

**The Republic of Lithuania: Second Review Under the Stand-By Arrangement—Staff Report; News Brief on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Lithuania**

In the context of the Second Review Under the Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the Second Review Under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **May 7, 2002**, 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 June 14, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a News Brief summarizing the **views of the Executive Board as expressed during its June 27, 2002 discussion** of the staff report that completed the request and/or review.
- 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 sent to the IMF by the authorities of the Republic of Lithuania\*  
Memorandum of Economic and Financial Policies by the authorities of the Republic of Lithuania\*  
Technical Memorandum of Understanding\*

\*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.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

**Second Review Under the Stand-By Arrangement**

Prepared by European II and Policy Development and Review Department

Approved by Mohammad Shadman-Valavi and Anne McGuirk

June 14, 2002

- Discussions were held in Vilnius during April 22–May 7, 2002. The Fund staff team comprised P. Alonso-Gamo (head), S. Fabrizio, V. Kramarenko (all EU2), T. Rasmussen (TRE), and Q. Wang (PDR), and was assisted by M. Horton, the Fund's resident representative. Mr. Isleifsson, Executive Director, and Mr. S. Kropas, Advisor to the Executive Director, attended some policy meetings.
- The mission met with President Adamkus, Prime Minister Brazauskas, Bank of Lithuania (BoL) Governor Šarkinas, Minister of Finance Grybauskaite, Minister of Economy Česna, other senior government officials, members of the banking and business communities, and EU representatives.
- 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). During the 2001 Article IV consultation and first program review Board discussion, on January 16, 2002, Directors emphasized the importance of continuing sound financial policies and structural reforms aimed at promoting growth, foreign direct investment, and competitiveness. Directors also endorsed the authorities' plan to switch the peg of the litas from the dollar to the euro, which was successfully implemented on February 2, 2002.
- In the attached letter dated June 13, 2002, the authorities request the completion of the second review. The authorities intend to publish the supporting Supplementary Memorandum of Economic Policies (SMEP, Attachment) and confirmed their intention not to make any purchases under the arrangement.
- 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; the periodicity and timeliness of the most important statistics are presented in Appendix III.

| Contents   | Page |
|--|------|
| Executive Summary .....  | 4    |
| I. Introduction .....  | 5    |
| II. Recent Developments and Performance Under the Program .....                  | 5    |
| A. Macroeconomic Developments .....  | 5    |
| B. Structural Reforms .....  | 13   |
| III. Policies and Program for 2002 .....   | 13   |
| A. Macroeconomic Outlook for 2002 and the Medium Term .....                      | 13   |
| B. The Currency Board Arrangement .....  | 15   |
| C. Fiscal Policy .....   | 17   |
| D. Structural Reforms .....  | 18   |
| Fiscal Reforms.....  | 18   |
| Financial Sector Reforms .....   | 20   |
| Other Areas .....  | 20   |
| IV. Staff Appraisal.....   | 22   |
| <br>Text Tables  |      |
| 1. Selected Macroeconomic Indicators, 1997–2002.....                             | 5    |
| 2. Selected Macroeconomic Indicators, 2001–02 .....                              | 14   |
| 3. Selected Economic Indicators, 1998–2007 .....                                 | 15   |
| 4. General Government’s Revenue and Expenditure, 1999–2002 .....                 | 17   |
| 5. Estimated Impact of Tax Reform in 2003 .....                                  | 18   |
| 6. Stock of Municipalities’ Payables, Arrears, and Short-Term Debt, 2001–02..... | 19   |
| 7. Planned Measures to Implement FSAP Recommendations .....                      | 21   |
| 8. Progress in EU Accession Negotiations Among Selected Candidates.....          | 22   |
| <br>Figures  |      |
| 1. Financial Indicators, 1997–2001 .....   | 6    |
| 2. Selected Economic Indicators, 1996–2001 .....                                 | 8    |
| 3. Indicators of External Competitiveness, 1996–2001 .....                       | 9    |
| 4. Baltic Countries: Macroeconomic Indicators, 1997–2001 .....                   | 10   |
| 5. Baltic Countries: Credit to the Non-Government Sector, 1997–2001 .....        | 11   |
| <br>Text Boxes   |      |
| 1. Initial Impact of the Repegging.....  | 12   |
| 2. Productivity Growth and Competitiveness.....                                  | 16   |

Tables

|     |  |    |
|-----|--|----|
| 1.  | Performance Criteria for Stand-By Arrangement, 2001–02.....                              | 26 |
| 2.  | Quantitative Benchmarks for Stand-By Arrangement, 2001–02.....                           | 27 |
| 3.  | Structural Benchmarks for Stand-By Arrangement, 2001–02.....                             | 28 |
| 4.  | Selected Macroeconomic Indicators, 1998–2002.....  | 39 |
| 5.  | Balance of Payments, 1998–2007 .....   | 30 |
| 6.  | Indicators of External and Financial Vulnerability, 1999–2002 .....                      | 32 |
| 7.  | Summary of Consolidated General Government Operations, 1998–2002.....                    | 33 |
| 8.  | Summary Monetary Accounts, 1998–2002.....  | 35 |
| 9.  | Indicators of Financial Sector Vulnerability, 1998–2002 .....                            | 36 |
| 10. | Macroeconomic Framework, 1998–2007.....  | 37 |
| 11. | Schedule of Available Purchases Under the Current Stand-By Arrangement,<br>2001–03 ..... | 38 |
| 12. | Indicators of Financial Obligations to the Fund, 2002–08 .....                           | 39 |

Appendices

|    |                                      |    |
|----|--------------------------------------|----|
| 1  | Fund Relations.....                  | 40 |
| 2. | World Bank Relations .....           | 43 |
| 3. | Status of Statistical Database ..... | 45 |

Attachment

|    |  |    |
|----|--|----|
| 1. | Letter of Intent and Supplementary Memorandum of Economic Policies ..... | 49 |
|----|--|----|

## Executive Summary

**Program implementation has been generally good.** Macroeconomic performance was better than expected in 2001: real GDP grew by 5.9 percent, driven by buoyant exports and investment, while the impact of the slowdown in the EU was limited and largely offset by strong demand from CIS countries. The current account deficit declined to 4.8 percent of GDP, and the external debt and liquidity situation strengthened. Credit to the private sector initiated a strong recovery, while prudential indicators of the banking system were adequate. All program fiscal targets were met.

**Positive trends continued in the first quarter of 2002** with real growth estimated at 4.2 percent and the current account deficit at 4.3 percent of GDP. Markets received well the repegging of the litas from the dollar to the euro. Credit continued to grow at a brisk pace and all fiscal targets were met, except the indicative benchmark on central government payment arrears.

**Further progress was made in structural reforms**, including tax reform, municipal finances, health care expenditure, banking privatization, financial sector reforms following FSAP recommendations, energy sector privatization and other areas; although some program measures were implemented with delays.

**The macroeconomic outlook for 2002** envisages faster growth and a slightly higher current account deficit, while inflation, wage, and employment projections remain largely unchanged. External and fiscal sustainability considerations call for further fiscal adjustment in the medium term.

**The currency board arrangement will continue to anchor macroeconomic policies.** Increased money demand would lead to broad money growth of 17 percent, while credit would expand after a period of stagnation. The pick-up in credit growth does not appear to raise immediate concerns regarding the quality of bank portfolios. Consistent with the BoL's plan to bring the required reserve ratio gradually to ECB levels, this ratio was reduced to 6 from 8 percent starting on May 24, 2002. The fiscal deficit target for 2002 of 1.5 percent of GDP remains appropriate and the June budget revision mainly targets expenditure reallocation and a slight increase in expenditure to be financed by additional revenue, in line with recent trends.

**Structural reforms are to advance in a number of areas.** The government is committed to: targeting revenue neutrality in the tax reform package; introducing additional measures to strengthen municipal finances; implementing additional expenditure reduction measures for the Health Insurance Fund, and finalizing the pension reform. Following the FSAP recommendations, the authorities plan to strengthen supervision of banking institutions, insurance companies and capital markets, as well as antimoney-laundering practices. Reforms would also advance in the areas of business environment, labor legislation, and privatization.

## I. INTRODUCTION

1. **Program implementation has been good and all performance criteria for end-December 2001 and end-March 2002 were met** (text Table 1 and Tables 1–3). The center-left government led by Prime Minister Brazauskas commands a majority in parliament (Seimas) and is able to garner support for needed measures, especially given the broad political consensus in favor of EU and NATO accessions. Political pressures may emerge, however, in the run-up to the December presidential elections, complicating the preparation of the 2003 budget.

Text Table 1. Lithuania: Selected Macroeconomic Indicators, 1997-2002

|   | 1997  | 1998  | 1999  | 2000  | 2001<br>Prel. | Q1 2002<br>Prel. |
|---|-------|-------|-------|-------|---------------|------------------|
| <b>National income, prices, and wages</b>               |       |       |       |       |               |                  |
| Real GDP growth (year-on-year, in percent)              | 7.3   | 5.1   | -3.9  | 3.8   | 5.9           | 4.1              |
| Average CPI (year-on-year change, in percent)           | 8.8   | 5.1   | 0.8   | 1.0   | 1.3           | 2.5              |
| Average monthly wage (in U.S. dollars)                  | 196   | 232   | 247   | 243   | 248           | ...              |
| Unemployment rate (end-of-period, in percent)           | 6.7   | 6.9   | 10.0  | 12.6  | 12.9          | 12.6             |
| <b>General government</b>                               |       |       |       |       |               |                  |
| Fiscal balance (in percent of GDP)                      | -1.8  | -5.9  | -8.5  | -2.8  | -1.9          | -1.0             |
| <b>External sector</b>                                  |       |       |       |       |               |                  |
| Current account balance (in percent of GDP)             | -10.2 | -12.1 | -11.2 | -6.0  | -4.8          | -4.3             |
| Gross official reserves (in millions of U.S. dollars)   | 1,063 | 1,460 | 1,242 | 1,359 | 1,669         | 1,740            |
| <b>Money and credit</b>                                 |       |       |       |       |               |                  |
| Reserve money (year-on-year change, in percent)         | 32.4  | 28.8  | -4.0  | -3.3  | 8.3           | 15.1             |
| Broad money (year-on-year change, in percent)           | 34.1  | 14.5  | 7.7   | 16.5  | 21.4          | 20.9             |
| Private sector credit (year-on-year change, in percent) | 18.9  | 16.9  | 13.8  | -1.2  | 21.4          | 21.6             |

Sources: Lithuanian authorities; and Fund staff estimates.

## II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

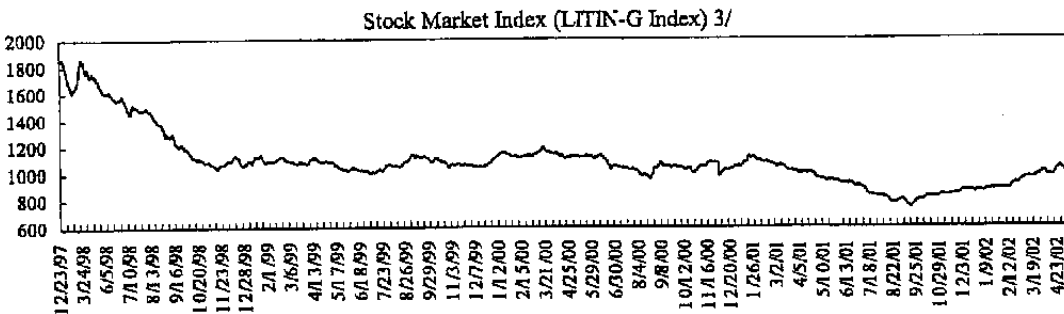
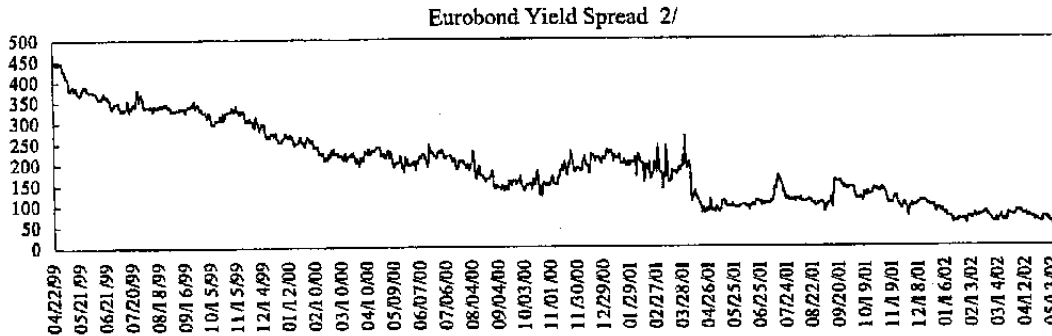
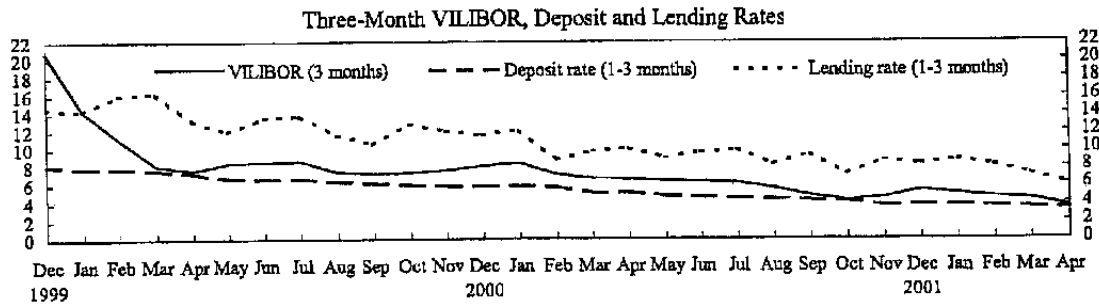
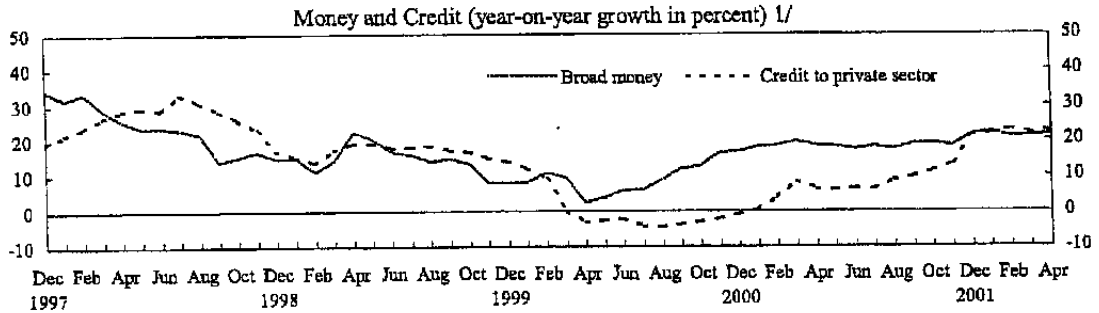
### A. Macroeconomic Developments

2. **Macroeconomic performance was better than expected in 2001** (text Table 1 and Table 4)<sup>1</sup>. Real GDP grew by 5.9 percent, driven by buoyant exports and investment,<sup>2</sup> while

<sup>1</sup> The rating agency Standard & Poor's raised the country's long-term foreign currency rating from BBB- to BBB in April 2002.

<sup>2</sup> Changes in tax legislation and a pick-up in credit growth (Figure 1) contributed to the strong investment performance.

Figure 1. Lithuania: Financial Indicators, 1997-2002



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 German benchmark bond; Lithuanian Eurobond maturing March 2004.

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

the impact of the slowdown in the EU was limited and largely offset by strong demand from CIS countries (Figures 2 and 3). Further fiscal consolidation—with the general government deficit declining to 1.9 percent of GDP<sup>3</sup> (from 2.8 percent in 2000)—together with sluggish consumption growth, attributable to wage restraint and a high unemployment rate (about 12 percent), led to a narrowing in the external current account deficit to 4.8 percent of GDP in 2001 from 6.0 percent in 2000 (Figure 4 and Table 5). Over 75 percent of the current account deficit was financed by FDI and borrowing costs declined sharply, entailing a marginal increase of net external debt to 26.4 percent of GDP. External liquidity indicators improved (Table 6), as gross official reserves reached \$1,669 million by year-end, increasing coverage of short-term debt to 58 percent (from 49 percent at end-2000). Sluggish private consumption and lower oil prices helped limit CPI inflation to 1.3 percent.

3. **These positive trends continued in early 2002.** Real GDP grew by 4.1 percent in the first quarter, despite temporary disruptions to crude oil supplies. Non-energy exports grew by 9 percent year-on-year in U.S. dollar terms, with a rebound in exports to the EU. Public finances continued to improve, and the general government deficit for the first quarter of 2002 was LTL 106 million, LTL 277 million lower than programmed (Table 1).<sup>4</sup> As in late 2001, revenue performance was stronger than projected, owing to better-than-expected value added tax (VAT) and natural resources tax receipts, as well as improved administration, especially customs. By contrast, expenditure was lower than programmed, due to lower expenditure on goods and services and the late approval of the public investment program. The CPI was unchanged over the first 4 months of 2002 and the unemployment rate declined to 11.8 percent by end-April.

4. **Sound economic fundamentals and fiscal consolidation bolstered confidence in the currency board arrangement (CBA), facilitating a smooth repegging (Box 1).** Financial markets received the change well, as evidenced by a further decline in eurobond spreads and the ability to borrow at longer maturities (Figure 1).<sup>5</sup> Broad money grew by 21 percent year-on-year at end-March, reflecting increased money demand (Table 8). Credit to the private sector grew at the same rate, owing to increased business confidence, declining interest rates, and the dynamism of recently privatized banks (Figure 5). Banking system vulnerability indicators remained sound at end-March, while profitability has improved recently (Table 9).

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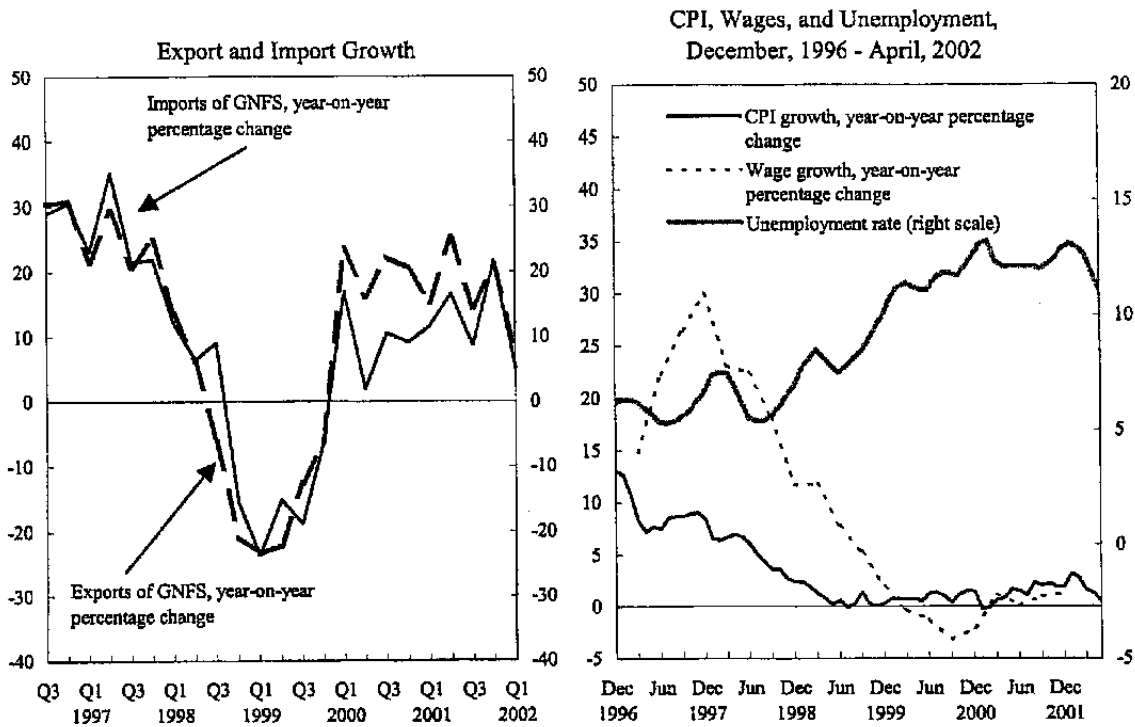
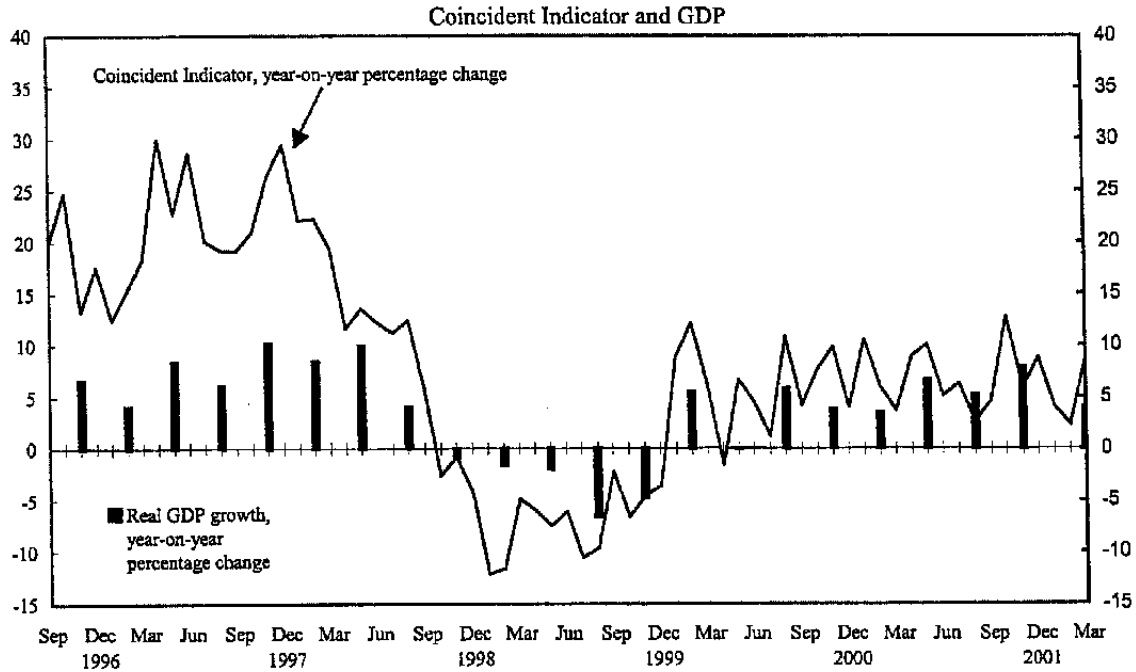
<sup>3</sup> This is below the adjusted fiscal deficit target, which was 2.1 percent of GDP (Table 1).

<sup>4</sup> The adjusted target was LTL 396 million.

<sup>5</sup> The first issue of a 10-year domestic treasury bond (yielding 6.15 percent) took place in March. In April, a 10-year eurobond of €400 million with a 94 basis point spread over comparable German instruments was successfully issued.

