March 2003
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Republic of Lithuania: Third Review Under the Stand-By Arrangement—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Lithuania

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

- the staff paper for the third review under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **December 13, 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 February 12, 2003**. 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 Press Release summarizing the **views of the Executive Board as expressed during its February 26, 2003 discussion** of the staff report that completed the 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

Third Review Under the Stand-by Arrangement

Prepared by European II and Policy Development and Review Department

Approved by Jose Fajgenbaum and Liam P. Ebrill

February 12, 2003

- Discussions were held in Vilnius during December 2-13, 2002. The Fund staff team comprised P. Alonso-Gamo (head), R. Burgess, S. George, T. Rasmussen (all EU2), and A. Matzen (PDR), and was assisted by Z. Brixiova, the Fund's resident representative. Mr. S. Kropas, Advisor to the Executive Director, attended policy meetings.
- The mission met with President Adamkus, Prime Minister Brazauskas, Bank of Lithuania Governor Šarkinas, Minister of Finance Grybauskaite, Vice-minister of Economy Miskinis, other senior government officials, the Seimas Budget Committee Chairman Mr. Butkevicius, EU representatives, commercial bankers, and the business community.
- 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 second review Board discussion, on June 27, 2002, Directors emphasized the importance of continuing sound fiscal policies and structural reforms for maintaining competitiveness and boosting productivity, so as to sustain growth and employment in the medium term. Directors also commended the authorities for the smooth repegging of the litas from the dollar to the euro on February 2, 2002.
- In the attached letter dated February 7, 2003, the authorities request the completion of the third and last 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.

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Executive Summary

Program implementation has been good and all end-December 2002 quantitative performance criteria were met. Macroeconomic performance in 2002 was better than expected: real GDP grew by 5.9 percent, led by domestic demand. Exports grew by 10 percent, as the impact of slower growth in the euro zone and the real appreciation of the litas was limited. Hence, the external current account deficit widened modestly to 5.4 percent of GDP, while external debt and liquidity indicators strengthened. The general government budget deficit was 1.2 percent of GDP, lower than the targeted 1.5 percent. Money and credit to the private sector grew strongly, reflecting the improved business environment and increased confidence after the successful repegging of the litas in February 2002. Prudential indicators of the banking system remained adequate. Inflation was close to zero in 2002. Unemployment fell gradually through the year but remains high at 10.9 percent.

Further progress was made in structural reforms during 2002, including tax reform, municipal finances, health care expenditure, banking privatization, financial sector reforms (in line with FSAP recommendations), and energy sector privatization. Some measures, however, were implemented with some delays, including privatization in the energy sector.

The macroeconomic outlook for 2003 envisages real GDP growth of 5.3 percent, as domestic demand growth moderates relative to the very high levels of the previous year. The current account deficit is expected to widen slightly to 5.8 percent of GDP, owing to slow growth in partner countries, and higher oil prices. Inflation will remain below 2 percent and the unemployment rate should continue to edge down.

The currency board arrangement (CBA) will continue to anchor macroeconomic policies. Broad money and credit are expected to grow by 16.4 and 24.5 percent respectively, somewhat more slowly than in 2002. Careful monitoring of loan quality is needed at this time of rapid credit growth, and the BoL has postponed plans to reduce the required reserve ratio. The fiscal deficit target for 2003 of 2 percent of GDP represents a temporary weakening, justified by the need to accommodate large EU accession-related expenditures.

The medium-term macroeconomic outlook remains robust, with the growth rate expected to increase to 5.9 percent in 2005-07, and the external current account deficit declining to about 4.5 percent of GDP over the same period. In order to support the CBA and maintain external viability, the authorities remain committed to achieving a structurally balanced budget over the medium term, once the one-off spending pressures associated with EU accession in 2003 and 2004 have eased. Fiscal restraint in 2003-05 remains crucial to support the authorities' objective of joining the ERMII and adopting the euro as soon as feasible.

Structural reforms are expected to advance in a number of areas. The government is committed to: strengthening municipal finances; implementing additional administrative measures for the Health Insurance Fund; improving tax administration; and completing the privatization agenda. Following the FSAP recommendations, the authorities plan to further strengthen supervision of banking institutions, insurance companies and capital markets, as well as tighten regulation on anti-money laundering practices.

I. Introduction

1. **In the ten years since independence, Lithuania has become a functioning market economy invited to join the EU.** Initially, the pace of structural reforms was relatively slow. By 1999, in the aftermath of the 1998 Russia crisis, expansionary domestic policies could not avert a deep recession and led to increased instability, threatening the future of the currency board arrangement (CBA). The strong fiscal adjustment implemented since 2000, coupled with ambitious and wide-ranging structural reforms, helped to regain credibility and transform the business environment, leading to a rebound in growth, very low inflation, new employment opportunities and restored external viability.

Selected Macroeconomic Indicators, 1998-2002

	1998	1999	2000	2001	2002	
					Prog.	Est.
Real GDP growth (year-on-year, in percent)	5.1	-3.9	3.8	5.9	4.4	5.9
Average CPI (year-on-year change, in percent)	5.1	0.8	1.0	1.3	1.3	0.3
Unemployment rate (end-of-period, in percent)	6.9	10.0	12.6	12.9	11.5	10.9
Fiscal balance (in percent of GDP)	-5.9	-8.5	-2.8	-1.9	-1.5	-1.2
Current account balance (in percent of GDP)	-12.1	-11.2	-6.0	-4.8	-5.9	-5.4
Gross official reserves (in millions of U.S. dollars)	1,460	1,242	1,359	1,669	1,928	2,419
Broad money (year-on-year change, in percent)	14.5	7.7	16.5	21.4	17.0	16.9
Private sector credit (year-on-year change, in percent)	16.9	13.8	-1.2	21.4	25.0	30.4

Sources: Lithuanian authorities; and Fund staff estimates.

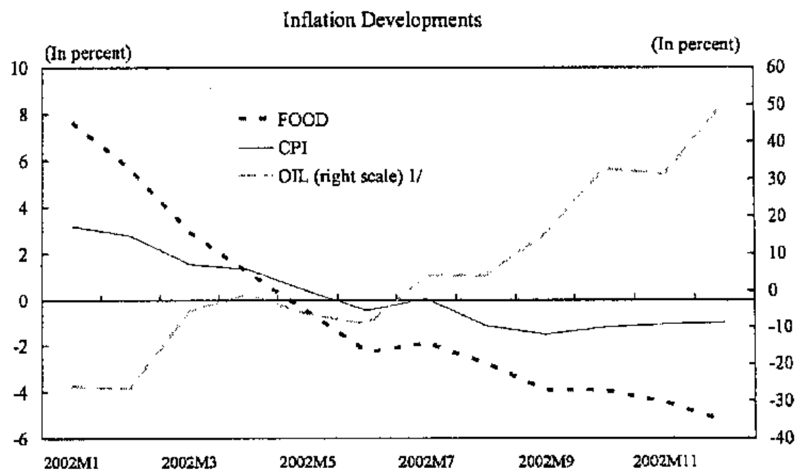
2. **Such ambitious reforms could be implemented owing to widespread support across the political spectrum for the goals of EU and NATO accession.** The surprise second-round electoral victory on January 5, 2003 of former Prime Minister Paksas against the incumbent President Adamkus introduces some uncertainty but is not expected to alter significantly the direction of economic policies. Prime Minister Brazauskas, backed by a solid parliamentary majority, should be reconfirmed comfortably, ensuring continuity.

II. Recent Developments and Performance Under the Program

3. **Program implementation has been good and all performance criteria for end-September and for end-December 2002 were met** (Tables 1-3). Some benchmarks were not met, however. The end-September quantitative benchmark for zero central government arrears was missed mainly due to arrears accumulated by the Health Insurance Fund. The submission to Seimas of the real estate tax law (an end-September structural benchmark) and of the unemployment insurance law (an end-December structural benchmark) was delayed to 2003.

A. Macroeconomic Developments in 2002

4. **Growth in 2002 was stronger than expected** (Table 4, Figure 1). Real GDP grew by 6.1 percent over the first three quarters of 2002 and reached 5.9 percent for the year as a whole. Domestic demand increasingly replaced exports as the main source of growth. Investment continued to recover, supported by a surge in construction activity. Private consumption growth also accelerated owing to lower unemployment and higher real wages. The registered unemployment rate fell from 13.1 percent in January 2002, to 10.9 percent in December 2002, while real wages increased by 4.5 percent in 2002, after a decline of 0.5 percent in 2001.The consumer price index (CPI) increased by only 0.3 percent in 2002, reflecting the appreciation of the litas against the US dollar and a sharp drop in food prices (see text figure below).[1]

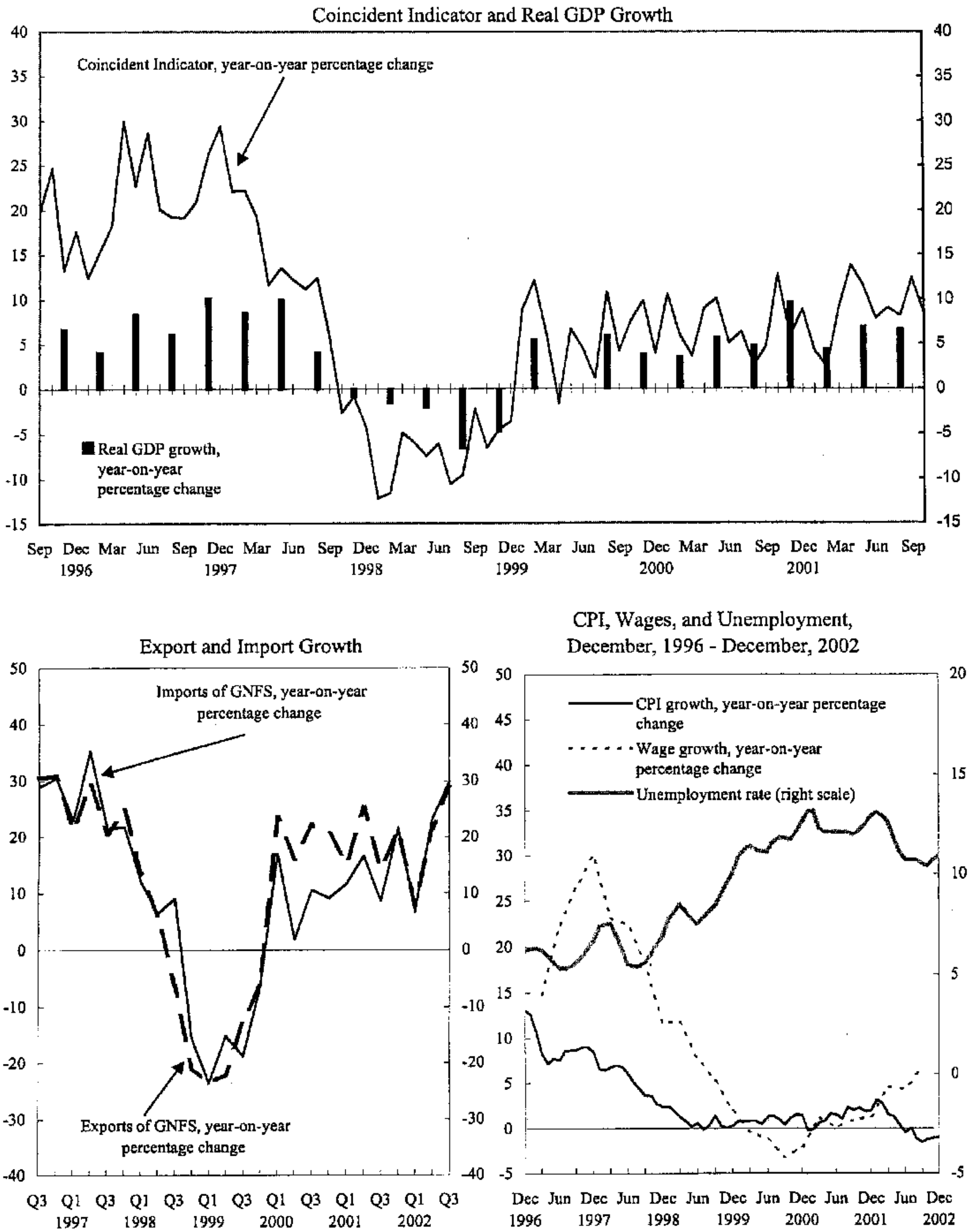


Source: Country authorities and Fund staff estimates.
1/ World oil prices (average of UK Brent, Dubai, and West Texas Intermediate).

5. **The weakening in export markets and the relatively strong growth of domestic demand contributed to a modest widening of the current account deficit,** which is estimated to have reached 5.4 percent of GDP in 2002 (from 4.8 percent in 2001) (Table 5). Strong productivity increases and moderate wage growth continued to provide a strong basis for exports, which increased by 16.5 percent over the first 10 months of 2002 compared to the same period in 2001, despite the real appreciation of the litas and the slowdown in the

[1] Food is the largest element of the CPI (more than one third of the basket). A general decline in global food prices (from exceptionally high levels in 2001), coupled with the appreciation of the litas and strong competition, led to a significant drop in domestic food prices. The swing in oil prices over the last two years also contributed to falling consumer price inflation through the first half of 2002, but added to inflationary pressures in recent months.

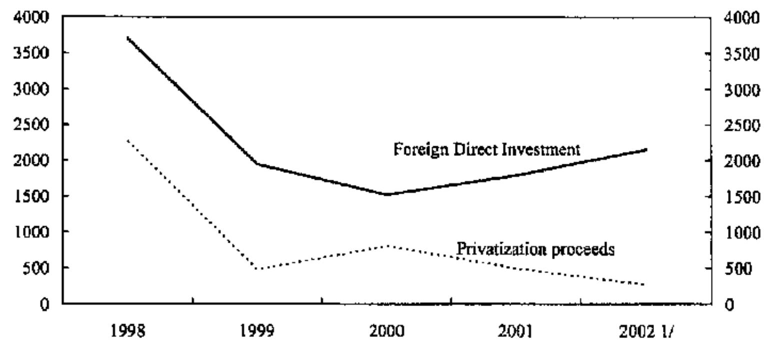
Figure 1. Lithuania: Selected Economic Indicators, 1996-2002



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

euro area (Figure 2).[2] Imports increased by 19.9 percent over the same period, largely driven by imports of capital goods. Non-energy exports and imports increased by 24 and 26 percent in the first 10 months of 2002 compared with 2001.[3]

Foreign Direct Investment in Lithuania and Privatization Proceeds
(In millions of LTL)



1/ First 9 months.
Source: Country authorities.

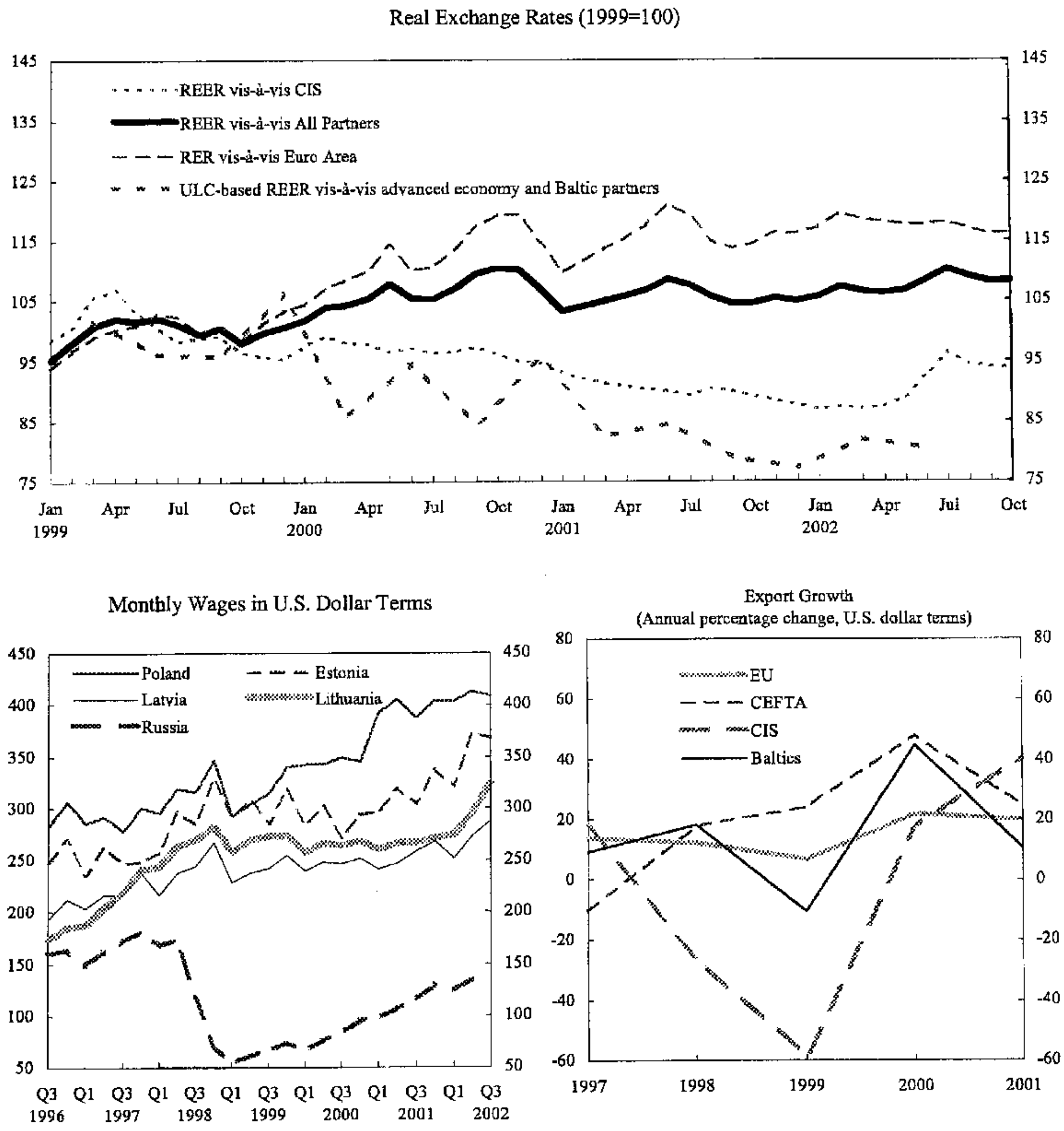
6. **Foreign direct investment (FDI) continued to be high, despite the decline in privatization activity**. Currently, FDI is mostly linked to the expansion of existing operations in Lithuania, based on the positive experiences of foreign investors and the anticipation of EU membership. In the first nine months of 2002, FDI in Lithuania amounted to US$577 million, more than 150 percent of the current account deficit for the period. The government successfully issued a €400 million 10-year Eurobond in May at a spread of only 94 basis points over comparable German bonds.[4] External liquidity indicators improved substantially (Table 6), as gross reserves reached US$2,419 million by year-end, and the reserve coverage of short-term debt reached 86 percent at end-September 2002.

[2] The changes in exports and imports are measured in litai. In US dollars, exports increased by 25.2 percent and imports increased by 28.8 percent over the same period.

[3] Measured in litai. Energy constitutes approximately 25 percent of total exports and 22 percent of total imports. Developments in energy trade are largely determined by the operations of the Mazeiku Nafta oil refinery.

[4] Moody's lifted Lithuania's foreign currency rating to Baa1, while Fitch-IBCA upgraded Lithuania's rating to BBB in December 2002.

Figure 2. Lithuania: Indicators of External Competitiveness, 1996-2002

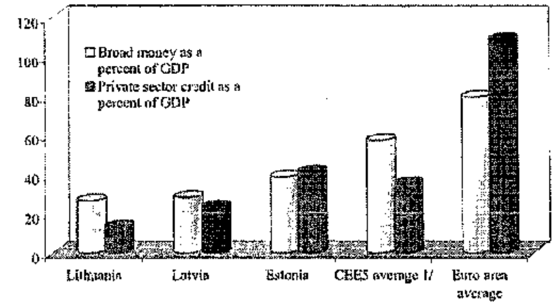


Sources: Lithuanian authorities; and Fund staff estimates.

