the EU. By the end of 2001 the country had provisionally closed 23 negotiating chapters, including some difficult ones, such as Environment, Free Movement of Persons, Customs Union, Competition, Transport and Taxation. The accession process clearly has a positive impact on economic development. Benchmarking and anchoring EU policies serve as additional incentives to speed up the structural reforms.

Fiscal Policy

A credible budget deficit reduction path and a structurally balanced budget in the medium term achieved through the maintenance of fiscal consolidation and expenditure rationalization continue to be at the core of the authorities' strategy.

The Government is moving quickly to tackle the problem of the declining revenue ratio by overhauling the entire tax system. The objective is to design a more comprehensive, internally consistent and stable system. The main measures are expected to take effect in 2003 but excise and corporate income tax laws are in force as of January 2002. The new excise legislation removes exemptions and broadens the tax bases in accordance with EU requirements. The corporate income tax rate is reduced from 24 to 15 percent and the exemption for reinvested earnings is eliminated. New VAT regulations will be effective from July 1, 2002, and laws on personal income taxes and on property taxation will come into force at the beginning of 2003. The tax reform is intended to be revenue neutral.

New legislation defining more precisely the functions performed by municipalities and their financing sources and establishing adequate principles for balancing revenue of municipal budgets has been approved by the Seimas. Functions and education expenditures delegated to the municipalities will be financed by transfers from the state budget. Municipalities will have discretion in setting tax rates and fees accruing to local budgets and will be required to take adequate measures in the event of shortfalls in their revenue. In addition, the Government will introduce a more comprehensive system of monitoring the municipal arrears, improving local governance by auditing statements, establishing financial measures for appropriation managers to follow, and requiring greater transparency.

Exchange Rate and Monetary Policies

The preparations for the repegging of the litas are proceeding as planned. Opinion polls indicate that the public is well informed about the details of the repegging and that the business community supports repegging. Low bank interest rates and government bonds spreads and forward exchange rates also indicate that market participants are confident.

The authorities expect that the monetary environment will continue to be supportive of economic growth in 2002. With the foreign reserve coverage of reserve money reaching 166 percent in December, confidence in the currency board will remain strong. Low inflation and nominal interest rates, along with the increasing efficiency of financial intermediation, should lead to further monetization and private credit growth. A further reduction of the minimum reserve requirements in line with EU requirements will be announced in the first quarter of the year 2002.

Financial Sector Assessment Program

The authorities value highly participating in the FSAP. They will draw on the assessments of the joint mission of the World Bank and the IMF when designing financial sector reforms. The self assessments and the discussions with the mission provided Lithuanian officials with excellent opportunities to deepen knowledge and analytical capabilities. The FSAP revealed a number of opportunities to enhance supervisory practices and fine-tune them in line with international financial standards. They also helped turn the authorities' attention to the steps that need to have priority in order to maintain financial system stability.

Some lessons for future FSAP development could be learned from the Lithuanian FSAP experience. The process of statistical information gathering could have been made smoother if authorities had been familiarized with the methodology of stress testing. Also, more attention could have been paid to the local characteristics of Lithuanian markets and supervisory practices.

Structural Reforms

Pension reform is the cornerstone of the authorities' structural reform agenda. A revised concept of the pension reform has been submitted to the Seimas. As the main principles of the three-pillar pension system remain, the Government decided to reduce the maximum mandatory age for participation in the reform to 30 years and to put in place the new system from 2004 when the Social Insurance Fund (Sodra) is expected to have a sizable accumulated surplus. The cost of the pension reform is currently estimated at 0.6 percent of GDP. Owing to the legislative and administrative measures already implemented, Sodra generated a surplus in 2001. The authorities are taking further measures in order to strengthen the social security system's financial position. A requirement of mandatory full pension insurance for certain groups of self-employed persons has been introduced and the legislation with tighter eligibility requirements and revised calculations of benefits will be submitted to the Seimas in the course of the year 2002. In addition, the Government has undertaken a number of significant steps to eliminate the arrears of the Health Insurance Fund and substantially improve its medium-term financial position by establishing more effective reimbursement procedures, reducing the list of pharmaceuticals subject to reimbursement and the levels of reimbursement, tightening the regulations on prescriptions for the most expensive pharmaceuticals, and introducing financial incentives for controlling pharmaceutical costs.

The remaining structural reforms are partly driven by the EU accession policies. They include completion of the large-scale privatization program and implementation of measures to enhance competitiveness. The Government is proceeding with the measures to restructure and privatize the Lithuanian Power Company (LPC) and Lithuanian Gas (LG). The registration of the restructured LPC is expected to be completed in the beginning of the year 200. The company will then be offered for sale during the second half of the year 2002. The initial sale of a 34 percent stake in the LG to a strategic investor is likely to be completed by May 2002, followed by the sale of another 34 percent to a gas supplier in the second half of the year. Lithuanian Airlines is expected to be restructured and ready for privatization by April 2002 as well as the Lithuanian Shipping Company's cargo business. Preparations for the privatization of the Lithuanian Railways is well underway following a comprehensive reorganization of the company approved by the Government in May 2001. The financial details of the privatization of the state owned Agricultural Bank will be finished early this year.

The Government is committed to continuing to improve the business environment. In order to streamline company registration and liquidation procedures, the authorities introduced a new company register from January 2001 and have been streamlining the effectiveness of the new insolvency laws through the training for administrators and judges, preparation of a manual on bankruptcy and restructuring procedures.