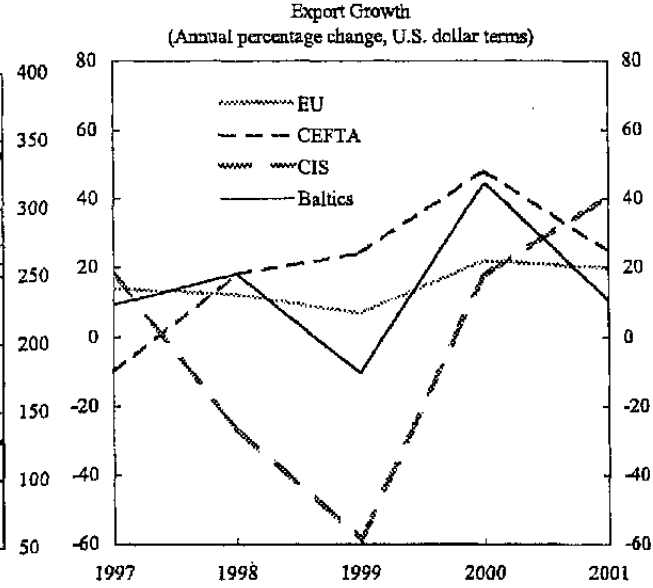
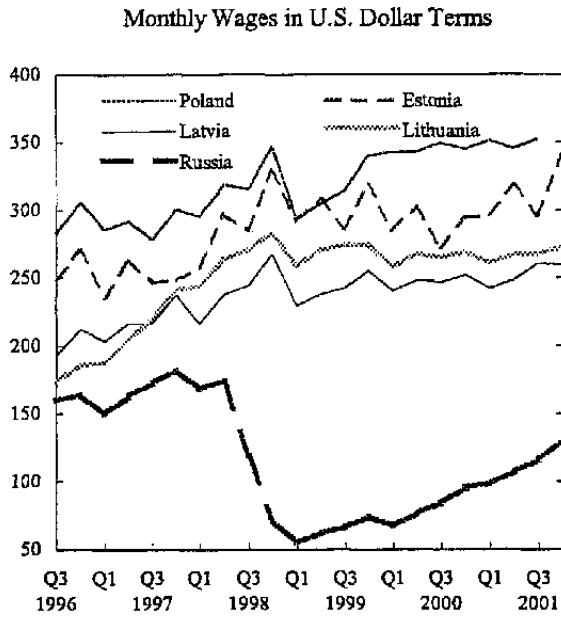
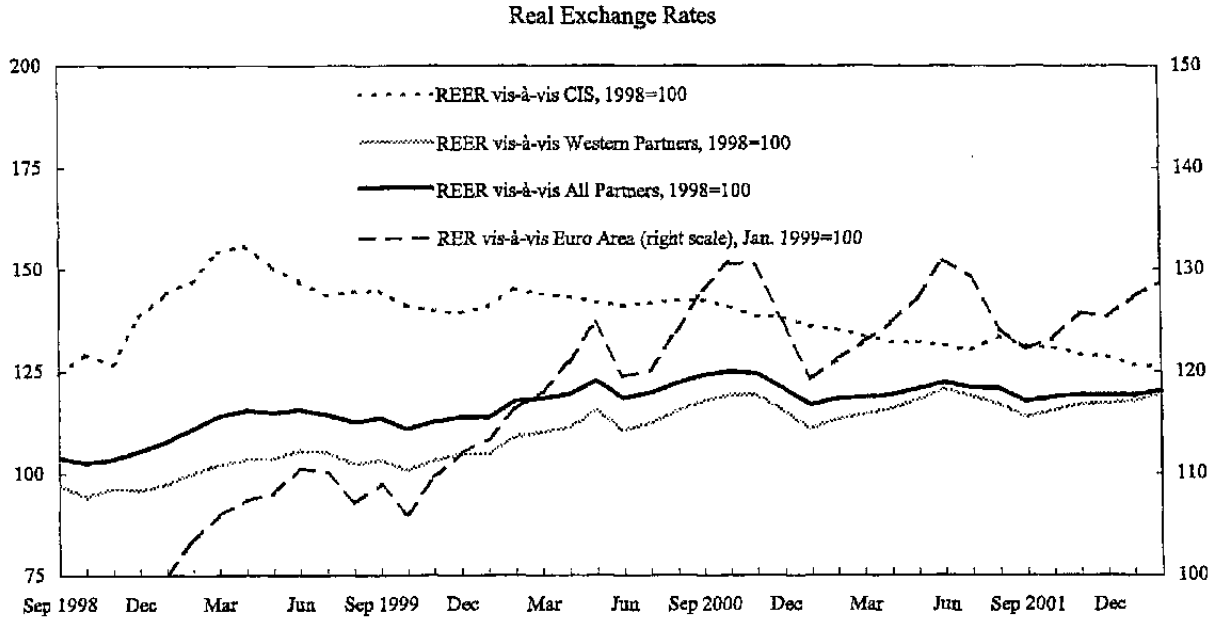


Figure 2. Lithuania: Selected Economic Indicators, 1996-2002



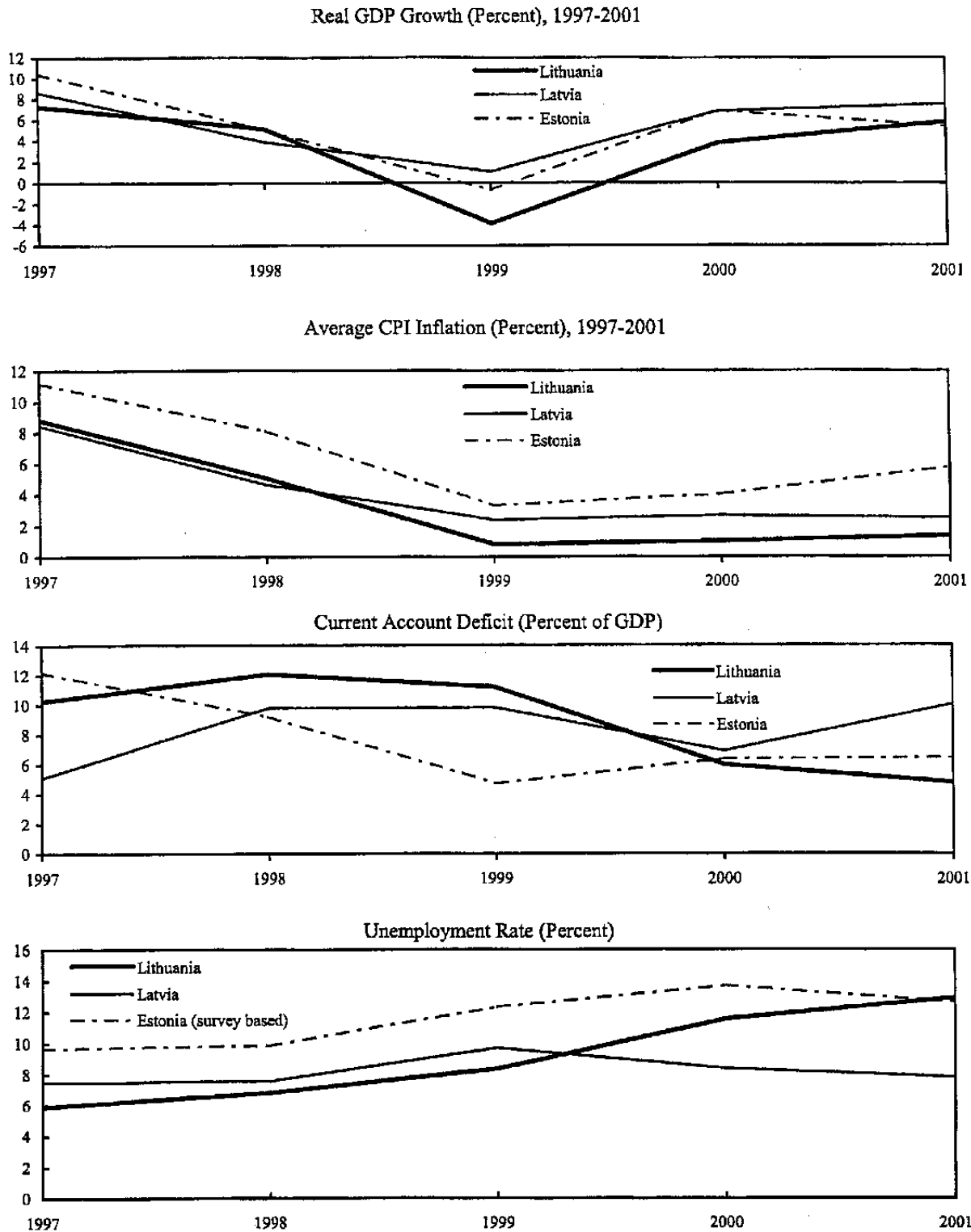
Sources: Lithuanian Department of Statistics; Bank of Lithuania; and Fund staff estimates.

Figure 3. Lithuania: Indicators of External Competitiveness, 1996-2001



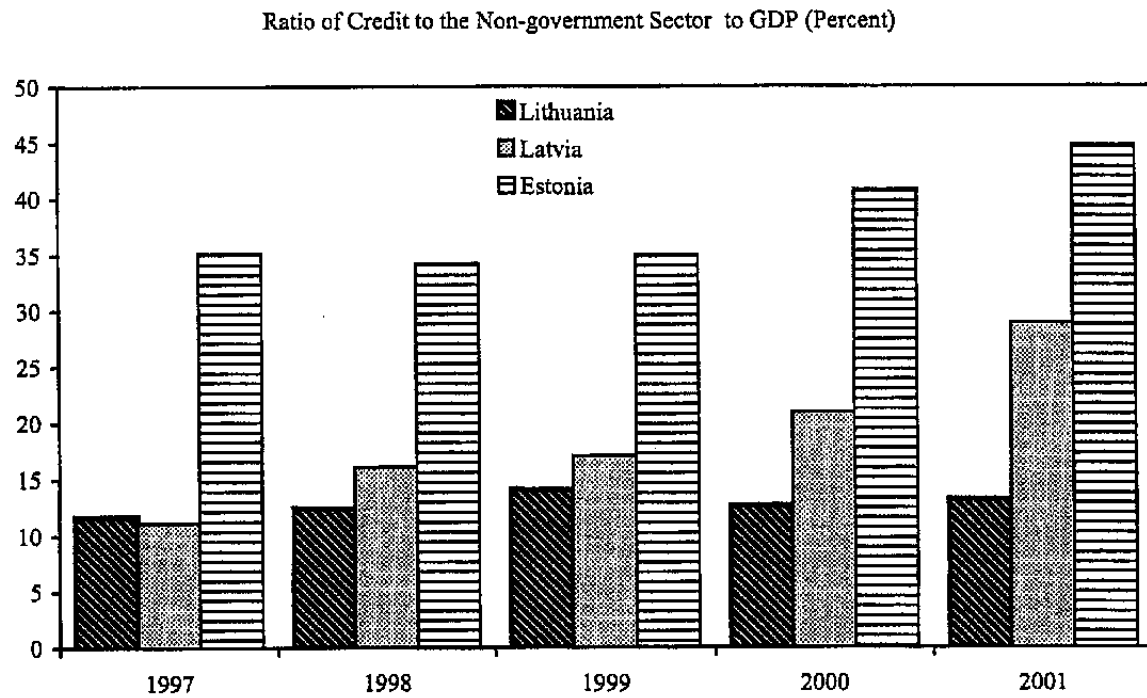
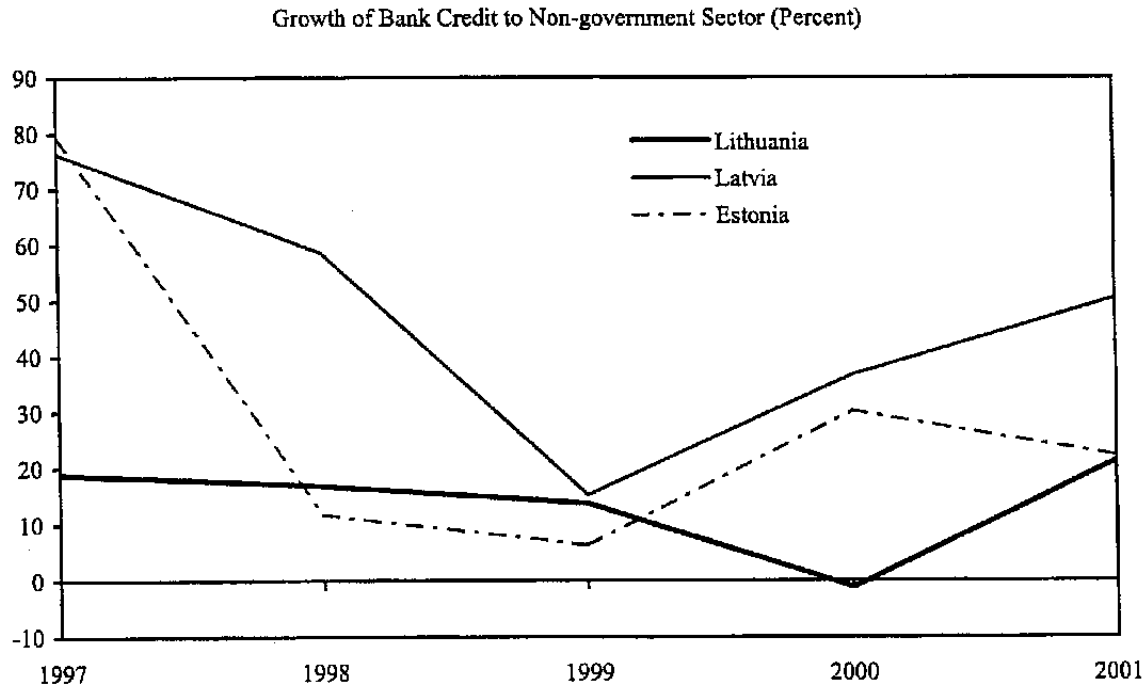
Sources: Lithuanian authorities; and Fund staff estimates.

Figure 4. Baltic Countries: Macroeconomic Indicators, 1997-2001



Source: EU2 Database.

Figure 5. Baltic Countries: Credit to the Non-Government Sector, 1997-2001



Source: EU2 Database.

### Box 1: Initial Impact of the Repegging

The peg of Lithuania's CBA was switched from the dollar to the euro on February 2, 2002 in response to closer economic integration with the EU. The repegging exchange rate of \$0.8632 per euro was only slightly more appreciated than the average of \$0.8962 per euro for 2001, and the authorities and entrepreneurs were generally confident that the economy remained competitive. The initial success of the repegging was the result of strong economic policies, as well as thorough technical preparations.

**Technical preparations involved many measures.** The BoL undertook an active information campaign explaining the modalities of the repegging and changing currency risk patterns, including through public statements, mailing of brochures, and seminars with financial intuitions. The BoL had also ensured that it could provide liquidity support to banks, if necessary. The BoL consulted with Fund staff, the ECB, and the Bank for International Settlements on all aspects of the repegging operation.

**Some progress was made in rebalancing financial portfolios.** The BoL successfully converted gross official reserves and the government converted a major part of its foreign exchange deposits into euros during the week prior to the repegging. The open position in foreign exchange of commercial banks is well within prudential limits (Table 9). There is no information, however, on the currency composition of stocks of loans and deposits. The flow data indicate that new loans in euro and litas account for a lower percentage of the total (60 percent) than new deposits in litas and euros (73 percent). Large corporations appear to manage the consequences of the repegging better than households and small businesses.

Table Currency Composition of New Loans and Deposits, February-March 2002  
In percent

| Loans |      |        |       | Deposits |      |        |       |
|-------|------|--------|-------|----------|------|--------|-------|
| LTL   | Euro | Dollar | Total | LTL      | Euro | Dollar | Total |
| 32.8  | 27.0 | 40.2   | 100.0 | 67.9     | 5.4  | 26.7   | 100.0 |

Source: Bank of Lithuania.

**Large and medium companies.** Commercial banks indicated that most large corporations and many medium enterprises had converted their dollar liabilities into euros or litas, and use of hedging instruments had expanded significantly, although from a low base. Large corporations indicated that many dollar liabilities had been converted into euros immediately prior to the repegging. Companies exposed to trade in products priced in dollars appear to have kept a portion of their liabilities in dollars, which in part explains a relatively large share of dollar denominated loans. Some companies also kept their liabilities in dollars, betting that the euro would appreciate. Moreover, companies had started to negotiate their export and import prices in euros, even in trade with the CIS, providing a hedge to their operations.

**Small businesses.** There is anecdotal evidence that small businesses, lacking access to credit or financial services, remain unhedged to exchange rate fluctuations.

**Households.** Leading commercial banks also indicated that more than 50 percent of the stock of mortgage loans at end-March were denominated either in litas or in euros, but deposits of households remained largely denominated in dollars. Therefore, some households incurred unrealized losses associated with the recent appreciation of the euro. Households have been reluctant to convert dollar deposits into euros or litas to avoid early withdrawal penalties, but bankers are of the view that they would be gradually converted as they mature.

## **B. Structural Reforms**

5. **Fiscal structural reforms continued in late 2001 and the first five months of 2002.** Tax reform advanced with the approval of the new corporate income tax (CIT) and VAT in December 2001 and January 2002, respectively. The new Personal Income tax (PIT) law was submitted to Seimas in May 2002. Important steps were taken to reform municipal finances, including the creation of a framework to finance delegated functions, but further efforts are needed, as evidenced by the LTL 38 million increase in arrears during the first quarter of 2002. Due to continued technical difficulties, the state budget incurred marginal arrears of LTL 6 million, resulting in the nonobservance of the benchmark for end-March (Table 2). All outstanding arrears of the Health Insurance Fund (HIF) were cleared in December<sup>6</sup> and a number of steps were taken to improve its financial position effective from March (SMEP, paragraph 11). Legislation to merge the Social Security Fund (SoDra) payroll tax collection unit with the State Tax Inspectorate was submitted to Seimas in December 2001.

6. **Other structural reforms generally advanced.** The sale of the Agricultural Bank completed the privatization of the banking sector. Following the FSAP, the BoL approved in March 2002 stricter monthly reporting requirements for banks on their shareholdings. Additional steps were taken to strengthen anti-money laundering (AML), in particular in insurance and capital market regulations (SMEP, paragraph 8). Amendments to the current Law on Insurance, passed by Seimas in May 2002, put in place FSAP recommendations concerning corporate governance ("fit-and-proper" test), consumer rights, and auditing. In addition, the EU peer review of the financial system was initiated in April 2002. Important advances were made toward restructuring and privatizing the energy sector, though with some delays. A number of rural development initiatives supported by the EU's SAPARD program were undertaken, and accession negotiations with the EU proceeded at a rapid pace. However, minimum prices for grain and sugar introduced in September 2001 remain in place.

## **III. POLICIES AND PROGRAM FOR 2002**

### **A. Macroeconomic Outlook for 2002 and the Medium Term**

7. **Real GDP is projected to grow by 4.4 percent in 2002**, compared with 4.0 percent envisaged earlier (text Table 2). This improvement is driven mainly by a strong rebound in private investment, aimed primarily at increasing efficiency with more capital-intensive technologies. The increase in private consumption would still lag GDP growth, given relatively low wage growth and the expectation that unemployment will decline only slowly. CPI inflation is expected to remain subdued at 1.5 percent. The external current account deficit is now projected to widen to 5.9 percent of GDP in 2002, owing to a high import

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<sup>6</sup> See Table 7, footnote 5.

content of investment and a deceleration of nonoil export growth to 6.5 percent in real terms, after two years of unusually rapid expansion (Table 5). This temporary widening appears sustainable given the increased growth potential of the economy and improved external financing terms. FDI would finance about half of the current account deficit, while both the public and private sectors are expected to be able to access markets on increasingly favorable terms. Net external debt would increase to 27.5 percent of GDP during 2002, but the external liquidity position would strengthen further, with the reserve coverage of short-term debt projected to increase to 64 percent (Table 5).

Text Table 2. Lithuania: Selected Macroeconomic Indicators, 2001-02

|   | 2001  | 2002  |            |
|---|-------|-------|------------|
|   | Prei. | Prog. | Rev. Prog. |
| <b>National income, prices and unemployment</b>         |       |       |            |
| Real GDP growth (year-on-year, in percent)              | 5.9   | 4.0   | 4.4        |
| Average CPI (year-on-year change, in percent)           | 1.3   | 2.8   | 1.5        |
| End-of-period CPI (year-on-year change, in percent)     | 2.0   | 2.8   | 2.2        |
| Unemployment rate (end-of-period, in percent)           | 12.9  | ...   | 11.5       |
| <b>General government</b>                               |       |       |            |
| Fiscal balance (in percent of GDP)                      | -1.9  | -1.5  | -1.5       |
| <b>External sector</b>                                  |       |       |            |
| Current account balance (in percent of GDP)             | -4.8  | -5.8  | -5.9       |
| Gross official reserves (in millions of U.S. dollars)   | 1,669 | 1,944 | 1,928      |
| <b>Money and credit</b>                                 |       |       |            |
| Reserve money (year-on-year change, in percent)         | 8.3   | 13.4  | 4.7        |
| Broad money (year-on-year change, in percent)           | 21.4  | 15.0  | 17.0       |
| Private sector credit (year-on-year change, in percent) | 21.4  | 15.9  | 25.0       |

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

8. **Over the medium term, real GDP growth is projected to rise to about 6 percent**, as the restructuring and investment geared to increase efficiency and productivity bear fruit, but unemployment would only come down slowly (Tables 10–12). Accession to the EU, possibly as early as 2004, would provide an additional impetus to investment and export-oriented growth. Export growth is already expected to pick up significantly in 2003 and to stay strong over the medium term. Nevertheless, national savings would need to increase by about 2 percent of GDP, mainly from the public sector, from 2001 to 2007 to finance investment and support the projected current account adjustment. Continuing prudent financial policies and structural reforms are essential to strengthen external viability, help attract significant FDI inflows and maintain favorable access to international capital markets, given that gross financing needs remain large (Table 5). Provided rapid growth and a favorable composition of financing materialize, gross external debt is projected to peak at 44 percent of GDP in 2003 and decline to 42 percent by 2007. The government aims to move toward a structurally balanced budget over the medium term to ensure long-term fiscal sustainability and underpin external adjustment. Although public debt ratios have increased

substantially over the last four years, they remain manageable at prevailing interest and exchange rates, given growth prospects. However, a further improvement in the primary balance would be needed in the medium-term, given the high share of foreign currency-denominated debt and vulnerability to interest rate and real shocks (text Table 3). To this end, the revenue-to-GDP ratio needs to be stabilized, given the limited scope for further expenditure cuts,<sup>7</sup> and the need to make room for EU and NATO accession-related expenditures, pension reform, and other social outlays. Improved budget management would also enable Lithuania to benefit fully from potentially large EU transfers. If the investment-savings imbalances generated by the private sector are larger than expected and/or the government is confronted with much higher real interest rates and significantly lower growth, the required fiscal and primary balances adjustment might need to be larger than currently projected, given that fiscal policy is the only instrument of macroeconomic management under the CBA.

Text Table 3: Lithuania. Selected Economic Indicators, 1998–2007

|  | 1998  | 1999  | 2000 | 2001 | 2002                | 2003 | 2004 | 2005 | 2006 | 2007 |
|--|-------|-------|------|------|---------------------|------|------|------|------|------|
|  |       |       |      |      | (In percent of GDP) |      |      |      |      |      |
| Consolidated general government fiscal balance         | -5.9  | -8.5  | -2.8 | -1.9 | -1.5                | -1.1 | -0.8 | -0.7 | -0.6 | -0.6 |
| Consolidated general government primary fiscal balance | -4.7  | -7.0  | -1.0 | -0.3 | -0.2                | 0.3  | 0.8  | 0.7  | 0.6  | 0.6  |
| Public and publicly guaranteed debt                    | 22.8  | 29.0  | 28.9 | 29.2 | 29.0                | 25.4 | 24.2 | 22.1 | 20.6 | 19.0 |
| of which: denominated in foreign currency              | 12.2  | 18.7  | 18.4 | 18.3 | 18.0                | 16.1 | 14.7 | 13.4 | 12.3 | 11.3 |
| Current account balance                                | -12.1 | -11.2 | -6.0 | -4.8 | -5.9                | -5.7 | -5.3 | -5.1 | -4.9 | -4.7 |
| Total external debt                                    | 34.8  | 42.5  | 43.0 | 43.9 | 42.7                | 44.1 | 43.5 | 42.9 | 42.5 | 41.7 |

## B. The Currency Board Arrangement

9. **The authorities' current strategy is to maintain the CBA in its present form until ERM2 participation and possibly until the eventual adoption of the euro, provided the EU concurs.** This strategy appears viable under current policies and given external prospects, assuming no major exogenous shocks. Continued fiscal restraint and perseverance in structural reforms are essential to foster competitiveness and sustain the current positive trends in core inflation and productivity (Box 2).

<sup>7</sup> Expenditure was reduced by 9 percentage points of GDP from 1999 to 2001 (text Table 4).

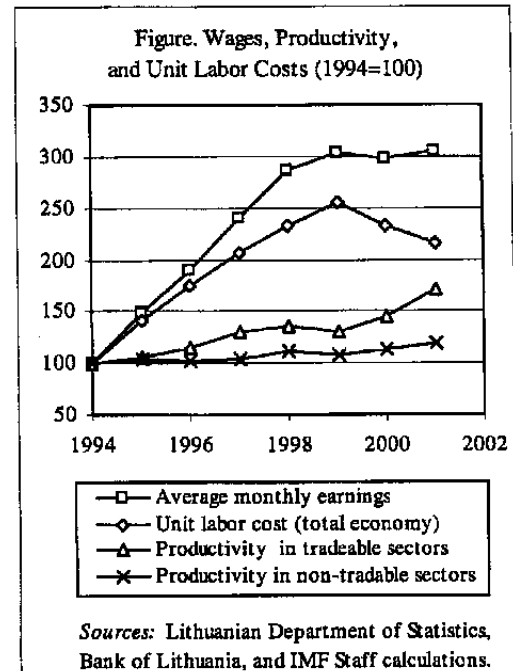


### Box 2. Productivity Growth and Competitiveness

The viability of the Lithuanian Currency Board Arrangement (CBA) hinges on the ability of the country to maintain external competitiveness through productivity growth and low inflation. This challenge became increasingly important in 1998–2000 due to the continued appreciation of the nominal effective exchange rate (see Figure 2). The appreciation was mainly driven by the substantial devaluations of CIS currencies in late 1998 and the appreciation of the U.S. dollar, the anchor currency for the CBA before the re-pegging to the euro on February 2, 2002. After a subsequent period of relative stability, the nominal effective exchange rate has recently appreciated again due to the appreciation of the euro.

The Lithuanian economy has undergone a remarkable transformation, as private sector firms have replaced state-owned enterprises and trade has become increasingly oriented toward the EU. While privatization was largely completed by 1998, many companies were still operated inefficiently due to poor management and outdated capital equipment, and the economy showed little resilience to the devaluations of CIS currencies in that year. The resulting crisis of 1998–99 proved to be a turning point. In response to mounting deficits the government drastically reduced expenditure and cut wages, and the private sector underwent a period of intense restructuring and labor shedding. In the wake of the subsequent sharp increase in unemployment, average nominal wages were actually reduced (see Figure). A low degree of labor unionization contributed to wage flexibility. This set the stage for a near-elimination of inflation and a rapid export-led recovery.

In the years up to 1999, wage growth outpaced productivity growth. Since then, however, the picture has reversed. Economy-wide productivity, which grew at an average rate of 5.1 percent during 1994–2001, picked up, while the wage level remained flat, resulting in a marked fall in unit labor costs (defined as average monthly earnings divided by economy-wide productivity). The productivity performance has been especially remarkable in the sectors that are mostly engaged in international trade, which also are the fastest growing activities. Since 1994, productivity in the tradable sectors has improved twice as fast as in the remaining sectors. Combined with the recent moderation of real wage increases, this suggests that competitiveness is strong despite the appreciation of the exchange rate. These trends need to continue for competitiveness to be maintained.



10. **Strong confidence in the CBA, improved business opportunities, and increased competition among recently privatized banks would lead to rapid growth of money and credit in 2002.** Rapid money growth is not expected to exert pressure on prices in the near term, as it is mainly driven by increased money demand, in particular deposits. Credit to the private sector is projected to grow by 25 percent in 2002 (by LTL 1,385 million, 2.7 percent of GDP), recovering from a low base after a period of stagnation (Figure 5). This pick-up does not appear to raise immediate concerns regarding the quality of bank portfolios, however, since major commercial banks indicated that their credit portfolios represented a

low share in their assets and internal risk management guidelines—in line with practices of their parent banks<sup>8</sup>—imposed strict requirements on potential borrowers, who are mainly well-known clients. Nonetheless, the BoL is strengthening its supervision to ensure the continued soundness of the banking system (SMEP, paragraph 8). Intensified competition, as reflected in declining lending/deposit rate spreads, has prompted banks to undertake cost-cutting efforts.

11. **Consistent with the BoL's plan to bring the required reserve ratio gradually to ECB levels, this ratio was reduced to 6 from 8 percent starting on May 24, 2002.** Moreover, as of November 24, 2002, the maturity of deposits subject to reserve requirements will be increased to 2 years from 1 year. The impact on liquidity of both measures is expected to be small (about LTL 200 million). No further reserve requirements reductions are envisaged in 2002.

### C. Fiscal Policy

12. The 2002 target for the general government deficit of 1.5 percent remains consistent with the attainment of the government's revised macroeconomic objectives (paragraph 7). Despite the favorable first quarter results, revenue and expenditure projections remain broadly as in the program, reflecting the government's caution in the face of lingering uncertainties about the external environment. Thus, despite pre-election pressures, a recent state budget revision, submitted to parliament in June, will maintain the same deficit target. The revision includes a reallocation of current expenditure (about 0.1 percent of GDP), mainly between interest payments and goods and services, and an increase of capital expenditure (0.1 percent of GDP), largely financed by slightly higher revenue, primarily of consumption taxes, in line with recent trends<sup>9</sup> (text Table 4 and Table 7). The deficit will be financed as originally planned: after the placement of the Eurobond in April, financing will rely mainly on the domestic market, given ample liquidity and favorable interest rates. Privatization receipts would be largely deposited with the BoL. In any event, the government maintains a highly liquid position (government deposits amounted to 4 percent of GDP at end-March).