7. **Fiscal consolidation continued, with the general government budget close to balance over the first three quarters** (Table 7). Expenditure on goods and services was contained and defaults on publicly guaranteed debt were lower than foreseen, more than offsetting higher-than-expected capital expenditure (linked to EU-related investment projects and higher implementation capacity). Revenue for the year was likely slightly higher than planned, with better than expected performance by municipalities and a small shortfall for the state budget. Despite higher current expenditure in the fourth quarter, the general government budget deficit for 2002 amounted to about 1.2 percent of GDP, well below the unadjusted program target of 1.5 percent (LTL 776 million) and the 2001 outcome of 1.9 percent.

8. **The smooth repegging of the litas from the dollar to the euro in February 2002 bolstered confidence in the CBA, and led to further financial deepening.** Broad money grew by 16.9 percent year-on-year by end-2002 (Figure 3, Table 8), reflecting continued growth in real money demand, with monetization levels gradually growing to the level of other advanced transition countries. Credit to the private sector grew by 30.4 percent in the same period, albeit from a low level, in response to low interest rates and increased business opportunities. Consumer and mortgage financing were the main growth areas. The very high credit growth rates suggest that these developments should be monitored carefully. Banking prudential indicators remained sound, with non-performing loans falling from 9.9 percent of total loans at end-September, 2001 to 6.6 percent at end-September, 2002 (Table 9),[5] and banks, despite heightened competition, regained profitability—combined net profits reached LTL 146.5 million in 2002 (after losses of LTL 22.5 million in 2001). As a result of greater confidence, dollar assets and liabilities of the banking sector and households declined after the repegging, with the litas share increasing significantly (see text figure below).[6]

Monetization and Private Sector Credit in the Baltics, Selected EU Accession Countries, and the Euro Area, 2001

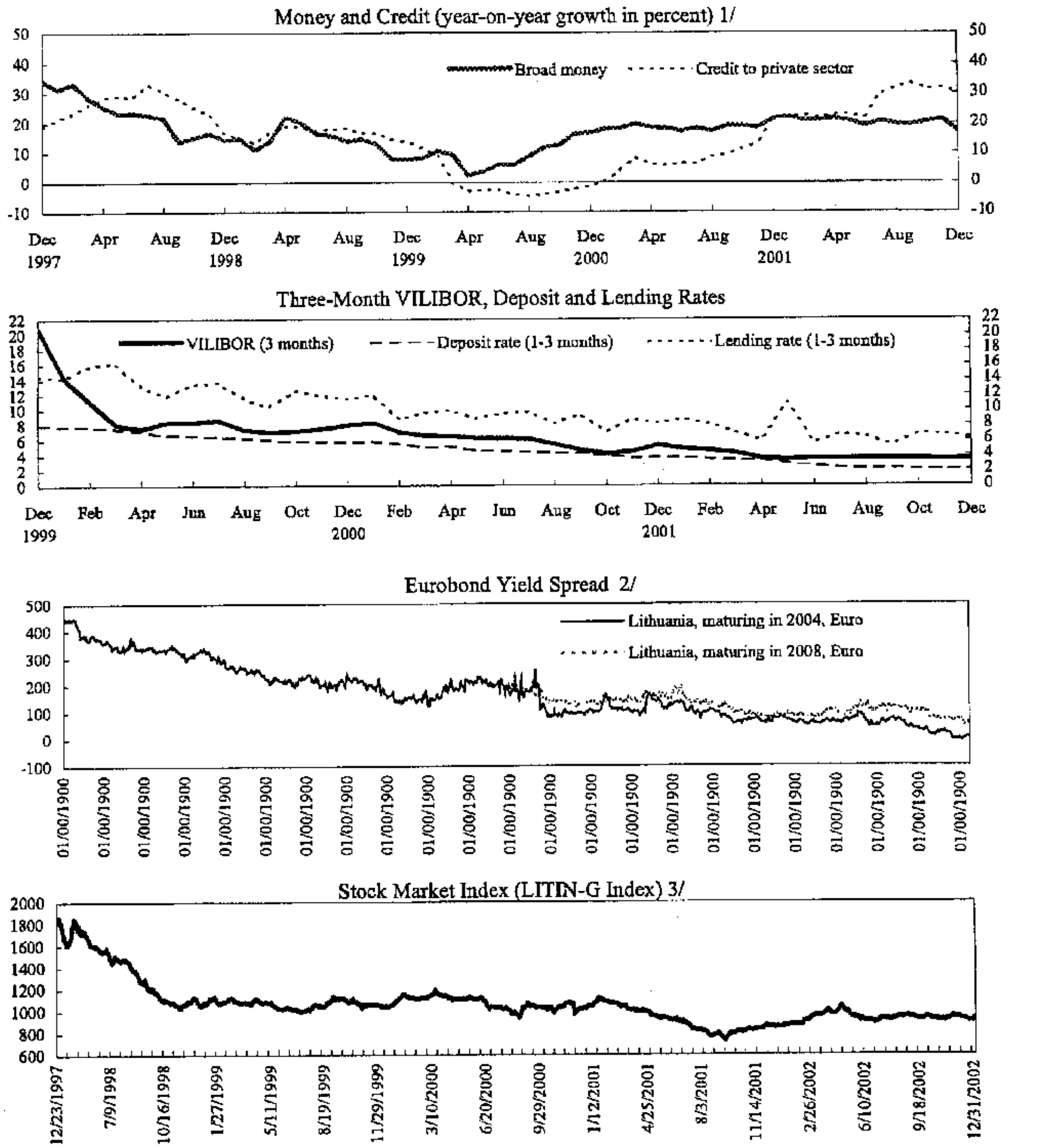


Source: International Financial Statistics and Economic Commission for Europe, Economic Survey of Europe 2002, No. 1.
1/ Includes Czech Republic, Hungary, Poland, Slovak Republic and Slovenia.

[5] The ratio of non-performing loans to total loans declined not only due to the rapid increase of the latter: the absolute value of non-performing loans fell from LTL 483.8 million at end-December 2001 to LTL 433.5 million at end-September 2002.

[6] See Box 1 in EBS/02/105 for an analysis on the initial impact of the repegging.

Figure 3. Lithuania: Financial Indicators, 1997-2003



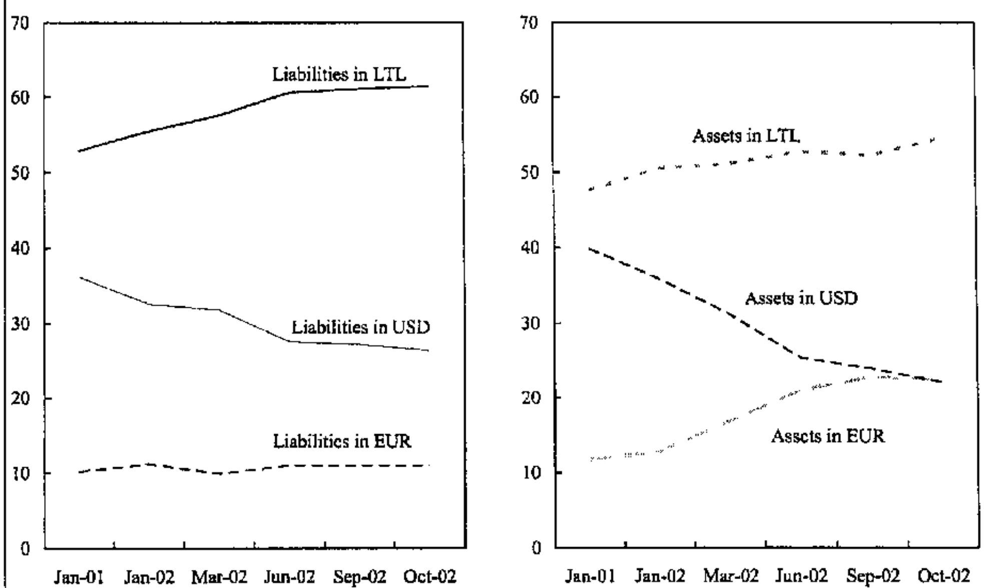
Sources: Bank of Lithuania; Bloomberg News; and National Stock Exchange of Lithuania.

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.

Currency Composition of Liabilities and Assets of Commercial Banks 1/
(End of period, in percent of total)



Source: Bank of Lithuania
1/ Excluding foreign bank branches.

B. Structural Reforms

9. **Structural reforms advanced in the fiscal area.** The approval of the new personal income tax (PIT) law in July 2002 completed the main elements of the tax reform.[7] While certain provisions of the new VAT law and excises taxes are still to be phased in, the tax system is now in general compliance with EU requirements. Cost-cutting measures at the Health Insurance Fund (HIF) successfully reduced expenditure on pharmaceuticals (SMEP, paragraph 12), and the authorities took steps to improve the financial situation in municipalities (SMEP, paragraph 11). The problem of expenditure arrears persists, however, with end-September arrears of LTL 55 million by the HIF, LTL 4 million by the state government, and LTL 209 million by municipalities.[8]

[7] The law, effective since January 1, 2003, reinstates taxation of capital gains (at a flat rate of 15 percent), sets a 33 percent rate on most other types of income, a tax exempt minimum of LTL 290 per month, and eliminates most current exemptions.

[8] The arrears of the state government were due to continued technical difficulties that are expected to have been resolved by end-2002. The arrears of the HIF originate in the difficult first quarter of 2002 and are expected to be gradually eliminated during the course of 2003.
(continued…)

10. **Progress was made in other structural reforms** (Box 1). After completing bank privatization, reforms in the supervision of credit institutions, accounting standards, and anti-money laundering and combating terrorist financing followed FSAP and EU peer review recommendations (SMEP, paragraph 14). Bankruptcy regulations were strengthened and labor market flexibility enhanced. However, the privatization process, while well advanced, proceeded more slowly than expected in a number of cases (including Lithuanian Gas and the two electricity distribution companies).

C. EU Accession

11. **Lithuania has been invited to join the EU on May 1, 2004, along with nine other countries, including its Baltic neighbors.** A referendum on membership is scheduled for May 2003, and public support stood at 64 percent in a December opinion poll. The final negotiations on enlargement were concluded at the Copenhagen summit on December 13, 2002 and settled the following issues: (i) Direct income support for farmers would be provided at 25 percent of the EU level, increasing by 5 percent every year until 2006, and then at 100 percent of the EU level during 2007-2013. Like other accession countries, Lithuania will be allowed to top up direct payments to farmers to 40 percent in 2004. Production quotas are generally higher than the current production levels, except for sugar. There will be a 7 year transition period for farmland sales.[9] (ii) The first unit at the Ignalina nuclear power plant will be closed in 2005, and the second in 2009. The EU will provide for the dismantling costs and partly finance the costs of alternative energy sources through grants to Lithuania, amounting to 95 million euro per year in 2004-2006. (iii) Lithuania will allow transit between Russia and Kaliningrad, with the technical costs financed by the EU.[10]

The state government had ample room under the program deficit target to cover the increases in arrears taking place in 2002, but new transfers would have required another supplementary budget.

[9] The continued exclusion of foreign citizens and foreign legal entities from ownership of agricultural land, in addition to the exclusion of Lithuanian legal entities, is likely to inhibit the restructuring of the agricultural sector. Access to finance for agricultural investments is difficult because banks are unwilling to lend against land on which they cannot foreclose.

[10] See Box 2 for total projected grants and contributions.

Box 1. Lithuania: Major Structural Reforms Implemented in 2002

The authorities continued to undertake a wide range of structural reforms in 2002, not only those under the program, but increasingly to comply with EU requirements. Key structural measures implemented in 2002 under the program include:

Fiscal Reforms

Tax Reform – A tax reform package was passed including a profit tax law effective since January 2002; a law on excise duties effective since July 2002; a law on Value Added Tax effective since July 2002; and law on Personal Income Tax adopted in March 2002, effective from January 2003, although some elements became effective in April 2002.

Municipal finances – Measures to improve financial management include the amendment of the Law on the state and municipalities budgets for 2002, making targeted subsidies for arrears clearance conditional on the previous reduction of the stock of arrears.

Pension reform – The Law on Pension System Reform was approved by Seimas in December 2002. It introduced a voluntary contribution-defined second pillar of pension, which will be financed by diverting some of the state social insurance contributions.

Financial Sector Reforms

Banking supervision—The BoL: (i) strengthened controls over connected lending and lending to groups of affiliated companies in July 2002; (ii) started stress testing of the banking system for credit and liquidity risks; (iii) concluded cooperation arrangements with Belarus in April 2002 and revised the agreement with Poland in July 2002; and (iv) approved a revised manual for bank supervisors implementing the new "Know Your Customer" rules.

Accounting standards-- IAS 39 is being implemented with more detailed disclosure requirements for commercial banks.

Anti-money laundering regulations and combating terrorist financing -- The authorities approved in September 2002 the criteria for deeming monetary transactions as suspicious, reflecting new recommendations of the FATF.

Labor and Social Protection

A new *Labor Code* (effective January 1, 2003) was approved by Seimas in June 2002, increasing labor markets flexibility.

A *Law on Social Assistance in Cash,* changing eligibility norms and replacing the current general reduction in housing bills with cash payments to long-term unemployed, was submitted to Seimas in November 2002.

A draft law on *unemployment insurance*, strengthening the insurance element in the payment of unemployment assistance, was approved by the government in 2002 and will be submitted to Seimas in early 2003.

Privatization

The Lithuanian Agricultural Bank, the last state-owned bank, was privatized on March 19, 2002. A 34 percent stake in the Lithuanian Gas Company was sold on June 26, 2002, although the World Bank would have preferred it to be a controlling share. An international tender for the sale of a second 34 percent stake was announced, and negotiations with Gazprom are ongoing.

A contract for advisory services on the sale of two shipping companies was signed in July 2002 with the selection of a consortium of firms led by a Lithuanian-Swedish consulting firm.

Legal Developments

Simplified *bankruptcy procedures*, ensuring compatibility with the civil process code were adopted in December 2002.

The *Bankruptcy law* was amended to strengthen the process for appointing bankruptcy administrators in December 2002, and a new short manual on bankruptcy procedures was prepared.

Box 2: Fiscal Implications of EU Accession

The accession process has already brought with it a sizeable inflow of EU grants (see table). The three pre-accession instruments, Phare, ISPA, and SAPARD, assist candidate countries by supporting institution building and investments in regulatory infrastructure and in economic and social cohesion; infrastructure projects in the fields of environment and transport; and agricultural and rural development. These programs have expanded, as the administrative capacity to carry out the different projects has improved and as a result of the urgency provided by the approaching accession date. With accession in 2004, a series of new programs will become available increasing existing support within the areas covered by the pre-accession instruments and expanding into areas including regional development and income support for farmers. The increase in EU-funded investment projects is expected to stimulate productivity, helping to gradually raise incomes to the levels enjoyed by current EU members.

Fiscal Impact of EU Accession 1/

	2002	2003	2004	2005	2006
	(In LTL million)				
Net cash flow	344	432	1,143	1,888	2,285
Grants	344	432	1,616	2,637	3,069
Pre-accession instruments	344	432	487	430	265
Post-accession instruments	0	0	1,129	2,207	2,804
Payments to the EU	0	0	-473	-749	-784
EU-related expenditure	795	1,279	3,750	5,140	5,636
Spending of grants	282	432	1,616	2,637	3,069
Co-financing	219	253	831	1,321	1,419
National investments	39	96	110	140	175
Administrative capacity building	255	498	376	247	142
Agriculture	0	0	344	47	47
Payments to the EU	0	0	473	749	784
	(In percent of GDP, unless otherwise noted)				
General government revenue and grants	30.2	30.0	32.1	33.4	33.6
Of which: grants	0.7	0.8	2.7	4.1	4.4
General government expenditure	31.4	32.0	34.1	34.3	34.1
EU-related expenditure	1.6	2.4	6.3	8.0	8.0
Other	29.9	29.7	27.8	26.4	26.1
Of which: discretionary spending 2/	17.8	17.6	15.6	14.6	14.4
Of which: current	17.3	16.8	15.0	13.7	13.6
current (percent real growth)	...	1.8	-4.9	-2.8	5.3
Financial balance 3/	-1.2	-2.0	-2.1	-1.0	-0.5

Source: Lithuanian authorities; and Fund staff estimates and projections.
1/ Assumes full absorption of available post-accession grants and no topping up of direct payments to farmers.
2/ Defined as total expenditure less EU-related expenditure, benefits paid by SoDra, defense spending, and interest.
3/ 2002 discrepancy between above and below the line (0.1 percent of GDP) divided equally between revenue and expenditure.

EU grants are generally required to finance projects that would not otherwise have been implemented. Also, disbursing the grants involves co-financing and administrative capacity building, and contributions to the EU budget must be paid. As a result, even with a temporary loosening of the fiscal stance, other spending must be contained. Budget pressures will be especially acute in 2004, as disbursement of post-accession grants related to agriculture will only be reimbursed with one year of delay, implying a projected outlay of 0.6 percent of GDP in the year of accession. To avoid an unduly large deficit, non EU-related expenditure in that year would need to be kept approximately constant in real terms. Discretionary spending, calculated with the assumption that EU-related spending is 100 percent additional, would then have to be significantly reduced, as mandatory spending requirements continue to grow. EU-related expenditure would, however, be expected to replace some of the expenditure that would otherwise have occurred. In subsequent years, rising income levels will increase tax revenue, and this makes deficit reduction less difficult while allowing expenditure to grow in real terms, albeit by less than GDP.

III. Policies and Outlook for 2003 and Medium-Term

A. Medium-term Macroeconomic Outlook

12. **Growth is expected to remain robust.** Real GDP growth is expected to moderate a little to 5.3 percent in 2003 as the recent surge in construction activity begins to dissipate and private investment growth returns to more sustainable rates (Table 10-12). Over the medium term, growth is expected to accelerate to about 5.9 percent, as exports continue to expand, and companies continue to position themselves for EU accession and take advantage of significant financing available from the EU for the co-financing of investment projects. A gradual reduction in unemployment, together with strong productivity growth and rising real incomes, should sustain private consumption. In the absence of the temporary factors that led to falling prices in 2002, annual consumer price inflation is expected to increase to about 2.5 percent over the medium term—a little above expected inflation rates in Lithuania's major EU trading partners.[11]

13. **The external current account deficit is expected to widen to 5.8 percent of GDP in 2003**, due to slow growth in partner countries, continued strong domestic demand and higher oil prices. In 2004-07, the external current account is expected to decline gradually. High FDI inflows would strengthen export capacity and competitiveness in the medium term, while a recovery in the euro area would also improve the external outlook. The appreciation of the litas vis-à-vis the dollar since the repegging is not expected to have a significant adverse impact on competitiveness, given that around 70 percent of exports are to EU and EU-accession countries.

14. **The main risk to the macroeconomic outlook would stem from an unsustainable increase in domestic demand.** This could occur, for instance, in the event of a further relaxation of fiscal policy in 2003 and 2004 beyond that resulting from the one-off spending pressures associated with EU accession, leading in turn to a further widening of the external current account deficit and an erosion of competitiveness which could undermine investor confidence. On the external side, higher oil prices, continued sluggish growth in the EU or higher international interest rates might also lead to a widening of the current account deficit and adversely impact growth. Finally, a drop in FDI inflows would lead to higher gross external financing requirements, and eventually a slowdown in growth. These vulnerability scenarios are analyzed in more detail in Appendix IV.

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[11] Productivity growth rates in Lithuania are expected to be higher than in EU trading partners, and thus a modest positive inflation differential would be consistent with the maintenance of Lithuania's competitiveness (the Balassa-Samuelson effect).