Text Table 4. Lithuania: General Government's Revenue and Expenditure, 1999-2002  
(In percent of GDP)

|                             | 1999 | 2000 | 2001 | 2002<br>Rev. Pr. |
|-----------------------------|------|------|------|------------------|
| Revenue                     | 32.1 | 30.3 | 29.8 | 29.1             |
| of which: tax revenue       | 30.4 | 28.4 | 27.4 | 27.0             |
| Expenditure and net lending | 40.2 | 33.2 | 31.4 | 30.6             |
| of which: expenditure       | 37.9 | 32.5 | 31.2 | 30.2             |

<sup>8</sup> The three major Lithuanian banks are directly or indirectly owned by major European banks.

<sup>9</sup> Some additional mutually offsetting changes in projections of certain revenue items and nondiscretionary spending reflect a different composition of growth.

## D. Structural Reforms

13. **The government is committed to pursuing its structural reform agenda to improve fiscal management, reform the tax system, strengthen financial sector soundness, and enhance competitiveness.** In addition to measures to be implemented under the SBA and described in the SMEP, the authorities will continue to undertake reforms supported by the World Bank<sup>10</sup>, as well as those associated with EU accession (see EBS/01/211, Box 6).

### Fiscal Reforms

14. **The revenue neutrality of the ongoing tax reform is crucial to maintaining fiscal sustainability in the medium term.** The new tax package introduces changes in the VAT, CIT, and PIT, and extends the coverage of the real estate tax. In 2003, the new VAT and CIT laws are expected to increase revenue by less than initially estimated<sup>11</sup> while the expected gain from the new real estate tax is estimated at LTL 70 million (slightly over 0.1 percent of GDP). The government is committed to amend the new CIT law to change back the declaration date from October to May, and to limit the increase in the tax exempt minimum (TEM) of the PIT so as to ensure the overall revenue neutrality of the tax package (text Table 5).<sup>12</sup> In addition,

Text Table 5. Lithuania: Estimated Impact of Tax Reform in 2003  
(In millions of litai; percent of GDP in parenthesis)

|  | Loss             | Gain             |
|--|------------------|------------------|
| Value added tax                        | 58 (0.1)         |                  |
| Corporate income tax                   |                  | 230 (0.4)        |
| Of which: with May as declaration date |                  | 90 (0.2)         |
| Personal income tax                    | 280 (0.5)        |                  |
| Real estate tax                        |                  | 70 (0.1)         |
| Tax administration improvement         |                  | 40 (0.1)         |
| <b>Total</b>                           | <b>338 (0.6)</b> | <b>340 (0.6)</b> |

<sup>10</sup> The cancellation of the second tranche of the Structural Adjustment Loan (SAL) of the World Bank (WB) mainly reflected the desire of the authorities to limit recourse to multilateral financing, given good market access. The authorities are still determined to implement reforms from the unfinished SAL agenda, including gas privatization, electricity distribution privatization and agriculture and to continue the cooperation with the WB in the areas of health, education, pension reform, municipal capacity building, and infrastructure projects.

<sup>11</sup> The new VAT and CIT laws, in compliance with EU requirements, will eliminate most of the previous exemptions; however, against the government's initial proposal, Seimas introduced a reduced VAT rate for hotels and fresh meat from 2003, entailing an overall revenue loss of 0.1 percent of GDP in 2003. In addition, the new CIT law would increase revenue only by about 0.3 percent of GDP in 2003, as moving the declaration period from May to October would lead to a one-off loss of 0.2 percent of GDP in 2003.

<sup>12</sup> The new PIT law includes a 33 percent rate on all types of income (with the exception of a few items, such as royalties, subject to a 15 percent rate) and an increase in the TEM in 2003.

efforts to improve tax administration will continue. Finally, additional changes in tax legislation required by the EU may lead to the abolition of the sales tax, possibly as early as 2004, and the government will have to implement revenue measures to offset this loss.

15. **Further efforts are needed to strengthen municipal finances.** Although important measures were taken in recent months (SMEP paragraph 10), municipalities still lack a sufficient own revenue base and suffer from shortcomings in planning and budgeting, inefficient expenditures, and inadequate financial discipline. The financial situation of many municipalities remains precarious, as reflected in the large overhang of outstanding expenditure arrears, which in fact increased during the first quarter of 2002 (text Table 6).

Thus, the authorities intend to introduce additional measures (SMEP, paragraph 10) to stabilize municipal revenue, streamline spending, strengthen financial discipline, and provide stronger incentives for municipalities to reduce

Text Table 6. Lithuania: Stock of Municipalities' Payables, Arrears, and Short-Term Debt, 2001-02  
(In million of Litas)

|                                     | 1-Jan-01 | 1-Apr-01 | 1-Jan-02 | 1-Apr-02 |
|-------------------------------------|----------|----------|----------|----------|
| Payables (0-45 days)                | 304.5    | 360.8    | 332.1    | 327.4    |
| Arrears ( more than 45 days)        | 195.1    | 244.7    | 200.0    | 238.3    |
| Short-term debt to commercial banks | 86.3     | 90.8     | 88.1     | 84.7     |
| Total                               | 585.9    | 696.3    | 620.2    | 650.4    |

their expenditure arrears. Strengthening municipal finances and strictly enforcing their reduced borrowing limits remain major priorities for the authorities, as the state budget cannot continue to bear the entire burden of fiscal adjustment or face additional potential liabilities.<sup>13</sup>

16. **The cash flow position of the HIF has improved in recent months, following the clearance of arrears and cost-cutting measures under the program.** Additional expenditure-cutting measures (with total savings of 0.2 percent of GDP) are envisaged (SMEP, Paragraph 11), but may encounter strong political opposition. These measures are key for the HIF's budget to be balanced in 2002 without accumulation of new arrears. In any event, the government would need to provide additional transfers to the HIF from 2003 onwards to compensate for the loss of PIT revenue stemming from the tax reform.

17. **To promote retirement savings, Seimas endorsed a pension reform plan in May 2002,** incorporating a voluntary second pillar based on supplementary matching government contributions and tax incentives (SMEP, Paragraph 12). The new plan is expected to be implemented in 2004.

<sup>13</sup> The new methodology on revenue sharing reduced the share of municipalities in PIT revenue and increased state budget transfers. Since the borrowing limit is set as a percentage of the municipalities' own revenue, the absolute amount of the borrowing limit declined in 2002. Moreover, the government is committed not to guarantee external borrowing by municipalities outside the public investment program.

## **Financial Sector Reforms**

18. **In line with FSAP and EU peer review recommendations, the authorities plan to implement a number of measures in the areas of banking supervision, AML, and insurance regulations (SMEP, paragraph 8 and text Table 7).** These measures will also be reflected in the action plan that the authorities will prepare following the finalization of the report by the EU peer review in mid-June. The December 2001 safeguards assessment made several recommendations, most of which are due to be implemented in the second half of 2002. In agreeing with the staff recommendations, the authorities noted that they had already implemented some of them. The BoL is in the process of compiling additional information requested by the staff to assess the status and effectiveness of the measures that have been taken.

## **Other Areas**

19. **Unemployment is unlikely to decline markedly over the medium term, given its structural nature and ongoing efforts by enterprises to improve productivity and reduce labor costs.** Following the large-scale labor-shedding of recent years, unemployment mainly affects older unskilled workers and is concentrated in rural regions. To address this issue, a multipronged approach is underway. First, planned improvements in the business environment would stimulate employment creation. Second, though conditions may deteriorate in the short run because of restructuring in the agricultural sector, measures to improve labor market flexibility such as allowing minimum wages to vary across types of jobs and possibly regions (SMEP, paragraph 14) would reduce unemployment over the longer term. Third, skill mismatches would be tackled through job-training programs targeted at the future needs of the private sector and rural development initiatives carried out with support from EU-SAPARD. Finally, improvements in the social safety net will be targeted at alleviating the hardship of the long-term unemployed (SMEP, paragraph 14). Given the structural nature of the problem, social programs may need to be stepped up in the coming years.

20. **Planned reforms in the energy and transportation sectors would largely complete the privatization agenda.** Completing the privatization of the energy sector has proven difficult due to strategic political considerations and the complexity of business arrangements, but the authorities are committed to avoiding further delays. Partially privatized Mazeikiu Nafta (MN) and Yukos have initialed an agreement for long-term oil supply by the latter in exchange for a 26.85 percent stake in MN. Once government approval has been obtained and the deal is finalized, it should improve the financial situation of the currently loss-making MN and facilitate modernization and expansion of its large refinery. The sale of an initial 34 percent stake in Lithuanian Gas to a consortium of Rhurgas and E.ON Energie is about to be completed and the sale of a second stake to suppliers is expected by end-2002. The Lithuanian Power Company was restructured into five new utilities, which started to operate in January 2002, and privatization of the two distribution companies is to be completed by June 2003. Progress has also been made preparing privatizations in the

transportation sector involving Lithuanian Airlines and Lithuanian Railways (SMEP, Paragraph 16).

Text Table 7. Lithuania: Planned Measures to Implement FSAP Recommendations

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**Supervision of credit institutions:**

- New requirements for banks to report monthly on all shareholdings, including holdings in other companies of less than 10 percent, the previous threshold, approved in March 2002.
- Changes to rules on large exposures, controls over connected lending, as well as lending to groups of affiliated companies, under preparation.
- Detailed reporting on qualified holding in banks and legal amendments to suspend shareholders' voting rights in cases of misconduct, under preparation.
- Changes to rules on loan provisioning, in line with Basel recommendations, allowing commercial banks to establish valuation for non-marketable, non-current loans, within an overall framework supervised by the BoL, under preparation.
- Additional cooperation arrangements with regulatory authorities of the countries of origin of major shareholders of Lithuanian banks.

**Anti-money laundering (AML) and combating terrorist financing:**

- Newly-reorganized Financial Crime Investigation Service (FCIS) recently increased staffing and will receive technical assistance for training via an EU-PHARE project.
- AML practices in insurance and capital markets recently strengthened. Amendments to the law on Prevention of Money Laundering passed by Seimas on March 28, 2002 extended responsibility for implementation of AML legislation to SISA and to the Lithuanian Securities Commission (LSC). FCIS prepared regulations for SISA and LSC on the detection and reporting of suspicious activities and is strengthening cooperation with other national financial investigation units in the region.
- Government will consider amendments to regulations on suspicious transactions to account for eight new recommendations on combating terrorist financing of the Financial Action Task Force by end-September 2002.
- Further amendments to comply with EU AML directives will widen coverage of agencies and businesses that must report on financial transactions by end-March 2003.
- The BoL is updating its training and instructions for supervisors for new "Know Your Customer" rules introduced in December 2001.

**Strengthening the payments system**

- New law on Funds Transfer and Securities Settlement Systems being prepared by the government and BoL to implement an EU directive on Settlement Finality in Payment and Securities Settlement Systems.

**Insurance regulations:**

- Amendments to the existing law on Insurance to put in place recommendations concerning corporate governance ("fit-and-proper" test), consumer rights and auditing until two new laws were passed by Seimas in May 2002.
  - New laws on Insurance Activity and Insurance Contracts to be approved by Seimas in early 2003.
-

21. **After the rapid progress experienced in 2001, accession negotiations with the EU are likely to be completed this year, paving the way for joining the EU in the first wave in 2004.** Agreement has been reached on 28 out of 31 chapters so far (text Table 8). Important outstanding issues include: agreeing on the framework for financial support for the closure of Ignalina Power Plant; determining the amounts of direct payments, reference periods and quotas for agriculture; and negotiating the transitional period with regard to Lithuania's contributions to the EU budget. All these issues are expected to be resolved by year-end.

Text Table 8. Progress in EU Accession Negotiations Among Selected Candidates  
(as of June 11, 2002)

| Chapter               | Lithuania | Latvia | Estonia | Bulgaria | Poland | Hungary | Czech Republic |
|-----------------------|-----------|--------|---------|----------|--------|---------|----------------|
| Total chapters closed | 28        | 27     | 26      | 20       | 25     | 24      | 25             |
| Total chapters open   | 3         | 4      | 5       | 11       | 6      | 7       | 6              |

#### IV. STAFF APPRAISAL

22. **Lithuania continues to implement sound economic policies aimed at maintaining macroeconomic stability and furthering structural reforms.** The authorities should be commended for their successful implementation of the program, which has bolstered Lithuania's credibility and contributed to the successful repegging of the litas to the euro in February 2002, in the midst of a challenging international financial environment. The BoL's extensive technical preparations and its strategy to minimize uncertainties by informing the population and making the process transparent also contributed to a smooth switch.

23. **These successes, however, should not lead to complacency.** While policies in 2002 remain on track, macroeconomic stability could be easily threatened if appropriate medium-term policies are not in place. Continued structural reforms are needed to support growth and competitiveness, and gradually to lead to a reduction in the still high unemployment rate. External vulnerability to potential exogenous shocks, although reduced, still calls for the continuation of prudent financial policies. There is thus little room for policy or implementation slippages given the challenges ahead in 2002-03 and the need to withstand competitive pressures, especially after joining the EU.

24. **Fiscal discipline is essential to maintain the credibility of the CBA, which has anchored macroeconomic stability.** The budget target for 2002 aimed at consolidating the

gains of 2000–01, with a modest further adjustment. While the 2002 budget appears to be on track, the 2003 draft budget should send a signal of continuity and consistency with medium-term goals, despite electoral pressures, especially at a critical moment of EU accession negotiations. Moreover, the authorities should be ready to tighten the fiscal stance if necessary in the event of more adverse external developments than currently envisaged.

25. **Hence stabilizing revenue constitutes an urgent priority.** The staff underscores the need for the comprehensive tax package to be revenue-neutral and for further progress in improving tax administration. Eliminating exemptions and loopholes can allow reductions in rates while preserving tax revenue, promoting fairness and transparency, and fostering private activity. The unexpected exemptions incorporated in the new VAT were regrettable. Such exemptions undermine the tax reform objectives without stimulating growth, and the staff urges the authorities to resist pressures to maintain or award preferential treatments to particular sectors. Finally, the planned reduction in the PIT TEM should be consistent with revenue neutrality.

26. **Expenditure should be allocated in line with medium-term priorities to promote growth.** Careful prioritization is required given that new EU- and NATO-related commitments will have to be faced, especially since there is little room for further cuts if essential services and social expenditures are to remain adequate. There is also 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, with effective use of EU preaccession grants.

27. **Further steps are called for to improve the financial situation of the HIF and municipalities, especially in view of the proposed PIT reduction in 2003.** Measures taken to limit HIF expenditures are significant and deserving of support. Additional measures, while politically difficult, are essential for financial viability. Regarding municipalities, new legislation allocating expenditure responsibilities and the concomitant resources, as well as regular audits and monitoring, were steps in the right direction, while the proposed real estate tax will help provide a more stable source of revenue. However, the staff urges the authorities to take further bold steps to redress municipal finances while the problem remains manageable, including expenditure rationalization, better budgeting and planning procedures, strict enforcement of low borrowing limits, and mechanisms to ensure that transfers to the municipalities are clearly linked to concrete measures and arrears reduction.

28. **After past delays the staff welcomes the progress in preparing for a reform of the pension system** to be implemented as of 2004. The staff also understands the cost considerations that led the authorities to opt for a less costly second pillar. Nonetheless, the government should guard against the risk of revenue losses if tax incentives for the second pillar are unaffordably generous.

29. **Decisive steps by the authorities to implement FSAP recommendations are needed to preserve the hard-won stability of the banking system.** While the system was



assessed as strong and resilient, vigilant banking supervision and tightened AML measures will help protect the integrity of bank and enterprise balance sheets, especially in a period of rapid growth and credit expansion. A dynamic and strengthened banking system will enhance the efficiency of financial intermediation and increase confidence.

**30. The structural reform momentum must continue so as to create the conditions for sustained growth and competitiveness.** Important structural reforms were completed in 2001: in particular, bank privatization led to efficiency gains and greater competition, while restructuring of the energy sector restored profitability and paved the way for privatization in 2002. Nonetheless, the staff urges the authorities not to lose momentum in the coming months, to avoid further delays in energy privatization, and to continue implementing measures that facilitate private activity and deregulation, which are key to improving Lithuania's business environment and competitiveness. The staff also urges the authorities to eliminate remaining agricultural price regulations that hamper competition. The judicious use of SAPARD structural funds should help prepare Lithuania's agricultural sector for EU accession and improve rural development prospects.

**31. 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 Special Data Dissemination Standard since May 1996. A data ROSC was conducted in May 2002. While its preliminary assessment is generally positive, substantial efforts will be required to improve general government statistics. A fiscal ROSC is scheduled for July 2002. In addition, the staff is satisfied with the authorities' commitment to implement the recommendations of the safeguards assessment, and will monitor their implementation.

**32. Although the risks of adverse external shocks in the near future have declined, the authorities' strategy may be subject to longer-term risks.** First, it relies heavily on the maintenance of fiscal discipline, which might be subject to pressures, especially around the elections. The government will also have to secure political support to ensure that the tax package approved by Seimas remains revenue-neutral, and pursue steadfastly the elimination of exemptions. Second, while the proposed exit strategy from the CBA appears viable at present, the authorities need to ensure continued credibility after the repegging, by fostering competitiveness through fiscal restraint and structural reforms. Third, although the current rapid growth of money and credit does not pose immediate concern, strict banking supervision is required to protect financial system stability. Fourth, gross financing needs in the medium-term remain large, and efforts to reduce external vulnerabilities should be stepped up. Increased competitiveness and domestic savings are called for to help reconcile the need for rapid investment and growth with a prudent external debt management strategy. While Lithuania now has access to international financial markets on very good terms, and net external debt remains at an acceptable level, it should be kept under check, in order to guard against possible unfavorable external developments. Fifth, the authorities' strategy relies on the private sector to provide the impetus for growth and competitiveness, and the state must promote a supportive business environment and flexible labor markets via effective implementation of the legal framework put in place over the last several years.

33. **Despite these concerns, the staff is of the view that the authorities' program remains on track and deserves support.** Overall, the stance of macroeconomic policies remains appropriate, and the staff is confident that the authorities would modify policies quickly and appropriately in response to adverse external or domestic shocks. Thus, the staff supports the completion of the second review under the Stand-by Arrangement.

Table 1. Lithuania: Performance Criteria for Stand-By Arrangement, 2001-02 1/

|  | Target         | Adjusted Target                              | Outcome 2/                          |
|--|----------------|--|-------------------------------------|
| <b>Continuous performance criteria</b>   |                |  |                                     |
| <b>I. Exchange rate</b>  |                |  |                                     |
| LTL 3.4528 per euro 3/   | ...            | ...  | Observed through June 13, 2002      |
| <b>II. 100-percent coverage of currency board liabilities, in percent</b>  |                |  |                                     |
|  | 100            | ...  | Observed through April 30, 2002     |
| <b>III. Reserve requirements, in percent</b>   |                |  |                                     |
| Reserve requirements through June 30, 2002   | 6              |  | Observed through May 31, 2002       |
| Reserve requirements from July 1, 2002 4/  | 4              |  |                                     |
| <b>IV. Non-accumulation of new external payments arrears</b>   |                |  |                                     |
|  | ...            | ...  | Observed through June 13, 2002      |
| <b>Quantitative performance criteria</b>   |                |  |                                     |
| <b>I. Ceiling on the general government deficit, mln. LTL</b>  |                |  |                                     |
| Cumulative from January 1, 2001  |                |  |                                     |
| March 31, 2001 (previous arrangement)  | 271            | 287  | 84                                  |
| June 30, 2001  | 460            | 496  | 321                                 |
| September 30, 2001   | 600            | 689  | 458                                 |
| December 31, 2001  | 841            | 1011   | 795                                 |
| Cumulative from January 1, 2002  |                |  |                                     |
| March 31, 2002   | 383            | 396  | 106                                 |
| June 30, 2002  | 564            | ...  | ...                                 |
| September 30, 2002   | 764            | ...  | ...                                 |
| December 31, 2002  | 776            | ...  | ...                                 |
| <b>II. Floors on net foreign exchange coverage of the currency board arrangement</b>                               |                |  |                                     |
| <b>Stocks</b>  |                |  |                                     |
| September 30, 2001, US\$ mln.  | -127           | ...  | 2                                   |
| December 31, 2001, US\$ mln.   | -127           | ...  | 11                                  |
| March 31, 2002, euro mln.  | -147           | ...  | 23                                  |
| June 30, 2002, euro, mln.  | -147           | ...  | ...                                 |
| September 30, 2002, euro, mln.   | -147           | ...  | ...                                 |
| December 31, 2002, euro, mln.  | -147           | ...  | ...                                 |
| <b>III. Ceilings on contracted public and publicly guaranteed medium- and long-term external debt; mln. US\$</b>   |                |  |                                     |
|  | All maturities | 1-5 year maturity<br>(medium- and long-term) | All maturities<br>1-5 year maturity |
| Cumulative from January 1, 2001  |                |  |                                     |
| March 31, 2001 (previous arrangement)  | 293            | 200  | 183                                 |
| June 30, 2001  | 433            | 200  | 194                                 |
| September 30, 2001   | 648            | 200  | 194                                 |
| December 31, 2001  | 683            | 200  | 248                                 |
| Cumulative from January 1, 2002  |                |  |                                     |
| March 31, 2002   | 450            | 200  | 34                                  |
| June 30, 2002  | 610            | 200  | ...                                 |
| September 30, 2002   | 640            | 200  | ...                                 |
| December 31, 2002  | 640            | 200  | ...                                 |
| <b>IV. Ceilings on the outstanding stock of public and publicly guaranteed short-term external debt; mln. US\$</b> |                |  |                                     |
| 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             | ...  | 0                                   |
| March 31, 2002   | 200            | ...  | 35                                  |
| June 30, 2002  | 200            | ...  | ...                                 |
| September 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.

2/ Based on latest available data.

3/ This performance criterion was modified on February 2, 2002 consistent with TMU paragraph 2.

4/ This is consistent with the statutorily imposed required reserve ratio of 6 percent, because, pursuant to paragraph 5 of the TMU, the required reserve ratio envisaged under the program allows for a 2 percentage point variation from the statutorily imposed required reserve ratio.

Table 2. Lithuania: Quantitative Benchmarks for Stand-By Arrangement, 2001-02

|   | Ceiling | Outcome |
|---|---------|---------|
| <b>I. Domestic guarantees, mln. LTL</b>         |         |         |
| Outstanding stock                               |         |         |
| March 31, 2001 (previous arrangement)           | 319     | 217     |
| September 30, 2001                              | 314     | 232     |
| December 31, 2001                               | 312     | 247     |
| March 31, 2002                                  | 315     | 197     |
| June 30, 2002                                   | 312     | ...     |
| September 30, 2002                              | 312     | ...     |
| December 31, 2002                               | 312     | ...     |
| <b>II. Central government arrears, mln. LTL</b> |         |         |
| Outstanding stock                               |         |         |
| March 31, 2001 (previous arrangement)           | 0       | 19      |
| September 30, 2001                              | 0       | 37      |
| December 31, 2001 1/                            | 0       | 0       |
| March 31, 2002                                  | 0       | 6       |
| June 30, 2002                                   | 0       | ...     |
| September 30, 2002                              | 0       | ...     |
| December 31, 2002                               | 0       | ...     |

Source: Ministry of Finance; and Fund staff estimates.

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

Table 3. Lithuania: Structural Benchmarks for Stand-By Arrangement, 2001-02

| Measure  | Date               | Status   |
|--|--------------------|--|
| Submit to Seimas draft amendments to the Law on Revenue Redistribution of Municipalities   | end-September 2001 | Observed   |
| Submit to Seimas draft amendments to the Privatization Law for establishing the Reserve Stabilization Fund   | end-September 2001 | Observed   |
| Tender for privatizing the Agricultural Bank   | end-September 2001 | Observed   |
| Government's decision on a set of measures to overhaul municipal finances  | end-December 2001  | Observed   |
| Submit to Seimas draft amendments to the Law on Social Security needed for the pension reform  | end-December 2001  | Observed, but supplemented with another benchmark (Pension reform concept) |
| Submit to Seimas a Pension Reform Concept  | end-December 2001  | Observed   |
| Submit to Seimas legal amendments on accounting standards  | end-December 2001  | Observed   |
| Submit to Seimas a new labor code  | end-December 2001  | Observed   |
| Submit to Seimas draft CIT and VAT   | end-December 2001  | Observed   |
| Submit to Seimas draft PIT law   | end-January 2002   | Done with delay (submitted in May)   |
| 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   | Observed   |
| Finalize quarterly plan for arrears reduction of municipalities  | end-March 2002     | Observed   |
| Submit to Seimas the draft unemployment insurance law  | end-June 2002      |  |
| Submit to Seimas Real Estate Tax law   | end-September 2002 |  |
| Submit to Seimas amendments to the CIT law to return the declaration date from October 2003 to May 2003  | end-September 2002 |  |
| Submit to Seimas amendments to the law on the State and Municipalities budget for 2002 to make transfers for clearance of arrears conditional on the reduction of the stock of arrears by municipalities | end-September 2002 |  |

Source: Lithuanian authorities.

Table 4. Lithuania: Selected Macroeconomic Indicators, 1998-2002

|  | 1998   | 1999   | 2000   | 2001   |        | 2002   |        |
|--|--------|--------|--------|--------|--------|--------|--------|
|  |        |        |        | Prog.  | Prel.  | Prog.  | Proj.  |
| <b>National income, prices, and wages</b>                    |        |        |        |        |        |        |        |
| Nominal GDP (in millions of litai)                           | 42,990 | 42,655 | 45,148 | 48,087 | 47,968 | 51,531 | 51,531 |
| GDP (in millions of U.S. dollars)                            | 10,747 | 10,664 | 11,287 | 12,022 | 11,992 | 12,883 | 13,523 |
| Real GDP growth (year-on-year, in percent)                   | 5.1    | -3.9   | 3.8    | 4.5    | 5.9    | 4.0    | 4.4    |
| Average CPI (year-on-year change, in percent)                | 5.1    | 0.8    | 1.0    | 1.4    | 1.3    | 2.8    | 1.3    |
| End-of-period CPI (year-on-year change, in percent)          | 2.4    | 0.3    | 1.5    | 2.0    | 2.0    | 2.8    | 2.2    |
| GDP deflator (year-on-year change, in percent)               | 6.7    | 3.2    | 2.0    | 1.6    | 0.4    | 3.0    | 2.9    |
| Average monthly wage (in U.S. dollars)                       | 232    | 247    | 243    | ...    | 248    | ...    | ...    |
| Unemployment rate (in percent) 1/                            | 6.9    | 10.0   | 12.6   | ...    | 12.9   | ...    | 11.5   |
| <b>Saving-investment balance (in percent of GDP)</b>         |        |        |        |        |        |        |        |
| Gross national saving  | 12.3   | 11.5   | 14.6   | 13.9   | 16.8   | 14.1   | 16.6   |
| General government   | -1.1   | -3.9   | -0.2   | -0.1   | 0.1    | 0.3    | 0.3    |
| Non-government   | 13.4   | 15.4   | 14.7   | 14.0   | 16.6   | 13.9   | 16.3   |
| Gross national investment                                    | 24.4   | 22.7   | 20.5   | 19.7   | 21.5   | 19.9   | 22.4   |
| Foreign saving   | 12.1   | 11.2   | 6.0    | 5.8    | 4.8    | 5.8    | 5.9    |
| <b>General government (in percent of GDP)</b>                |        |        |        |        |        |        |        |
| Financial balance  | -4.4   | -6.2   | -2.1   | -1.7   | -1.8   | -1.1   | -1.2   |
| Net lending  | 1.5    | 2.4    | 0.7    | 0.1    | 0.2    | 0.4    | 0.3    |
| Fiscal balance   | -5.9   | -8.5   | -2.8   | -1.7   | -1.9   | -1.5   | -1.5   |
| <b>External sector</b>                                       |        |        |        |        |        |        |        |
| Current account balance                                      |        |        |        |        |        |        |        |
| in percent of GDP  | -12.1  | -11.2  | -6.0   | -5.8   | -4.8   | -5.8   | -5.9   |
| in millions of U.S. dollars                                  | -1,298 | -1,194 | -675   | -695   | -574   | -741   | -791   |
| Gross official reserves (in millions of U.S. dollars) 2/     | 1,460  | 1,242  | 1,359  | 1,565  | 1,669  | 1,944  | 1,928  |
| Gross external debt (in percent of GDP) 3/                   | 34.8   | 42.5   | 43.0   | 43.6   | 43.9   | 43.8   | 42.7   |
| Debt service (in percent of exports of GNFS)                 | 22.6   | 20.0   | 20.9   | 28.9   | 31.0   | 24.7   | 24.6   |
| Exchange rate (litai/euro, period average)                   | ...    | 4.18   | 3.70   | ...    | 3.58   | ...    | ...    |
| Real effective exchange rate (1998=100, "+"=appreciation) 4/ | 100.0  | 112.9  | 120.4  | ...    | 119.3  | ...    | ...    |
| <b>Money and credit</b>                                      |        |        |        |        |        |        |        |
| Reserve money (year-on-year change, in percent)              | 28.8   | -4.0   | -3.3   | 5.5    | 8.3    | 13.4   | 4.7    |
| Broad money (year-on-year change, in percent)                | 14.5   | 7.7    | 16.5   | 15.8   | 21.4   | 15.0   | 17.0   |
| Private sector credit (year-on-year change, in percent) 5/   | 16.9   | 13.8   | -1.2   | 9.8    | 21.4   | 15.9   | 25.0   |
| Money multiplier   | 2.0    | 2.2    | 2.6    | 2.9    | 3.0    | 2.9    | 3.3    |
| Currency/deposits, in percent                                | 50.7   | 43.9   | 34.1   | 31.3   | 29.9   | 31.6   | 27.8   |
| Foreign currency deposits/ litai deposits, in percent        | 57.0   | 77.7   | 83.8   | 88.6   | 74.8   | 88.6   | 73.0   |

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 table due to valuation differences.

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, July 2001 numbers have been adjusted by LTL 785 million of reclassified assets.

Table 5: Lithuania: Balance of Payments, 1998-2002

|   | 1998   | 1999   | 2000   | 2001   |        | 2002  |        |        |
|---|--------|--------|--------|--------|--------|-------|--------|--------|
|   |        |        |        | Prog.  | Actual | Q1    |        | Year   |
|   |        |        |        |        |        | Est.  | Prog.  |        |
| (In millions of US dollars, unless otherwise indicated) |        |        |        |        |        |       |        |        |
| Current account   | -1,298 | -1,194 | -675   | -693   | -574   | -120  | -741   | -791   |
| Trade balance   | -1,318 | -1,405 | -1,104 | -1,036 | -1,108 | -200  | -1,108 | -1,231 |
| Exports (f.o.b.)  | 3,962  | 3,147  | 4,050  | 4,800  | 4,889  | 1,227 | 4,961  | 5,217  |
| Imports (f.o.b.)  | 5,480  | 4,551  | 5,154  | 5,835  | 5,997  | 1,427 | 6,068  | 6,447  |
| Non-factor services, net                                | 241    | 303    | 330    | 426    | 457    | 96    | 437    | 463    |
| Credits   | 1,109  | 1,092  | 1,059  | 1,112  | 1,157  | 244   | 1,147  | 1,187  |
| Debits  | 868    | 786    | 679    | 686    | 700    | 148   | 710    | 723    |
| Factor income, net                                      | -255   | -258   | -194   | -335   | -180   | -63   | -340   | -269   |
| Current transfers, net                                  | 233    | 163    | 243    | 250    | 238    | 47    | 269    | 245    |
| Of which: EU accession related                          | ...    | ...    | ...    | ...    | 44     | ...   | ...    | 45     |
| Capital and financial account                           | 1,412  | 1,041  | 705    | 1,064  | 800    | 133   | 1,160  | 1,037  |
| Capital transfers, net                                  | -2     | -3     | 2      | 6      | 1      | 0     | 5      | 5      |
| Financial account                                       | 1,414  | 1,044  | 702    | 1,058  | 799    | 133   | 1,155  | 1,032  |
| Direct investment, net                                  | 921    | 478    | 375    | 433    | 439    | 117   | 545    | 395    |
| Portfolio investment, net                               | -33    | 306    | 265    | 318    | 284    | 19    | 235    | 173    |
| Inflows   | 55     | 545    | 424    | 318    | 308    | ...   | 235    | 528    |
| Outflows  | -108   | -39    | -159   | 0      | -24    | ...   | 0      | -355   |
| Other capital inflows, net                              | 345    | 61     | 63     | 307    | 76     | -3    | 375    | 464    |
| Inflows   | 1,412  | 1,011  | 1,057  | 1,792  | 1,961  | ...   | 1,612  | 1,417  |
| Outflows  | -867   | -950   | -994   | -1,456 | -1,885 | ...   | -1,237 | -953   |
| Net errors and omissions                                | 315    | -26    | 127    | -63    | 132    | 32    | 0      | 52     |
| Financing   | -429   | 179    | -157   | -306   | -359   | -65   | -419   | -298   |
| Fund financing 1/                                       | -30    | -17    | -26    | -30    | -34    | -10   | -40    | -39    |
| Change in official reserves (=increase)                 | -399   | 196    | -131   | -277   | -325   | -55   | -379   | -259   |
| Gross official reserves 2/                              | 1,460  | 1,242  | 1,359  | 1,565  | 1,569  | 1,740 | 1,944  | 1,928  |
| Gross external debt 3/                                  | 3,741  | 4,528  | 4,856  | 5,236  | 5,259  | ...   | 5,647  | 5,781  |
| Public and publicly guaranteed                          | 1,687  | 2,392  | 2,364  | 2,525  | 2,384  | ...   | 2,696  | 2,472  |
| Private   | 2,054  | 2,137  | 2,493  | 2,711  | 2,875  | ...   | 2,949  | 3,309  |
| Net external debt 4/                                    | 2,243  | 2,818  | 2,948  | 3,284  | 3,166  | ...   | 3,805  | 3,714  |
| Public and publicly guaranteed                          | 1,687  | 2,392  | 2,364  | 2,525  | 2,384  | ...   | 2,696  | 2,472  |
| Private   | 556    | 426    | 584    | 759    | 782    | ...   | 1,107  | 1,243  |
| Short-term gross external debt                          |        |        |        |        |        |       |        |        |
| On a remaining maturity basis                           | 1,730  | 1,899  | 2,786  | 2,546  | 2,878  | ...   | 2,548  | 3,019  |
| On an original maturity basis                           | 1,042  | 1,045  | 1,114  | 1,262  | 1,551  | ...   | 1,340  | 1,689  |
| Debt service 5/   | 1,144  | 846    | 1,066  | 1,709  | 1,874  | ...   | 1,508  | 1,577  |
| Gross amortization                                      | 984    | 688    | 854    | 1,486  | 1,672  | ...   | 1,260  | 1,328  |
| Interest payments                                       | 160    | 158    | 212    | 214    | 202    | ...   | 248    | 249    |
| (In percent of GDP, unless otherwise indicated)         |        |        |        |        |        |       |        |        |
| Current account   | -12.1  | -11.2  | -6.0   | -5.8   | -4.8   | -4.3  | -5.8   | -5.9   |
| Trade balance of goods and services                     | -11.9  | -10.3  | -6.4   | -5.1   | -5.4   | -3.8  | -5.2   | -5.7   |
| Trade balance, goods                                    | -14.1  | -13.2  | -9.8   | -8.6   | -9.2   | -7.2  | -8.6   | -9.1   |
| Of which:   |        |        |        |        |        |       |        |        |
| Non-energy trade balance                                | -8.2   | -6.6   | -3.2   | -4.0   | -3.8   | ...   | -5.0   | -4.2   |
| Trade balance, services                                 | 2.2    | 2.9    | 3.4    | 3.5    | 3.8    | 3.5   | 3.4    | 3.4    |
| Factor income, net                                      | -2.4   | -2.4   | -1.7   | -2.8   | -1.5   | -2.3  | -2.6   | -2.0   |
| Current transfers, net                                  | 2.2    | 1.5    | 2.1    | 2.1    | 2.1    | 1.7   | 2.1    | 1.8    |
| Of which: EU accession related                          | ...    | ...    | ...    | ...    | 0.4    | ...   | ...    | 0.3    |
| Financial account                                       | 13.2   | 9.8    | 6.2    | 8.8    | 5.7    | 4.8   | 9.0    | 7.6    |
| Direct investment, net                                  | 8.6    | 4.5    | 3.3    | 3.6    | 3.7    | 4.2   | 4.2    | 2.9    |
| Portfolio investment, net                               | -0.5   | 4.7    | 2.3    | 2.6    | 2.4    | 0.7   | 1.8    | 1.3    |
| Other investment, net                                   | 5.1    | 0.6    | 0.6    | 2.6    | 0.6    | -0.1  | 2.9    | 3.4    |
| Gross external debt 3/                                  | 34.8   | 42.5   | 43.0   | 43.6   | 43.9   | ...   | 43.8   | 42.7   |
| Public and publicly guaranteed                          | 15.7   | 22.4   | 20.9   | 21.0   | 19.9   | ...   | 20.9   | 18.3   |
| Private   | 19.1   | 20.0   | 22.1   | 22.5   | 24.0   | ...   | 22.9   | 24.5   |
| Net external debt 4/                                    | 20.9   | 26.4   | 26.1   | 27.3   | 26.4   | ...   | 29.5   | 27.5   |
| Short-term gross external debt                          |        |        |        |        |        |       |        |        |
| On a remaining maturity basis                           | 16.1   | 17.3   | 24.7   | 21.2   | 24.0   | ...   | 20.6   | 22.3   |
| On an original maturity basis                           | 9.7    | 9.8    | 9.9    | 10.5   | 12.9   | ...   | 10.4   | 12.5   |
| Debt service, in percent of exports of GNFS 5/          | 22.6   | 20.0   | 20.9   | 28.9   | 31.0   | ...   | 24.7   | 24.6   |
| Gross amortization                                      | 19.4   | 16.2   | 16.7   | 25.1   | 27.7   | ...   | 20.6   | 20.7   |
| Interest payments                                       | 3.2    | 3.7    | 4.1    | 3.6    | 3.3    | ...   | 4.1    | 3.9    |
| <b>Memorandum items:</b>                                |        |        |        |        |        |       |        |        |
| Nominal GDP (millions of U.S. dollars)                  | 10,747 | 10,664 | 11,287 | 12,022 | 11,992 | 2,764 | 12,883 | 13,523 |
| Exports of GNFS (nominal percent change, y-o-y)         | -2.9   | -16.4  | 20.6   | 15.7   | 18.3   | 7.5   | 3.3    | 5.9    |
| of which: non-energy exports of GNFS                    | -3.6   | -12.7  | 13.6   | 12.5   | 14.8   | 8.8   | 4.9    | 6.6    |
| Imports of GNFS (nominal percent change, y-o-y)         | 1.8    | -15.9  | 9.3    | 11.8   | 14.8   | 5.2   | 3.9    | 7.1    |
| of which: non-energy imports of GNFS                    | 4.3    | -16.0  | 1.9    | 14.6   | 15.5   | 12.2  | 7.9    | 8.9    |
| Crude oil price (US\$/bbl) 6/                           | 13.1   | 18.0   | 28.2   | 29.0   | 24.3   | 21.2  | 22.5   | 23.0   |

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

1/ "-" indicates repurchase; "+" indicates purchase.

2/ Gross official reserves reported here differ from the monetary survey due to valuation differences.

3/ External liabilities minus foreign equity investment.

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

5/ Debt service comprises interest and repayment on external loans, and interest and repayment on debt securities.

6/ Oil prices for 2002 are based on WBO baseline projections.

Table 5: Lithuania: Balance of Payments, 2001-07 (continued)

|   | 2001   |        | 2002   |            | 2003   | 2004   | 2005   | 2006   | 2007   |
|---|--------|--------|--------|------------|--------|--------|--------|--------|--------|
|   | Prog.  | Actual | Prog.  | Rev. Prog. |        |        | Proj.  |        |        |
| (In millions of US dollars, unless otherwise indicated) |        |        |        |            |        |        |        |        |        |
| Current account   | -695   | -574   | -741   | -751       | -838   | -846   | -890   | -921   | -962   |
| Trade balance   | -1,036 | -1,108 | -1,108 | -1,231     | -1,277 | -1,456 | -1,477 | -1,524 | -1,571 |
| Exports (f.o.b.)  | 4,800  | 4,889  | 4,961  | 5,217      | 5,687  | 6,188  | 6,765  | 7,369  | 8,019  |
| Imports (f.o.b.)  | 5,835  | 5,997  | 6,068  | 6,447      | 6,964  | 7,644  | 8,242  | 8,893  | 9,590  |
| Non-factor services, net                                | 426    | 457    | 437    | 463        | 468    | 479    | 496    | 513    | 536    |
| Credits   | 1,112  | 1,157  | 1,147  | 1,187      | 1,219  | 1,265  | 1,312  | 1,361  | 1,418  |
| Debits  | 686    | 700    | 710    | 723        | 751    | 785    | 816    | 848    | 882    |
| Factor income, net                                      | -355   | -180   | -340   | -269       | -308   | -400   | -449   | -504   | -561   |
| Current transfers, net                                  | 250    | 258    | 269    | 245        | 279    | 532    | 540    | 594    | 635    |
| Of which: EU accession related                          | ...    | 44     | ...    | 45         | 60     | 321    | 341    | 380    | 414    |
| Capital and financial account                           | 1,064  | 800    | 1,160  | 1,037      | 1,181  | 1,022  | 998    | 1,071  | 1,090  |
| Capital transfers, net                                  | 6      | 1      | 5      | 5          | 5      | 5      | 5      | 5      | 5      |
| Financial account                                       | 1,058  | 799    | 1,155  | 1,032      | 1,176  | 1,017  | 993    | 1,066  | 1,085  |
| Direct investment, net                                  | 413    | 439    | 545    | 395        | 580    | 525    | 554    | 602    | 659    |
| Portfolio investment, net                               | 318    | 284    | 235    | 173        | 135    | 84     | 96     | 100    | 93     |
| Inflows   | 318    | 308    | 235    | 528        | 395    | 344    | 433    | 150    | 150    |
| Outflows  | 0      | -24    | 0      | -355       | -260   | -260   | -337   | -51    | -57    |
| Other capital inflows, net                              | 307    | 76     | 375    | 464        | 461    | 408    | 343    | 365    | 334    |
| Inflows   | 1,792  | 1,961  | 1,612  | 1,417      | 1,513  | 1,481  | 1,544  | 1,644  | 1,720  |
| Outflows  | -1,456 | -1,885 | -1,237 | -953       | -1,052 | -1,074 | -1,201 | -1,279 | -1,386 |
| Net errors and omissions                                | -63    | 132    | 0      | 52         | 0      | 0      | 0      | 0      | 0      |
| Financing   | -306   | -359   | -419   | -298       | -344   | -176   | -108   | -150   | -128   |
| Fund financing 1/                                       | -30    | -34    | -40    | -39        | -39    | -31    | -24    | -13    | -5     |
| Change in official reserves (-increase)                 | -277   | -325   | -379   | -259       | -305   | -145   | -84    | -137   | -123   |
| Gross official reserves 2/                              | 1,565  | 1,669  | 1,944  | 1,928      | 2,233  | 2,378  | 2,462  | 2,599  | 2,722  |
| Gross external debt 3/                                  | 5,236  | 5,259  | 5,647  | 5,781      | 6,465  | 6,956  | 7,474  | 8,051  | 8,605  |
| Public and publicly guaranteed                          | 2,525  | 2,384  | 2,698  | 2,472      | 2,436  | 2,312  | 2,175  | 2,084  | 1,993  |
| Private   | 2,711  | 2,875  | 2,949  | 3,309      | 4,029  | 4,644  | 5,299  | 5,967  | 6,612  |
| Net external debt 4/                                    | 3,284  | 3,166  | 3,805  | 3,714      | 4,242  | 4,672  | 5,058  | 5,480  | 5,871  |
| Public and publicly guaranteed                          | 2,525  | 2,384  | 2,698  | 2,472      | 2,436  | 2,312  | 2,175  | 2,084  | 1,993  |
| Private   | 759    | 782    | 1,107  | 1,243      | 1,806  | 2,360  | 2,883  | 3,396  | 3,877  |
| Short-term gross external debt                          |        |        |        |            |        |        |        |        |        |
| On a remaining maturity basis                           | 2,546  | 2,878  | 2,648  | 3,019      | 3,127  | 3,435  | 3,351  | 3,629  | ...    |
| On an original maturity basis                           | 1,262  | 1,551  | 1,340  | 1,689      | 1,765  | 1,874  | 2,009  | 2,180  | 2,348  |
| Debt service 5/   | 1,709  | 1,874  | 1,508  | 1,577      | 1,623  | 1,713  | 1,943  | 1,751  | 1,888  |
| Gross amortization                                      | 1,486  | 1,672  | 1,260  | 1,328      | 1,329  | 1,365  | 1,561  | 1,343  | 1,449  |
| Interest payments                                       | 214    | 202    | 248    | 249        | 294    | 348    | 382    | 409    | 438    |
| (In percent of GDP, unless otherwise indicated)         |        |        |        |            |        |        |        |        |        |
| Current account   | -5.8   | -4.8   | -5.8   | -5.9       | -5.7   | -5.3   | -5.1   | -4.9   | -4.7   |
| Trade balance of goods and services                     | -5.1   | -5.4   | -5.2   | -5.7       | -5.5   | -6.1   | -5.6   | -5.3   | -5.0   |
| Trade balance, goods                                    | -8.6   | -9.2   | -8.6   | -9.1       | -8.7   | -9.1   | -8.5   | -8.0   | -7.6   |
| Of which:   |        |        |        |            |        |        |        |        |        |
| Non-energy trade balance                                | -4.0   | -3.8   | -5.0   | -4.2       | -4.1   | -4.8   | -4.4   | -4.1   | -3.8   |
| Trade balance, services                                 | 3.5    | 3.8    | 3.4    | 3.4        | 3.2    | 3.0    | 2.9    | 2.7    | 2.6    |
| Factor income, net                                      | -2.8   | -1.5   | -2.6   | -2.0       | -2.1   | -2.5   | -2.6   | -2.7   | -2.7   |
| Current transfers, net                                  | 2.1    | 2.1    | 2.1    | 1.8        | 1.9    | 3.3    | 3.1    | 3.1    | 3.1    |
| Of which: EU accession related                          | ...    | 0.4    | ...    | 0.3        | 0.4    | 2.0    | 2.0    | 2.0    | 2.0    |
| Financial account                                       | 8.8    | 6.7    | 9.0    | 7.6        | 8.0    | 6.4    | 5.7    | 5.6    | 5.3    |
| Direct investment, net                                  | 3.6    | 3.7    | 4.2    | 2.9        | 4.0    | 3.3    | 3.2    | 3.2    | 3.2    |
| Portfolio investment, net                               | 2.6    | 2.4    | 1.8    | 1.3        | 0.9    | 0.5    | 0.6    | 0.5    | 0.4    |
| Other investment, net                                   | 2.6    | 0.6    | 2.9    | 3.4        | 3.1    | 2.5    | 2.0    | 1.9    | 1.6    |
| Gross external debt 3/                                  | 43.6   | 43.9   | 43.8   | 42.7       | 44.1   | 43.5   | 42.9   | 42.5   | 41.7   |
| Public and publicly guaranteed                          | 21.0   | 19.9   | 20.9   | 18.3       | 16.6   | 14.4   | 12.5   | 11.0   | 9.7    |
| Private   | 22.5   | 24.0   | 22.9   | 24.5       | 27.5   | 29.0   | 30.4   | 31.5   | 32.0   |
| Net external debt 4/                                    | 27.3   | 26.4   | 29.5   | 27.5       | 28.9   | 29.2   | 29.1   | 28.9   | 28.4   |
| Short-term gross external debt                          |        |        |        |            |        |        |        |        |        |
| On a remaining maturity basis                           | 21.2   | 24.0   | 20.6   | 22.3       | 21.3   | 21.5   | 19.3   | 19.1   | ...    |
| On an original maturity basis                           | 10.5   | 12.9   | 10.4   | 12.5       | 12.0   | 11.7   | 11.5   | 11.5   | 11.4   |
| Debt service, in percent of exports of GNFS 5/          | 28.9   | 31.0   | 24.7   | 24.6       | 23.5   | 23.0   | 24.1   | 20.1   | 20.0   |
| Gross amortization                                      | 25.1   | 27.7   | 20.6   | 20.7       | 19.2   | 18.3   | 19.3   | 15.4   | 15.4   |
| Interest payments                                       | 3.6    | 3.3    | 4.1    | 3.9        | 4.3    | 4.7    | 4.7    | 4.7    | 4.6    |
| <b>Memorandum items:</b>                                |        |        |        |            |        |        |        |        |        |
| Nominal GDP (millions of U.S. dollars)                  | 12,022 | 11,992 | 12,883 | 13,523     | 14,659 | 16,003 | 17,407 | 18,958 | 20,651 |
| Exports of GNFS (nominal percent change, y-o-y)         | 15.7   | 18.3   | 3.3    | 5.9        | 7.9    | 7.9    | 8.4    | 8.1    | 8.1    |
| of which: non-energy exports of GNFS                    | 12.5   | 14.8   | 4.9    | 6.6        | 10.5   | 10.7   | 10.2   | 9.7    | 9.6    |
| Imports of GNFS (nominal percent change, y-o-y)         | 11.8   | 14.8   | 3.9    | 7.1        | 7.6    | 9.3    | 7.5    | 7.6    | 7.5    |
| of which: non-energy imports of GNFS                    | 14.6   | 15.5   | 7.9    | 8.9        | 10.8   | 13.0   | 9.4    | 9.3    | 9.1    |
| Crude oil price (US\$/bbl) 6/                           | 20.0   | 24.3   | 22.5   | 23.0       | 22.0   | 21.0   | 21.0   | 21.0   | 21.0   |

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

1/ "-" indicates repurchase; "+" indicates purchase.

2/ Gross official reserves reported here differ from the monetary survey due to valuation differences.

3/ External liabilities minus foreign equity investment.

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

5/ Debt service comprises interest and repayment on external loans, and interest and repayment on debt securities.

6/ Oil prices for 2003-07 are based on WEO baseline projections.