B. The Currency Board Arrangement and Monetary Sector Issues

15. **The currency board arrangement has served the economy well and remains a key element of the authorities' economic strategy.** The authorities intend to participate in the exchange rate mechanism ERM II as soon as possible following EU accession, subject to agreement with the competent EU authorities on the assessment of Lithuania's competitiveness and the sustainability of the framework.[12] The authorities believe that it would be desirable to maintain the CBA within ERM II through the eventual adoption of the euro. This would augment the commitment to exchange rate stability deriving from participation in ERM II and avoid the need for a double regime shift in the exchange rate arrangements prior to the adoption of the euro. The authorities aim at adopting the euro upon meeting the Maastricht criteria, including the minimum two-year compulsory period of membership in ERM II.[13]

16. **Continued rapid growth of money and credit aggregates is expected in 2003.** Broad money is expected to grow by 16.4 percent, with monetization of the economy reaching about 30 percent of GDP by end-year 2003. Credit to the private sector would grow by 24.5 percent, given good lending opportunities in the growing domestic economy. The authorities are committed to rigorous banking supervision in order to protect financial system stability at a time of rapid growth of money and credit. Moreover, mindful of the risk of overheating, the BoL intends to maintain the required reserve ratio at its current level of 6 percent, postponing plans to converge towards lower ECB levels for the time being.

Fiscal Policy

17. **The planned accession to the EU will put pressure on government finances in 2003-04.** EU grants have been increasing rapidly and are projected to reach 2.7 percent of GDP in 2004 (see Box 2). The majority of grants are earmarked for certain projects.

[12] The key features of the ERM II are that it has stable but adjustable central rates to the euro for the participating currency, with standard fluctuation bands of +/- 15 percent around the central rate. The ERM II is flexible enough to accommodate features of a number of different exchange rate regimes, including currency board arrangements based on a peg to the euro. The EU has noted that, "although such arrangements cannot be regarded as an acceptable substitute for participation in ERM II, they may in some circumstances constitute an appropriate unilateral commitment within ERM II. Such a unilateral commitment would not impose any additional obligation on the ECB beyond those deriving from the ERM II resolution and the Central Bank Agreement."

[13] The Maastricht criteria reflect the degree of economic convergence that each EU member state must achieve before participating in the euro area. For more details see: http://europa.eu.int/scadplus/leg/en/lvb/l25014.htm.

Requirements for co-financing and, after accession, payments to the EU budget, must therefore be financed from the national budget. Also, defense expenditure is set to increase, as Lithuania prepares to join NATO in mid-2004. The authorities recognize the importance of meeting these challenges without unduly increasing the fiscal deficit, and are committed to containing non EU-related expenditure, avoiding further tax revenue erosion, and achieving a structurally balanced budget over the medium term (excluding the cost of pension reform).

18. **The 2003 budget law passed by Seimas on December 10, 2002 envisages a general government fiscal deficit of 2 percent of GDP.** This target would represent a weakening relative to 2002, largely explained by the projected EU-related additional expenditure of about LTL 335 million (0.6 percent of GDP). The 2003 budget includes LTL 105 million for savings restitution, up from LTL 76 million in 2002.[14] The 2003 budget was also negatively affected by several amendments by Seimas to the tax reform proposals, which are estimated to cost LTL 114 million.[15] This means that the tax reform will not achieve the planned revenue neutrality until 2004.[16] The 2003 deficit may, however, be lower than budgeted, as the very ambitious plan for EU-related investments may only be partially completed and recent developments make revenue projections appear conservative.[17]

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[14] The savings restitution program was established in 1997 to compensate for losses incurred in the early 1990s by holders of ruble-denominated bank accounts. The program became unaffordable and was suspended in late 1999. It was subsequently reintroduced at a very reduced scale, settling small amounts each year, starting with the older cohorts. Claims worth about 4 percent of GDP are still outstanding. Schemes to settle all claims by distributing long-term government securities would immediately increase the budget deficit by the full amount of the transfer and would have an adverse impact on liquidity. The government is committed to proceed with savings restitution in a manner compatible with its medium-term fiscal consolidation objectives.

[15] In line with recommendations of the fiscal ROSC, the 2003 budget included a medium-term macroeconomic projection with underlying assumptions, which is available on the internet, and a detailed estimation of the revenue impact of changes to the tax code.

[16] The original tax reform package was designed to stabilize tax revenue, improve administration, and create a tax system consistent with EU requirements, and was generally in line with FAD recommendations. Seimas subsequently introduced a number of amendments that were not always consistent with the reform objectives.

[17] Implementation rates of capital expenditure were about 50 percent until 2001, and the program previously included an adjustor. Implementation rates have, however, been increasing and the 2003 budget projection assumes full implementation of capital expenditure and net lending.

Impact of Legislative Changes in 2003-04 Associated with Tax Reform 1/ (LTL million)	2003	2004
Value added tax	-63	89
Introduction of reduced 5 percent rate on meat 2/	-40	-40
Introduction of reduced 5 percent rate on hotels 2/	-23	-23
Elimination of remaining exemptions	...	152
Corporate income tax	109	141
Elimination of zero tax on reinvested profits	199	141
Move declaration date from May to October 2/	-90	
Personal income tax 3/	-320	-406
New rates and tax exempt minimum (TEM) raised to LTL 290/month	-213	-213
Increased exemption for children	-107	-107
New deductions (life insurance, pension contributions, and study)		-86
Excise taxes	120	174
Higher rate on cigarettes	50	94
Higher rate on diesel	70	145
Elimination of tax on diesel for agricultural use	...	-65
Introduction of real estate tax for personal property	...	70
Transfer of tariff revenue to the EU	...	-72
EU required elimination of turnover tax related to Ignalina	...	-70
Administrative improvements	40	86
Total	-114	12

Source: Lithuanian authorities.
1/ Estimated change compared to counterfactual result with legislation as in 2002.
2/ Amendments and changes by Seimas to the original tax reform proposal presented by the government. See EBS/01/211 and EBS/02/105 for a description of the original proposal.
3/ The cost increased from LTL 280 million in 2003, as the increase in the TEM was larger than in the original proposal.

19. **The authorities consider the envisioned increase of the general government deficit in 2003 as unavoidable in view of the upfront costs of EU-membership.** Given the strong initial position, the restraint on non EU-related current expenditure, which is set to grow by less than GDP, [18] and the government commitment to medium-term fiscal balance, this widening should not jeopardize macroeconomic stability. The 2003 deficit can be readily financed: a €400 million Eurobond issue is scheduled for early 2003, of which €250 million will be used to refinance a Eurobond maturing in April, and remaining financing needs will be satisfied in the domestic market. The government also has sizable deposits. The 2003 budget prohibits issuance of government guaranteed debt, a positive step given the large cost associated with defaults on previously guaranteed debt.

20. **EU-related expenditure pressures will intensify in 2004,** due in large part to sizable upfront payments for agricultural support of about 0.6 percent of GDP. In addition, the EU-required elimination of the turnover tax collected by the Ignalina NPP will cost about 0.1 percent of GDP.[19] However, the postponement of accession from January 1 to May 1 will reduce payments to the EU budget to two thirds of the originally envisioned full-year

[18] As shown in Box 2, discretionary current spending (which excludes EU-related expenditure) is projected to grow by 1.8 percent in real terms.

[19] The turnover tax related to the Road Fund (about 0.6 percent of GDP) is likely be converted into an excise tax.

payments of about 1.2 percent of GDP, while EU grants will still be received on a full-year basis. Nonetheless a determined effort will be required to avoid a further deterioration of the general government deficit in 2004. In particular, increasing the budget deficit at the top of the economic cycle would leave no room for maneuver in the event of a slowdown or an adverse external shock, jeopardizing compliance with the Maastricht criteria at a critical stage.

21. **The effective management of EU funds represents a significant challenge.** The scale of available grants will increase sharply upon accession, at which stage Lithuania will take over full responsibility for the approval and oversight of all EU-financed projects. Two new departments created in the Ministry of Finance to coordinate and monitor financial issues related to the EU have improved administration. The authorities are committed to further enhancing administrative capacity to ensure that grants are used productively and that adequate mechanisms are in place to guard against mismanagement and corruption, limiting the risk of refunds to the EU in the event of an unfavorable audit.

D. Structural Issues

22. **Administrative improvements are being made at all levels of government,** in particular municipalities and the HIF (Box 3). Tax administration is still a problem area, but the merger of the payroll tax collection unit within the Social Security Fund (SoDra) with the State Tax Inspectorate in 2004 and computerization projects currently underway will improve matters. In accordance with EU requirements, and in line with the recommendation of the fiscal ROSC, progress is being made in comprehensively adopting ESA'95 accounting standards which will increase transparency and aid decision making.

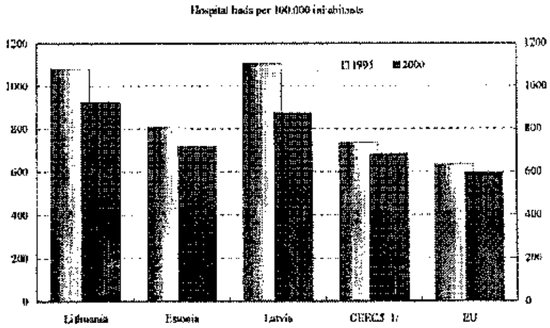
23. **The challenge of an aging population still needs to be addressed.** The recently approved pension reform measures introduced a voluntary fully-funded defined contribution plan (SMEP paragraph 13). The reform is, however, modest in scope and insufficient to ensure the long-term sustainability of the system, as expected contributions under the new second pillar are small—about LTL 25 million in 2004—and earlier plans to develop the third pillar have faltered.[20] Moreover, a recent court ruling entails that working pensioners will from now on be entitled to full pension benefits. While SoDra's current financial position is healthy, and expected to improve in the medium term, the resulting extra cost (about 0.1 percent of GDP each year) worsens the long-run outlook.

[20] The pension reform concept involves a pay-as-you-go pillar; a contribution-defined second pillar; and a voluntary privately funded third pillar (see EBS/01/211). The second pillar was originally meant to have been mandatory for younger cohorts.

Box 3. Public Health Care Finances

The issues in the health sector in Lithuania are similar to those in other transition countries. Although the system provides universal health care coverage, costs are poorly controlled and the provision of health care tends to be inefficient, over-specialized, and of relatively poor quality. Fixed costs are high due to the excessive infrastructure, including a large number of doctors and hospital beds. The decentralized nature of decision making has also hindered both cost control and progress on rationalization of health care infrastructure. Over the medium-to-longer term, the health system is also likely to come under increasing pressure from rapid increases in technology and salary costs. A long term plan is therefore needed to address the multiple priorities of rationalization, modernization, and effective cost control. Preliminary work has begun in this area in the context of a World Bank health sector project loan.

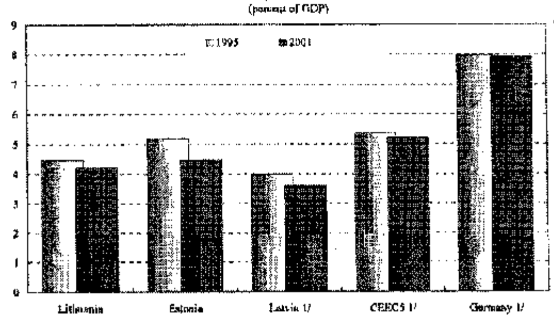
Hospital beds per 100,000 inhabitants



1/ Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia
Source: WHO Regional Office for Europe

The maintenance of the HIF as a separate extrabudgetary fund with dedicated revenue sources (primarily a fixed percentage of personal income tax revenue) was at least partly intended to safeguard resources for health care. In practice, however, funding for health care has been squeezed in recent years as tax revenues have performed poorly. Although the proportion of public spending directed towards health care has increased slightly, spending on health care has declined relative to GDP and remains relatively low by comparison to similar countries. Together with the relative inefficiency of public health care, this has resulted in an increase in private expenditure on health care and emerging concerns about reduced access to high-quality health care among the poorer sections of society.

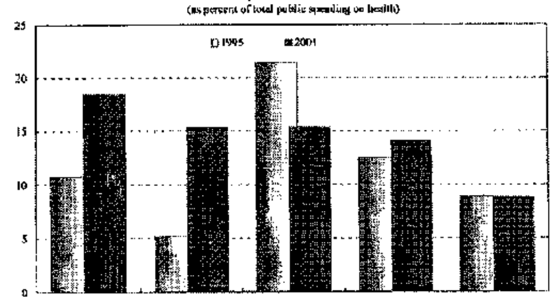
Public Expenditure on Health
(percent of GDP)



1/ Latest figures are 2000, except for Poland and Germany, which are 1999.
Source: WHO Regional Office for Europe, and staff estimates.

The financial pressure on the HIF has been by exacerbated by rapid increases in spending on pharmaceuticals, which now accounts for just under one fifth of public spending on health, and is reflected in the emergence of arrears of the HIF to pharmaceutical providers. A number of recent measures aimed at improving administration through the introduction of patients' medication booklets, limiting over-supply through the application of prescription limits for health service providers, and better cost control through lower negotiated prices and a reduction in the number of fully compensated medicines, appear to have been successful in limiting expenditure on pharmaceuticals and stabilizing the finances of the HIF. Additional measures to limit the price at which medicines are compensated to internationally competitive rates, and to reduce compensation from 100 to 90 percent for some medicines, are expected to lead to further improvements in 2003.

Public Expenditure on Pharmaceuticals
(as percent of total public spending on health)



1/ Latest figures are 2000 for Czech Republic and Slovenia, and 1998 for Germany
Source: WHO Regional Office for Europe, and staff estimates.

24. **The authorities plan to continue implementing measures to strengthen the financial system (SMEP, paragraph 14).** To improve banking supervision, a draft is being prepared to change the rules on provisioning for non-marketable loans. In compliance with EU anti-money laundering directives, further amendments to widen the coverage of agencies and businesses that must report on financial transactions will be submitted to Seimas in early 2003. A new draft law on the Settlement Finality in Payment and Security Settlement Systems, to be submitted to Seimas in the first half of 2003, seeks to improve the payments system and bring it in line with EU directives. Two new laws on Insurance Activities and Insurance Contracts will be submitted to Seimas in early 2003.

25. **The unemployment rate continued to decline in 2002**, mainly due to job creation in construction, but remains well above the EU average (Box 4). Skill mismatches have led to large regional disparities in unemployment and a high share of long-term unemployed. Government efforts focus on improving the business environment and the legal and regulatory framework, and on providing training and information. Given the large structural component of unemployment, however, the social safety net needs to be reinforced. In this connection, the government is extending unemployment insurance from 6 to 9 months.

26. **Efforts are being made to complete the privatization agenda.** Negotiations with Gazprom on the sale of a second 34 percent stake in Lithuanian Gas continue, and the deal could be closed by mid-2003. A Gazprom-led consortium is in the process of taking over two utility companies in Kaunas and plans to invest in 2004 to increase capacity. The sale of 34 percent of shares of Lithuanian airlines should be completed by mid-2003.

IV. Staff Appraisal

27. **As the stand-by supported program draws to a close, Lithuania's economic performance continues to be strong.** The sound economic policies of the last three years, aimed at maintaining macroeconomic stability and furthering structural reforms, are bearing fruit. Growth remains robust, inflation is subdued, unemployment has fallen significantly, and external viability has been restored. The authorities should be commended for their successful implementation of the program, which has bolstered Lithuania's credibility, and the staff encourages them to persevere in their efforts as there is little room for policy or implementation slippages. This combination of policies to maintain macroeconomic stability and ongoing structural reforms will be necessary to ensure sustained growth and further reductions in unemployment in the period up to and following EU accession.

28. **The CBA, which has anchored macroeconomic stability, continues to serve Lithuania well.** The successful repegging of the litas from the dollar to the euro in February 2002 strengthened market confidence and helped lower spreads to historic lows. The authorities' strategy, aiming to maintain the CBA during ERMII and adopt the euro as soon as feasible thereafter appears viable, provided domestic policies remain supportive and appropriate measures are taken in the event of adverse external shocks.

Box 4. Labor Market Trends and Policies

Labor Market Trends

Lithuania's successful transition has been characterized by the emergence of a dynamic private sector that serves as the engine of growth, job creation and economic integration. Strong job creation in the service sector, however, was unable to compensate for job losses in industry and agriculture: while share of services in employment increased from 45 percent in 1993 to 56 percent in 2002, during the same period, the share of agriculture declined from 23 to 17 percent and that of industry from 26 percent to 21 percent. Consequently—and similarly to other transition countries—the cumulative fall in employment since 1991 amounts to 20 percent, or about 400 thousand people. This phenomenon has led to an increase in unemployment (by about 220 thousand), but also to a reduction in the labor force and migration. Thus, the official employment rate in Lithuania decreased sharply from 51 percent of the total population in 1991 to 43 percent in 2002, below the EU average of 45 percent. Large social security contributions (34 percent) have also resulted in a high share of involuntary part-time and fixed-term work among employed workers, as well as significant employment in the informal sector—the UNDP Human Development Report quoted unrecorded employment to be about 225,000 in H1 2000, or 20 percent of official employment.

Characteristics of Unemployment

The official unemployment rate increased from 5.5 percent in Q2 1998 to a peak of 13.2 percent in Q1 2001, and has declined to 10.9 percent at end-2002, mainly due to the expansion of jobs in the construction sector. Long-term unemployment is high and increasing, as the share of people unemployed for 6 months or more increased from 34 percent in 1997 to 67 percent in 2002. The outward shift in the Beveridge curve (vacancy - unemployment curve) indicates that the mismatch in skills between the unemployed and the private sectors as well as the geographical mismatch contribute to the high and persistent unemployment, and suggests that policies aimed at improving skills and increasing mobility are needed. At the same time, the low vacancy-unemployment ratio points to the need for policies aimed at encouraging private job creation.

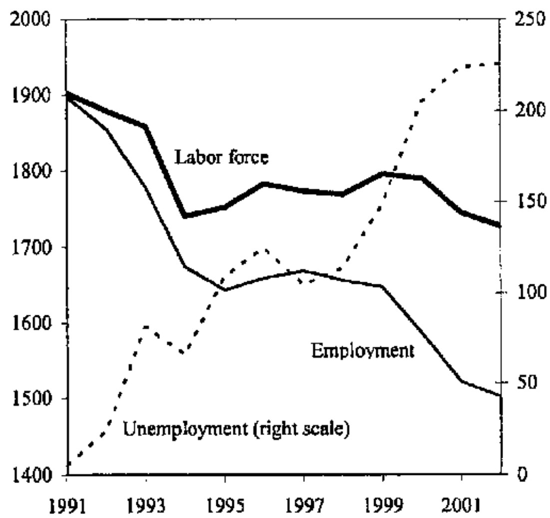
Although unemployment declined across the board, regional disparities in unemployment rates remain high, with the lowest rates in areas benefiting from FDI inflows and a strong presence of the service sector. The group of low-skilled, older workers (ages 50-54) suffers most from high and persistent unemployment. Relatedly, and as an inheritance from the central planning, unemployment is higher in rural areas and small towns than in large cities. However, labor mobility as a balancing mechanism is hampered by poor housing infrastructure and the prevalence of involuntary fixed-term contracts (which renders moving less attractive).

Policies

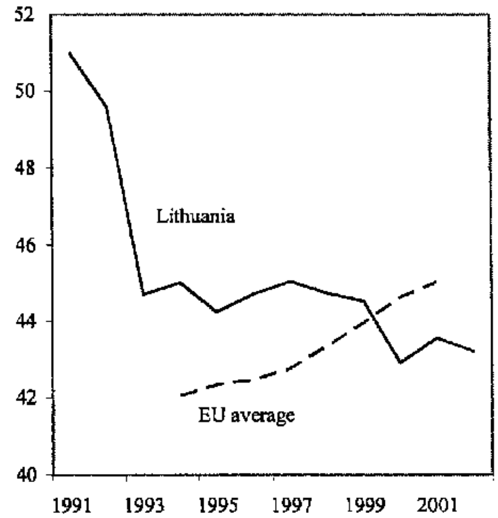
The government strategy for reducing unemployment focuses on promoting high and sustainable growth, attracting FDI, and promoting development of small and medium sized enterprises. Nonetheless, unemployment is likely to remain high in the next few years, given its structural characteristics and the likely reduction in agricultural employment from its current high level, as the reforms induced by EU accession lead to a restructuring of the sector. While the recent changes aiming at further increasing labor markets flexibility—lower minimum wages for certain regions or categories of workers with high unemployment rates; simplified dismissal procedures; and reduced severance payments—are likely to help, the government will also have to respond by ensuring that an adequate social safety net for the most vulnerable groups of workers is in place.