Table 6. Lithuania: Indicators of External and Financial Vulnerability, 1999-2002

|   | 1999   | 2000   |       | 2001  |       |       | Latest  | Data    |
|---|--------|--------|-------|-------|-------|-------|---------|---------|
|   |        | Year   | Mar.  | June  | Sept. | Dec.  |         |         |
| <b>Financial indicators</b>   |        |        |       |       |       |       |         |         |
| State debt (domestic and foreign, in percent of GDP) 1/                               | 28.4   | 28.2   | 28.7  | 27.8  | 28.1  | 26.9  | 29.8    | Q1/2002 |
| Broad money (year-on-year change in percent)  | 7.7    | 16.5   | 19.4  | 17.2  | 18.9  | 21.4  | 20.9    | 3/2002  |
| Broad money in percent of gross official reserves                                     | 180.6  | 192.4  | 206.2 | 188.0 | 183.2 | 190.1 | 177.9   | 3/2002  |
| Private sector credit (year-on-year change in percent) 2/                             | 13.8   | -1.2   | 8.2   | 6.2   | 9.5   | 21.4  | 21.6    | 3/2002  |
| <b>External indicators</b>  |        |        |       |       |       |       |         |         |
| Current account balance in percent of GDP   | -11.2  | -6.0   | -3.1  | -4.0  | -0.1  | -10.1 | -4.3    | Q1/2002 |
| Exports of GNFS (year-on-year change in percent)                                      | -16.4  | 20.6   | 12.8  | 25.3  | 14.4  | 21.0  | 7.5     | Q1/2002 |
| Imports of GNFS (year-on-year change in percent)                                      | -15.9  | 9.2    | 11.7  | 16.6  | 8.6   | 21.6  | 3.2     | Q1/2002 |
| Capital and financial account balance in percent of GDP                               | 9.8    | 6.2    | 4.9   | 6.5   | 4.5   | 10.5  | 4.8     | Q1/2002 |
| Gross official reserves (in millions of U.S. dollars) 3/                              | 1,242  | 1,359  | 1,287 | 1,455 | 1,598 | 1,669 | 1,803   | 4/3/02  |
| Gross official reserves/short-term debt 4/  | 0.65   | 0.49   | 0.56  | 0.68  | 0.60  | 0.58  | 0.58    | Q4/2001 |
| Gross official reserves/reserve money   | 1.22   | 1.37   | 1.40  | 1.52  | 1.69  | 1.56  | 1.56    | Q4/2001 |
| Gross official reserves in months of imports of GNFS over the following year          | 2.6    | 2.4    | 2.2   | 2.5   | 2.6   | 2.8   | 2.8     | Q4/2001 |
| Net foreign assets of financial sector (in millions of U.S. dollars) 5/               | -79    | 187    | 244   | 160   | 291   | 152   | 103     | 3/2002  |
| Total gross external debt (in millions of U.S. dollars) 6/                            | 4,528  | 4,856  | 5,008 | 4,861 | 5,188 | 5,259 | 5,259   | Q4/2001 |
| in percent of GDP   | 42.5   | 43.0   | 43.7  | 41.7  | 44.0  | 43.9  | 43.9    | Q4/2001 |
| of which: Public sector debt (in millions of U.S. dollars)                            | 2,392  | 2,364  | 2,461 | 2,406 | 2,552 | 2,384 | 2,383.8 | Q4/2001 |
| in percent of GDP   | 22.4   | 20.9   | 21.5  | 20.6  | 21.7  | 19.9  | 19.9    | Q4/2001 |
| Total net external debt (in millions of U.S. dollars) 7/                              | 2,818  | 2,948  | 2,885 | 2,854 | 3,031 | 3,166 | 3,165.8 | Q4/2001 |
| in percent of GDP   | 26.4   | 26.1   | 25.2  | 24.5  | 25.7  | 26.4  | 26.4    | Q4/2001 |
| of which: Public sector debt (in millions of U.S. dollars)                            | 2,392  | 2,364  | 2,461 | 2,406 | 2,552 | 2,384 | 2,384   | Q4/2001 |
| in percent of GDP   | 22.4   | 20.9   | 21.5  | 20.6  | 21.7  | 19.9  | 19.9    | Q4/2001 |
| Total net external short-term debt (in millions of U.S. dollars) 8/                   | -78    | -59    | -285  | -132  | -68   | 278   | 278     | Q4/2001 |
| in percent of GDP   | -0.7   | -0.5   | -2.5  | -1.1  | -0.6  | 2.3   | 2.3     | Q4/2001 |
| External interest payments in percent of exports GNFS                                 | 3.7    | 4.1    | 4.0   | 4.1   | 2.8   | 2.6   | 2.6     | Q4/2001 |
| External amortization payments in percent of exports GNFS                             | 16.2   | 16.7   | 59.2  | 24.0  | 14.4  | 16.9  | 16.9    | Q4/2001 |
| Public and publicly guaranteed debt service as percent of tax revenue                 | 13.0   | 12.7   | 6.2   | 7.2   | 9.9   | 10.1  | 10.1    | Q4/2001 |
| Debt service as percent of exports of GNFS 9/   | 20.0   | 20.9   | 63.1  | 28.1  | 17.2  | 19.5  | 19.5    | Q4/2001 |
| Real effective exchange rate (year-on-year change in percent, "+" = appreciation) 10/ | 4.20   | 6.55   | 0.01  | 1.19  | -0.04 | -1.54 | 1.71    | 2/28/02 |
| <b>Financial market indicators</b>  |        |        |       |       |       |       |         |         |
| Stock market index, end of period 11/   | 1,089  | 1,047  | 1,007 | 910   | 791   | 855   | 939     | 5/23/02 |
| Foreign currency debt rating 12/  | BBB-   | BBB-   | BBB-  | BBB-  | BBB-  | BBB-  | BBB     | 5/23/02 |
| <b>Memorandum item:</b>   |        |        |       |       |       |       |         |         |
| GDP (in millions of U.S. dollars)   | 10,664 | 11,287 | 2,671 | 3,023 | 3,186 | 3,112 | 3,202   | Q1/2002 |
| Nominal exchange rate (litai/U.S. dollar, end-of-period)                              | 4.0    | 4.0    | 4.0   | 4.0   | 4.0   | 4.0   | 3.7     | 6/11/02 |
| Nominal exchange rate (litai/euro, end-of-period)                                     | 4.0    | 3.7    | 3.4   | 3.6   | 3.5   | 3.3   | 3.5     | 6/11/02 |

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/ 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, July 2001 numbers have been adjusted by LTL 785 million of reclassified assets.

3/ Gross official reserves reported here differ from the monetary survey due to valuation differences.

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

9/ Debt service comprises interest and repayment on external loans, and interest and repayment on debt securities.

10/ CPI-based RBER against the 21 major trading partners in 1999.

11/ 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.

12/ S&P investment grade rating.

Table 7. Lithuania: Summary of Consolidated General Government Operations, 1998-2002

|  | 1998   | 1999   | 2000 1/ | 2001     |        | 2002     |            |       |       |
|--|--------|--------|---------|----------|--------|----------|------------|-------|-------|
|  |        |        |         | Prog. 2/ | Prel.  | Prog. 3/ | Rev. Prog. | Mar   |       |
|  |        |        |         |          |        |          |            | Prog. | Prel. |
| (In millions of litai)                           |        |        |         |          |        |          |            |       |       |
| Revenue  | 14,036 | 13,687 | 13,707  | 14,122   | 14,296 | 14,950   | 15,005     | 3,488 | 3,537 |
| Tax revenue                                      | 13,433 | 12,955 | 12,841  | 12,997   | 13,154 | 13,901   | 13,925     | 3,207 | 3,257 |
| Taxes on income and profits                      | 4,017  | 3,971  | 3,835   | 3,808    | 3,785  | 3,956    | 3,845      | 922   | 889   |
| Payroll tax (social security tax)                | 3,063  | 2,891  | 3,194   | 3,193    | 3,265  | 3,407    | 3,387      | 826   | 802   |
| Taxes on goods and services                      | 5,596  | 5,385  | 5,157   | 5,380    | 5,474  | 5,749    | 5,866      | 1,275 | 1,348 |
| Other tax revenue                                | 756    | 709    | 655     | 616      | 630    | 789      | 828        | 183   | 218   |
| Non-tax Revenue 4/                               | 603    | 732    | 866     | 1,125    | 1,142  | 1,049    | 1,079      | 281   | 280   |
| Expenditure and net lending                      | 16,362 | 17,152 | 15,011  | 14,853   | 15,065 | 15,727   | 15,741     | 3,872 | 3,603 |
| Expenditure                                      | 15,734 | 16,146 | 14,711  | 14,820   | 14,989 | 15,529   | 15,585     | 3,831 | 3,588 |
| Current expenditure 5/                           | 14,326 | 15,190 | 13,839  | 14,073   | 14,072 | 14,811   | 14,814     | 3,673 | 3,450 |
| Wages and salaries, excl. contributions to SoDra | 3,290  | 3,513  | 3,450   | 3,524    | 3,509  | 3,554    | 3,520      | 822   | 823   |
| Goods and services                               | 4,899  | 4,425  | 4,088   | 4,009    | 4,100  | 4,526    | 4,715      | 1,147 | 920   |
| Transfers to EU                                  | 0      | 0      | 0       | 0        | 0      | 0        | 0          | 0     | 0     |
| Transfers to households                          | 4,977  | 5,244  | 5,401   | 5,646    | 5,586  | 5,783    | 5,760      | 1,405 | 1,410 |
| Subsidies  | 202    | 150    | 103     | 93       | 81     | 66       | 66         | 9     | 9     |
| Interest payments                                | 507    | 650    | 782     | 781      | 781    | 834      | 672        | 278   | 253   |
| Savings restitution program                      | 450    | 1,207  | 15      | 19       | 15     | 48       | 81         | 12    | 36    |
| Capital expenditure                              | 1,408  | 956    | 872     | 747      | 918    | 718      | 771        | 158   | 138   |
| Discrepancy                                      | 190    | 170    | -59     | 110      | 163    | 0        | 39         | 0     | 39    |
| Financial balance                                | -1,888 | -2,629 | -944    | -808     | -856   | -579     | -620       | -343  | -90   |
| Net lending 4/                                   | 628    | 1,006  | 300     | 33       | 76     | 198      | 156        | 41    | 16    |
| Lending  | 1,017  | 1,381  | 529     | 337      | 455    | 365      | 355        | 73    | 73    |
| of which: Mazeikiiai Oil Company                 | 240    | 800    | 88      | 0        | 0      | 0        | 0          | 0     | 0     |
| Repayments                                       | 389    | -375   | -230    | -304     | -378   | -167     | -199       | -32   | -57   |
| Fiscal balance (deficit (-))                     | -2,516 | -3,635 | -1,244  | -841     | -932   | -776     | -776       | -383  | -106  |
| Financing 5/                                     | 2,516  | 3,635  | 1,244   | 841      | 932    | 776      | 776        | -383  | 106   |
| Net domestic                                     | -286   | 392    | -61     | 118      | 153    | -583     | -18        | 377   | -85   |
| Bank financing                                   | -666   | 337    | -109    | -24      | 105    | -683     | -104       | 327   | -121  |
| Monetary Authorities                             | -635   | 602    | -480    | -689     | -706   | -897     | -563       | 230   | -243  |
| Commercial Banks                                 | -31    | -265   | 371     | 665      | 812    | 214      | 459        | 97    | 122   |
| Non-bank financing                               | 380    | 55     | 47      | 142      | 48     | 100      | 86         | 50    | 36    |
| Net foreign                                      | 535    | 2,762  | 502     | 145      | 281    | 160      | 194        | -79   | 94    |
| Privatization proceeds                           | 2,267  | 481    | 803     | 579      | 498    | 1,200    | 599        | 86    | 97    |

Table 7. Lithuania: Summary of Consolidated General Government Operations, 1998-2002 (concluded)

|  | 1998   | 1999   | 2000 1/ | 2001     |        | 2002     |            |              |        |
|--|--------|--------|---------|----------|--------|----------|------------|--------------|--------|
|  |        |        |         | Prog. 2/ | Prel.  | Prog. 3/ | Rev. Prog. | Mar<br>Prog. | Prel.  |
| (In percent of GDP)                              |        |        |         |          |        |          |            |              |        |
| Revenue and grants                               | 32.7   | 32.1   | 30.4    | 29.4     | 29.8   | 29.0     | 29.1       | 30.9         | 32.0   |
| Grants   | 0.0    | 0.0    | 0.0     | 0.0      | 0.0    | 0.0      | 0.0        | 0.0          | 0.0    |
| Revenue  | 32.7   | 32.1   | 30.4    | 29.4     | 29.8   | 29.0     | 29.1       | 30.9         | 32.0   |
| Tax revenue                                      | 31.2   | 30.4   | 28.4    | 27.0     | 27.4   | 27.0     | 27.0       | 28.4         | 29.5   |
| Taxes on income and profits                      | 9.3    | 9.3    | 8.5     | 7.9      | 7.9    | 7.7      | 7.5        | 8.2          | 8.0    |
| Payroll tax (social security tax)                | 7.1    | 6.8    | 7.1     | 6.6      | 6.8    | 6.6      | 6.6        | 7.3          | 7.3    |
| Taxes on goods and services                      | 13.0   | 12.6   | 11.4    | 11.2     | 11.4   | 11.2     | 11.4       | 11.3         | 12.2   |
| Other tax revenue                                | 1.8    | 1.7    | 1.5     | 1.3      | 1.3    | 1.5      | 1.6        | 1.6          | 2.0    |
| Non-tax Revenue 4/                               | 1.4    | 1.7    | 1.9     | 2.3      | 2.4    | 2.0      | 2.1        | 2.5          | 2.5    |
| Expenditure and net lending                      | 38.1   | 40.2   | 33.2    | 30.9     | 31.4   | 30.5     | 30.5       | 34.3         | 32.6   |
| Expenditure                                      | 36.6   | 37.9   | 32.6    | 30.8     | 31.2   | 30.1     | 30.2       | 34.0         | 32.5   |
| Current expenditure 5/                           | 33.3   | 35.6   | 30.7    | 29.3     | 29.3   | 28.7     | 28.7       | 32.6         | 31.2   |
| Wages and salaries, excl. contributions to SoDra | 7.7    | 8.2    | 7.6     | 7.3      | 7.3    | 6.9      | 6.8        | 7.3          | 7.4    |
| Goods and services                               | 11.4   | 10.4   | 9.1     | 8.3      | 8.5    | 8.8      | 9.2        | 10.2         | 8.3    |
| Transfers to households                          | 11.6   | 12.3   | 12.0    | 11.7     | 11.6   | 11.2     | 11.2       | 12.5         | 12.8   |
| Subsidies  | 0.5    | 0.4    | 0.2     | 0.2      | 0.2    | 0.1      | 0.1        | 0.1          | 0.1    |
| Interest payments                                | 1.2    | 1.5    | 1.7     | 1.6      | 1.6    | 1.6      | 1.3        | 2.5          | 2.3    |
| Savings restitution program                      | 1.0    | 2.8    | 0.0     | 0.0      | 0.0    | 0.1      | 0.2        | 0.1          | 0.3    |
| Capital expenditure                              | 3.3    | 2.2    | 1.9     | 1.6      | 1.9    | 1.4      | 1.5        | 1.4          | 1.2    |
| Discrepancy                                      | 0.4    | 0.4    | -0.1    | 0.2      | 0.3    | 0.0      | 0.1        | 0.0          | 0.4    |
| Financial balance                                | -4.4   | -6.2   | -2.1    | -1.7     | -1.8   | -1.1     | -1.2       | -3.0         | -0.8   |
| Net lending 4/                                   | 1.5    | 2.4    | 0.7     | 0.1      | 0.2    | 0.4      | 0.3        | 0.4          | 0.1    |
| Lending  | 2.4    | 3.2    | 1.2     | 0.7      | 0.9    | 0.7      | 0.7        | 0.6          | 0.7    |
| of which: Mazeikiiai 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     | -0.8   | -0.3     | -0.4       | -0.3         | -0.5   |
| Fiscal balance (deficit (-))                     | -5.9   | -8.5   | -2.8    | -1.7     | -1.9   | -1.5     | -1.5       | -3.4         | -1.0   |
| Financing 5/                                     | 5.9    | 8.5    | 2.8     | 1.7      | 1.9    | 1.5      | 1.5        | -3.4         | 1.0    |
| Net domestic                                     | -0.7   | 0.9    | -0.1    | 0.2      | 0.3    | -1.1     | 0.0        | 3.3          | -0.8   |
| Bank financing                                   | -1.5   | 0.8    | -0.2    | -0.1     | 0.2    | -1.3     | -0.2       | 2.9          | -1.1   |
| Monetary Authorities                             | -1.5   | 1.4    | -1.1    | -1.4     | -1.5   | -1.7     | -1.1       | 2.0          | -2.2   |
| Commercial Banks                                 | -0.1   | -0.6   | 0.8     | 1.4      | 1.7    | 0.4      | 0.9        | 0.9          | 1.1    |
| Non-bank financing                               | 0.9    | 0.1    | 0.1     | 0.3      | 0.1    | 0.2      | 0.2        | 0.4          | 0.3    |
| Net foreign                                      | 1.2    | 6.5    | 1.1     | 0.3      | 0.6    | 0.3      | 0.4        | -0.7         | 0.8    |
| Privatization proceeds                           | 5.3    | 1.1    | 1.8     | 1.2      | 1.0    | 2.3      | 1.2        | 0.8          | 0.9    |
| <i>Memorandum Items:</i>                         |        |        |         |          |        |          |            |              |        |
| Public and publicly guaranteed debt, mln. LTL    | 9,817  | 12,371 | 13,028  | 13,924   | 13,994 | 14,617   | 14,953     | ...          | ...    |
| In percent of GDP                                | 22.83  | 29.00  | 28.86   | 28.96    | 29.17  | 28.37    | 29.02      | ...          | ...    |
| GDP, in mln. LTL                                 | 42,990 | 42,655 | 45,148  | 48,087   | 47,968 | 51,531   | 51,531     | 11,277       | 11,055 |

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 (LTL128 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.

4/ In order to make the treatment of the repurchase of the IMF loan consistent with the treatment in the financing, transfers for debt service payments by the Bank of Lithuania have been included in non-tax revenue (interest) and net lending (repayments).

5/ For 2001, current expenditure and non-bank financing include LTL72 million of pharmaceutical arrears rescheduled in December 2001 (according to the definition in the SMEP (EBS/01/211)). The entire amount was repaid in March 2002 through a commercial bank loan contracted by the Health Insurance Fund. The latter operations are recorded in 2002Q1 as domestic bank borrowing for LTL 72 million, and amortization to the non-bank sector by the same amount. The terms of the loan include repayments in eight equal tranches of LTL 9 million, starting in 2003, with the final payment due on December 31, 2006.

Table 8. Lithuania: Summary Monetary Accounts, 1998-2002

|   | 1998<br>Dec. | 1999<br>Dec. | 2000<br>Dec. | 2001   |        | 2002   |        | Prog.  | Rev.   | Prog. |
|---|--------------|--------------|--------------|--------|--------|--------|--------|--------|--------|-------|
|   |              |              |              | Dec.   |        | Mar.   |        |        |        |       |
|   |              |              |              | Prog.  | Act.   | Prog.  | Act.   |        |        |       |
| (In millions of litai, unless otherwise indicated)        |              |              |              |        |        |        |        |        |        |       |
| <b>Monetary Authority</b>                                 |              |              |              |        |        |        |        |        |        |       |
| Net Foreign Assets  | 4,836        | 4,054        | 4,607        | 5,602  | 5,818  | 5,423  | 6,056  | 7,278  | 6,710  |       |
| Net Domestic Assets                                       | -575         | 35           | -655         | -1,431 | -1,538 | -1,249 | -1,819 | -2,549 | -2,231 |       |
| Net credit to government                                  | -947         | -326         | -804         | -1,493 | -1,510 | -1,264 | -1,752 | -2,390 | -2,073 |       |
| Credit to banks   | 52           | 30           | 24           | 24     | 15     | 24     | 14     | 24     | 16     |       |
| Credit to private sector                                  | 7            | 6            | 6            | 6      | 6      | 6      | 7      | 6      | 7      |       |
| Credit to non-bank financial institutions                 | 7            | 20           | 0            | 10     | 0      | 10     | 0      | 10     | 0      |       |
| Other items, net  | 305          | 305          | 120          | 22     | -50    | -25    | -88    | -198   | -181   |       |
| Reserve Money   | 4,260        | 4,088        | 3,953        | 4,171  | 4,280  | 4,174  | 4,237  | 4,729  | 4,480  |       |
| Currency outside the central bank                         | 3,036        | 2,972        | 2,904        | 3,087  | 3,263  | 3,129  | 3,149  | 3,543  | 3,584  |       |
| Currency outside banks                                    | 2,800        | 2,739        | 2,658        | 2,887  | 2,920  | 2,929  | 2,828  | 3,343  | 3,229  |       |
| Cash in vaults of banks                                   | 236          | 233          | 246          | 200    | 343    | 200    | 321    | 200    | 355    |       |
| Deposit money banks' deposits                             | 1,212        | 1,109        | 1,037        | 1,069  | 1,000  | 1,030  | 1,069  | 1,171  | 876    |       |
| Transaction and required reserves accounts in litas       | 868          | 445          | 621          | 642    | 584    | 615    | 616    | 673    | 484    |       |
| Time and special deposits                                 | 0            | 0            | 0            | 0      | 0      | 0      | 0      | 0      | 0      |       |
| Required reserves in foreign currency                     | 344          | 436          | 416          | 427    | 417    | 415    | 453    | 497    | 392    |       |
| Private and non monetary financial institutions           | 13           | 7            | 12           | 15     | 17     | 15     | 19     | 16     | 20     |       |
| <b>Banking Survey</b>                                     |              |              |              |        |        |        |        |        |        |       |
| Net Foreign Assets  | 4,292        | 3,656        | 5,368        | 6,452  | 6,426  | 5,923  | 6,410  | 8,358  | 7,394  |       |
| Monetary authority  | 4,836        | 4,054        | 4,607        | 5,602  | 5,818  | 5,423  | 6,056  | 7,278  | 6,710  |       |
| Banks and other banking institutions                      | -544         | -398         | 761          | 850    | 608    | 500    | 355    | 1,080  | 684    |       |
| Net Domestic Assets                                       | 4,035        | 5,316        | 5,087        | 5,660  | 6,265  | 6,281  | 6,416  | 5,570  | 7,454  |       |
| Net claims on government 1/                               | -426         | 199          | 569          | 546    | 947    | 873    | 926    | -138   | 895    |       |
| Monetary authority 2/                                     | -947         | -326         | -804         | -1,493 | -1,510 | -1,264 | -1,752 | -2,390 | -2,073 |       |
| Banks and other banking institutions 3/                   | 521          | 525          | 1,373        | 2,040  | 2,456  | 2,136  | 2,678  | 2,253  | 2,968  |       |
| Credit to non-financial public enterprises                | 273          | 277          | 304          | 611    | 253    | 503    | 199    | 655    | 266    |       |
| Credit to private sector 3/                               | 4,874        | 5,545        | 5,209        | 4,933  | 5,538  | 5,361  | 5,777  | 5,718  | 6,923  |       |
| Credit to non-bank financial institutions                 | 470          | 468          | 513          | 546    | 791    | 578    | 827    | 585    | 831    |       |
| Other items, net  | -1,155       | -1,173       | -1,509       | -976   | -1,265 | -1,033 | -1,312 | -1,250 | -1,460 |       |
| Broad Money   | 8,327        | 8,972        | 10,455       | 12,113 | 12,691 | 12,204 | 12,826 | 13,927 | 14,848 |       |
| Currency outside banks                                    | 2,800        | 2,739        | 2,658        | 2,887  | 2,920  | 2,929  | 2,828  | 3,343  | 3,229  |       |
| Deposits  | 5,527        | 6,233        | 7,797        | 9,225  | 9,771  | 9,275  | 9,999  | 10,585 | 11,619 |       |
| <b>Memorandum items:</b>                                  |              |              |              |        |        |        |        |        |        |       |
| Reserve money (yearly percent change)                     | 28.8         | -4.0         | -3.3         | 5.5    | 8.3    | 13.4   | 15.1   | 13.4   | 4.7    |       |
| Broad money (yearly percent change)                       | 14.5         | 7.7          | 16.5         | 15.8   | 21.4   | 15.0   | 20.9   | 15.0   | 17.0   |       |
| Private sector credit (yearly percent change)             | 16.9         | 13.8         | -6.1         | ...    | 6.3    | ...    | 7.0    | ...    | 25.0   |       |
| Private sector credit adjusted (yearly percent change) 3/ | 16.9         | 13.8         | -1.2         | 9.8    | 21.4   | 13.9   | 21.6   | 15.9   | 25.0   |       |
| Money multiplier  | 1.95         | 2.19         | 2.65         | 2.90   | 2.97   | 2.92   | 3.03   | 2.94   | 3.31   |       |
| Currency / deposits, in percent                           | 50.7         | 43.9         | 34.1         | 31.3   | 29.9   | 31.6   | 28.3   | 31.6   | 27.8   |       |
| Foreign currency / litai deposits, in percent             | 57.0         | 77.7         | 83.8         | 88.6   | 74.8   | 80.9   | 73.6   | 88.6   | 73.0   |       |
| End-period velocity 4/                                    | 5.2          | 4.8          | 4.3          | 4.0    | 3.8    | ...    | ...    | 3.7    | 3.5    |       |
| Gross official reserves, in US\$ mln. 5/                  | 1,462        | 1,244        | 1,344        | 1,565  | 1,657  | 1,515  | 1,727  | 1,944  | 1,928  |       |
| Gross official reserves adjusted for short-term repos     | 1,462        | 1,244        | 1,344        | 1,565  | 1,606  | 1,515  | 1,675  | 1,944  | ...    |       |
| GDP, mln. LTL   | 42,990       | 42,655       | 45,148       | 48,087 | 47,968 | ...    | ...    | 51,531 | 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, July 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 of valuation differences.

Table 9. Lithuania: Indicators of Financial Sector Vulnerability, 1998-2002  
(In percent, unless otherwise indicated)

|  | 1998  | 1999  |       |       |       | 2000  |       |       |       | 2001  |       |        |        | 2002   |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|--------|--------|
|  |       | Mar.  | Jun.  | Sep.  | Dec.  | Mar.  | Jun.  | Sep.  | Dec.  | Mar.  | Jun.  | Sept.  | Dec.   |        |
| Private sector credit (percentage change, year-on-year) 1/               | 16.9  | 17.0  | 17.5  | 16.8  | 13.8  | 0.0   | -2.4  | -4.0  | -1.2  | 8.2   | 6.2   | 9.5    | 21.4   | 21.6   |
| Loans to private enterprises   | 3,493 | 3,625 | 3,892 | 3,927 | 3,858 | 3,573 | 3,714 | 3,629 | 3,715 | 3,792 | 3,855 | 3,927  | 4,549  | 4,674  |
| 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    | 22.5   | 23.3   |
| Share of loans to private enterprises in total lending                   | 67.8  | 67.0  | 66.7  | 65.5  | 65.3  | 62.7  | 63.4  | 63.8  | 62.8  | 62.2  | 62.5  | 61.2   | 62.5   | 62.2   |
| Commercial bank reserves (in percent of deposits) 2/                     | 26.2  | 20.5  | 17.9  | 18.2  | 21.5  | 14.9  | 13.4  | 12.7  | 14.0  | 11.9  | 10.7  | 10.8   | 11.5   | 12.0   |
| Cash   | 4.3   | 3.8   | 3.4   | 3.1   | 3.7   | 2.2   | 2.0   | 1.7   | 2.7   | 2.1   | 2.6   | 2.1    | 2.9    | 2.8    |
| Reserves held at the BOL   | 21.9  | 16.6  | 14.5  | 15.1  | 17.8  | 12.6  | 11.3  | 11.0  | 11.3  | 9.8   | 8.1   | 8.7    | 8.6    | 9.3    |
| Official risk indicators 3/  |       |       |       |       |       |       |       |       |       |       |       |        |        |        |
| Share of non-performing loans in total loans 4/                          | 12.9  | 12.2  | 10.9  | 9.1   | 12.5  | 15.1  | 16.5  | 14.0  | 11.3  | 12.0  | 10.0  | 9.9    | 8.2    | 7.7    |
| Risk-weighted capital asset ratio (capital over risk-weighted assets) 5/ | 23.8  | 22.7  | 22.6  | 22.1  | 17.4  | 18.0  | 16.4  | 16.7  | 16.3  | 16.4  | 16.5  | 16.8   | 15.7   | 15.2   |
| Leverage ratio 6/  | 14.9  | 14.8  | 15.2  | 14.7  | 11.1  | 11.1  | 10.3  | 10.4  | 10.2  | 10.5  | 11.0  | 10.7   | 9.8    | 10.3   |
| Share of private sector credit collateralized by real estate             | 12.0  | 11.5  | 11.2  | 11.3  | 10.3  | 10.7  | 10.5  | 9.3   | 9.7   | 9.0   | 8.9   | 8.6    | 8.8    | ...    |
| Financial sector risk factors of DMB's                                   |       |       |       |       |       |       |       |       |       |       |       |        |        |        |
| Share of foreign currency loans in total lending                         | 55.9  | 57.5  | 59.3  | 58.7  | 61.6  | 63.7  | 64.1  | 66.9  | 66.8  | 64.4  | 66.2  | 63.8   | 60.6   | 62.2   |
| Share of foreign currency deposits in total deposits                     | 41.9  | 41.1  | 43.2  | 46.4  | 48.8  | 48.9  | 48.4  | 48.0  | 49.5  | 48.7  | 49.1  | 49.2   | 49.1   | 47.0   |
| Short-term loans in percent of total loans                               | 45.9  | 44.7  | 42.7  | 43.4  | 41.0  | 42.2  | 39.7  | 37.6  | 37.9  | 36.0  | 33.2  | 33.2   | 31.9   | 31.6   |
| Demand deposits in percent of total deposits                             | 62.3  | 58.2  | 55.1  | 51.8  | 51.4  | 50.0  | 49.1  | 49.9  | 48.9  | 46.6  | 45.5  | 45.9   | 46.5   | 46.8   |
| Bank profitability   |       |       |       |       |       |       |       |       |       |       |       |        |        |        |
| Return on Assets   | ...   | ...   | ...   | ...   | ...   | ...   | ...   | ...   | 0.49  | ...   | ...   | ...    | -0.11  | 0.97   |
| Return on Equity   | ...   | ...   | ...   | ...   | ...   | ...   | ...   | ...   | 5.01  | ...   | ...   | ...    | -1.08  | 9.47   |
| Market assessment  |       |       |       |       |       |       |       |       |       |       |       |        |        |        |
| Share price of Vilniaus Banka (in LTL, end of period)                    | 29    | 28    | 27    | 23    | 26    | 31    | 30    | 40    | 50    | 50    | 51    | 51     | ...    | ...    |
| Spread between VILIBID and VILIBOR 7/ 8/                                 | 268   | 232   | 202   | 239   | 296   | 296   | 254   | 264   | 233   | 199   | 191   | 176    | 194    | 160    |
| 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    | 1.9    | 10.8   |
| Total loans (in millions)  | 5,150 | 5,412 | 5,834 | 5,997 | 5,911 | 5,695 | 5,860 | 5,686 | 5,916 | 6,093 | 6,167 | 6,416  | 7,284  | 7,519  |
| Total deposits (in millions)   | 6,670 | 6,702 | 7,019 | 7,296 | 7,450 | 7,638 | 8,136 | 8,858 | 9,176 | 9,653 | 9,755 | 10,442 | 11,659 | 11,551 |

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, July 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 computation 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 VILIBOR 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 10. Lithuania: Macroeconomic Framework, 1998-2007

|  | 1998   | 1999   | 2000   | 2001   |        | 2002   |        | 2003   | 2004   | 2005   | 2006   | 2007   |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
|  |        |        |        | Prog.  | Prel.  | Prog.  | Proj.  |        |        |        |        |        |
| (In percent of GDP, unless otherwise indicated)        |        |        |        |        |        |        |        |        |        |        |        |        |
| Gross national saving                                  | 12.3   | 11.5   | 14.6   | 13.9   | 16.8   | 14.1   | 16.6   | 16.9   | 18.4   | 18.9   | 19.1   | 19.2   |
| General government                                     | -1.1   | -3.9   | -0.2   | -0.1   | 0.1    | 0.3    | 0.3    | 1.0    | 2.3    | 2.8    | 2.8    | 2.8    |
| Non-government   | 13.4   | 15.4   | 14.7   | 14.0   | 16.6   | 13.9   | 16.3   | 15.9   | 16.1   | 16.1   | 16.3   | 16.4   |
| Gross national investment                              | 24.4   | 22.7   | 20.5   | 19.7   | 21.5   | 19.9   | 22.4   | 22.6   | 23.7   | 24.0   | 23.9   | 23.8   |
| General government                                     | 3.3    | 2.2    | 1.9    | 1.6    | 1.9    | 1.4    | 1.5    | 2.1    | 3.1    | 3.5    | 3.4    | 3.4    |
| Non-government   | 21.1   | 20.4   | 18.6   | 18.1   | 19.6   | 18.5   | 20.9   | 20.5   | 20.6   | 20.5   | 20.5   | 20.4   |
| Foreign saving 1/                                      | 12.1   | 11.2   | 6.0    | 5.8    | 4.8    | 5.8    | 5.9    | 5.7    | 5.3    | 5.1    | 4.9    | 4.7    |
| General government financial balance 2/                | -4.4   | -6.2   | -2.1   | -1.7   | -1.8   | -1.1   | -1.2   | -1.1   | -0.8   | -0.7   | -0.6   | -0.6   |
| General government net lending                         | 1.5    | 2.4    | 0.7    | 0.1    | 0.2    | 0.4    | 0.3    | 0.0    | 0.0    | 0.0    | 0.0    | 0.0    |
| Consolidated general government fiscal balance 2/ 3/   | -5.9   | -8.5   | -2.8   | -1.7   | -1.9   | -1.5   | -1.5   | -1.1   | -0.8   | -0.7   | -0.6   | -0.6   |
| Current account balance                                | -12.1  | -11.2  | -6.0   | -5.8   | -4.8   | -5.8   | -5.9   | -5.7   | -5.3   | -5.1   | -4.9   | -4.7   |
| External debt 4/                                       | 34.8   | 42.5   | 43.0   | 43.6   | 43.9   | 43.8   | 42.7   | 44.1   | 43.5   | 42.9   | 42.5   | 41.7   |
| Debt service (in percent of exports of GNFS)           | 22.6   | 20.0   | 20.9   | 28.9   | 31.0   | 24.7   | 24.6   | 23.5   | 23.0   | 24.1   | 20.1   | 20.0   |
| Nominal GDP (in millions of Litai)                     | 42,990 | 42,655 | 45,148 | 48,087 | 47,968 | 51,531 | 51,531 | 55,860 | 60,982 | 66,332 | 72,241 | 78,693 |
| Real GDP growth (annual percentage change)             | 5.1    | -3.9   | 3.8    | 4.5    | 5.9    | 4.0    | 4.4    | 4.8    | 5.3    | 6.0    | 6.0    | 6.1    |
| Average CPI inflation (annual percentage change)       | 5.1    | 0.8    | 1.0    | 1.4    | 1.3    | 2.8    | 1.3    | 2.5    | 2.5    | 2.5    | 2.5    | 2.5    |
| End-of-period CPI inflation (annual percentage change) | 2.4    | 0.3    | 1.5    | 2.0    | 2.0    | 2.8    | 2.2    | 2.5    | 2.5    | 2.5    | 2.5    | 2.5    |

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/ From 2004, includes the estimated cost of pension reform (0.5-0.6 percent of GDP).

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

Table 11. Lithuania: Schedule of Available Purchases under the Current Stand-By Arrangement, 2001-03

| Amount of Purchase                           | Availability      | Contingent On   |
|--|-------------------|---|
| SDR 12.36 million<br>(8.57 percent of quota) | August 30, 2001   | Undrawn   |
| SDR 12.36 million<br>(8.57 percent of quota) | December 1, 2001  | Undrawn   |
| SDR 12.36 million<br>(8.57 percent of quota) | March 1, 2002     | Undrawn   |
| SDR 12.36 million<br>(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<br>(8.57 percent of quota) | September 1, 2002 | Observance of end-June 2002 performance criteria                                      |
| SDR 12.36 million<br>(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<br>(8.57 percent of quota) | March 1, 2003     | Observance of end-Dec. 2002.  |

Source: Fund staff calculations.

1/ In addition to other provisions in the arrangement.

Table 12. Lithuania: Indicators of Financial Obligations to the Fund, 2002-08

|  | 2002        | 2003   | 2004   | 2005   | 2006   | 2007   | 2008   |
|--|-------------|--------|--------|--------|--------|--------|--------|
|  | Projections |        |        |        |        |        |        |
| <b>Obligations from existing drawings 1/</b>           |             |        |        |        |        |        |        |
| Debt Service to the Fund (in millions of SDRs)         | 34.9        | 33.8   | 26.3   | 19.9   | 10.8   | 4.4    | 0.0    |
| Repurchases (in millions of SDRs)                      | 31.1        | 31.1   | 24.6   | 19.0   | 10.4   | 4.3    | 0.0    |
| Charges (in millions of SDRs)                          | 3.8         | 2.7    | 1.7    | 1.0    | 0.4    | 0.1    | 0.0    |
| In percent of exports GNFS                             | 0.7         | 0.6    | 0.4    | 0.3    | 0.2    | 0.1    | 0.0    |
| In percent of external debt service                    | 2.9         | 2.7    | 1.9    | 1.3    | 0.8    | 0.3    | 0.0    |
| In percent of gross official reserves                  | 2.3         | 1.9    | 1.4    | 1.0    | 0.5    | 0.2    | 0.0    |
| Exports GNFS (in millions of U.S. dollars)             | 6,403       | 6,906  | 7,452  | 8,077  | 8,730  | 9,437  | 10,239 |
| External debt service (in millions of U.S. dollars)    | 1,508       | 1,583  | 1,713  | 1,943  | 1,751  | 1,888  | 2,048  |
| Gross official reserves (in millions of U.S. dollars)  | 1,928       | 2,233  | 2,378  | 2,462  | 2,599  | 2,722  | 2,953  |
| US\$/SDR exchange rate                                 | 1.25        | 1.25   | 1.25   | 1.25   | 1.26   | 1.26   | 1.26   |
| Quota (in millions of SDR)                             | 144         | 144    | 144    | 144    | 144    | 144    | 144    |
| External debt (in millions of U.S. dollars)            | 5,507       | 6,159  | 6,627  | 7,120  | 7,670  | 8,198  | 8,894  |
| GDP (in millions of U.S. dollars)                      | 13,523      | 14,659 | 16,003 | 17,407 | 18,958 | 20,651 | 22,406 |
| <i>Memorandum items:</i>                               |             |        |        |        |        |        |        |
| <b>Fund credit outstanding</b>                         |             |        |        |        |        |        |        |
| <b>Without drawings under the stand-by arrangement</b> |             |        |        |        |        |        |        |
| In millions of SDRs                                    | 89.3        | 58.2   | 33.6   | 14.7   | 4.3    | 0.0    | 0.0    |
| In millions of U.S. dollars                            | 111.5       | 72.8   | 42.1   | 18.4   | 5.4    | 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         | 1.2    | 0.6    | 0.3    | 0.1    | 0.0    | 0.0    |
| In percent of GDP                                      | 0.8         | 0.5    | 0.3    | 0.1    | 0.0    | 0.0    | 0.0    |

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

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



LITHUANIA: FUND RELATIONS  
(As of April 30, 2002)

**I. Membership Status:** Joined: 04/29/1992; Article VIII.

| <b>II. General Resources Account:</b> | <b>SDR Million</b> | <b>Percent of Quota</b> |
|---------------------------------------|--------------------|-------------------------|
| Quota                                 | 144.20             | 100.0                   |
| Fund holdings of currency             | 252.43             | 175.06                  |
| Reserve position in Fund              | 0.02               | 0.01                    |

| <b>III. SDR Department:</b> | <b>SDR Million</b> | <b>Percent of Allocation</b> |
|-----------------------------|--------------------|------------------------------|
| Holdings                    | 46.24              | N.A.                         |

| <b>IV. Outstanding Purchases and Loans:</b> | <b>SDR Million</b> | <b>Percent of Quota</b> |
|---|--------------------|-------------------------|
| Extended arrangements                       | 93.15              | 64.6                    |
| Systemic Transformation                     | 15.09              | 10.47                   |

**V. Latest Financial Arrangements:**

| <b>Type</b> | <b>Approval Date</b> | <b>Expiration Date</b> | <b>Amount Approved (SDR Million)</b> | <b>Amount Drawn (SDR Million)</b> |
|-------------|----------------------|------------------------|--------------------------------------|-----------------------------------|
| 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:**

**Under the Repurchase Expectations Assumptions<sup>1</sup>**  
(SDR Million; based on existing use of resources and present holdings of SDRs):

|                | <u>2002</u>  | <u>2003</u>  | <u>Forthmng</u><br><u>2004</u> | <u>2005</u>  | <u>2006</u>  |
|----------------|--------------|--------------|--------------------------------|--------------|--------------|
| Principal      | 19.00        | 31.10        | 24.60                          | 19.00        | 10.40        |
| Charges/Intert | <u>2.40</u>  | <u>2.40</u>  | <u>1.50</u>                    | <u>0.80</u>  | <u>0.40</u>  |
| <b>Total</b>   | <u>21.40</u> | <u>33.50</u> | <u>26.10</u>                   | <u>19.80</u> | <u>10.80</u> |

**VII. Implementation of HIPC Initiative:**

N/A

<sup>1</sup> Disbursements made after November 28, 2000—with the exception of disbursements of emergency assistance and loans from the Poverty Reduction and Growth Facility—are expected to be repaid on the expectations schedule. Countries may request the IMF Executive Board to make repayments according to the obligations schedule if their external payments position is not strong enough to meet the repayment expectations without undue hardship or risk. Please note: Repayments under the Supplemental Reserve Facility are scheduled to be repaid on the expectations schedule.

**VIII. Current Status of Safeguards Assessments:**

Under the Fund's safeguards assessment policy, BOL is subject to a full safeguards assessment with respect to the current SBA. A safeguards assessment of the BOL was completed on December 10, 2001. The assessment concluded that an on-site visit was not necessary, but identified certain weaknesses and made appropriate recommendations, as reported in EBS/01/211. The BOL has decided to implement these recommendations under a timetable agreed with the Fund.

**IX. Exchange Arrangements:**

The currency of Lithuania is the litas. From April 1, 1994 to February 1, 2002, the litas was pegged to the U.S. dollar at LTL 4 per U.S. dollar under a currency board arrangement. Since February 2, 2002 the litas has been pegged to the euro at LTL 3.4528 per euro. 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 completed. STA ROSC is underway, and Fiscal ROSC is scheduled for July, 2002.

**XII. Technical Assistance:**

The following table summarizes the technical assistance missions provided by the Fund to Lithuania since February 1997.<sup>2</sup>

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<sup>2</sup> 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                            |
| STA        | ROSC  | Mission               | May 8-22, 2002                               | Department of Statistics, Ministry of Finance, and Bank of Lithuania |

**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 May 27, 2002. 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\$262.06 million and €69.34 million. A Second Structural Adjustment Loan (SALII) for the period July 1, 2000–June 30, 2001 in the amount of US\$98.5 million was approved in July 2000, with the first tranche being disbursed in July 2000. Since not all agreed measures were undertaken by summer 2001, the closing date of the loan has been extended until June 30, 2002. In May, 2002, however, the government has decided to cancel the SALII. Preparation for other operations is proceeding in the areas of education, pension reform and housing.
3. IFC supported projects for US\$115.1 million in Lithuania as of February 2002. Total IFC's exposure was US\$54.2 million as of February 2002 and consisted 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\$0.6 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\$18.7 million). The following projects were approved by the Board, but have been canceled: (i) modernization of production facility and financial restructuring of a plywood and particleboard manufacturer (US\$2.75 million) 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 has also 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 Macro Financial Vulnerability Study was completed in 1999. In 2002, the final report of the Financial Sector Assessment Program produced in cooperation with the IMF was presented to the government, and later this year, the Bank will present a report on Municipal Finance, and a second Lithuania Country Economic Memorandum.

World Bank Loans Approved by the Board  
(As of May 27, 2002, 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<br>(effective November 1995) | 26.4        | 25.49                |
| Environment (Klaipeda) (effective May 1995)                         | 7.0         | 6.12                 |
| EFSAP (effective December 1995) 4/                                  | 22.0<br>3.0 | 21.80<br>2.8(€)      |
| Environment (Siauliai) (effective December 1996)                    | 6.2         | 6.02                 |
| Agricultural Development Project (effective August 1996) 5/         | 30.0        | 9.43                 |
| Klaipeda Geothermal (effective October 1996)                        | 5.9         | 5.72                 |
| Energy Efficiency/Housing Pilot (effective November 1996) 6/        | 10.0        | 9.99                 |
| Social Policy (effective January 1998)                              | 3.7         | 2.31                 |
| Municipal Development (effective October 2000)                      | 18.89       | 11.85(€)             |
| Health Project (effective May 2000)                                 | 21.2        | 1.92                 |
| SAL II (effective July 2000)  | 98.5        | 54.69(€)             |
| Klaipeda Port (effective October 2000)                              | 35.3        | 15.46                |
| Vilnius District Heating  | 17.1        | -                    |
| Total   | US\$465.4   | US\$262.06<br>€69.34 |

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 on a quarterly basis 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 non-observed economy and the deflators used to derive estimates of value added at constant prices. 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 have been updated each year. The last update was undertaken in December 2001 and based on the Household Budget Survey (HBS) covering the period October 2000 to September 2001. The monthly CPI is available in the second week following the reference month. The producer price index is calculated according to the chain-linked Laspeyres formula.

### **Public finance**

5. Data on the central government budget execution are available quarterly, although these data are subject to frequent revisions. The ongoing treasury project is expected to improve fiscal data quality substantially. The budget data are only compiled on a cash basis; compilation of the budget data on an accrual basis would allow for better monitoring of arrears and facilitate forecasting of future budgetary flows. In January 1999, the Ministry of Finance began publishing data on monthly and quarterly consolidated central government operations and on annual consolidated general government operations, which include the budgetary central government, municipalities and extrabudgetary and social security funds. Further work is needed to clarify the treatment of public health care providers and of EU transactions, and the consolidation procedure for government operations. Monthly and quarterly data on consolidated central government are not reconciled because they are on different recording bases. There is a need to define a medium-term migration path to *GFSM2001* and its link to *ESA95*.

### **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. Hence, in addition to quarterly balance of payments data, the BoL has started publishing monthly balance of payments statistics since January 2002. The monthly data correspond to several key balance of payments components, compiled on the basis of a sample survey covering the public sector, commercial banks, and some nonfinancial private sector institutions.

8. 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. 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

9. 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 (<http://dsbb.imf.org>);
- 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 May 30, 2002)

|                            | Exchange Rates | International Reserves | Reserve/<br>Base Money | Central Bank<br>Balance sheet | Broad Money | Interest Rates | Consumer Price Index | Exports/<br>Imports | Current Account Balance | Overall Government Balance | GDP/<br>GNP | Public External Debt |
|----------------------------|----------------|------------------------|------------------------|-------------------------------|-------------|----------------|----------------------|---------------------|-------------------------|----------------------------|-------------|----------------------|
| Date of latest observation | 5/30/02        | 4/30/02                | 4/30/02                | 4/30/02                       | 4/30/02     | 4/30/02        | 4/30/02              | Q1 02               | Q4 01                   | Q1 02                      | Q4 01       | Q1 02                |
| Date received              | 5/30/02        | 5/08/02                | 5/15/02                | 5/15/02                       | 5/24/02     | 5/15/02        | 5/8/02               | 5/14/02             | 3/29/02                 | 4/26/02                    | 3/29/02     | 4/25/02              |
| 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.

Frequency of reporting: M-Monthly, Q-Quarterly, V-irregular in conjunction with staff visits.

Mode of reporting: C-cable or facsimile, E-electronic news reporting, V-staff visits, or O-other.

Confidentiality: (B) for use by the staff and the Executive Board, (C) for unrestricted use.

Vilnius

June 13, 2002

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

Dear Mr. Köhler:

1. Lithuania's economic policies aim at promoting sustained economic growth and improved living standards through macroeconomic stability and the further implementation of structural reforms. Early accession to the EU and NATO remain our main policy goals. 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 so as to foster an efficiently functioning market economy and greater competitiveness. The attached Supplemental Memorandum of Economic Policies (SMEP) specifies the concrete policy measures to be taken during July — December 2002.
2. In support of the policies detailed in the SMEP, we request completion of the second 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 one more program review will be conducted, as described in the original Memorandum of Economic Policies signed on July 26, 2001 and the attached 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 second program review.

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 May– December 2002**

**I. INTRODUCTION**

1. The economic program supported by the Stand-by Arrangement (SBA) with the IMF is being implemented with positive results. Growth of real GDP accelerated in 2001 to 5.9 percent, compared with 3.9 percent in 2000. The external economic position strengthened further, with the current account deficit narrowing from 6.0 percent to 4.8 percent, as exports of goods and services grew by a further 21 percent in real terms. Annual average CPI inflation amounted to just 1.3 percent in 2001. These positive trends have continued in 2002, with real GDP growth of 4.1 percent in the first quarter. Supported by favorable macroeconomic developments and thorough preparation, the litas was successfully repegged to the euro on February 2, 2002. Confidence continued to strengthen after the repegging, as reflected in a further decline in spreads. The unemployment rate dropped to 11.8 percent at end-April. Structural reforms also advanced, particularly in the energy sector and banking privatization. This memorandum extends the objectives and framework described in the Memorandum of Economic Policies (MEP) of July 26, 2001 and in the Supplementary Memorandum (SMEP) of December 13, 2001.

2. All program performance criteria for end-December 2001 and end-March 2002 were met, while program structural benchmarks have been implemented, albeit in some cases with slight delays. The benchmark on zero arrears of the central budget for end-March was not observed, as the state budget incurred LTL 6 million of arrears. By contrast, the government took a decision to clear all arrears of the Health Insurance Fund (HIF) in late-December, with final payment in March. New VAT and corporate income tax (CIT) laws were approved by Seimas. However, submission to Seimas of the new personal income tax (PIT) law was delayed from January until May. Finally, municipal finances remain weak and a source of concern.

**II. THE GOVERNMENT'S PROGRAM**

**A. Macroeconomic Outlook**

3. The macroeconomic outlook for 2002 envisages continued growth and low inflation. For 2002, real GDP is projected to grow by 4.4 percent, with weakening external demand, mainly from the EU area, largely offset by stronger domestic demand. Rapid growth in private investment and private consumption would contribute to a widening of the external current account deficit to 5.9 percent of GDP. The current account deficit would be financed by sizeable capital inflows, including a pick-up in greenfield foreign direct investment and

privatization receipts. CPI inflation is projected to remain subdued at 1.5 percent. The continued expansion would lead to a further reduction in the unemployment rate.

4. Over the medium term, macroeconomic policies continue to aim at achieving real growth rates of 5-6 percent per year, with low inflation and faster productivity growth than in trading partners, to maintain competitiveness. An appropriately cautious fiscal position remains essential, in light of remaining fiscal weaknesses and the need to provide for substantial financing of EU- and NATO-accession related projects. Hence we recognize the need to reverse the recent erosion of tax revenue via the tax reform, and to limit claims from the savings and land restitution schemes to no more than 0.1 percent of GDP per year each. Such prudence is also warranted by a possible further widening of the current account deficit, fueled by a rapid acceleration of domestic demand and commercial bank credit, as well as significant gross external financing requirements over the next few years, which could threaten external viability.

### **B. The Currency Board Arrangement**

5. After the successful repegging of the litas to the euro on February 2, 2002, the Currency Board Arrangement (CBA) has continued to anchor economic policies. The government and the Bank of Lithuania (BoL) believe that the CBA in its present form should be preserved until accession to ERM2 and eventually adoption of the euro.

6. Program projections of money and credit growth rates for 2002 have been revised to 17 and 25 percent, respectively. This revision reflects a faster increase in money demand and a greater willingness of banks to look for lending opportunities, attributable to the privatization-induced strengthening of the banking system. A low interest rate environment, better business opportunities for investment and the development of mortgage finance instruments would also contribute to credit growth. In this regard, the BoL is mindful of the potential additional risk to banks' portfolios associated with rapid credit growth, and the banking supervisory authority will continue to step up its efforts to maintain the soundness of the banking system. Consistent with our strategy to bring gradually the required reserve ratio to ECB levels, this ratio was reduced from 8 percent to 6 percent beginning on May 24, 2002. This would contribute only marginally to higher growth of money and credit. Moreover, as of November 24, 2002, the maturity of deposits subject to reserve requirements will be increased from 1 year to 2 years. Further adjustment in the required reserve ratio will only be undertaken in consultation with Fund staff. Under the current circumstances, given ample liquidity, the BoL does not consider it advisable to undertake any further reductions in 2002.

### **C. Fiscal Policy in 2002**

7. The fiscal deficit target of 1.5 percent of GDP remains appropriate and continues to be the government's objective for 2002. Revenue improved somewhat in the first quarter of 2002, reflecting the pick-up in domestic demand, increased collection on account of the natural resource tax, and better tax administration, especially by customs. However, the yearly target remains as originally programmed, given the uncertainties about the recovery of

external demand, in particular in the EU area. Thus, a budget revision, to be submitted to Seimas in June, maintains the same deficit target. The revision involves some current expenditure reallocation (about 0,1 percent of GDP) and a slight increase in capital expenditure (about 0.1 percent of GDP), financed by an upward revision of revenue, mainly of consumption taxes, in line with recent trends. The financing strategy remains broadly unchanged; after the successful placement of a €400 million eurobond in April, financing will rely mainly on the domestic market and will be geared toward diversifying and lengthening maturities of treasury securities.

#### D. Structural Policies

##### Financial Structural Reforms

8. Following the FSAP and an EU peer review that took place in April 2002, the government and BoL will continue to implement a number of measures in the financial sector. In the area of **supervision of credit institutions**, the BoL is preparing: (i) changes to rules on large exposures, to strengthen controls over connected lending, as well as lending to groups of affiliated companies; (ii) detailed reporting on qualified holding in banks and legal amendments to suspend shareholders' voting rights in cases of misconduct; and (iii) changes to rules on loan provisioning, in line with Basel recommendations, to allow for commercial banks to establish valuation for non-marketable, non-current loans, within an overall framework supervised by the BoL. Finally, the BoL is making its best effort to conclude additional cooperation arrangements with regulatory authorities of the countries of origin of major shareholders of Lithuanian banks, during the program period. In the area of **anti-money laundering (AML)** and combating terrorist financing, the newly reorganized Financial Crime Investigation Service (FCIS) has recently increased staffing and will receive technical assistance for training via a major EU-PHARE project. AML practices in insurance and capital markets have recently been strengthened, including by amendments to the law on the Prevention of Money Laundering passed by Seimas on March 28, 2002, which extended responsibility for implementation of AML legislation to the State Insurance Supervisory Authority (SISA) and to the Lithuanian Securities Commission (LSC). FCIS has prepared regulations for SISA and LSC on the detection and reporting of suspicious activities and is strengthening cooperation with other national financial investigation units in the region. By end-September, the government will consider amendments to regulations on suspicious transactions to account for eight new recommendations on combating terrorist financing of the Financial Action Task Force. By end-March 2003, the government will introduce further amendments to comply with EU AML directives by widening the coverage of agencies and businesses that must report on financial transactions. Moreover, the BoL is updating its training and instructions for supervisors for new "Know Your Customer" rules introduced in December 2001. To strengthen **the payments system**, the government and BoL are preparing a new law on Funds Transfer and Securities Settlement Systems to implement an EU directive on Settlement Finality in Payment and Securities Settlement Systems. This new law, which will be presented to the government by end-September 2002 and to Seimas in 2003, will provide for full enforceability of netting in the payments system and for formal BoL oversight of payment systems it does not directly operate, both key recommendations of

the FSAP. In the **insurance regulation area**, amendments to the existing law on Insurance were approved by the government in mid-April and have been submitted to Seimas. These amendments would put in place FSAP recommendations concerning corporate governance (“fit-and-proper” test), consumer rights and auditing until two new laws, the law on Insurance Activity and the law on Insurance Contracts, are approved by Seimas in early 2003.