Labor Markets

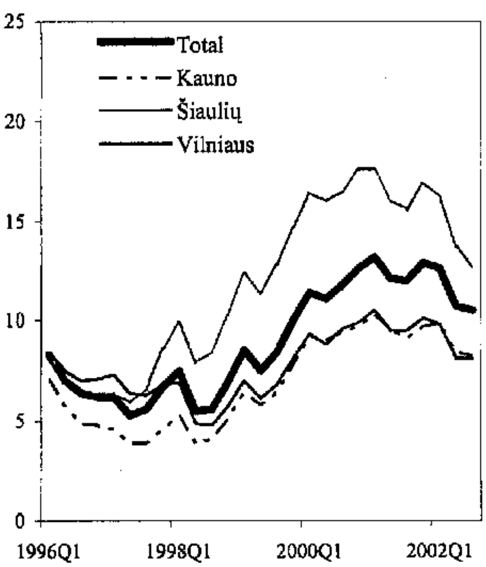
Labor force, employment, and unemployment, 1991 - 2002 Q1
(In thousands)



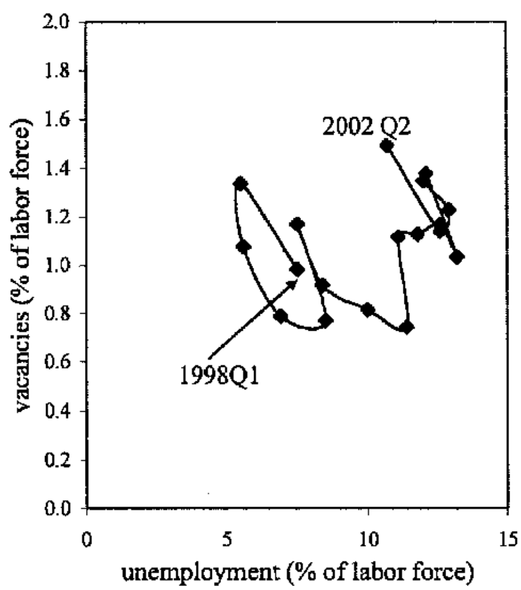
Employment rates, 1991 - 2002 Q1
(As percent of total population)



Regional unemployment, 1996 Q1- 2002 Q2
(In percent of regional labor force)



Beveridge curve, 1998 Q1 - 2002 Q2



Source: Lithuanian authorities.

29. **Maintaining the credibility of the CBA will require continued fiscal discipline.** Steady fiscal consolidation has taken place since 2000, with the budget deficit declining by over seven percentage points to 1.2 percent of GDP in 2002. A temporary weakening of the fiscal stance in 2003-04 would allow the budget to accommodate the upfront costs of EU membership while maintaining external viability. This weakening, however, must remain strictly limited and temporary, sending a signal of consistency with the medium-term goal of a structurally balanced budget. Continuity is key in 2003-04 in order to support the CBA and the stated objectives of joining ERMII and adopting the euro as soon as feasible. Moreover, a higher deficit at this stage in the cycle would leave no room for countercyclical policies in the event of a slowdown or adverse external shocks, precisely at a time when Lithuania aims to remain in compliance with the Maastricht criteria.

30. **The comprehensive tax reform package is now in place, and efforts should be geared to maintaining revenue.** A stable environment is now needed, with no significant changes in the tax system for some time, and the focus should shift toward eliminating exemptions and loopholes, promoting fairness and transparency, and improving tax administration. The staff urges the authorities to resist pressures for new tax reductions or for maintaining or awarding preferential treatments to particular groups or sectors.

31. **Expenditure pressures are expected to intensify in 2004,** in the run-up to parliamentary elections. Careful prioritization is required given that new EU and NATO-related commitments will have to be faced and that there is little room for further cuts if essential services and social expenditures are to remain adequate. Efforts geared toward expenditure rationalization should be pursued vigorously, but even if successful there would be no scope for topping up payments to agriculture from national funds. There is also no room for any new schemes for accelerating or increasing payments in connection with the savings and land restitution plans. Finally, in a year's time, very large transfers of EU funds will be channeled to Lithuania, and the concomitant responsibilities for its absorption and financial management will be devolved. The staff welcomes authorities' efforts to strengthen administrative capacity, financial controls, and audit capabilities, given the scope for potential mismanagement and even corruption. It is essential that these transfers be used effectively.

32. **Some progress was registered in fiscal structural reforms.** The measures to limit HIF expenditures are commendable and have led to a marked improvement in its financial prospects, though further efforts are needed to enhance the efficiency of the health sector. The overall financial situation of most municipalities has improved, mainly because of the generally more favorable economic environment, but underlying problems are far from being resolved. While the proposed real estate tax will help provide a more stable source of own revenue, the staff urges the authorities to take further steps, 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.

33. **By contrast, meaningful pension reform has essentially been postponed, mainly due to cost considerations.** The measures passed by Seimas do not ensure the long-term viability of the pension system and constitute a modest first step in establishing a second pillar, with very low rates of contribution and voluntary participation. Thus, it would be important that the authorities expand gradually the scope of the reform by raising rates and making participation mandatory for younger cohorts, and refraining from measures that would increase costs to the system. Moreover, steps are needed to establish appropriate supervision for the pension funds.

34. **The staff welcomes the efforts by the BoL to implement FSAP recommendations in order to reinforce the stability of the banking system.** The system was assessed as sound and resilient to foreseeable shocks, but vigilant banking supervision and tightened anti-money laundering measures should help assure the integrity of bank and enterprise balance sheets, especially in a period of rapid growth and credit expansion. The staff urges the authorities to continue monitoring very closely the quality of banks' credit portfolios and, in this connection, it supports the authorities' intention not to lower the required reserve ratio given ample liquidity in the banking system.

35. **The momentum for structural reforms must be maintained to create the conditions for sustained growth and employment creation.** Important reforms were completed in 2001-02: in particular, bank privatization, the restructuring of the energy sector, and measures to increase labor market flexibility. By contrast, privatization efforts in other areas faltered, and the unemployment insurance law was delayed. For Lithuania to take full advantage of the opportunities associated with EU accession, the impetus for growth must come from the private sector, but the state must promote a supportive environment. The staff urges the authorities to step up privatization efforts, and to persevere in implementing measures to facilitate private activity and deregulation, which are key to improving Lithuania's business environment and competitiveness.

36. **Lithuania's statistical base is generally adequate, and the quality and timeliness of data allow effective surveillance and macroeconomic analysis.** The authorities have subscribed to Standard Data Dissemination System since May 1996. A data ROSC was conducted in May 2002, with a favorable assessment, and a fiscal ROSC, providing recommendations for improving transparency and data quality in the budget process took place in July 2002. The staff encourages the authorities to implement the fiscal ROSC recommendation, in particular those aimed at enhancing budget comprehensiveness, streamlining fiscal management and strengthening budget documentation and analysis. In addition, the staff urges the authorities to follow the recommendations of the safeguards assessment and achieve compliance in the near future.

37. **There are additional risks associated to the authorities' macroeconomic strategy.** Gross financing needs in the medium-term are quite large, and external vulnerabilities remain. 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 has now access to international financial markets on very good terms, and net external debt remains at an acceptable level, it should be kept low, so as to guard against possible unfavorable external developments.

38. **Despite these concerns, the staff would like to reiterate its overall assessment that the authorities' program has been successful and Lithuania is well placed to reap the benefits of EU membership.** Future cooperation between the authorities and the Fund is expected to continue to be close in the context of surveillance. Overall, the stance of macroeconomic policies remains appropriate, and the staff is confident that the authorities will respond appropriately to adverse external or domestic shocks. Thus, the staff recommends the completion of the third review under the stand-by arrangement.

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

	Target	Adjusted Target	Outcome 2/
Continuous performance criteria			
I. Exchange rate			
LTL 3.4528 per euro 3/	...	...	Observed through December 31, 2002
II. 100-percent coverage of currency board liabilities, in percent	100	...	Observed through December 31, 2002
III. Reserve requirements, in percent			Observed through December 31, 2002
Reserve requirements through June 30, 2002	6		
Reserve requirements from July1, 2002 4/	4		
IV. Non-accumulation of new external payments arrears	...	...	Observed through December 31, 2002
Quantitative performance criteria			
I. Ceiling on the general government deficit, mln. LTL			
Cumulative from January 1, 2001			
March 31, 2001 (previous arrangement)	271	287	91
June 30, 2001	460	496	337
September 30, 2001	600	689	546
December 31, 2001	841	1011	932
Cumulative from January 1, 2002			
March 31, 2002	383	412	103
June 30, 2002	564	642	72
September 30, 2002	764	886	-11
December 31, 2002	776	...	603
II. Floors on net foreign exchange coverage of the currency board arrangement			
Stocks			
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	...	20
September 30, 2002, euro, mln.	-147	...	36
December 31, 2002, euro, mln.	-147	...	49

III. Ceilings on contracted public and publicly guaranteed medium- and long-term external debt; mln. US$	All maturities	1-5 year maturity	All maturities (medium- and long-term)	1-5 year maturity
Cumulative from January 1, 2001				
March 31, 2001 (previous arrangement)	293	200	183	0
June 30, 2001	433	200	183	0
September 30, 2001	648	200	194	0
December 31, 2001	683	200	250	0
Cumulative from January 1, 2002				
March 31, 2002	450	200	34	34
June 30, 2002	610	200	472	0
September 30, 2002	640	200	501	0
December 31, 2002	640	200	515	34

IV. Ceilings on the outstanding stock of public and publicly guaranteed short-term external debt; mln. US$	Target	Adjusted Target	Outcome 2/
Maximum stock during the period			
March 31, 2001 (previous arrangement)	0	...	0
June 30, 2001	50	...	3
September 30, 2001	50	...	3
December 31, 2001	50	...	3
March 31, 2002	200	...	37
June 30, 2002	200	...	3
September 30, 2002	200	...	3
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. The figures for the cumulative fiscal deficit outcome have been revised from the previous staff report (EBS/02/105) but remain below the program targets.

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	210
September 30, 2002	312	214
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	44
September 30, 2002	0	60
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	Observed 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 new Real Estate Tax law	end-September 2002	Delayed. Submission now expected in 2003
Submit to Seimas amendments to the CIT law to return the declaration date from October 2003 to May 2003 1/	end-September 2002	Observed
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	Observed
Submit to Seimas the draft unemployment insurance law 2/	end-December 2002	Delayed. Submission now expected in mid-2003

Source: Lithuanian authorities.
1/ Not discussed by Seimas.
2/ The current timing is as agreed in SMEP from EBS/02/105

Table 4. Lithuania: Selected Macroeconomic Indicators, 1999-2003

	1999	2000	2001	2002		2003	
				Prog.	Est.	EBS/02/105	Proj.
National income, prices, and wages							
Nominal GDP (in millions of litai)	42,655	45,148	47,958	51,531	50,704	55,860	54,391
GDP (in millions of U.S. dollars)	10,664	11,287	11,990	13,523	13,853	15,631	15,813
Real GDP growth (year-on-year, in percent)	-3.9	3.8	5.9	4.4	5.9	4.8	5.3
Average CPI (year-on-year change, in percent)	0.8	1.0	1.3	1.3	0.3	2.5	2.1
End-of-period CPI (year-on-year change, in percent)	0.3	1.5	2.0	2.2	-1.0	2.5	2.1
GDP deflator (year-on-year change, in percent)	3.2	2.0	0.3	2.9	-0.2	3.4	1.9
Average monthly wage (in U.S. dollars)	269	264	266	...	...	...	...
Unemployment rate (in percent) 1/	10.0	12.6	12.9	11.5	10.9	...	...
Saving-investment balance (in percent of GDP)							
Gross national saving	11.5	14.6	17.0	16.6	17.3	16.9	17.4
General government	-3.9	-0.2	0.1	0.3	1.0	1.0	1.1
Non-government	15.4	14.7	16.9	16.3	16.3	15.9	16.3
Gross national investment	22.7	20.5	21.8	22.4	22.7	22.6	23.2
General government	2.2	1.9	1.9	1.5	2.4	2.1	2.9
Non-government	20.4	18.6	19.9	20.9	20.3	20.5	20.3
Foreign saving	11.2	6.0	4.8	5.9	5.4	5.7	5.8
General government fiscal balance (in percent of GDP) 2/	-8.5	-2.8	-1.9	-1.5	-1.2	-1.1	-2.0
External sector							
Current account balance							
in percent of GDP	-11.2	-6.0	-4.8	-5.9	-5.4	-5.7	-5.8
in millions of U.S. dollars	-1,194	-675	-574	-791	-752	-893	-920
Gross official reserves (in millions of U.S. dollars) 3/	1,242	1,359	1,669	1,928	2,419	2,233	2,728
Gross external debt (in percent of GDP) 4/	42.5	43.0	43.9	42.7	38.8	44.1	38.5
Debt service (in percent of exports of GNFS)	18.5	20.9	31.0	24.6	43.2	23.5	19.0
Exchange rate (litai/euro, period average)	4.26	3.69	3.58	...	3.46	...	...
Real effective exchange rate (1998=100, "+"=appreciation) 5/	112.9	120.2	119.1	...	...	...	...
Money and credit							
Reserve money (year-on-year change, in percent)	-4.0	-3.3	8.3	4.7	20.8	...	6.0
Broad money (year-on-year change, in percent)	7.7	16.5	21.4	17.0	16.9	...	16.4
Private sector credit (year-on-year change, in percent) 6/	13.8	-1.2	21.4	25.0	30.4	...	24.5
Money multiplier	2.2	2.6	3.0	3.3	2.9	...	3.2
Currency/deposits, in percent	43.9	34.1	29.9	27.8	33.9	...	31.0
Foreign currency deposits/ litai deposits, in percent	77.7	83.8	74.8	73.0	48.4	...	50.0

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

1/ Registered unemployment, end-of-period.
2/ The program target for 2002 assumes 50 percent implementation of outlays for capital expenditure and net lending, as explained in the Technical Memorandum of Understanding. The projection for 2003 assumes 100 percent implementation, and an implementation rate of 50 percent would reduce the projected deficit to 1.3 percent of GDP. The figures for 2003 do not include the early repurchase of Lithuania's EFF by the BoL in net lending.
3/ Gross official reserves reported here differ from the monetary table due to valuation differences.
4/ External liabilities minus foreign equity investment in Lithuania.
5/ CPI-based, trade-weighted real effective exchange rate against 21 major trading partners in 1999.
6/ 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(a). Lithuania: Balance of Payments, 1998-2003

	1998	1999	2000	2001	2002 H1	2002 Q3	2002 Full year	2002 Full year	2003
					Actual	Actual	Prog.	Est.	Proj.
	(In millions of US dollars, unless otherwise indicated)								
Current account	-1,298	-1,194	-675	-574	-322	-42	-791	-752	-920
Trade balance	-1,518	-1,405	-1,104	-1,108	-549	-249	-1,231	-1,357	-1,471
Exports (f.o.b.)	3,962	3,147	4,050	4,889	2,721	1,599	5,217	5,839	6,621
Imports (f.o.b.)	5,480	4,551	5,154	5,997	3,270	1,848	6,447	7,195	8,093
Non-factor services, net	241	305	380	457	258	176	463	549	547
Credits	1,109	1,092	1,059	1,157	634	412	1,187	1,398	1,436
Debits	868	786	679	700	376	236	723	848	889
Factor income, net	-255	-258	-194	-180	-131	-33	-269	-196	-243
Current transfers, net	235	163	243	258	99	63	245	251	247
Of which: EU accession related	...	...	...	44	...	...	45	94	126
Capital and financial account	1,412	1,041	705	780	804	-200	1,037	1,154	1,308
Capital transfers, net	-2	-3	2	1	18	29	5	60	58
Financial account	1,414	1,044	702	779	786	-229	1,032	1,094	1,250
Direct investment, net	921	478	375	439	420	132	395	642	550
Assets	-4	-9	-4	-7	0	-25	-7	-42	0
Liabilities	926	486	379	446	419	158	402	684	550
Portfolio investment, net	-53	506	265	264	255	-258	173	-50	241
Inflows	-43	508	406	238	358	-234	528	132	525
Outflows	-10	-2	-141	26	-102	-24	-355	-182	-284
Other capital inflows, net	545	61	63	76	111	-103	464	503	459
Inflows	1,412	1,011	1,057	1,961	1,349	988	1,417	3,373	1,392
Outflows	-867	-950	-994	-1,885	-1,238	-1,091	-953	-2,870	-933
Net errors and omissions	315	-26	127	340	5	66	52	35	0
Financing	-429	179	-157	-547	-488	177	-298	-438	-388
Fund financing 1/	-30	-17	-26	-34	-14.2	-5.7	-39	-35	-79
Change in official reserves (-=increase)	-399	196	-131	-513	-473	182	-259	-403	-309
Gross official reserves 2/	1,460	1,242	1,359	1,669	2,349	2,155	1,928	2,419	2,728
Gross external debt 3/	3,741	4,528	4,856	5,259	5,373	5,373	5,781	5,379	6,081
Public and publicly guaranteed	1,687	2,392	2,364	2,384	2,192	2,192	2,472	2,470	2,522
Private	2,054	2,137	2,493	2,875	3,180	3,180	3,309	2,910	3,559
Net external debt 4/	2,243	2,818	2,948	3,166	3,233	3,233	3,714	3,514	4,105
Short-term gross external debt									1,525
On a remaining maturity basis	1,730	1,899	2,786	4,452	3,578	3,578	3,019	2,993	3,136
On an original maturity basis	1,042	1,045	1,114	1,551	1,477	1,477	1,689	1,718	1,791
Of which:									
Excluding trade credit	648	692	382	689	563	586	777	806	839
Currency and deposits at banks	145	189	59	166	179	218	221	250	255
Short-term net external debt	88	-78	-59	278	198	37	455	392	644
Debt service 5/	1,144	786	1,066	1,874	1,558	1,071	1,577	3,127	1,531
Gross amortization	984	627	854	1,672	1,438	1,020	1,328	2,901	1,275
Interest payments	160	158	212	202	120	51	249	226	256
	(In percent of GDP, unless otherwise indicated)								
Current account	-12.1	-11.2	-6.0	-4.8	-5.2	-1.1	-5.9	-5.4	-5.8
Trade balance of goods and services	-11.9	-10.3	-6.4	-5.4	-4.7	-1.9	-5.7	-5.8	-5.8
Trade balance, goods	-14.1	-13.2	-9.8	-9.2	-8.9	-6.5	-9.1	-9.8	-9.3
Of which:									
Non-energy trade balance	-8.2	-6.6	-3.2	-3.8	-3.6	-1.3	-4.2	-4.0	-4.9
Trade balance, services	2.2	2.9	3.4	3.8	4.2	4.6	3.4	4.0	3.5
Factor income, net	-2.4	-2.4	-1.7	-1.5	-2.1	-0.9	-2.0	-1.4	-1.5
Current transfers, net	2.2	1.5	2.1	2.1	1.6	1.7	1.8	1.8	1.6
Of which: EU accession related	...	...	...	0.4	...	...	0.3	0.7	0.8
Financial account	13.2	9.8	6.2	6.5	12.7	-6.0	7.6	7.9	7.9
Direct investment, net	8.6	4.5	3.3	3.7	6.8	3.4	2.9	4.6	3.5
Portfolio investment, net	-0.5	4.7	2.3	2.2	4.1	-6.7	1.3	-0.4	1.5
Other investment, net	5.1	0.6	0.6	0.6	1.8	-2.7	3.4	3.6	2.9
Gross external debt 3/	34.8	42.5	43.0	43.9	38.8	38.8	42.7	38.8	38.5
Public and publicly guaranteed	15.7	22.4	20.9	19.9	15.8	15.8	18.3	17.8	15.9
Private	19.1	20.0	22.1	24.0	23.0	23.0	24.5	21.0	22.5
Net external debt 4/	20.9	26.4	26.1	26.4	23.3	23.3	27.5	25.4	26.0
Public and publicly guaranteed	15.7	22.4	20.9	19.9	15.8	15.8	18.3	17.8	15.9
Private	5.2	4.0	5.2	6.5	7.5	7.5	9.2	7.5	10.0
Short-term gross external debt									
On a remaining maturity basis	16.1	17.8	24.7	37.1	25.8	25.8	22.3	21.6	19.8
On an original maturity basis	9.7	9.8	9.9	12.9	10.7	10.7	12.5	12.4	11.3
Of which:									
Excluding trade credit	6.03	6.49	3.38	5.74	4.6	3.7	5.75	5.82	5.31
Currency and deposits at banks	1.34	1.8	0.52	1.39	1.5	1.4	1.6	1.80	1.61
Short-term net external debt 6/	0.81	-0.74	-0.52	2.32	1.6	0.2	3.36	2.83	4.07
Debt service, in percent of exports of GNFS 5/	22.6	18.5	20.9	31.0	46.4	53.3	24.6	43.2	19.0
Gross amortization	19.4	14.8	16.7	27.7	42.9	50.7	20.7	40.1	15.8
Interest payments	3.2	3.7	4.1	3.3	3.6	2.5	3.9	3.1	3.2
Memorandum items:									
Nominal GDP (millions of U.S. dollars)	10,747	10,664	11,287	11,990	6,198	3,829	13,523	13,853	15,813
Exports of GNFS (nominal percent change, y-o-y)	-2.9	-16.4	20.6	18.3	15.1	28.7	5.9	19.7	11.3
of which: non-energy exports of GNFS	-3.6	-12.7	13.6	14.8	22.7	34.6	6.6	25.3	11.7
Imports of GNFS (nominal percent change, y-o-y)	1.8	-15.9	9.3	14.8	15.4	29.7	7.1	20.1	11.7
of which: non-energy imports of GNFS	4.3	-16.0	1.9	15.5	23.8	33.7	8.9	25.2	15.6
Crude oil price (US$/bll)	13.1	18.0	28.2	24.3	...	...	23.0	25.2	25.0

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

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

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

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

Table 5(b). Lithuania: Balance of Payments, 2001-2008 (continued)

	2001	2002		2003	2004	2005	2006	2007	2008
		Prog.	Est.			Proj.			
Current account	-574	-791	-752	-920	-932	-912	-938	-1,016	-1,049
Trade balance	-1,108	-1,231	-1,357	-1,471	-1,550	-1,707	-1,814	-1,941	-2,011
Exports (f.o.b.)	4,889	5,217	5,839	6,621	7,208	7,910	8,653	9,499	10,458
Imports (f.o.b.)	5,997	6,447	7,195	8,093	8,758	9,617	10,466	11,441	12,469
Non-factor services, net	457	463	549	547	549	568	586	613	672
Credits	1,157	1,187	1,398	1,436	1,490	1,545	1,603	1,670	1,834
Debits	700	723	848	889	940	977	1,017	1,057	1,162
Factor income, net	-180	-269	-196	-243	-372	-431	-484	-540	-600
Current transfers, net	258	245	251	247	440	658	773	852	891
Of which: EU accession related	44	45	94	126	335	550	667	729	795
Capital and financial account	780	1,037	1,098	1,308	1,110	1,064	1,084	1,168	1,200
Capital transfers, net	1	5	60	58	58	58	58	58	58
Financial account	779	1,032	1,038	1,250	1,052	1,006	1,026	1,110	1,142
Direct investment, net	439	395	642	550	550	554	602	659	700
Portfolio investment, net	264	173	-50	241	280	169	100	93	92
Inflows	238	528	132	525	564	538	150	150	362
Outflows	26	-355	-182	-284	-285	-369	-51	-57	-270
Other capital inflows, net	76	464	446	459	222	283	325	359	351
Inflows	1,961	1,417	3,373	1,392	1,264	1,450	1,576	1,723	1,724
Outflows	-1,885	-953	-2,870	-933	-1,042	-1,167	-1,251	-1,364	-1,374
Net errors and omissions	152	52	92	0	0	0	0	0	0
Financing	-359	-298	-438	-388	-178	-153	-147	-153	-152
Fund financing 1/	-34	-39	-35	-79	-18	-13	-7	-3	-2
Change in official reserves (-=increase)	-325	-259	-403	-309	-160	-140	-140	-150	-150
Gross official reserves 2/	1,669	1,928	2,419	2,728	2,888	3,028	3,168	3,318	3,468
Gross external debt 3/	5,259	5,781	5,379	6,081	6,596	7,093	7,627	8,156	8,709
Public and publicly guaranteed	2,384	2,472	2,470	2,522	2,585	2,480	2,404	2,303	2,200
Private	2,875	3,309	2,910	3,559	4,011	4,612	5,223	5,852	6,509
Net external debt 4/	3,166	3,714	3,514	4,105	4,559	4,968	5,356	5,775	6,186
Public and publicly guaranteed	2,384	2,472	2,470	2,522	2,585	2,480	2,404	2,303	2,200
Private	782	1,243	1,044	1,583	1,974	2,488	2,952	3,472	3,985
Short-term gross external debt									
On a remaining maturity basis	4,452	3,019	2,993	3,136	3,452	3,346	3,632	3,801	4,194
On an original maturity basis	1,551	1,689	1,718	1,791	1,903	2,037	2,209	2,377	2,545
Debt service 5/	1,874	1,577	3,127	1,531	1,659	1,899	1,685	1,827	2,077
Gross amortization	1,672	1,328	2,901	1,275	1,344	1,549	1,308	1,424	1,649
Interest payments	202	249	226	256	314	350	376	403	428
Current account	-4.8	-5.9	-5.4	-5.8	-5.4	-4.8	-4.6	-4.5	-4.3
Trade balance of goods and services	-5.4	-5.7	-5.8	-5.8	-5.8	-6.0	-6.0	-5.9	-5.5
Trade balance, goods	-9.2	-9.1	-9.8	-9.3	-9.0	-9.1	-8.8	-8.6	-8.2
Of which:									
Non-energy trade balance	-3.8	-4.2	-4.0	-4.9	-5.0	-5.4	-5.4	-5.4	-5.9
Trade balance, services	3.8	3.4	4.0	3.5	3.2	3.0	2.8	2.7	2.7
Factor income, net	-1.5	-2.0	-1.4	-1.5	-2.2	-2.3	-2.4	-2.4	-2.4
Current transfers, net	2.1	1.8	1.8	1.6	2.6	3.5	3.8	3.8	3.6
Of which: EU accession related	0.4	0.3	0.7	0.8	1.9	2.9	3.2	3.2	3.2
Financial account	6.5	7.6	7.5	7.9	6.1	5.3	5.0	4.9	4.7
Direct investment, net	3.7	2.9	4.6	3.5	3.2	2.9	2.9	2.9	2.9
Portfolio investment, net	2.2	1.3	-0.4	1.5	1.6	0.9	0.5	0.4	0.4
Other investment, net	0.6	3.4	3.2	2.9	1.3	1.5	1.6	1.6	1.4
Gross external debt 3/	43.9	42.7	38.8	38.5	38.3	37.7	37.1	36.3	35.5
Public and publicly guaranteed	19.9	18.3	17.8	15.9	15.0	13.2	11.7	10.2	9.0
Private	24.0	24.5	21.0	22.5	23.3	24.5	25.4	26.0	26.6
Net external debt 4/	26.4	27.5	25.4	26.0	26.5	26.4	26.0	25.7	25.2
Public and publicly guaranteed	19.9	18.3	17.8	15.9	15.0	13.2	11.7	10.2	9.0
Private	6.5	9.2	7.5	10.0	11.5	13.2	14.3	15.4	16.3
Short-term gross external debt									
On a remaining maturity basis	37.1	22.3	21.6	19.8	20.1	17.8	17.6	16.9	17.1
On an original maturity basis	12.9	12.5	12.4	11.3	11.1	10.8	10.7	10.6	10.4
Debt service, in percent of exports of GNFS 5/	31.0	24.6	43.2	19.0	19.1	20.1	16.4	16.4	16.9
Gross amortization	27.7	20.7	40.1	15.8	15.5	16.4	12.8	12.7	13.4
Interest payments	3.3	3.9	3.1	3.2	3.6	3.7	3.7	3.6	3.5
Memorandum items:									
Nominal GDP (millions of U.S. dollars)	11,990	13,523	13,853	15,813	17,210	18,828	20,583	22,479	24,513
Exports of GNFS (nominal percent change, y-o-y)	18.3	5.9	19.7	11.3	7.9	8.7	8.5	8.9	10.0
of which: non-energy exports of GNFS	14.8	6.6	25.3	11.7	11.2	10.6	10.3	10.2	9.5
Imports of GNFS (nominal percent change, y-o-y)	14.8	7.1	20.1	11.7	8.0	9.2	8.4	8.8	9.1
of which: non-energy imports of GNFS	15.5	8.9	25.2	15.6	12.1	11.8	10.7	10.4	10.5
Crude oil price (US$/bll) 6/	24.3	23.0	25.2	25.0	22.5	22.0	21.0	21.0	21.0

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

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

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

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 2002-8 are based on WEO baseline projection.

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

	2000	2001				2002			
	Year	Mar.	June	Sept.	Dec.	Mar.	Jun.	Latest	Date
Financial indicators									
State debt (domestic and foreign, in percent of GDP) 1/	28.2	27.7	27.8	28.7	28.6	32.2	34.8	31.6	Q3/2002
Broad money (year-on-year change in percent)	16.5	19.4	17.2	18.9	21.4	20.9	19.0	19.3	Q3/2002
Broad money in percent of gross official reserves	192.4	206.2	188.0	183.2	190.1	185.7	147.0	184.9	Q3/2002
Private sector credit (year-on-year change in percent) 2/	-1.2	8.2	6.2	9.5	21.4	21.6	21.8	33.3	Q3/2002
External indicators									
Current account balance in percent of GDP	-6.0	-5.4	-4.3	-0.1	-10.8	-4.4	-5.8	-1.1	Q3/2002
Exports of GNFS (in millions of U.S. dollars)	5,109	1,370	1,545	1,562	1,569	1,478	1,878	2,011	Q3/2002
Exports of GNFS (year-on-year change in percent)	20.6	12.8	25.3	14.4	21.0	7.9	21.6	28.7	Q3/2002
Imports of GNFS (year-on-year change in percent)	9.3	11.7	16.6	8.6	21.6	6.7	23.3	29.7	Q3/2002
Capital and financial account balance in percent of GDP	6.2	15.7	6.7	5.0	10.5	6.1	18.2	-6.0	Q3/2002
Gross official reserves (in millions of U.S. dollars) 3/	1,359	1,287	1,455	1,598	1,669	1,740	2,349	2,155	Q3/2002
Gross official reserves/short-term debt 4/	0.49	0.47	0.47	0.39	0.37	0.45	0.66	0.77	Q3/2002
Gross official reserves/reserve money	1.37	1.40	1.52	1.69	1.56	1.56	0.00	1.56	Q3/2002
Gross official reserves in months of imports of GNFS over the following year	2.4	2.1	2.3	2.4	2.5	2.5	3.3	3.0	Q3/2002
Total gross external debt (in millions of U.S. dollars) 6/	4,856	4,856	4,861	5,188	5,259	5,109	5,373	5,373	Q3/2002
in percent of GDP	43.0	43.0	43.1	46.0	46.6	42.6	38.8	38.8	Q3/2002
of which: Public sector debt (in millions of U.S. dollars)	2,364	2,364	2,406	2,552	2,384	2,000	2,192	2,192	Q3/2002
in percent of GDP	20.9	20.9	21.3	22.6	21.1	14.4	15.8	15.8	Q3/2002
of which: Short-term external debt (in millions of U.S. dollars) 4/	2,786	2,748	3,074	4,131	4,452	3,907	3,578	2,804	Q3/2002
in percent of gross international reserves	205.1	213.5	211.3	258.5	266.7	224.6	152.3	130.2	Q3/2002
in percent of GDP	24.7	24.7	27.2	39.4	39.4	39.4	0.0	39.4	Q3/2002
of which: excluding short-term liabilities of the commercial banks	2,463	2403.4	2700.1	3672.0	3929.8	3450.7	3193.5	2435.6	Q3/2002
Total net external debt (in millions of U.S. dollars) 7/	2,948	2,948	2,854	3,031	3,166	3,100	3,233	3,233	Q3/2002
in percent of GDP	26.1	26.1	25.3	26.9	28.0	22.4	23.3	23.3	Q3/2002
of which: Public sector debt (in millions of U.S. dollars)	2,364	2,364	2,406	2,552	2,384	2,000	2,192	2,192	Q3/2002
in percent of GDP	20.9	20.9	21.3	22.6	21.1	14.4	15.8	15.8	Q3/2002
Total net external short-term debt (in millions of U.S. dollars) 8/	-59	-285	-132	-68	278	213	228	42	Q3/2002
in percent of GDP	-0.5	-2.0	-0.9	-0.6	2.5	1.8	1.1	0.2	Q3/2002
External interest payments in percent of exports GNFS	4.1	15.5	4.1	2.8	2.6	4.0	3.3	2.5	Q3/2002
External amortization payments in percent of exports GNFS	16.7	62.3	24.0	14.4	16.9	52.2	35.5	50.7	Q3/2002
Public and publicly guaranteed debt service as percent of tax revenue	12.7	6.2	7.2	9.9	10.1	5.4	6.6	6.2	Q3/2002
Debt service as percent of exports of GNFS 9/	20.9	77.8	28.1	17.2	19.5	56.1	38.8	53.3	Q3/2002
Real effective exchange rate (year-on-year change in percent, "+" = appreciation) 10/	6.55	0.01	1.19	-0.04	-1.54	1.47	2.63	2.63	7/31/2002
Financial market indicators									
Stock market index, end of period 11/	1,047	1,007	910	791	855	939	921	921	10/24/2002
Foreign currency debt rating 12/	BBB-	BBB-	BBB-	BBB-	BBB-	BBB	BBB	BBB	10/24/2002
Memorandum item:									
GDP (in millions of U.S. dollars)	11,990	2,514	2,810	3,042	2,920	2,815	3,383	3,829	Q3/2002
Nominal exchange rate (litai/U.S. dollar, end-of-period)	4.0	4.0	4.0	4.0	4.0	4.0	3.8	3.5	Q3/2002
Nominal exchange rate (litai/euro, end-of-period)	3.7	3.4	3.6	3.5	3.5	3.5	3.5	3.5	Q3/2002

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

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 table 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 REER 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 com

12/ S&P investment grade rating.

Table 7. Lithuania: Summary of Consolidated General Government Operations, 1998-2003

	1998	1999	2000 1/	2001 2/	2002 Jan-Sept Prog. 3/	2002 Jan-Sept Prel.	2002 Prog. 4/	2002 Est. 5/	2003 Proj. 5/
	(In millions of litai)								
Revenue and grants	14,036	13,687	13,707	14,296	11,025	11,338	15,005	15,364	16,301
Grants 6/						259		344	432
Revenue	14,036	13,687	13,707	14,296	11,025	11,079	15,005	15,020	15,870
Tax revenue	13,433	12,955	12,841	13,154	10,161	10,223	13,925	13,902	14,706
Taxes on income and profits	4,017	3,971	3,835	3,785	2,854	2,843	3,845	3,799	3,861
Payroll tax (social security tax)	3,063	2,891	3,194	3,265	2,474	2,559	3,387	3,390	3,606
Taxes on goods and services	5,596	5,385	5,157	5,474	4,330	4,333	6,007	6,026	6,504
Other tax revenue	756	709	655	630	502	489	687	687	735
Non-tax Revenue 7/	603	732	866	1,142	865	856	1,079	1,118	1,163
Expenditure and net lending	16,362	17,152	15,011	15,065	11,750	11,229	15,741	15,912	17,408
Expenditure	15,734	16,146	14,711	14,989	11,607	11,309	15,585	16,014	17,287
Current expenditure 8/	14,326	15,190	13,839	14,072	11,011	10,509	14,814	14,803	15,712
Wages and salaries, excl. contributions to SoDra	3,290	3,513	3,450	3,509	2,645	2,680	3,520	3,620	3,770
Goods and services	4,899	4,425	4,088	4,100	3,449	2,966	4,715	4,623	5,005
Transfers to EU	0	0	0	0	0	0	0	0	0
Transfers to households	4,977	5,244	5,401	5,586	4,257	4,161	5,760	5,698	5,959
Subsidies	202	150	103	81	39	83	66	102	162
Interest payments	507	650	782	781	554	562	672	684	711
Savings restitution program	450	1,207	15	15	66	57	81	75	105
Capital expenditure	1,408	956	872	918	596	800	771	1,210	1,575
Discrepancy	190	170	-59	163	39	98	39	54	0
Financial balance	-1,888	-2,629	-944	-856	-621	-69	-620	-704	-986
Net lending 7/	628	1,006	300	76	143	-80	156	-101	121
Lending	1,017	1,381	529	455	297	147	355	218	248
of which: Mazeikiu Oil Company	240	800	88	0	0	0	0	0	0
Repayments	389	-375	-230	-378	-154	-227	-199	-320	-127
Fiscal balance (deficit (-))	-2,516	-3,635	-1,244	-932	-764	11	-776	-603	-1,107
Financing 8/	2,516	3,635	1,244	932	764	-11	776	603	1,107
Net domestic	-286	392	-61	153	251	-563	-18	194	198
Bank financing	-666	337	-109	105	165	-800	-104	-215	-22
Monetary Authorities	-635	602	-480	-706	-460	-939	-563	-462	-861
Commercial Banks	-31	-265	371	812	625	139	459	247	839
Non-bank financing	380	55	47	48	86	237	86	410	220
Net foreign	535	2,762	502	281	79	305	194	163	11
Privatization proceeds	2,267	481	803	498	434	247	599	245	898

Table 7. Lithuania: Summary of Consolidated General Government Operations, 1998-2003 (concluded)

	1998	1999	2000 1/	2001 2/	2002 Jan-Sept Prog. 3/	2002 Jan-Sept Prel.	2002 Prog. 4/	2002 Est. 5/	2003 Proj. 5/
	(In percent of GDP)								
Revenue and grants	32.7	32.1	30.4	29.8	29.0	30.3	29.1	30.3	30.0
Grants 6/	0.0	0.0	0.0	0.0	0.0	0.7	0.0	0.7	0.8
Revenue	32.7	32.1	30.4	29.8	29.0	29.7	29.1	29.6	29.2
Tax revenue	31.2	30.4	28.4	27.4	26.7	27.4	27.0	27.4	27.0
Taxes on income and profits	9.3	9.3	8.5	7.9	7.5	7.6	7.5	7.5	7.1
Payroll tax (social security tax)	7.1	6.8	7.1	6.8	6.5	6.8	6.6	6.7	6.6
Taxes on goods and services	13.0	12.6	11.4	11.4	11.4	11.6	11.7	11.9	12.0
Other tax revenue	1.8	1.7	1.5	1.3	1.3	1.3	1.3	1.4	1.4
Non-tax Revenue 7/	1.4	1.7	1.9	2.4	2.3	2.3	2.1	2.2	2.1
Expenditure and net lending	38.1	40.2	33.2	31.4	30.9	30.1	30.5	31.4	32.0
Expenditure	36.6	37.9	32.6	31.3	30.5	30.3	30.2	31.6	31.8
Current expenditure 8/	33.3	35.6	30.7	29.3	28.9	28.1	28.7	29.2	28.9
Wages and salaries, excl. contributions to SoDra	7.7	8.2	7.6	7.3	7.0	7.2	6.8	7.1	6.9
Goods and services	11.4	10.4	9.1	8.5	9.1	7.9	9.2	9.1	9.2
Transfers to EU	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transfers to households	11.6	12.3	12.0	11.6	11.2	11.1	11.2	11.2	11.0
Subsidies	0.5	0.4	0.2	0.2	0.1	0.2	0.1	0.2	0.3
Interest payments	1.2	1.5	1.7	1.6	1.5	1.5	1.3	1.3	1.3
Savings restitution program	1.0	2.8	0.0	0.0	0.2	0.2	0.2	0.1	0.2
Capital expenditure	3.3	2.2	1.9	1.9	1.6	2.1	1.5	2.4	2.9
Discrepancy	0.4	0.4	-0.1	0.3	0.1	0.3	0.1	0.1	0.0
Financial balance	-4.4	-6.2	-2.1	-1.8	-1.6	-0.2	-1.2	-1.4	-1.8
Net lending 7/	1.5	2.4	0.7	0.2	0.4	-0.2	0.3	-0.2	0.2
Lending	2.4	3.2	1.2	0.9	0.8	0.4	0.7	0.4	0.5
of which: Mazeikiu 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	-0.8	-0.4	-0.6	-0.4	-0.6	-0.2
Fiscal balance (deficit (-))	-5.9	-8.5	-2.8	-1.9	-2.0	0.0	-1.5	-1.2	-2.0
Financing 8/	5.9	8.5	2.8	1.9	2.0	0.0	1.5	1.2	2.0
Net domestic	-0.7	0.9	-0.1	0.3	0.7	-1.5	0.0	0.4	0.4
Bank financing	-1.5	0.8	-0.2	0.2	0.4	-2.1	-0.2	-0.4	0.0
Monetary Authorities	-1.5	1.4	-1.1	-1.5	-1.2	-2.5	-1.1	-0.9	-1.6
Commercial Banks	-0.1	-0.6	0.8	1.7	1.6	0.4	0.9	0.5	1.5
Non-bank financing	0.9	0.1	0.1	0.1	0.2	0.6	0.2	0.8	0.4
Net foreign	1.2	6.5	1.1	0.6	0.2	0.8	0.4	0.3	0.0
Privatization proceeds	5.3	1.1	1.8	1.0	1.1	0.7	1.2	0.5	1.7
Memorandum Items:									
Fiscal balance in percent of GDP									
with EFF repayment of SDR 39 million in net lending 9/	...	...	...	...	...	...	...	...	-1.7
Primary fiscal balance in percent of GDP	-4.7	-7.0	-1.0	-0.3	-0.6	1.5	-0.2	0.2	-0.7
Public and publicly guaranteed debt, mln. LTL	9,817	12,371	13,195	13,422	...	13,774	14,953	13,704	13,622
In percent of GDP	22.83	29.00	29.23	27.99	...	...	29.02	27.03	25.04
GDP in mln. LTL	42,990	42,655	45,148	47,958	38,060	37,359	51,531	50,704	54,391

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

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

2/ From 2001 onward, fees paid to educational establishments and their spending (LTL128 million) were added to general government operations.