### **Fiscal Structural Reforms**

9. Stabilizing the tax revenue-to-GDP ratio remains a government priority, in order to ensure medium-term fiscal sustainability. To this end, the tax reforms that are needed to ensure compliance with EU requirements and to modernize the tax system are intended to be revenue neutral. The government is finalizing its tax reform package, following approval by Seimas of new CIT and VAT laws in December 2001 and January 2002, respectively. The new draft PIT law, submitted to Seimas in May, includes a 33 percent rate on all types of income (with the exception of a few items, such as royalties, which will be subject to a 15 percent rate). An increase in the tax exempt minimum (TEM) under the PIT from the current LTL 250 per month is also planned for 2003. The new law will eliminate most exemptions, including for prizes and winnings and for capital gains on sales of securities. On June 1, 2002, new requirements for accounting and record-keeping for better control of patents were introduced, and the list of activities for which patents may be granted will be shortened via the new PIT as of 2003. In order to fulfill the government’s objective of revenue neutrality of the tax reform, any revenue loss of the new PIT (estimated at LTL 280 million for 2003) and the new VAT (a loss of LTL 58 million in 2003) will be offset by expected gains from the CIT (LTL 140 million) and the new real estate tax law will expand the current tax base to property owned by individuals (LTL 70 million, see paragraph 10). Moreover, the new CIT law will be amended to return the declaration date from October 2003 to May 2003 (an additional LTL 90 million in 2003) and the TEM of the PIT will be adjusted only to the extent that overall revenue neutrality of the package is ensured. Efforts to improve tax administration will also continue with expected gains of LTL 40 million.

10. Despite the efforts of recent months, municipal finances suffer from fundamental weaknesses of chronic underfinancing, lax financial discipline and a large overhang of overdue payables, as evidenced by the increase of arrears of LTL 38 million during the first quarter of 2002. If not addressed, these weaknesses could eventually threaten macroeconomic stability. First, revenue needs to be stabilized at an adequate level. While recent reforms have ensured the appropriate and equitable financing of delegated functions, own revenue sources need to be enhanced. To this end, a number of local fees were increased by Seimas in April, including fees for the installation of equipment, and the Government will submit to Seimas by end-September a draft law for the extension of the real estate tax to individual property (benchmark for the third review). Under the new draft law, municipal councils will be granted the right to set tax rates (with a minimal homestead deduction), and the government will urge municipalities to strictly refrain from granting exemptions. The

new property tax should be structured so as to yield at least LTL 70 million in 2003. Given that the PIT remains the major source of municipal finance, the government will ensure that the loss of revenue on account of the envisaged PIT reform will not exceed what can be reasonably raised through the property tax and the other tax measures described in paragraph 9. Second, to streamline spending, municipalities will undertake an expenditure review along the lines proposed by the World Bank study with concrete rationalization proposals for the 2003 budget. Third, in order to strengthen financial discipline, the central government will not support external borrowing by municipalities or an increase of borrowing limits. Finally, to tackle the large stock of existing payables, the government will approve by end-September additional measures to be implemented in 2002, including (i) submission to Seimas of amendments to the law on the State and Municipalities Budgets of 2002 to make the additional transfers for clearance of arrears conditional on the reduction of the stock of arrears, following the schedule submitted by municipalities (benchmark for end-September); (ii) monthly publication in the mass media of the arrears position of all municipalities; (iii) approval by the government of a decree to provide internal or external loans or to grant guarantees on loans only to municipalities complying with the debt limits and constantly reducing their arrears.

11. The government has undertaken a number of significant steps to improve the financial position of the HIF and intends to implement additional measures in 2002. Despite a weakening in January-February, the HIF's financial performance started to stabilize in March-April as some of the expenditure measures began to take effect. The measures recently introduced include: (i) reduction of the list of illnesses the treatment costs of which are fully compensated; (ii) reduction in the margins for wholesalers and retailers of compensated medications (in May); (iii) introduction of patient's medication registration certificates (in June) to improve control; and (iv) introduction of limits on prescribed medications by doctors. The government plans to introduce additional measures in 2002, including: (i) reduction of the list of most expensive compensated medications; (ii) conclusion of negotiations with health service providers on prescription limits; and (iii) approval of procedures for the computation of basic prices of compensated medications. The implementation of all measures (with total savings of 0.2 percent of GDP for this year) will allow the HIF's budget to be balanced in 2002 without accumulation of new arrears.

12. The government is committed to ensuring a sound and viable pension system. A pension reform plan, incorporating a voluntary second pillar based on supplementary matching government contributions and tax incentives, was endorsed by Seimas in May 2002. A government working group will incorporate Seimas recommendations and work out technical details in a final plan that will be submitted to Seimas by end-October for final consideration during the fall 2002 session. The new plan will start to be implemented as of January 1, 2004.

### **Other Structural Reforms**

13. The government is continuing its efforts to strengthen the bankruptcy process and to improve the business environment. The new bankruptcy law that came into force in July

2001 has allowed for an increase of the number of cases and streamlining of bankruptcy procedures. New bankruptcy procedures will be proposed to Seimas by end-September 2002, to ensure full compatibility with the new civil process code. Also by end-September, the bankruptcy law will be amended to strengthen the process for appointing bankruptcy administrators, in order to lessen pressures from major creditors. A new manual on bankruptcy procedures is expected to be adopted by the Ministry of Economy by end-2002.

14. The government remains committed to reducing unemployment further, through enhanced labor market flexibility and well-targeted training opportunities. A new labor code, expected to be passed in June 2002, will 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. Laws on Workers' Councils and on Lockouts will be proposed to Seimas by end-2002. The Unemployment Insurance Law, which strengthens the insurance element in the payment of unemployment assistance, will be submitted to Seimas in the second half of 2002. In addition, the Government is committed to improving the social safety net. Thus, the law on Social Assistance in Cash, which will be submitted to Seimas by end-June 2002, will change eligibility norms by introducing greater means testing, as well as introduce additional social assistance to the long-term unemployed.

15. The government is committed to developing an efficient and competitive energy sector. Shortly after the closing of the sale of the first 34 percent stake in Lithuanian Gas (LG) to a consortium of Ruhrgas and E.on by end-June 2002, the government will announce an international tender for the sale of a second 34 percent stake to gas suppliers. Closure of the second share sale is targeted for end-2002. Tender procedures for the privatization of the two Lithuanian Power Company successor distribution companies will begin in the fourth quarter of 2002, after a nine-month period of pilot operations. Privatization is expected to be completed by the end of the second quarter of 2003. A ten-year oil supply-share sale arrangement for Mazeikiu Nafta (MN) was initialed with Yukos in April; this arrangement should facilitate a major modernization and expansion of MN's refinery. The government is reviewing the proposed deal, with a view to strictly limiting financial contributions or guarantees to the remaining US\$118 million arising from the 1999 privatization agreement.

16. One of the key structural objectives of the government is to complete its privatization program. Advisors for the privatization of Lithuanian Airlines (LA) have prepared a timeline for privatization, with a tender for a 49 percent stake in LA to be announced this fall, with closure targeted for the first quarter of 2003. In the financial sector, the sale of the Import-Export Insurance Company is planned for later this year, and the sale of the National Stock Exchange for 2003. In transportation, two shipping firms remain to be sold; a tender for advisory services on the sale should be closed in July, with sale in 2003. Four large state-owned alcohol producers are to be sold during the first half of 2003. The Ministry of Transport and Communications has engaged advisors for the reorganization and eventual privatization of Lithuanian Railways.

17. Significant progress has been made on accession negotiations with the EU. The government has completed 26 of 31 chapters so far and aims to close the remaining chapters



(Agriculture, Energy, Financial and Budgetary Provisions, Regional Policy and Other) by the end of the year, with a view to joining the EU in 2004. Some outstanding issues remain; in particular the government is seeking support from the EU to help defray the estimated costs of closing the Ignalina Nuclear Power Station.

### **III. PROGRAM ISSUES AND MONITORING**

18. The program will continue to be monitored on the basis of quarterly quantitative performance criteria and benchmarks and a set of structural policy benchmarks for end-June 2002, end-September 2002, and end-December 2002 consistent with the revised economic program (specified in the attached tables), and the third review by the IMF Executive Board. The definitions of the program targets are provided in the Technical Memorandum of Understanding (Annex). The third review will be based on end-September 2002 outcomes, and will focus on the 2003 budget, measures to improve municipal finances, as well as the recommendations of the Data and Fiscal Transparency Reports on the Observance of Standards and Codes (ROSCs) and is expected to be completed by December 2002.

Table 1. Lithuania: Performance Criteria for Stand-By Arrangement, 2001-02 1/

|  | Target         | Adjusted Target                           | Outcome 2/                      |                   |
|--|----------------|---|---------------------------------|-------------------|
| <b>Continuous performance criteria</b>   |                |   |                                 |                   |
| <b>I. Exchange rate</b>  |                |   |                                 |                   |
| LTL 3.4528 per euro 3/   | ...            | ...                                       | Observed through June 13, 2002  |                   |
| <b>II. 100-percent coverage of currency board liabilities, in percent</b>  |                |   |                                 |                   |
|  | 100            | ...                                       | Observed through April 30, 2002 |                   |
| <b>III. Reserve requirements, in percent</b>   |                |   |                                 |                   |
| Reserve requirements through June 30, 2002   | 6              |   | Observed through May 31, 2002   |                   |
| Reserve requirements from July 1, 2002 4/  | 4              |   |                                 |                   |
| <b>IV. Non-accumulation of new external payments arrears</b>   |                |   |                                 |                   |
|  | ...            | ...                                       | Observed through June 13, 2002  |                   |
| <b>Quantitative performance criteria</b>   |                |   |                                 |                   |
| <b>I. Ceiling on the general government deficit, mln. LTL</b>  |                |   |                                 |                   |
| Cumulative from January 1, 2001  |                |   |                                 |                   |
| March 31, 2001 (previous arrangement)  | 271            | 287                                       | 84                              |                   |
| June 30, 2001  | 460            | 496                                       | 321                             |                   |
| September 30, 2001   | 600            | 689                                       | 458                             |                   |
| December 31, 2001  | 841            | 1011                                      | 795                             |                   |
| Cumulative from January 1, 2002  |                |   |                                 |                   |
| March 31, 2002   | 383            | 396                                       | 106                             |                   |
| June 30, 2002  | 564            | ...                                       | ...                             |                   |
| September 30, 2002   | 764            | ...                                       | ...                             |                   |
| December 31, 2002  | 776            | ...                                       | ...                             |                   |
| <b>II. Floors on net foreign exchange coverage of the currency board arrangement</b>                               |                |   |                                 |                   |
| <b>Stocks</b>  |                |   |                                 |                   |
| September 30, 2001, US\$ mln.  | -127           | ...                                       | 2                               |                   |
| December 31, 2001, US\$ mln.   | -127           | ...                                       | 11                              |                   |
| March 31, 2002, euro mln.  | -147           | ...                                       | 23                              |                   |
| June 30, 2002, euro, mln.  | -147           | ...                                       | ...                             |                   |
| September 30, 2002, euro, mln.   | -147           | ...                                       | ...                             |                   |
| December 31, 2002, euro, mln.  | -147           | ...                                       | ...                             |                   |
| <b>III. Ceilings on contracted public and publicly guaranteed medium- and long-term external debt; mln. US\$</b>   |                |   |                                 |                   |
|  | 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                                       | 248                             | 0                 |
| Cumulative from January 1, 2002  |                |   |                                 |                   |
| March 31, 2002   | 450            | 200                                       | 34                              | 34                |
| June 30, 2002  | 610            | 200                                       | ...                             | ...               |
| September 30, 2002   | 640            | 200                                       | ...                             | ...               |
| December 31, 2002  | 640            | 200                                       | ...                             | ...               |
| <b>IV. Ceilings on the outstanding stock of public and publicly guaranteed short-term external debt; mln. US\$</b> |                |   |                                 |                   |
| 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             | ...                                       | 0                               |                   |
| March 31, 2002   | 200            | ...                                       | 35                              |                   |
| June 30, 2002  | 200            | ...                                       | ...                             |                   |
| September 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.

2/ Based on latest available data.

3/ This performance criterion was modified on February 2, 2002 consistent with TMU paragraph 2.

4/ This is consistent with the statutorily imposed required reserve ratio of 6 percent, because, pursuant to paragraph 5 of the TMU, the required reserve ratio envisaged under the program allows for a 2 percentage point variation from the statutorily imposed required reserve ratio.

Table 2. Lithuania: Quantitative Benchmarks for Stand-By Arrangement, 2001-02

|  | 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     | 247     |
| March 31, 2002                           | 315     | 197     |
| June 30, 2002                            | 312     | ...     |
| September 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       | 0       |
| March 31, 2002                           | 0       | 6       |
| June 30, 2002                            | 0       | ...     |
| September 30, 2002                       | 0       | ...     |
| December 31, 2002                        | 0       | ...     |

Source: Ministry of Finance; and Fund staff estimates.

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

Table 3. Lithuania: Structural Benchmarks for Stand-By Arrangement, 2001-02

| Measure  | Date               | Status   |
|--|--------------------|--|
| Submit to Seimas draft amendments to the Law on Revenue Redistribution of Municipalities   | end-September 2001 | Observed   |
| Submit to Seimas draft amendments to the Privatization Law for establishing the Reserve Stabilization Fund   | end-September 2001 | Observed   |
| Tender for privatizing the Agricultural Bank   | end-September 2001 | Observed   |
| Government's decision on a set of measures to overhaul municipal finances  | end-December 2001  | Observed   |
| Submit to Seimas draft amendments to the Law on Social Security needed for the pension reform  | end-December 2001  | Observed, but supplemented with another benchmark (Pension reform concept) |
| Submit to Seimas a Pension Reform Concept  | end-December 2001  | Observed   |
| Submit to Seimas legal amendments on accounting standards  | end-December 2001  | Observed   |
| Submit to Seimas a new labor code  | end-December 2001  | Observed   |
| Submit to Seimas draft CIT and VAT   | end-December 2001  | Observed   |
| Submit to Seimas draft PIT law   | end-January 2002   | Done with delay (submitted in May)   |
| 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   | Observed   |
| Finalize quarterly plan for arrears reduction of municipalities  | end-March 2002     | Observed   |
| Submit to Seimas the draft unemployment insurance law  | end-June 2002      |  |
| Submit to Seimas Real Estate Tax law   | end-September 2002 |  |
| Submit to Seimas amendments to the CIT law to return the declaration date from October 2003 to May 2003  | end-September 2002 |  |
| Submit to Seimas amendments to the law on the State and Municipalities budget for 2002 to make transfers for clearance of arrears conditional on the reduction of the stock of arrears by municipalities | end-September 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 3.4528 per €1 will be maintained throughout the period of the program. The currency of the peg was changed on February 2, 2002. In this connection, all performance criteria related to the currency board arrangement were 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 24<sup>th</sup> of one month to the 23<sup>rd</sup> 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 6 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 March 14, 2002 Resolution No. 38 of the Board of the Bank of Lithuania ("Regulations on Reserve Requirements for Credit Institutions"). 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 euros 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.<sup>1</sup>

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.

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<sup>1</sup> 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 total repurchases under IMF arrangements comprising those directly serviced by the government and those on-lent to the BoL and other entities—the counter entries of the latter two items are reflected in repayments under net lending); 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 5<sup>th</sup> 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 10<sup>th</sup> 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 18<sup>th</sup> 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).<sup>2</sup>

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.

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<sup>2</sup> Outstanding payment obligations of municipalities will be reported on a quarterly basis.

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.

**Information on the External Sector**

33. *On an monthly basis*, the Ministry of Finance and the Bank of Lithuania will provide information on:<sup>3</sup>

- short-term and long-term external debt stock of the public and private sector<sup>4</sup> 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.

June 13, 2002

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Ms. Ungulaitiene  
Secretary of  
the Ministry of Finance

-----  
Mr. A. Kregzde  
Deputy Chairman of the Board  
Bank of Lithuania

<sup>3</sup> The Ministry of Finance will provide data on public debt and the Bank of Lithuania will report data on private debt.

<sup>4</sup> 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, 2000-02

|  | 2000    |         |         |         | 2001    |         |         |         | 2002   |
|--|---------|---------|---------|---------|---------|---------|---------|---------|--------|
|  | Q1      | Q2      | Q3      | Q4      | Q1      | Q2      | Q3      | Q4      | Q1     |
| Stocks, millions of litai (end of period)                              |         |         |         |         |         |         |         |         |        |
| <b>Domestic credit to government</b>                                   |         |         |         |         |         |         |         |         |        |
| Short term loans & advances to central government (DMBs)               | 41.5    | 41.5    | 7.6     | 8.0     | 0.0     | 0.0     | 0.0     | 0.0     | 1.3    |
| Long term loans & advances to central government (DMBs)                | 121.6   | 118.0   | 135.0   | 95.6    | 126.7   | 157.7   | 167.7   | 161.4   | 156.0  |
| Claims on municipal governments (DMBs)                                 | 214.2   | 203.1   | 239.4   | 273.5   | 271.8   | 277.6   | 282.1   | 279.6   | 264.6  |
| Claims on social insurance fund (DMBs)                                 | 231.6   | 243.4   | 234.6   | 267.6   | 281.6   | 243.6   | 253.8   | 239.2   | 306.6  |
| Savings bonds  | 75.6    | 87.3    | 113.8   | 130.1   | 149.4   | 135.3   | 144.3   | 173.2   | 219.3  |
| Recapitalization bonds   | 634.0   | 634.0   | 634.0   | 514.2   | 514.2   | 514.2   | 514.2   | 398.8   | 398.8  |
| 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 | 1838.8  | 1983.7 |
| Held by DMBs   | 530.2   | 640.0   | 775.2   | 892.4   | 995.0   | 1,013.7 | 993.0   | 1278.0  | 1360.9 |
| Held by OBIs   | 18.7    | 23.1    | 28.1    | 31.2    | 54.8    | 57.5    | 1.4     | 2.0     | 2.1    |
| Held by Nonbanks   | 671.4   | 664.0   | 659.8   | 625.5   | 523.7   | 538.4   | 606.6   | 558.5   | 620.7  |
| 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 | 3,090.9 | 3330.3 |
| <b>Government deposits</b>   |         |         |         |         |         |         |         |         |        |
| Central government deposits (BOL)                                      | 927.9   | 1,246.9 | 994.4   | 781.7   | 832.7   | 1,275.7 | 1,460.8 | 1488.2  | 1730.9 |
| Central government deposits (DMBs)                                     | 672.6   | 723.4   | 906.3   | 576.7   | 807.0   | 666.7   | 539.2   | 365.0   | 384.4  |
| Central government deposits (OBIs)                                     | 132.7   | 104.6   | 105.6   | 105.6   | 110.7   | 116.5   | 0.0     | 0.0     | 0.0    |
| Municipal government deposits (DMBs)                                   | 108.0   | 119.6   | 194.9   | 135.8   | 115.0   | 124.9   | 154.3   | 99.9    | 121.0  |
| Privatization funds (DMBs)   | 225.3   | 174.6   | 151.9   | 149.2   | 219.8   | 33.2    | 59.4    | 1.9     | 2.0    |
| Social insurance fund (DMBs)   | 26.2    | 30.1    | 35.8    | 58.4    | 39.0    | 55.9    | 45.0    | 73.9    | 48.7   |
| 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 | 2,028.9 | 2286.9 |
| Flows, in millions of litai  |         |         |         |         |         |         |         |         |        |
| Changes in domestic credit (change in line 8)                          | 210.6   | 115.7   | 173.0   | 10.6    | 79.2    | 20.8    | 25.0    | 127.9   | 239.4  |
| Changes in domestic deposits (change in line 15)                       | -717.2  | -306.4  | 10.3    | 581.5   | -316.8  | -148.7  | 14.3    | 229.7   | 258.0  |
| Float between government deposits nuncaptured through monetary account | 0.0     | 0.0     | 0.0     | -73.5   | 73.5    | 0.0     | 0.0     | -24.0   | 6.0    |
| Net domestic repayments to nonbanks                                    | 0.0     | -43.5   | 0.0     | -32.5   | 0.0     | 0.0     | 0.0     | 72.0    | -72.0  |
| Net domestic financing (sum of lines 16-19)                            | -506.6  | -234.2  | 183.3   | 496.1   | -164.1  | -127.9  | 39.3    | 406.1   | -84.7  |
| <b>Foreign Borrowing</b>   | 992.4   | 61.3    | 535.4   | 35.7    | 760.8   | 14.8    | 90.6    | 102.9   | 166.7  |
| Amortization by the central budget                                     | 41.0    | 127.0   | 571.1   | 220.3   | 41.5    | 111.9   | 164.0   | 304.6   | 51.1   |
| Amortization by appropriation managers                                 | 23.5    | 61.1    | 23.0    | 55.7    | 12.6    | 12.0    | 26.0    | 16.5    | 21.7   |
| Change in the government deposit abroad                                |         |         |         |         | 526.7   | -153.6  | -193.7  | -180.0  | 0.0    |
| Net flows of funds from abroad (line 21+line 22-line 23-line 24)       | 927.9   | -126.8  | -58.7   | -240.3  | 180.0   | 44.5    | 94.3    | -38.2   | 93.9   |
| Net privatization proceeds   | 45.6    | 602.0   | 72.4    | 83.3    | 75.2    | 359.2   | 45.4    | 18.4    | 97.0   |
| General government fiscal balance (line 20+line 25+line 26)            | 466.9   | 241.0   | 197.0   | 339.1   | 91.1    | 275.8   | 179.0   | 386.3   | 106.2  |
| Cumulative fiscal deficit  | 466.9   | 707.9   | 904.9   | 1,244.0 | 91.1    | 366.9   | 545.9   | 932.1   | 106.2  |

Sources: Ministry of Finance; and staff estimates.

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

| Creditor  | Reg.<br>Nr. | 2001                    |                |               |                |                |               | 2002          |               |              |                |
|---|-------------|-------------------------|----------------|---------------|----------------|----------------|---------------|---------------|---------------|--------------|----------------|
|   |             | Q1-Q3                   |                |               | Year           |                |               | Q1            |               | Year         |                |
|   |             | Prog.                   | Act.           | Adjustor      | Prog.          | Act.           | Adjustor      | Prog.         | Act.          | Adjustor     | Prog.          |
|   |             | (In thousands of litai) |                |               |                |                |               |               |               |              |                |
| <b>I. Nonbudgetary organizations</b>                                    |             |                         |                |               |                |                |               |               |               |              |                |
| World Bank (Lithuanian Energy)  | 0019        | 21,970                  | 20,762         | 9,777         | 28,000         | 30,870         | 14,000        | 11,388        | 8,298         | 2,604        | 11,388         |
| World Bank (Klaipėda Water)   | 0020        | 8,320                   | 3,802          | 0             | 12,480         | 5,983          | 0             | 2,000         | 1,851         | 851          | 2,000          |
| World Bank (Šiauliai Water)   | 0032        | 840                     | -112           | 0             | 840            | 125            | 0             | 0             | 0             | 0            | 0              |
| World Bank (CJSC "Geoterma")  | 0033        | 6,300                   | 3,424          | 274           | 6,300          | 3,674          | 524           | 0             | 325           | 0            | 0              |
| World Bank (The Housing Credit Foundation)                              | 0034        | 10,700                  | 11,158         | 5,350         | 10,700         | 11,559         | 5,350         | 0             | 0             | 0            | 0              |
| World Bank (Agriculture Sector)   | 0035        | 3,520                   | 6,306          | 1,760         | 6,000          | 6,306          | 3,000         | 0             | 0             | 0            | 0              |
| European Investment Bank (Lithuanian Railways)                          | 0046.1      | 8,963                   | 26,459         | 4,482         | 8,963          | 41,879         | 4,482         | 0             | 0             | 0            | 0              |
| European Investment Bank (Lithuanian Railways)                          | 0046.2      | 6,452                   | 0              | 0             | 12,904         | 0              | 0             | 12,695        | 0             | 0            | 41,882         |
| NIB (municipality 20 mln. EUR)  | 0052        | 25,047                  | 45,997         | 12,524        | 73,442         | 50,698         | 13,977        | 0             | 6,875         | 0            | 0              |
| European Investment Bank (municipality 15 mln. EUR)                     | 0059        | 3,470                   | 0              | 0             | 6,940          | 0              | 0             | 5,960         | 0             | 0            | 23,840         |
| European Investment Bank (Panevėžio municipality - 6 mln. EUR)          | 0060        | 500                     | 0              | 0             | 1,000          | 0              | 0             | 1,500         | 0             | 0            | 7,000          |
| World Bank (municipality - 18,89 mln. EUR)                              | 0066        | 15,050                  | 0              | 0             | 31,120         | 39,025         | 15,560        | 1,500         | 1,212         | 462          | 6,385          |
| World Bank (energy saving project - 20 mln. USD)                        | ...         | 0                       | 0              | 0             | 2,000          | 0              | 0             | 500           | 0             | 0            | 2,000          |
| Lithuanian Railway (Pauostis)   | ...         | 0                       | 0              | 0             | 0              | 4,000          | 0             | 0             | 0             | 0            | 0              |
| EBRD (energy saving project for institutions 20 mln. USD)               | ...         | 0                       | 0              | 0             | 0              | 0              | 0             | 2,000         | 0             | 0            | 8,000          |
| <b>Total (I-15)</b>   |             | <b>111,132</b>          | <b>117,796</b> | <b>34,166</b> | <b>200,689</b> | <b>194,119</b> | <b>56,893</b> | <b>37,543</b> | <b>18,561</b> | <b>3,917</b> | <b>102,495</b> |
| <b>II. Budgetary organizations</b>                                      |             |                         |                |               |                |                |               |               |               |              |                |
| World Bank (Ministry of Social Security and Labor)                      | 0042        | 3,100                   | 368            | 0             | 4,661          | 368            | 0             | 0             | 0             | 0            | 5,260          |
| Europe Social Development Fund (Ministry of Social Security and Labor)  | 0043        | 0                       | 0              | 0             | 1,000          | 0              | 0             | 0             | 0             | 0            | 1,500          |
| Europe Social Development Fund (Ministry of Social Security and Labor)  | 0058        | 3,600                   | 2,556          | 756           | 5,459          | 2,556          | 0             | 0             | 0             | 0            | 0              |
| Europe Social Development Fund (Ministry of Social Security and Labour) | 0058.4      |                         |                |               |                | 1,000          |               | 0             | 0             | 0            | 0              |
| World Bank (health project -21 mln. USD)                                | 0069        | 13,000                  | 0              | 0             | 13,000         | 2,240          | 0             | 1,791         | 1,791         | 896          | 23,040         |
| World Bank (education project - 25 mln. USD)                            | ...         | 2,000                   | 0              | 0             | 2,000          | 0              | 0             | 0             | 0             | 0            | 5,900          |
| European Development Bank (School renovation project - 2,5 mln. USD)    | 0073        | 10,000                  | 0              | 0             | 10,000         | 0              | 0             | 5,897         | 5,897         | 2,949        | 10,000         |
| GS (High school renovation project)                                     | ...         | 10,000                  | 0              | 0             | 10,000         | 10,000         | 5,000         | 0             | 0             | 0            | 0              |
| GS Courts   | ...         | 2,000                   | 542            | 0             | 2,000          | 1,963          | 963           | 0             | 0             | 0            | 0              |
| GS Ministry of Health   | ...         | 29,000                  | 0              | 0             | 29,000         | 29,122         | 14,500        | 0             | 0             | 0            | 0              |
| GS Ministry of Health (health care)                                     | ...         |                         |                |               |                | 7,000          |               | 0             | 0             | 0            | 0              |
| GS Ministry of Health (other projects)                                  | ...         |                         |                |               |                | 7,654          |               | 0             | 0             | 0            | 0              |
| GS Ministry of internal affairs   | ...         | 5,884                   | 0              | 0             | 10,884         | 10,884         | 5,442         | 0             | 0             | 0            | 0              |
| GS Custom   | ...         | 6,830                   | 0              | 0             | 6,830          | 6,830          | 3,415         | 0             | 0             | 0            | 0              |
| <b>Total (I-12)</b>   |             | <b>85,414</b>           | <b>3,466</b>   | <b>756</b>    | <b>94,834</b>  | <b>79,617</b>  | <b>29,320</b> | <b>7,688</b>  | <b>7,688</b>  | <b>3,844</b> | <b>45,700</b>  |
| <b>Total (I-II)</b>   |             | <b>196,546</b>          | <b>116,684</b> | <b>34,922</b> | <b>295,523</b> | <b>273,736</b> | <b>86,213</b> | <b>45,231</b> | <b>26,249</b> | <b>7,761</b> | <b>148,195</b> |

Ministry of Finance.

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

| Nr.                                  | Creditor  | Reg.<br>Nr. | 2002    |        |        |        |        |
|--------------------------------------|---|-------------|---------|--------|--------|--------|--------|
|                                      |   |             | year    | Q1     | Q2     | Q3     | Q4     |
|                                      |   |             | Prog.   | Prog.  | Prog.  | Prog.  | Prog.  |
| <b>I. Nonbudgetary organisations</b> |   |             |         |        |        |        |        |
| 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 (1-15)  |             | 102,495 | 37,543 | 18,255 | 24,540 | 22,157 |
| <b>II. Budgetary organisations</b>   |   |             |         |        |        |        |        |
| 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) | 43          | 1,500   |        | 1,500  | 0      | 0      |
| 3                                    | Europe Social Development Fund (Ministry of Social Security and Labour) | 0058        | 0       | 0      | 0      | 0      | 0      |
| 4                                    | Europe Social Development Fund (Ministry of Social Security and Labour) | 0058.4      |         |        |        |        |        |
| 5                                    | World Bank (health project -21 mln. USD)                                | 0069        | 23,040  | 5,760  | 5,760  | 5,760  | 5,760  |
| 6                                    | 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)    | 0073        | 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 Health (other projects)                                  | ...         | 0       | 0      | 0      | 0      | 0      |
| 11                                   | GS Ministry of Internal affairs   | ...         | 0       | 0      | 0      | 0      | 0      |
| 12                                   | GS Custom   | ...         | 0       | 0      | 0      | 0      | 0      |
|                                      | Total (I-12)  |             | 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  |      |          |       |
|--|-------|-------|----------|-------|-------|-------|----------|-------|------|----------|-------|
|  | Q1-Q3 |       |          | Q4    | Year  | Year  | Year     | Q1    |      |          | Year  |
|  | Prog. | Act.  | Adjustor | Prog. | Prog. | Act.  | Adjustor | Prog. | Act. | Adjustor | Prog. |
| <b>Total</b>   | 177.8 | 139.7 | 54.3     | 51.9  | 229.7 | 228.3 | 83.7     | 111.0 | 88.2 | 5.1      | 444.1 |
| <b>Ministries</b>  | 127.0 | 85.9  | 23.9     | 35.0  | 162.0 | 130.8 | 49.8     | 43.3  | 43.8 |          | 173.2 |
| Ministry of National Defense   | 62.3  | 41.0  | 9.8      | 13.4  | 75.8  | 67.6  | 29.7     | 19.5  | 23.4 | 9.7      | 77.8  |
| Ministry of Culture  | 6.2   | 4.0   | 0.9      | 2.1   | 8.3   | 7.0   | 2.8      | 3.4   | 1.7  | 0.0      | 13.4  |
| Ministry of Social Security and Labor  | 7.3   | 2.1   | 0.0      | 2.4   | 9.7   | 6.9   | 2.0      | 1.4   | 0.6  | 0.0      | 5.5   |
| Ministry of Health   | 29.6  | 26.9  | 12.1     | 9.9   | 39.5  | 22.9  | 3.2      | 5.4   | 7.3  | 2.7      | 21.6  |
| Ministry of Education and Science  | 21.6  | 11.9  | 1.1      | 7.2   | 28.8  | 26.4  | 12.0     | 2.2   | 6.1  | 1.1      | 8.6   |
| Ministry of Environment  | 0.0   | 0.0   | 0.0      | 0.0   | 0.0   | 0.0   | 0.0      | 0.1   | 0.0  | 0.0      | 0.3   |
| Ministry of Finance  | 0.0   | 0.0   | 0.0      | 0.0   | 0.0   | 0.0   | 0.0      | 2.0   | 0.1  | 0.0      | 8.1   |
| Ministry of Interior Affairs   | 0.0   | 0.0   | 0.0      | 0.0   | 0.0   | 0.0   | 0.0      | 4.5   | 2.5  | 0.2      | 18.1  |
| Ministry of Agriculture  | 0.0   | 0.0   | 0.0      | 0.0   | 0.0   | 0.0   | 0.0      | 3.2   | 0.6  | 0.0      | 12.9  |
| Ministry of Communications   | 0.0   | 0.0   | 0.0      | 0.0   | 0.0   | 0.0   | 0.0      | 0.1   | 0.0  | 0.0      | 0.3   |
| Ministry of Communications   | 0.0   | 0.0   | 0.0      | 0.0   | 0.0   | 0.0   | 0.0      | 0.4   | 1.3  | 0.2      | 1.4   |
| Ministry of Justice  | 0.0   | 0.0   | 0.0      | 0.0   | 0.0   | 0.0   | 0.0      | 0.9   | 0.1  | 0.0      | 3.4   |
| Ministry of Economy  | 0.0   | 0.0   | 0.0      | 0.0   | 0.0   | 0.0   | 0.0      | 0.5   | 0.1  | 0.0      | 1.8   |
| 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   |
| <b>Government Bodies</b>   | 0.0   | 0.0   | 0.0      | 0.0   | 0.0   | 0.0   | 0.0      | 1.3   | 1.0  | 0.4      | 5.0   |
| <b>Projects of Municipalities</b>  | 0.0   | 0.0   | 0.0      | 0.0   | 0.0   | 0.0   | 0.0      | 13.3  | 0.0  | 0.0      | 53.2  |
| <b>Regions</b>   | 30.0  | 34.1  | 19.1     | 10.0  | 40.0  | 48.6  | 20.0     | 12.9  | 7.4  | 0.9      | 51.7  |
| <b>Departments, Services, and Inspectorates</b>                                | 6.2   | 1.2   | 0.0      | 2.1   | 8.2   | 8.5   | 4.1      | 7.6   | 4.9  | 1.1      | 30.4  |
| Department of Sciences and Studies under the Ministry of Education and Science | 6.2   | 1.2   | 0.0      | 2.1   | 8.2   | 0.9   | 0.0      |       |      |          | ...   |
| <b>Enterprises and Organizations</b>   | 0.3   | 0.0   | 0.0      | 0.1   | 0.4   | 0.4   | 0.2      | 23.1  | 2.8  | 0.0      | 92.4  |
| <b>Education, culture and other institutions and organizations</b>             | 14.4  | 18.5  | 11.2     | 4.8   | 19.2  | 40.0  | 9.6      | 9.6   | 28.3 | 3.1      | 38.2  |
| Science and studies  | 14.3  | 18.4  | 11.2     | 4.8   | 19.1  | 40.0  | 9.6      | 8.6   | 6.9  | 2.6      | 34.4  |
| Public enterprises: translation, documentation and information center          | 0.0   | 0.1   | 0.0      | 0.0   | 0.0   | 0.0   | 0.0      | 1.0   | 21.4 | 0.5      | 3.8   |

Source: Ministry of Finance.

Table 4. Lithuania: Ceilings on Stock of General Government Guarantees for Domestic Borrowing, 2001-02  
(In millions of Litai)

|  | 2001 |      |     |      |     |      |     |      | 2002 |      |     |     |     |
|--|------|------|-----|------|-----|------|-----|------|------|------|-----|-----|-----|
|  | Q1   | Act. | Q2  | Act. | Q3  | Act. | Q4  | Act. | Q1   | Act. | Q2  | Q3  | Q4  |
| Total  | 319  | 217  | 315 | 237  | 314 | 232  | 312 | 247  | 315  | 197  | 312 | 312 | 312 |
| Special agencies                               | 270  | 178  | 255 | 180  | 252 | 169  | 250 | 183  | 250  | 137  | 250 | 250 | 250 |
| Agricultural marketing agency                  | 230  | 165  | 230 | 165  | 230 | 154  | 230 | 171  | 220  | 125  | 220 | 220 | 220 |
| <i>of which: SAPARD program cofinancing</i>    | 20   | -    | 20  | -    | 20  | -    | 30  | -    | 30   | -    | 30  | 30  | 30  |
| Export and import credit insurance agency      | 40   | 14   | 25  | 15   | 22  | 15   | 20  | 13   | 15   | 4    | 15  | 15  | 15  |
| Investment and business guarantee agency (SoDr | -    | -    | -   | -    | -   | -    | -   | -    | 15   | 7    | 15  | 15  | 15  |
| Other  | 49   | 39   | 60  | 57   | 62  | 63   | 62  | 64   | 65   | 60   | 62  | 62  | 62  |

Source: Ministry of Finance.

Table 5. Lithuania: Stock of General Government Outstanding Payment Obligations, 1999-2002  
(In millions of Litai, unless otherwise indicated)

|   | 1999       |            | 2000       |            |            |            | 2001       |            |            | 2002       |  |
|---|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|--|
|   | Dec. 31    | Apr. 1     | Jul. 1     | Oct. 1     | Dec. 31    | Apr. 1     | Jul. 1     | Oct. 1     | Dec. 31    | Apr. 1     |  |
| Total outstanding payment obligations<br>(in percent of annual GDP) | 594<br>1.4 | 470<br>1.0 | 443<br>1.0 | 317<br>0.7 | 236<br>0.5 | 264<br>0.5 | 238<br>0.5 | 224<br>0.5 | 200<br>0.4 | 245<br>0.5 |  |
| State government  | 125        | 81         | 86         | 65         | 17         | 18         | 15         | 8          | 0          | 6          |  |
| Wages and salaries  | 8          | 5          | 7          | 3          | 2          | 3          | 3          | 0          | 0          | 1          |  |
| Other expenditure   | 118        | 77         | 80         | 62         | 15         | 15         | 12         | 8          | 0          | 5          |  |
| Municipalities  | 155        | 233        | 237        | 183        | 195        | 245        | 218        | 188        | 200        | 238        |  |
| Wages and salaries  | 14         | 21         | 11         | 7          | 10         | 12         | 11         | 10         | 6.8        | 5          |  |
| Other expenditure   | 140        | 212        | 225        | 176        | 185        | 233        | 206        | 178        | 193.3      | 233        |  |
| SoDra   | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          |  |
| Pensions, wages and salaries  | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          |  |
| Other expenditure   | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          |  |
| Health Insurance Fund   | 0          | 14         | 55         | 23         | 23         | 0          | 5          | 29         | 0          | 0          |  |
| Payments to health care providers                                   | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          |  |
| Wages and salaries  | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          |  |
| Other expenditure   | 0          | 14         | 55         | 23         | 23         | 0          | 5          | 29         | 0          | 0          |  |
| Privatization Fund  | 0          | 3          | 0          | 0          | 0          | 1          | 0          | 0          | 0          | 0          |  |
| Wages and salaries  | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          |  |
| Other expenditures  | 0          | 3          | 0          | 0          | 0          | 1          | 0          | 0          | 0          | 0          |  |
| Rural Support Fund  | 231        | 129        | 62         | 19         | 0          | 0          | 0          | 0          | 0          | 0          |  |
| Wages and salaries  | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          |  |
| Other expenditure   | 231        | 129        | 62         | 19         | 0          | 0          | 0          | 0          | 0          | 0          |  |
| Road Fund   | 83         | 10         | 4          | 28         | 2          | 0          | 0          | 0          | 0          | 0          |  |
| Wages and salaries  | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          |  |
| Other expenditure   | 83         | 10         | 4          | 28         | 2          | 0          | 0          | 0          | 0          | 0          |  |
| <i>Memorandum item:</i>   |            |            |            |            |            |            |            |            |            |            |  |
| Nominal GDP   | 42,655     | 45,254     | 45,254     | 45,254     | 45,254     | 48,087     | 48,087     | 48,087     | 48,087     | 50,531     |  |

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                   | ...                     | 732.0      | 183.0       |
| Q2  |                                       |                         |            |             |
| Road projects   | Lithuanian Road Administration Agency | EIB and NIB             | 27.0       | 6.8         |
| Gravel Roads projects   |                                       |                         | 15.0       | 3.8         |
| Q3  | ...                                   | ...                     | 0.0        | 0.0         |
| Q4  |                                       |                         |            |             |
| Lithuanian Rail Road project  | AB "Lietuvos geležinkeliai"           | Kena                    | 10.0       | 2.5         |
| Lithuania - Corridor IX track renewal project                       | AB "Lietuvos geležinkeliai"           | EBRD                    | 216.0      | 54.0        |
| 2002  |                                       |                         |            |             |
| Q1  |                                       |                         |            |             |
| Bonds   | Ministry of Finance                   | ...                     | 139.2      | 34.8        |
| Q2  |                                       |                         |            |             |
| Buildings renovation of science and higher education establishments | Municipalities                        | Social Development Fund | 10.0       | 2.5         |
| Education project   | Ministry of Education                 | World Bank              | 100.0      | 25.0        |
| Mazeikiu Nafta  | Mazeikiu Nafta                        | ...                     | 472.0      | 118.0       |
| Public sector energy management programme                           | Public sector                         | EBRD                    | 80.0       | 20.0        |
| Eurobonds   | Ministry of Finance                   | ...                     | 1,400.0    | 350.0       |
| Housing/Energy efficiency project                                   | Various                               | World Bank              | 100.0      | 25.0        |
| Q3  |                                       |                         |            |             |
| Vilnius District Heating project                                    | Vilniaus energija                     | World Bank              | 68.0       | 17.0        |
| New projects  | Various agencies                      | ...                     | 32.0       | 8.0         |

Source: Ministry of Finance.

**NEWS  BRIEF**

**FOR IMMEDIATE RELEASE**

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News Brief No. 02/55  
FOR IMMEDIATE RELEASE  
June 27, 2002

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

**IMF Completes Second Review of Lithuania Under Stand-By Arrangement**

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Lithuania's economic performance under the 19-month stand-by arrangement. Completion of this review entitles Lithuania to purchase an additional amount equivalent to SDR 12.36 million (about US\$16 million) from the IMF, bringing the total IMF resources potentially available to Lithuania to SDR 49.44 million (about US\$65 million). Lithuania has not so far drawn any of those resources, and the authorities have indicated their intention not to make any purchase under the arrangement.

The IMF's Executive Board approved the stand-by arrangement on August 30, 2001 (see Press Release No. 01/36) for a total of SDR 86.5 million (about US\$114 million).

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

"Executive Directors welcomed Lithuania's strong economic performance in 2001, when real GDP grew by 5.9 percent, inflation remained low, and the external current account deficit narrowed to 4.8 percent of GDP. All program targets for 2001 were met.

"Developments remained favorable in the first quarter of 2002. In a setting of continued fiscal adjustment and good growth performance, the repegging of the *litas* to the euro was successfully implemented in February, and was well received by the markets—as evidenced by a

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**EXTERNAL RELATIONS DEPARTMENT**

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decline in interest rate spreads. Also, further progress was made in structural reforms in the tax system, health care expenditure, privatization, and the financial sector. However, some measures envisaged in the program were implemented with delays, and the planned improvements in municipal finances were not fully achieved.

“The macroeconomic outlook for 2002 envisages a rate of growth of real GDP of 4.4 percent, a further reduction in the fiscal deficit to 1.5 percent of GDP, and a moderate increase in the external current account deficit. The currency board arrangement will continue to anchor macroeconomic policies. Reforming the tax system, strengthening the financial sector, and improving the economy’s competitiveness are at the forefront of the authorities’ agenda of structural policies for 2002.

“Over the medium term, maintaining external sustainability will require continued fiscal adjustment, while at the same time making room for additional expenditures related to accession to the EU and membership of NATO, as well as pension reform and other social priorities. The government is committed to achieve its medium-term fiscal objectives by stabilizing revenues, introducing additional measures to strengthen financial management of the municipalities, and reducing further the expenditures of the Health Insurance Fund,” Mr. Sugisaki said.

**Statement by Ólafur Ísleifsson, Executive Director, and Stasys Kropas, Advisor to the  
Executive Director for the Republic of Lithuania  
June 27, 2002**

The period of the second review of the Stand-By program coincides with the ten-year anniversary of Lithuania's membership in the Fund. Our authorities are very pleased with the results of cooperation and want to thank the management and the staff for their continuous support of the country's economic reform efforts. Lithuania is a small, open economy with fixed exchange rate arrangements, and a fully liberalized capital account. The high capital account deficit which has been a feature of the country's economy, has resulted from the need for financing its transformation process. Lithuania may have been more vulnerable to external shocks, if we did not have IMF arrangements in place in the different phases of transformation to a market economy. The country also went through several changes in the exchange rate arrangements, starting from the introduction of a national currency, a period of currency float, the introduction of currency board arrangements, the modification of arrangements, the reorientation of the anchor currency, and the preparation to EU accession. The Fund's advice was always helpful.

The authorities were pleased to join the Nordic constituency in the Fund. It has been one of the first concrete forms of cooperation and policy coordination, contributing substantially to developing a more comprehensive framework for regional integration which has now become an important source of wealth creation. The countries of our constituency contribute well above 50 percent of Lithuania's FDI. The strong presence of high-quality Nordic companies in the financial, telecommunications, media, retail, and other sectors contributes positively to the business environment and facilitates advanced market culture. Lithuania's economic relations with its Baltic neighbors Latvia and Estonia have grown to a historically unprecedented level. Lithuania's exports to Latvia and Estonia constitutes now 15.6 percent.

### **Recent Economic Developments and Prospects**

Last year the Lithuanian economy experienced growth that exceeded the most optimistic forecasts and macroeconomic conditions improved further, with the trade and current account deficits narrowing relative to the previous years. Growth was driven by exports but also by domestic demand, in particular investment.

Positive trends continued in early 2002 with business confidence and external vulnerability indicators improving substantially. Rating agencies upgraded Lithuania's ratings and outlook.

Real GDP grew by 4.1 percent in the first quarter of 2002, in line with the authorities' expectations. While export growth was slower due to the slowdown in EU, domestic demand is recovering after three years of stagnation. Strong retail sales and investment growth in the first quarter of 2002 indicates that domestic demand is becoming an increasingly important engine of growth. It is also expected that export growth may pick up towards the end of the year due to the expected recovery in the EU and reasonably strong growth in neighboring

markets. Strong domestic demand is likely to lead to a widening of the current account deficit this year, which to a large extent is to be financed by inflows of foreign direct investment.

Despite commencing EU accession negotiations almost two years after the first wave of accession candidates, Lithuania has now provisionally closed 28 chapters of the *acquis*. The discussion on the remaining chapters is well advanced and Lithuania is well posed to conclude negotiations with the first group of EU candidates.

Staff emphasis in the report on competitiveness is much welcomed. Productivity and corporate sector profitability trends and wage flexibility indicators confirm the authorities' views that competitiveness remains strong despite the appreciation of the exchange rate. The much faster growth in 2001 of small and medium sized companies seems to support this proposition.

### **Fiscal issues**

A tight overall fiscal stance has contributed strongly to the stabilization of the economy. In 2001 the fiscal stance was in line with the MEP. In the first quarter of 2002, public finances continued to improve with revenue performance being stronger than projected which resulted in the general government deficit being lower than planned. Important progress has been made in recent months in improving HIF finances as arrears clearance and cost-cutting measures have been implemented. The authorities are committed to implementing the remaining envisaged measures to balance HIF's budget without accumulation of new arrears.

Earlier this year the government successfully launched a Eurobond issue of 10-year maturity. Further financing needs will rely on domestic market as interest rates on longer-term securities have converged to EU level. In March the government issued the first 10-year domestic treasury bond with the Maastricht standard yield, establishing a benchmark for longer-term securities and a 10-year yield curve. The debt composition has improved further, which is evidenced by the decreased short-term and foreign debt shares in the overall debt portfolio. Our authorities look forward to work on further implementation of the Data and Fiscal Transparency Reports on Observance of Standards and Codes. These will be the last modules of the comprehensive set of standards and codes, strengthening ongoing improvements of fiscal and debt management practices.

However, our authorities agree with staff that further measures are needed to strengthen municipal finances, as evidenced by increased arrears. They are committed to taking further comprehensive regulatory measures to strengthen financial discipline of the municipalities and to reinforcing new principles of financial relations between the state and municipal budgets, including stabilizing municipal revenues, streamlining spending, strengthening financial discipline and providing stronger incentives for municipalities. The regrettable occurrence of marginal state budget arrears resulting in the nonobservance of the benchmark was due to technical difficulties, which occurred within a framework of ongoing



improvements of treasury operations. The authorities are making further efforts to achieve a revenue neutral tax reform package.

### **Exchange rate and monetary policies**

The monetary environment has become more conducive to strong economic growth. The recent smooth repegging of the national currency—the litas—from the US dollar to the euro supports further convergence with the EU. The new peg has established a steady exchange rate relationship *vis-à-vis* the majority of Lithuania's trading partners. The reorientation has induced a wider use of the domestic currency in financial transactions and led to a substantial increase in litas deposits. Real estate is now largely priced in litas.

Low inflation and nominal interest rates have led to further monetization. Intensified competition among commercial banks and other private financial institutions has led to an increased efficiency of financial intermediation as well as a higher supply of high-quality financial services. Domestic credit has been growing significantly mainly due to increased business confidence and the dynamism of recently privatized banks. This goes along with the improvement in the quality of the banks' credit portfolios and rapid growth of deposits. The authorities will continuously monitor developments in this area to preserve soundness of the banking system.

Consistent with the policy of harmonization with ECB standards, the required reserve ratio was reduced to 6 percent in May and the new rules of calculation comparable to the ECB standard were introduced. No further changes in the reserve ratio are envisaged in 2002. We would like to thank the staff for their substantial contribution to the debate on Lithuania's exchange rate strategy while preparing for participation in ERM2 and the eventual adoption of the euro. The ongoing bilateral consultations with the staff contributes substantially to a formulation of economic policies and preconditions needed for the success of the long term strategy of the authorities.

### **Financial sector policies**

The sale in February of the last state-owned Agriculture bank completed the privatization and restructuring of the banking sector. The authorities have benefited from the FSAP and an EU peer review, which was successfully completed in 2002. Both reviews provided comprehensive analysis of the financial sector in Lithuania.

Some of the recommendations of the FSAP report have already been implemented. The BOL approved stricter monthly requirements for banks on their shareholdings. AML practices in insurance and capital markets have been strengthened by reorganizing and increasing responsibilities of FCIS and by amendments of the law on prevention of AML which extends responsibilities for implementation of AML legislation, and preparing regulations on detection and reporting of suspicious activities.

Concerns regarding insurance supervision have already been taken into consideration by an amendment of the current law on insurance and by putting in place FSAP recommendations concerning corporate governance, consumer rights, and auditing. Furthermore, in the supervisory work in the period ahead, special focus will be placed on implementation of recommendations outlined in the EU peer review final report, which is expected to be issued soon.

### **Structural reform issues**

Reform and preparation for privatization in the largest infrastructure sectors require careful consideration and discussions between political partners and society, and might be a reason for some delays in the initial privatization agenda. However, steady further progress has been reached in recent months in the energy sector and pension reform.

The successfully completed restructuring of Lithuania's power company and improved regulatory transparency led to a positive revision on its rating outlook. The energy sector has reduced its operational risks and introduced a transparent pricing system, which provides some tariff-setting flexibility to cover costs. After the sale of the initial stake to a foreign strategic investor, privatization of the Lithuanian Gas is about to be completed and the sale of a second stake to suppliers is expected by the end of 2002. The finalization of the agreement on long-term oil supply and sale of the stake in oil refinery to a supplier paves the way to facilitate modernization and expansion. In May, the Seimas endorsed a plan for pension reform incorporating a voluntary second pillar based on supplementary matching government contributions and tax incentives.

Unemployment is currently on a downward trend. In April it fell for the third consecutive month to 11.8 percent from 13.1 percent. The authorities take note of staff's suggestions on ways to improve the business environment to make it more conducive to employment creation. As mentioned in the report, they have been working further on a measures package. The new labor code is expected to increase minimum wage flexibility for certain categories of workers and regions. These measures, together with the unemployment insurance law are expected to be passed this year, targeted job-training programs and an improved social safety net will enhance the functioning of the labor market and increase protection of the unemployed.