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

4/ Based on an implementation rate of 50 percent for certain capital expenditure and net lending. With full implementation of these items the programmed deficit would be 2.1 percent of GDP.

5/ Assuming 100 percent implementation of budgeted capital expenditure and net lending.

6/ Grants from EU and related expenditures are not included prior to 2002 nor in the 2002 program figures.

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

8/ 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.

9/ The early repurchase on January 2, 2003, could in principle reduce the deficit by SDR 39.244 million, as this amount was previously on-lent to the monetary authorities and treated as above-the-line expenditure in net lending.

Table 8. Lithuania: Summary Monetary Accounts, 1998-2003

	1998	1999	2000	2001	2002					2003
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.		Dec.
								Prog.	Act.	Proj.
	(In millions of litai, unless otherwise indicated)									
Monetary Authority										
Net Foreign Assets	4,836	4,054	4,607	5,818	6,056	7,480	6,844	6,710	7,355	8,491
Net Domestic Assets	-575	35	-655	-1,538	-1,819	-3,200	-2,558	-2,231	-2,187	-3,013
Net credit to government	-947	-326	-804	-1,510	-1,752	-3,142	-2,448	-2,073	-1,972	-2,832
Credit to banks	52	30	24	15	14	14	14	16	16	16
Credit to private sector	7	6	6	6	7	7	8	7	8	7
Credit to non-bank financial institutions	7	20	0	0	0	0	0	0	0	0
Other items, net	305	305	120	-50	-88	-79	-131	-181	-238	-204
Reserve Money	4,260	4,088	3,953	4,280	4,237	4,281	4,286	4,480	5,168	5,478
Currency outside the central bank	3,036	2,972	2,904	3,263	3,149	3,490	3,696	3,584	4,218	4,536
Currency outside banks	2,800	2,739	2,658	2,920	2,828	3,209	3,349	3,229	3,756	4,086
Cash in vaults of banks	236	233	246	343	321	281	347	355	461	449
Deposit money banks' deposits	1,212	1,109	1,037	1,000	1,069	773	571	876	930	923
Transaction and required reserves accounts in litas	868	445	621	584	616	468	253	484	591	571
Time and special deposits	0	0	0	0	0	4	0	0	0	0
Required reserves in foreign currency	344	436	416	417	453	301	318	392	339	351
Private and non monetary financial institutions	13	7	12	17	19	18	19	20	20	20
Banking Survey										
Net Foreign Assets	4,292	3,656	5,368	6,426	6,410	7,638	7,311	7,394	7,012	7,482
Monetary authority	4,836	4,054	4,607	5,818	6,056	7,480	6,844	6,710	7,355	8,491
Banks and other banking institutions	-544	-398	761	608	355	158	468	683	-343	-1,010
Net Domestic Assets	4,035	5,316	5,087	6,265	6,416	5,373	6,657	7,454	7,823	9,785
Net claims on government 1/	-426	199	569	947	926	-399	287	895	808	787
Monetary authority 2/	-947	-326	-804	-1,510	-1,752	-3,142	-2,448	-2,073	-1,972	-2,832
Banks and other banking institutions 3/	521	525	1,373	2,456	2,678	2,743	2,735	2,968	2,780	3,619
Credit to non-financial public enterprises	273	277	304	253	199	198	224	266	198	186
Credit to private sector 3/	4,874	5,545	5,209	5,538	5,777	5,886	6,410	6,923	7,221	8,990
Credit to non-bank financial institutions	470	468	513	791	827	799	858	831	980	1,069
Other items, net	-1,155	-1,173	-1,509	-1,265	-1,312	-1,111	-1,122	-1,460	-1,385	-1,247
Broad Money	8,327	8,972	10,455	12,691	12,826	13,011	13,969	14,848	14,835	17,267
Currency outside banks	2,800	2,739	2,658	2,920	2,828	3,209	3,349	3,229	3,756	4,086
Deposits	5,527	6,233	7,797	9,771	9,999	9,802	10,620	11,619	11,078	13,181
Memorandum items:										
Reserve money (yearly percent change)	28.8	-4.0	-3.3	8.3	15.1	11.9	13.5	4.7	20.8	6.0
Broad money (yearly percent change)	14.5	7.7	16.5	21.4	20.9	19.0	19.3	17.0	16.9	16.4
Private sector credit (yearly percent change)	16.9	13.8	-6.1	6.3	7.0	7.5	33.3	25.0	30.4	24.5
Private sector credit adjusted (yearly percent change) 3/	16.9	13.8	-1.2	21.4	21.6	21.8	...	25.0	...	...
Money multiplier	1.95	2.19	2.65	2.97	3.03	3.04	3.26	3.31	2.87	3.15
Currency / deposits, in percent	50.7	43.9	34.1	29.9	28.3	32.7	31.5	27.8	33.9	31.0
Foreign currency / litai deposits, in percent	57.0	77.7	83.8	74.8	73.6	62.2	58.8	73.0	48.4	50.0
End-period velocity	5.2	4.8	4.3	3.8	...	...	...	3.5	3.4	3.2
Velocity of broad money	5.5	4.9	4.6	4.1	...	...	...	...	3.7	3.4
Gross official reserves, in US$ mln. 4/	1,462	1,244	1,344	1,657	1,727	2,325	2,130	1,928	2,400	2,698.0
Gross official reserves adjusted for short-term repos	1,462	1,244	1,344	1,606	1,675	2,270	2,071	...	2,342	...
Reserve coverage (without adjustment)	137	122	136	155	161	191	175	165	154	163
GDP, mln. LTL	42,990	42,655	45,148	47,958	...	...	...	51,531	50,704	54,391
Credit to private sector (% of GDP)	9.9	12.2	12.2	12.0	...	...	...	...	12.6	14.9
Monetization (% of GDP)	...	20.3	21.5	24.1	...	...	...	...	27.1	29.5

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.

Table 9. Lithuania: Financial Sector Indicators, 1998-2002

(In percent, unless otherwise indicated)

	1998	1999	2000				2001				2002		
			Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sept.	Dec.	Mar.	Jun.	Sept.
Private sector credit (percentage change, year-on-year) 1/	16.9	13.8	0.0	-2.4	-4.0	-1.2	8.2	6.2	9.5	21.4	21.6	21.8	33.3
Loans to private enterprises	3,493.3	3,858.1	3,572.9	3,714.0	3,629.3	3,715.3	3,791.6	3,855.3	3,926.9	4,549.4	4,673.7	4,737.8	5069.4
of which: share of foreign currency loans	59.8	65.2	68.2	68.3	70.1	70.0	68.8	69.9	67.1	63.8	65.4	62.3	59.0
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	22.9	29.1
Share of loans to private enterprises in total lending	67.8	65.3	62.7	63.4	63.8	62.8	62.2	62.5	61.2	62.5	62.2	63.6	62.7
Loans to individuals	523.7	660.1	...	...	...	573.0	582.8	614.6	648.2	713.8	778.6	829.4	1,036.8
of which: share of foreign currency loans	16.7	31.6	...	...	...	49.7	49.6	46.0	48.3	45.9	42.9	41.3	33.0
Loans to individuals (percentage change, year-on-year)	...	26.0	...	...	...	-13.2	...	...	...	24.6	33.6	34.9	60.0
Share of loans to individuals in total lending	10.2	11.2	...	...	...	9.7	9.6	10.0	10.1	9.8	10.4	11.1	12.8
Required reserves (in percent of total reserves)	59.9	69.8	85.7	85.4	85.5	71.6	76.1	78.9	87.4	83.2	81.4	84.0	97.6
Official risk indicators 2/													
Share of non-performing loans in total loans 3/	12.9	12.5	15.1	16.5	14.0	11.3	12.0	10.0	9.9	8.2	7.7	7.1	6.6
Risk-weighted capital asset ratio (capital over risk-weighted assets) 4/	23.8	17.4	18.0	16.4	16.7	16.3	16.4	16.5	16.8	15.7	15.2	15.4	14.7
Leverage ratio 5/	14.9	11.1	11.1	10.3	10.4	10.2	10.5	11.0	10.7	9.8	10.3	11.0	10.8
Financial sector risk factors of DMB's													
Share of foreign currency loans in total lending	55.9	61.6	63.7	64.1	66.9	66.8	64.4	66.2	63.8	60.6	62.2	59.2	56.0
Share of foreign currency deposits in total deposits	41.9	48.8	48.9	48.4	48.0	49.5	48.7	49.1	49.2	49.1	47.0	43.9	42.8
Short-term loans in percent of total loans	45.9	41.0	42.2	39.7	37.6	37.9	36.0	33.2	33.2	31.9	31.6	29.4	28.5
Demand deposits in percent of total deposits	62.3	51.4	50.0	49.1	49.9	48.9	46.6	45.5	45.9	46.5	46.8	46.1	48.1
Bank profitability													
Return on Assets	...	...	...	...	...	0.5	...	...	...	-0.1	1.0	1.2	1.3
Return on Equity	...	...	...	...	...	5.0	...	...	...	-1.1	9.5	11.6	12.9
Market assessment													
Spread between VILIBID and VILIBOR 6/ 7/	268.0	295.9	296.0	254.2	264.0	233.3	199.4	191.5	176.0	194.0	160.0	161.1	119.8
Open position in foreign exchange 8/ 9/	...	6.0	12.4	7.9	4.4	3.8	4.1	3.8	8.6	1.9	10.8	8.2	6.3
Total loans (in millions)	5,150.3	5,910.6	5,695.4	5,860.3	5,686.3	5,916.1	6,093.3	6,167.4	6,415.9	7,283.7	7,519.2	7,450.6	8089.9
Total deposits (in millions)	6,669.5	7,450.2	7,638.2	8,135.7	8,857.5	9,175.7	9,653.2	9,755.0	10,441.8	11,658.9	11,551.0	11,593.8	12522.0
Average annual interest rate on lita loans to enterprises	...	12.95	...	...	...	11.82	...	...	...	8.20	7.41	6.93	5.83
Average annual interest rate on lita loans to individuals	...	13.25	...	...	...	12.65	...	...	...	8.48	8.69	7.21	6.69

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/ 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.

3/ 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).

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

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

6/ Interbank rates; basis points.

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

8/ Open position includes off-balance exposure.

9/ 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	2003	2004	2005	2006	2007
					Prog.	Est.	EBS/02/105			Proj.		
	(In percent of GDP, unless otherwise indicated)											
Gross national saving	12.3	11.5	14.6	17.0	16.6	17.3	16.9	17.4	18.2	19.5	20.3	20.7
General government	-1.1	-3.9	-0.2	0.1	0.3	1.0	1.0	1.1	1.4	2.6	3.2	3.6
Non-government	13.4	15.4	14.7	16.9	16.3	16.3	15.9	16.3	16.8	16.8	17.1	17.1
Gross national investment	24.4	22.7	20.5	21.8	22.4	22.7	22.6	23.2	23.6	24.3	24.8	25.3
General government	3.3	2.2	1.9	1.9	1.5	2.4	2.1	2.9	3.5	3.6	3.7	3.7
Non-government	21.1	20.4	18.6	19.9	20.9	20.3	20.5	20.3	20.1	20.7	21.1	21.5
Foreign saving 1/	12.1	11.2	6.0	4.8	5.9	5.4	5.7	5.8	5.4	4.8	4.6	4.5
General government financial balance 2/	-4.4	-6.2	-2.1	-1.8	-1.2	-1.4	-1.1	-1.8	-2.1	-1.0	-0.5	-0.1
General government net lending	1.5	2.4	0.7	0.2	0.3	-0.2	0.0	0.2	0.0	0.0	0.0	0.0
Consolidated general government fiscal balance 2/	-5.9	-8.5	-2.8	-1.9	-1.5	-1.2	-1.1	-2.0	-2.1	-1.0	-0.5	-0.1
Current account balance	-12.1	-11.2	-6.0	-4.8	-5.9	-5.4	-5.7	-5.8	-5.4	-4.8	-4.6	-4.5
External debt 3/	34.8	42.5	43.0	43.9	42.7	38.8	44.1	38.5	38.3	37.7	37.1	36.3
Debt service (in percent of exports of GNFS)	22.6	18.5	20.9	31.0	24.6	43.2	23.5	19.0	19.1	20.1	16.4	16.4
Nominal GDP (in millions of Litai)	42,990	42,655	45,148	47,958	51,531	50,704	55,860	54,391	59,189	64,599	70,493	76,870
Real GDP growth (annual percentage change)	5.1	-3.9	3.8	5.9	4.4	5.9	4.8	5.3	5.7	5.9	5.9	5.9
Average CPI inflation (annual percentage change)	5.1	0.8	1.0	1.3	1.3	0.3	2.5	2.1	2.5	2.5	2.5	2.5
End-of-period CPI inflation (annual percentage change)	2.4	0.3	1.5	2.0	2.2	-1.0	2.5	2.1	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/ External liabilities minus equity investment in Lithuania. Includes public, publicly guaranteed and private external debt.

Table 11. Lithuania: Schedule of Available Purchases under the Proposed Stand-By Arrangement, 2001-2003

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

Source: Fund staff calculations.

1/ In addition to the other standard clauses in the arrangement.

Table 12. Lithuania: Indicators of Financial Obligations to the Fund, 2003-2007

	2003	2004	2005	2006	2007
	Projections				
Obligations from existing drawings 1/					
Debt Service to the Fund (in millions of SDRs)	60.3	14.0	9.8	5.3	2.2
Repurchases (in millions of SDRs)	59.0	13.4	9.5	5.2	2.2
Charges (in millions of SDRs)	1.2	0.6	0.3	0.2	0.0
In percent of exports GNFS	1.0	0.2	0.1	0.1	0.0
In percent of external debt service	5.2	1.1	0.7	0.4	0.2
In percent of gross official reserves	2.9	0.6	0.4	0.2	0.1
Exports GNFS, in millions of US$	8,058	8,698	9,456	10,256	11,170
External debt service, in millions of US$	1,531	1,659	1,899	1,685	1,827
Gross official reserves, in millions of US$	2,728	2,888	3,028	3,168	3,318
Quota, in millions of SDR	144.2	144.2	144.2	144.2	144.2
External debt, in millions of US$	6,081	6,611	7,093	7,627	8,156
GDP, in millions of US$	15,813	17,210	18,828	20,583	22,479
Obligations from existing and prospective drawings 2/					
Debt Service to the Fund (in millions of SDRs)	62.1	16.7	44.7	49.9	13.1
Repurchases (in millions of SDRs)	59.0	13.4	41.9	48.4	12.9
Charges (in millions of SDRs)	3.1	3.3	2.8	1.4	0.2
In percent of exports GNFS	1.0	0.3	0.6	0.6	0.2
In percent of external debt service	5.4	1.3	3.1	3.9	1.0
In percent of gross official reserves	3.0	0.8	2.0	2.1	0.5
Memorandum items:					
Fund credit outstanding					
Without drawings under the stand-by arrangement					
In millions of SDRs	30.3	16.9	7.4	2.2	0.1
In millions of US$	40.3	22.4	9.9	3.0	0.1
In percent of quota	21.0	11.7	5.1	1.5	0.1
In percent of external debt	0.7	0.3	0.1	0.0	0.0
In percent of GDP	0.3	0.1	0.1	0.0	0.0
With drawings under the prospective stand-by arrangement					
In millions of SDRs	85.7	72.3	30.4	-18.0	-30.9
In millions of US$	114.1	96.3	40.6	-24.0	-41.3
In percent of quota	59.5	50.2	21.1	-12.5	-21.5
In percent of external debt	1.9	1.5	0.6	-0.3	-0.5
In percent of GDP	0.7	0.6	0.2	-0.1	-0.2

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

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

2/ Assuming all drawings are made as of March 1, 2003, under the stand-by arrangement.

LITHUANIA: FUND RELATIONS
(As of December 31, 2002)

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

II. General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	144.20	100.00
Fund holdings of currency	233.46	161.90
Reserve position in Fund	0.02	0.01

III. SDR Department:	**SDR Million**	**Percent of Allocation**
Holdings	39.31	N.A.

IV. Outstanding Purchases and Loans:	**SDR Million**	**Percent of Quota**
Extended arrangements	78.49	54.43
Systemic Transformation	10.78	7.48

V. Latest Financial Arrangements:

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

VI. Projected Obligations to Fund:
Under the Repurchase Expectations Assumptions[1]
(SDR Million; based on existing use of resources and present holdings of SDRs):

		Forthcoming			
	2003	2004	2005	2006	2007
Principal	31.05	24.58	18.98	10.35	4.31
Charges/Interest	2.04	1.27	0.70	0.30	0.06
Total	33.09	25.86	19.68	10.65	4.37

VII. Implementation of HIPC Initiative:

N/A

[1] 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, and Fiscal ROSC have been recently completed.

XII. Technical Assistance:

The following table summarizes the technical assistance missions provided by the Fund to Lithuania since February 1997.[2]

[2] 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
STA	ROSC	Mission	May 8-22, 2002	Department of Statistics, Ministry of Finance, and Bank of Lithuania
FAD	ROSC	Mission	July 10-23, 2002	Ministry of Finance

XIII. Resident Representative:

The resident representative of the Fund in Lithuania is Ms. Zuzana Brixiova, who took up her post in November, 2002.

LITHUANIA: WORLD BANK RELATIONS

Partnership in Lithuania's Development Strategy

1. Lithuania's leading political, economic and social objective for the coming years is integration into the European Union, and subsequent improvement in living standards and income convergence. In the pre-accession period Lithuania seeks to maintain rapid and sustainable economic growth and increase competitiveness of Lithuanian economy. A long-term vision of Lithuania is a welfare state which would ensure that benefits of economic growth are spread broadly through the population by supporting knowledge economy, improving public services and strengthening social policies.

2. The IMF has taken the lead in assisting Lithuania to maintain macroeconomic stability. Since 1992, the Bank has contributed to Lithuania's transition through investment and adjustment lending, policy dialogue and analytical advisory assistance. Bank-supported investment projects were designed to help the Government implement structural reforms and to build institutional and human capacity at sector and local levels. The Bank's analytic work was oriented to analyzing the steps needed to implement Lithuania's structural reform agenda. In addition, the Government's overall reform efforts were supported through two structural adjustment loans in 1996 and in 2000 dealing with banking, energy, agriculture, social, private sector development and budget management issues.

World Bank Group Strategy

3. The most recent World Bank Group Country Assistance Strategy was prepared in 1999 for the period 2000-2002. During this period, the Bank has taken the lead in policy dialogue in pensions and social services, health and education, energy, housing and environment, transport and financial sector as well as budget management, agricultural and municipal reforms.

4. A new CAS for the assistance in 2003-2005 is under preparation. Government has indicated its continuing interest in the Bank's strategic advice on medium and long-term issues and its intention to shift to a non-lending relationship for this upcoming period. The Government's priority areas for the Bank's support in the next three years are:

- public administration reform
- fiscal decentralization and municipal finance
- rural restructuring
- social and health sector reforms
- education and knowledge economy

5. According to the framework for World Bank Group support to EU accession countries and the Bank's graduation policy, the Bank would continue operational activities in Lithuania after EU accession on the basis of the CAS and normal graduation criteria. As for

other EU accession countries, the Bank will support Lithuania's accession process by helping the Government to implement reforms and to undertake investment needed for EU accession and will concentrate its in depth advice primarily in areas not explicitly covered by the *Acquis Communautaire*. The selection of specific areas for assistance will reflect mutually agreed prioritization with the authorities.

6. To date, the Bank has approved 17 projects in the amount of US$490.8 million equivalent, of which 10 operations are completed. Of this amount, US$331.4 has been disbursed and US$55.7 million has been repaid.

7. IFC supported projects for US$ 130 million in the financial markets, electronics, chemicals, textile, wood processing, construction materials, and food processing sectors. Current IFC's exposure is US$ 38.6 in four projects as of January, 2003. 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 produced a study on administrative barriers to investment.

World Bank-Fund Collaboration in Specific Areas

8. The IMF and the World Bank maintain a collaborative relationship in promoting macroeconomic stability through support of structural reforms. Bank input was important in developing the structural elements of the Fund's SBA which was aimed at maintaining macroeconomic stability under the currency board arrangement, continuing fiscal consolidation, together with advancing the remaining key structural reforms.

9. The Government's reform program supported by the World Bank's SAL II was designed within a framework for macroeconomic stability consistent with IMF SBA. The Bank's policy advice and lending assistance under SAL II were designed to help Lithuania prepare and implement a comprehensive program of structural reforms to put the economy back on a growth path after Russian crisis. To achieve this a number of synergetic reforms were planned in the areas of budget management, pensions and social assistance, private sector development, energy and agricultural sectors, having a large impact on growth potential. The IMF provided important technical assistance in several areas covered by SALII, including bankruptcy and fiscal management. Major accomplishments under the reform program supported by SAL II included, *inter alia,* privatization of two remaining state-owned banks, adoption of new bankruptcy and enterprise restructuring laws, and restructuring and readying for privatization of Lithuanian Power company through separation of generation, transmission and distribution functions, which fully meets EU directives for market opening. The Government and the Bank consider that the development objectives of the reform program and of SAL II were for the most part met. However, a few of the reform actions originally agreed under the loan were not fully implemented, in particular those dealing with shifting ownership and managerial control of Lithuanian Gas to a strategic investor, and maintaining restrictions on budgetary expenditures on and market regulation of certain agricultural commodities. After an initial one year extension of the loan's closing

date, in May 2002 the Government requested that SAL II be closed without release of its second tranche.

10. Areas of the World Bank supported policy reforms which involve collaboration with the IMF include:

Public expenditure management

11. The SAL II supported medium-term reforms of public finances and the core budget process. Specific reform areas included government accounting, budgetary support for commercial activities, debt management, control and governance of extra-budgetary arrears, and management of budget process. These complemented the reform program under the IMF SBA, which focused on the Treasury, capital budgeting and establishment of Fiscal Reserve Fund for privatization. The IMF has also supported continuing fiscal consolidation efforts to achieve a structurally balanced budget by the time of EU accession, rationalization of the tax structure with new expenditure obligations, stabilization of municipal finances and other structural fiscal reforms.

12. Subsequent to SAL II, technical assistance is being provided to debt management through a World Bank Institutional Development Fund (IDF) grant facility.

Municipal finance

13. Lithuania is midway through the process of transforming its local governments from appendages of the central government to politically autonomous independent units of government. Fundamental reforms in the structure of intergovernmental relations were made in 1994 and 1997. Reforms in 2002 improved the division of revenue and expenditure responsibilities between central and local governments.

14. The World Bank has contributed to analyzing and shaping policies in municipal finance with 1998 policy notes and a report on municipal finance in 2002. The Fund has focused on measures which help to reduce municipal expenditure arrears in its stand-by arrangement. The Bank and the Fund are closely monitoring developments in municipal finance. The future agenda includes greater tax autonomy and expenditure autonomy at municipal level, improving the selection and financing of municipal capital investments, and strengthening financial reporting of municipal operations.

Financial sector reforms

15. Following the banking crisis in 1995-96, the Lithuanian banking system has undergone substantial consolidation and restructuring. In the last two years, the government privatized two remaining state-owned banks – the Savings Bank and the Agricultural bank – which made the sector predominantly foreign-owned. As a result, competition has increased and new financial products have been presented on the market. The non-bank financial sector has grown in recent years, but remains small. The further development of non-bank financial

institutions and services will be strongly influenced by efforts to achieve greater integration between the Lithuanian economy and other European economies.

16. The World Bank and the Fund worked closely together to support financial sector reforms. The Bank has maintained close dialogue with the government on banking sector restructuring and provided policy advice in 1998 policy notes and a Macro Financial Vulnerability Study of 1999. Most recently, the Bank and the Fund conducted a joint Financial Sector Assessment Program (FSAP). Post-FSAP technical assistance is being arranged for the State Insurance Supervisory authority and to strengthen accounting and auditing capacity in Lithuania.

Energy sector

17. There were major achievements in reforming Lithuania's energy sector in 1995-1998, including under SAL I . These included the establishment of an energy pricing commission with substantial autonomy, the settling of energy arrears of public authorities, the decentralization of district heating sector, and preparing for sector restructuring and privatization programs. These reforms were further supported by the SAL II program, which included the objectives to establish a competitive framework, to restructure and to unbundle the sector, to create incentive for cost reduction, to select market models for electricity and gas, and to privatize the Lithuanian Power Company (LPC) and Lithuanian Gas (LG). The Fund program has emphasized restructuring and subsequent privatization of LPC, and the privatization of LG under its structural reform measures.

Labor markets

18. In July 2002, Lithuania passed a new labor market code. The law introduces new forms of flexible employment contracts, liberalizes firing conditions, and foresees the possibility of reducing minimum wages for specific sector or groups. These steps are very important for enhancing Lithuanian labor market flexibility. The Bank has provided an advice on labor market reform with the analysis presented in Lithuania Country Economic Memorandum(CEM) 2002. The IMF has included submission of a new labor code to the parliament in the SBA structural conditionalities.

Pensions

19. The Bank worked with the government on pension reform in the context of SAL II, under which government raised the retirement age, reduced payments to working pensioners, introduced improved disability criteria and sickness benefits rules, all directed at achieving fiscal balance of the social insurance system in the short-term.

20. In 2002, the government approved a law on pension system reform which introduces a voluntary defined contribution second pillar beginning in 2004, in addition to the existing mandatory pay-as-you-go pillar. Preparation for pension reform and a possible Bank operation has been financed through a PHRD grant. The major implementation challenges

under the pension reform will be: (i) to carry out a comprehensive public information campaign, (ii) to ensure that legislation and regulations offer the right protection of pension assets in the private funds, (iii) to develop an efficient supervision of pension providers, (iv) to increase compliance and efficiency of joint tax and social security revenue collection, (v) to secure the financial position of the pay-as-you-go system. The IMF has focused on pension reform financing and overall fiscal sustainability of the social insurance system.

Health sector reform

21. Lithuania's health reform is aimed at improving quality and equity in health service provision, strengthening fiscal sustainability of the health system and increasing efficiency in the use of public funds.

22. The Bank has been supporting the government reform program in the health sector through a Health project which became effective in mid 2000. Implementation of the project investment component has been satisfactory, but the health policy framework, including health financing issues, has not yet been adequately addressed. The Bank and the Fund share concerns about the Health Insurance Fund's (HIF) poor performance and the accumulation of arrears. The Bank and Fund fully coordinate their advice to the government on making HIF's financial situation sustainable in the medium-term and identifying measures to improve health financing and health sector management.

Lithuania: Financial Relations with the World Bank Group
Statement of active IBRD loans (as of January 13, 2003, in millions of original currency)

ID	Project	Orig. Currency	Principal	Availab le	Disbur sed	Closing Date
P008539	SOCIAL POLICY AND COMMUNITY SERVICES	USD	3.70	1.04	2.66	15-Jun-03
P035802	MUNICIPAL DEVELOPMENT	EUR	18.89	6.84	12.04	30-Jun-05
P035780	HEALTH	USD	21.24	14.77	6.46	30-Sep-04
P035776	KLAIPEDA PORT	USD	35.36	14.68	20.67	30-Sep-04
P070112	EDUCATION IMPROVEMENT	EUR	29.00	28.71	0.29	30-Jun-06

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. 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.Lithuania subscribed to the Special Data Dissemination Standard in May 1996, 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. The DOS also produces annual and quarterly series on GDP using the expenditure approach and since 2001, these data have been available in constant prices.

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. Regarding classification, amortization of foreign debt in the appropriation to line managers appears to be currently misclassified by the authorities above the line as capital expenditure and would need to be addressed in the Data ROSC update. (The staff reclassifies this item for program monitoring purposes.) Monthly and quarterly data on consolidated central government are not reconciled because they are on different recording bases. Authorities intend to define a medium-term migration path to *GFSM2001* and its link to *ESA95* in 2002.

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. 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

8. 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 January 24, 2003)

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	Public External Debt
Date of latest observation	01/13/03	12/31/02	12/31/02	12/31/02	12/31/02	12/31/02	12/31/02	11/30/02	Q3/02	12/31/02	Q3/02	12/31/02
Date received	01/13/03	01/08/03	01/15/03	01/15/03	01/24/03	01/14/03	01/14/03	01/13/03	12/31/02	01/28/03	12/30/02	01/28/03
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	C	C	C	C	A 1/, C	C	A 1/, C	A 1/, C	A 1/	A, N 1/	A 1/
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.

LITHUANIA – ALTERNATIVE MACROECONOMIC SCENARIOS

The scenarios described below consider a range of alternative assumptions underlying the medium term projection for the Lithuanian economy, including an increase in oil prices, higher interest rates, and a fall in foreign direct investment (FDI). A major adverse external shock, for example resulting from increased geo-political tensions, could result in a combination of all three of these developments. A fourth scenario, involving higher domestic demand, was also considered. The outcome of these scenarios are summarized in the table below.

- **Higher oil prices.** In this scenario it is assumed that oil prices rise to 40 dollars in 2003 and 30 dollars in 2004 (60 percent and 33 percent, respectively, over the baseline). Export demand is expected to slow down in this situation, but this effect is likely to be cushioned by higher exports to Russia. The adverse impact on economic activity would be limited by higher external borrowing.

- **Higher interest rates.** It is assumed that interest rates are 200 basis points higher over the entire medium term horizon as a result of a general rise in international interest rates. However, if the increase in interest rates occurred in response to a country-specific loss of investor confidence, the negative effect on growth would most likely be significantly larger than depicted in the table below.

- **Lower FDI.** It is assumed that FDI falls by 30 percent relative to the baseline over the entire medium term horizon, with about half of the drop in FDI offset by increased external borrowing. The resulting reduction in investment leads to an improvement in the external balance in the short term, given the high import intensity of FDI. Over the medium-to-longer term, however, lower investments will lead to slower export growth and a deterioration in the external balance as the productivity of Lithuanian exporters declines.

- **Higher domestic demand.** Domestic demand is assumed to be 1 percentage point higher throughout the entire medium term. This will not only bring in additional imports, but could also lead to higher inflationary pressures and wage increases, which over time will lead to an erosion of competitiveness, and thus lower exports. This scenario results in a significant deterioration of the external balance, a relatively large buildup of external debt, and eventually a slowdown in growth. Moreover, such a development would most likely be regarded as unsustainable by investors, and the negative impact could therefore be further compounded by higher interest rates and lower FDI as described above.

The impact of lower growth in the EU was analyzed in Box 5 of the 2001 Article IV staff report (EBS/01/211). It was estimated that significantly lower growth in the EU would lead to a substantial reduction in real GDP growth and an increase in the current account deficit in Lithuania in 2002. Since then, however, growth in Lithuania has remained robust despite a slowdown in growth in the EU, while the deterioration in the current account deficit has been less than might have been expected in such circumstances. This is partly the result of the surprising strength of exports in 2002. There appear to be two factors behind this: (i) some exports are concentrated in niche markets, which are less sensitive to changes in external demand; (ii) competitive pressures within the EU may have increased the attractiveness of low-cost Lithuanian substitutes. The latter is also consistent with recent increases in FDI, as foreign companies have relocated some of their production activities to Lithuania to take advantage of the lower-cost environment in Lithuania. While such supply factors may continue to drive exports for a time, ultimately there will be a limit to how long export performance can remain de-coupled from demand conditions in Lithuania's major export markets. The staff's baseline scenario is, therefore, already based on conservative assumptions for export growth in 2003.

Lithuania: Macroeconomic Indicators Under Alternative Scenarios, 2002-07

	2002	2003	2004	2005-2007
Baseline				
Real GDP (year-on-year change in percent)	5.9	5.3	5.7	5.9
GDP deflator (year-on-year change in percent)	-0.2	1.9	3.0	3.0
Current Account (in percent of GDP)	-5.4	-5.8	-5.4	-4.6
Gross external debt (in percent of GDP)	38.8	38.5	38.3	37.0
Gross external reserves/short-term debt (in percent) 1/	75.7	87.0	83.7	88.3
Higher oil prices				
Real GDP (year-on-year change in percent)	...	4.8	5.3	5.9
GDP deflator (year-on-year change in percent)	...	4.7	2.4	2.8
Current Account (in percent of GDP)	...	-6.8	-6.6	-4.9
Gross external debt (in percent of GDP)	...	39.4	40.5	40.0
Gross external reserves/short-term debt (in percent)	...	77.0	77.0	78.5
Higher interest rates				
Real GDP (year-on-year change in percent)	...	4.8	5.3	5.6
GDP deflator (year-on-year change in percent)	...	2.0	3.0	3.0
Current Account (in percent of GDP)	...	-6.0	-5.7	-4.7
Gross external debt (in percent of GDP)	...	38.9	38.9	38.3
Gross external reserves/short-term debt (in percent)	...	80.1	80.1	78.4
Lower FDI				
Real GDP (year-on-year change in percent)	...	5.1	5.6	5.3
GDP deflator (year-on-year change in percent)	...	1.9	3.0	3.3
Current Account (in percent of GDP)	...	-5.3	-5.0	-5.1
Gross external debt (in percent of GDP)	...	38.8	38.8	39.5
Gross external reserves/short-term debt (in percent)	...	81.8	78.4	82.9
Higher domestic demand				
Real GDP (year-on-year change in percent)	...	5.5	6.1	3.7
GDP deflator (year-on-year change in percent)	...	2.5	3.5	4.5
Current Account (in percent of GDP)	...	-6.5	-7.2	-9.1
Gross external debt (in percent of GDP)	...	39.0	40.2	46.6
Gross external reserves/short-term debt (in percent)	...	77.0	70.4	68.6

Sources: Fund staff estimates and projections.

1/The current stock of short-term debt is largely offset by short-term assets.

Vilnius

February 7, 2003

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. Lithuania's strategic goal of joining the EU and NATO has been boosted by the invitation to become a member of both in 2004, helping us achieve our policy objectives. The key elements of our economic policy strategy will be to maintain the currency board arrangement as the cornerstone of macroeconomic stability; to continue appropriately prudent fiscal policies in order to avoid external imbalance; and to advance the remaining key structural reforms to promote growth with job creation and greater competitiveness. The attached Supplemental Memorandum of Economic Policies (SMEP) specifies the concrete policy measures to be taken during December 2002 — March 2003.

2. In support of the policies detailed in the SMEP, we request completion of the third 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, and is set to expire on March 29, 2003. The government will continue to maintain its close cooperation with the Fund in the coming years. Given the favorable external position, the government has made an early repurchase of an amount equivalent to SDR 39.2 million (about half of Lithuania's outstanding purchases under an earlier EFF) on January 2, 2003.

3. We believe that the implementation of policies described in the SMEP will achieve the objectives of the program, and we stand ready to take any additional measures that maybe necessary to achieve those objectives. 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 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 completion of the third 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 until March 2003**

I. Introduction

1. Following a decade of fruitful co-operation with the IMF, Lithuania stands on the threshold of membership of the European Union (EU). The transformation that has taken place has been remarkable, and Lithuania's economic performance has continued to strengthen over the last eighteen months under the policies supported by the current Stand-By Arrangement (SBA). All major program objectives have been met. Growth has remained robust, despite the ongoing weakness in some major trading partners. Inflation is subdued, and unemployment has fallen significantly in the last year. Steady fiscal consolidation has taken place since 2000, with the budget close to balance over the first three quarters of 2002, and a deficit of about 1.2 percent of GDP for the year as a whole. The repegging of the litas from the dollar to the euro has been a success: spreads are near historic lows, confidence in the currency board arrangement (CBA) remains strong, and foreign direct investment flows are high. The banking system has been strengthened through the implementation of the recommendations of the Financial Sector Assessment Program (FSAP). The privatization process is well advanced and the business environment has been improved. Recent reforms have laid the foundations for continued economic growth in the medium term, and leave Lithuania well placed to reap the potential benefits of EU membership.

2. These successes will not, however, lead to complacency. The government will continue to ensure macroeconomic stability, in particular through the adoption of appropriately prudent fiscal policies. In addition, the government remains committed to continued structural reforms, and especially: the strengthening of the finances of municipalities and the Health Insurance Fund (HIF); improved tax administration; the development of a pension system that will ensure the sustainability of the public finances over the longer term; the completion of the privatization process in a transparent manner; and the creation of an attractive and competitive environment within which businesses, and in particular small- and medium-sized enterprises, can flourish. This combination of macroeconomic stability and ongoing structural reforms will be necessary to ensure sustained growth and further reductions in unemployment in the period up to and following EU accession.

II. The Government's Program

A. Macroeconomic Outlook

3. The economy grew by an estimated 5.9 percent in 2002 (compared to the 4.4 percent previously anticipated) and growth is expected to remain robust in the period leading up to EU accession. The strength of domestic demand relative to external demand coupled with higher oil prices led to a modest widening of the current account deficit to an estimated

5.4 percent of GDP in 2002 and a further increase to 5.8 percent is expected for 2003. This would be financed by sizable capital inflows, including high levels of foreign direct investment largely associated with foreign acquisition of private companies. The appreciation of the litas against the dollar since the repegging on February 2, 2002 is not expected to have a significant adverse impact on competitiveness, given that more than two-thirds of exports are to EU and EU-accession countries. Moreover, productivity growth remains strong and export capacity is likely to benefit from recent investment activity. Against this backdrop, the government believes that its fiscal target for 2003 remains consistent with external sustainability. Nevertheless, it will continue to monitor developments closely, and adapt policies if necessary.

4. Over the medium term, high economic growth rates are crucially dependent on vigorous export growth and cautious domestic demand management. The main risk to the macroeconomic outlook would stem from an unsustainable level of domestic demand that could lead to a sharp widening of the current account deficit and an erosion of competitiveness. Higher oil prices, continued sluggish growth in the EU or higher international interest rates could also lead to such a widening and adversely impact growth. The economy is also reliant on robust FDI inflows to finance the current account deficit, and any reduction in these inflows would result in higher gross external financing requirements, and eventually a slowdown in growth.

B. The Currency Board Arrangement

5. Maintaining the credibility of the CBA continues to be the cornerstone of the economic policy framework. The government and the Bank of Lithuania (BoL) believe that the CBA in its present form should be preserved until accession to ERM2 and the adoption of the euro at the earliest possible date.

6. The growth of money and credit reached 16.9 and 30.4 percent, respectively, in 2002, reflecting strong economic growth, low interest rates, and a more aggressive lending strategy by banks operating in a competitive environment. Brisk credit growth is also expected in 2003, although at a slower pace. While these developments also reflect a gradual convergence toward the higher levels of monetization and credit found in other advanced transition countries, the BoL remains mindful of the potential risks to loan quality associated with rapid credit growth, and will continue its efforts to strengthen banking supervision. In view of the ample liquidity in the banking system, there is a risk of overheating, and the BoL intends to maintain the required reserve ratio at 6 percent for the foreseeable future, although its ultimate objective is to align it with lower ECB levels and institute the remuneration of required reserves over the medium term.

C. Fiscal Policy

7. Preliminary below-the-line results show that the general government budget deficit in 2002 was 1.2 percent of GDP, below the program target of 1.5 percent, even with full implementation of capital expenditures and net lending. Over the first three quarters of 2002,

it was close to balance. Current expenditures ran significantly below budget, but were likely to have increased in the fourth quarter as appropriation managers brought expenditure closer into line with budget plans. Some shortfall in tax revenue from VAT and excise taxes was also expected during the last quarter, related to the timing of some changes in these taxes. Capital expenditure was higher than expected due to additional EU-related projects and a virtually full implementation rate.

8. The budget for 2003, approved by Seimas on December 10, 2002, targets a fiscal deficit of 2.0 percent of GDP (equivalent to a deficit of 1.3 percent of GDP using the 2002 program definition and adjustors described in the Technical Memorandum of Understanding). This target would represent some easing of the fiscal position relative to the outcome for 2002. The government believes this is unavoidable due to significant additional EU-related expenditures of about LTL 335 million (0.6 percent of GDP), comprising LTL 35 million for co-financing, and LTL 300 million for administrative capacity building and investment. The changes to the personal income tax (PIT) are likely to prove somewhat more costly (LTL 40 million) than had initially been anticipated, while the decisions to postpone the corporate income tax (CIT) declaration to October and not to introduce a real estate tax (RET) in 2003 will cost LTL 90 million and LTL 70 million, respectively. While higher indirect taxation will provide additional revenue of LTL 120 million, the government recognizes the need to limit current expenditure on non-EU-related programs, which is thus set to grow by less than GDP. The financing strategy remains unchanged and involves €150 million of net proceeds from eurobonds with remaining financing to come from domestic markets, in accordance with the objective of moving gradually towards longer maturities and a greater share of domestic securities.

9. Fiscal policy will respond appropriately to changes in the macroeconomic outlook. In the event of an unsustainable increase in the current account deficit, the government stands ready to tighten fiscal policy as necessary to ensure external sustainability. In addition, if growth is significantly higher than expected in 2003, the automatic stabilizers will be allowed to operate in full. Despite the temporary weakening in the fiscal position in 2003 and 2004 associated with the costs of EU accession, the government remains committed to moving towards a structurally balanced budget over the medium term. In particular, 2004 will be extremely challenging, due to the expected expenditure pressures associated with the initial year of EU membership. Given the need to contain the deficit, there will be little room for outlays for the savings and land restitution programs, let alone new subsidies such as the Housing Saving Scheme. In any case, the government is determined not to allow spending pressures to derail the fiscal consolidation process, as it believes that maintaining strong fiscal discipline over the coming years will be crucial to support participation in ERM2 and enable Lithuania to fulfill the prospective obligations of EMU membership.

D. Structural Policies

Fiscal Structural Reforms

10. The main components of the tax reform package have now been completed. The new PIT law, which was passed in July 2002 and became effective on January 1, 2003, increases the tax exempt minimum to LTL 290 per month and is estimated to result in a higher than previously expected cost of about LTL 320 million in 2003. This adds to the estimated cost of about LTL 60 million associated with the new VAT law. These costs are partially offset by the gains of about LTL 120 million from higher excises on cigarettes and diesel, gains of about LTL 110 million from the new CIT law, gains of about LTL 40 million from improvements in tax administration, and the reinstatement of the capital gains tax as of January 1, 2003. The tax reform package therefore implies a net cost of about LTL 110 million in 2003. Given the need to finance the increase in additional EU-related expenditure, the government recognizes the necessity of stopping the decline in the ratio of tax revenue to GDP. Hence, the government is committed to not awarding new preferential tax treatments to specific sectors in the coming years, to re-examining existing treatments, and to improving tax administration.

11. The overall financial situation of municipalities improved somewhat in 2002. The stock of arrears went down by LTL 30 million in the six months to end-September 2002 and municipalities are likely to show a combined fiscal surplus for the year. These positive developments were supported by a number of measures, including: a legal amendment to the 2002 budget making state budget transfers for clearance of arrears conditional on municipal arrears being reduced by at least the amount of the previous transfers; the publication in the media of the arrears of all municipalities; the establishment of a commission to monitor municipal decision making; and expenditure reviews broadly along the lines proposed by the World Bank study. While the overall situation has improved, a number of municipalities show persistent weaknesses. The central government will not support external borrowing by municipalities or an increase of borrowing limits. Only in the case of Birzai Rural Municipality, which is reducing arrears, was the borrowing limit increased to finance an environmental project. The 2003 budget law allows for borrowing only by those municipalities that are constantly reducing their arrears. The government is also considering making approval of EU financing of municipal projects conditional on reduction of arrears. The government intends to submit to Seimas a draft RET law in 2003 for implementation in 2004. This law will constitute an important first step in providing municipalities with control over their tax base, allowing municipal councils the right to set tax rates.

12. In order to improve the finances of the HIF, a number of cost saving measures were introduced from March 2002. These measures included the introduction of patients' medication booklets to improve control; a reduction in the number of fully compensated medications from 40 to 9; a reduction in the margins applicable to wholesalers; the introduction of prescription limits for health service providers; and negotiations with pharmaceutical companies leading to a reduction in the price of 60 drugs by an average of 19 percent. This was, however, insufficient to compensate for large cost overruns on

pharmaceuticals in the first quarter. In 2003, the government will take additional steps to ensure that the HIF is in balance, eliminating the need for new special transfers from the state budget. To this end, legislation is being prepared limiting the price of compensated prescription medicines to no more than 5 percent higher than the lowest price in the EU (saving LTL 10-15 million). In addition, in March 2003 the compensation of a number of medicines will be reduced from 100 percent to 90 percent (saving LTL 10 million). Full implementation of all the measures by mid-2003 would reduce costs by about LTL 120 million, allowing for the elimination of all arrears by end-2003. The government also intends to develop a long-term plan for hospital restructuring.

13. The Law on the Pension System Reform was passed by Seimas in December 2002, introducing a voluntary defined-contribution second pillar from the beginning of 2004. This new accumulative pillar will be financed by diverting part of the state social insurance contributions of those who elect to participate in it. The size of the pension contribution will be 2.5 percentage points in 2004, rising to 3.5 percentage points in 2005, 4.5 percentage points in 2006, and 5.5 percentage points in 2007. Due to the reform, the State Social Insurance Scheme would lose from 20 to 60 million litas of revenue in 2004 depending on the number of participants in the new pension system, and the cost would be expected to rise in line with the increase in the size of pension contributions. The new system is less costly and ambitious than earlier proposals, but by itself does not ensure the sustainability of public finances over the longer term as the population continues to age. The government and the relevant supervisory authorities will ensure that adequate oversight arrangements for the new pension funds are in put place before the new second pillar becomes effective.

Financial Sector

14. The government and Bank of Lithuania (BoL) will continue to strengthen the financial sector along the lines recommended in the FSAP and EU peer review (April 2002) in a number of areas. First, in the area of supervision of credit institutions, in addition to already amended rules on large exposures controlling connected lending, the BoL will bring the rules on loan provisioning into line with best international practices. To strengthen the legal protection for banking supervision staff, an amendment to the BoL Law will be submitted to Seimas in early 2003. A co-operation agreement with the Swedish regulatory authorities is being finalized. Second, in the area of anti-money laundering (AML) and combating the financing of terrorism, in addition to strengthened AML practices in insurance and capital markets, staffing and training are being upgraded in the newly reorganized Financial Crime Investigation Service (FCIS). The BoL has also updated its training for supervisors to include new "Know Your Customer" rules, and by end-March 2003, the government will introduce further amendments to comply with EU directives by widening the coverage of agencies and businesses that must report on financial transactions. Third, to strengthen the payments system, the government and BoL are drafting the Law on Amendments of the Law on Payments and the Law on Settlement Finality in Payment and Securities Systems, which they plan to submit to Seimas in 2003. The Law on Payments will regulate the relations between the credit institutions and their clients in making payments, and the Law on Settlement Finality in Payment and Securities Systems will regulate the

settlement systems, rights and duties of the participants of the systems. The Bank of Lithuania is supposed to perform the supervision of the systems. Finally, in the insurance regulation area, amendments to the existing law on Insurance were passed by Seimas on May 23, 2002, which put in place FSAP recommendations concerning corporate governance, consumer rights and auditing until two new laws, the law on Insurance Activity and the law on Insurance Contracts, are approved by Seimas in 2003.

Other Structural Reforms

15. Unemployment has continued to decline from a peak of 13.2 percent in March 2001, but remains high (10.9 percent in December 2002). With the recent introduction of a differentiated minimum wage, limits on wage indexation, simplification of dismissal procedures, and reduction of severance payments, the labor market is becoming even more flexible. The high unemployment rate and persistent regional disparities result mainly from skill mismatches and lack of regional mobility, as well as from insufficient job creation in the private sector. In that connection, the government is committed to further improving the business environment, in particular reducing excessive bureaucratic procedures, improving the legal framework, and facilitating the activities of small and medium-sized enterprises.

16. Privatization, especially in the energy sector, has proceeded more slowly than expected. Protracted negotiations with Gazprom continue on the privatization of Lithuanian Gas (34 percent of shares), and in the event a deal is not reached the government will need to seek a new buyer. Negotiations also continue with Gazprom on privatization of the power plant in Kaunas. Tender procedures for the privatization of two distribution companies, successors of the Lithuania Power Company, will start in 2003, to be completed by year-end.

17. The government concluded its enlargement negotiations at the European Council in Copenhagen in December 2002, and is expected to join the European Union on May 1, 2004, subject to parliamentary approval followed by a referendum. Lithuania would only be required to pay two thirds of the annual contribution in 2004, but would be eligible for grants for the entire year. Consequently, contributions would amount to about 0.8 percent of GDP in 2004, and 1.2 percent in 2005. Grants would amount to approximately 0.8 percent of GDP in 2003, rising to 2.7 percent in 2004, and 4.1 percent in 2005. In agriculture, direct income support for farmers would be provided at 25 percent of the EU level. This would be increased by 5 percent every year until 2006, and then provided at 100 percent of the EU level by 2013. Finally, it has been agreed that the first unit at the Ignalina power plant would be closed by 2005, followed by the closing of the second unit in 2009. The EU would finance the dismantling costs and partly finance the costs of alternative energy sources.

III. Program Issues

18. The current SBA (equivalent to SDR 86.52 million), which Lithuania has treated as precautionary, is set to expire on March 29, 2003. Progress in implementation of the program continued to be monitored through quantitative performance criteria and benchmarks for end-December 2002 and structural policy benchmarks for end-2002 and 2003 (presented in the

attached tables). The third review by the IMF Executive Board is scheduled to take place at the end of February, 2003. The definitions of the program targets remain as those established in the Technical Memorandum of Understanding (Annex). The government will continue to maintain its close cooperation with the Fund in the coming years. Lithuania made an early repurchase of an amount equivalent to SDR 39.2 million (about half of the outstanding purchases under an earlier EFF) on January 2, 2003.

ATTACHMENT

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

	Target	Adjusted Target	Outcome 2/
Continuous performance criteria			
I. Exchange rate			
LTL 3.4528 per euro 3/	...	...	Observed through December 31, 2002
II. 100-percent coverage of currency board liabilities, in percent	100	...	Observed through December 31, 2002
III. Reserve requirements, in percent			Observed through December 31, 2002
Reserve requirements through June 30, 2002	6		
Reserve requirements from July1, 2002 4/	4		
IV. Non-accumulation of new external payments arrears	...	...	Observed through December 31, 2002
Quantitative performance criteria			
I. Ceiling on the general government deficit, mln. LTL			
Cumulative from January 1, 2001			
March 31, 2001 (previous arrangement)	271	287	91
June 30, 2001	460	496	337
September 30, 2001	600	689	546
December 31, 2001	841	1011	932
Cumulative from January 1, 2002			
March 31, 2002	383	412	103
June 30, 2002	564	642	72
September 30, 2002	764	886	-11
December 31, 2002	776	...	603
II. Floors on net foreign exchange coverage of the currency board arrangement			
Stocks			
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	...	20
September 30, 2002, euro, mln.	-147	...	36
December 31, 2002, euro, mln.	-147	...	49

III. Ceilings on contracted public and publicly guaranteed medium- and long-term external debt; mln. US$	All maturities	1-5 year maturity	All maturities	1-5 year maturity
	(medium- and long-term)			
Cumulative from January 1, 2001				
March 31, 2001 (previous arrangement)	293	200	183	0
June 30, 2001	433	200	183	0
September 30, 2001	648	200	194	0
December 31, 2001	683	200	250	0
Cumulative from January 1, 2002				
March 31, 2002	450	200	34	34
June 30, 2002	610	200	472	0
September 30, 2002	640	200	501	0
December 31, 2002	640	200	515	34

IV. Ceilings on the outstanding stock of public and publicly guaranteed short-term external debt; mln. US$	Target	Adjusted Target	Outcome 2/
Maximum stock during the period			
March 31, 2001 (previous arrangement)	0	...	0
June 30, 2001	50	...	3
September 30, 2001	50	...	3
December 31, 2001	50	...	3
March 31, 2002	200	...	37
June 30, 2002	200	...	3
September 30, 2002	200	...	3
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. The figures for the cumulative fiscal deficit outcome have been revised from the previous staff report (EBS/02/105) but remain below the program targets.

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.

ATTACHMENT

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	210
September 30, 2002	312	214
December 31, 2002	312	216
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	44
September 30, 2002	0	60
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.

ATTACHMENT

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	Observed 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 new Real Estate Tax law	end-September 2002	Delayed. Submission now expected in 2003
Submit to Seimas amendments to the CIT law to return the declaration date from October 2003 to May 2003 1/	end-September 2002	Observed
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	Observed
Submit to Seimas the draft unemployment insurance law 2/	end-December 2002	Delayed. Submission now expected in mid-2003

Source: Lithuanian authorities.
1/ Not discussed by Seimas.
2/ The current timing is as agreed in SMEP from EBS/02/105

ATTACHMENT I
ATTACHMENT
ANNEX

REPUBLIC OF LITHUANIA

TECHNICAL MEMORANDUM OF UNDERSTANDING FOR THE 2001-2003 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^{th} of one month to the 23^{rd} 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.[1]

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

(i) monetary gold holdings;

(ii) holdings of SDRs;

(iii) reserve position in the IMF; and

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

11. Excluded from gross foreign reserves are:

(i) capital subscriptions to foreign financial institutions;

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

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

(iv) assets in nonconvertible currencies; and

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

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

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

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

(ii) the outstanding use of Fund credit.

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

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

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

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

16. The general government encompasses the national government (comprising the state and municipal governments) and the extrabudgetary funds. The extrabudgetary funds include the Social Insurance Fund (SoDra), Health Insurance Fund, Privatization Fund, Ignalina Closure and Decommissioning Fund, and any other extra-budgetary operations (as of January 1, 2002, the Road Fund was included in the state budget). 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 2001 and 2002: for faster-than-projected implementation of net lending operations and for faster-than-projected implementation of investment projects by budgetary organizations and appropriation managers. No adjustors apply for 2003.

19. For the purpose of assessing the observance of the ceilings on the general government fiscal balance in 2001 and 2002, 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 and excluding Road Fund investment, is specified in Table 3 on a quarterly institution-by-institution basis. The performance criterion on the fiscal deficit will be adjusted in 2001 and 2002 by the amount equal to the excess of the actual appropriations over the programmed cumulative quarterly amount for every project, assuming a 50 percent implementation rate of the total annual commitment. The adjusted amount for every project for each test date shall not exceed the annual appropriation for each project based on a 100 percent implementation rate.

21. General government guarantees on domestic borrowing include all guarantee commitments for (i) borrowing in domestic currency from residents and nonresidents and

(ii) borrowing in foreign currency issued for the Agricultural Marketing Agency and the Export and Import Credit Insurance Agency (Table 4).

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

III. Performance Criteria on External Debt

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

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

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

24. For purposes of this performance criterion, the public sector excludes the Bank of Lithuania. The term debt has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 by the Executive Board (Decision No. 12274-(00/85). Excluded are normal import-related credits, liabilities on the correspondent accounts with central banks of the BRO (Baltics, Russia, and other countries of the former Soviet Union) countries, guarantees of foreign currency-denominated borrowing of the Agricultural Marketing Agency and the Export and Import

Credit Insurance Agency covered under paragraph 21, and foreign currency direct borrowing and guarantee by the municipalities from resident banks which are not guaranteed by the central government.

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

IV. Reporting

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

Information on money and banking

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

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

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

General government budget implementation and financing

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

- below the line financing of the consolidated general government;

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

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

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

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

[2] 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:[3]

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

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

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

February 7, 2003

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

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

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

Table 1. Lithuania General Government Financing, 2000-02

	2000				2001				2002			
	Q1	Q2	Q 3	Q4	Q1	Q2	Q 3	Q4	Q1	Q2	Q3	Q4
	Stocks, millions of litai (end of period)											
Domestic credit to government												
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	1.6	0.1	0.1
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	140.9	124.7	102.7
Claims on municipal governments (DMBs)	214.2	203.1	239.4	273.5	271.8	277.6	282.1	279.6	264.6	236.2	253.7	302.5
Claims on social insurance fund (DMBs)	231.6	243.4	234.6	267.6	281.6	243.6	253.8	239.2	306.6	238.3	228.4	106.4
Savings bonds	75.6	87.3	113.8	130.1	149.4	135.3	144.3	173.2	219.3	262.0	312.8	476.1
Recapitalization bonds	634.0	634.0	634.0	514.2	514.2	514.2	514.2	398.8	398.8	398.8	283.3	283.3
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	1,838.8	1,983.7	2,235.0	2,482.1	2,557.6
Held by DMBs	530.2	640.0	775.2	892.4	995.0	1,013.7	993.0	1,278.0	1,360.9	1,518.2	1,752.2	1,817.7
Held by OBIs	18.7	23.1	28.1	31.2	54.8	57.5	1.4	2.0	2.1	2.3	2.3	2.6
Held by Nonbanks	671.4	664.0	659.8	625.5	523.7	538.4	606.6	558.5	620.7	714.5	727.6	737.3
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	3,330.3	3,512.7	3,685.0	3,828.6
Government deposits												
Central government deposits (BOL)	927.9	1,246.9	994.4	781.7	832.7	1,275.7	1,460.8	1,488.2	1,730.9	3,121.1	2,427.0	1,950.3
Central government deposits (DMBs)	672.6	723.4	906.3	576.7	807.0	666.7	539.2	365.0	384.4	406.8	416.1	285.4
Central government deposits (OBIs)	132.7	104.6	105.6	105.6	110.7	116.5	0.0	0.0	0.0	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	108.3	177.5	114.0
Privatization funds (DMBs)	225.3	174.6	151.9	149.2	219.8	33.2	59.4	1.9	2.0	1.9	0.7	2.5
Social insurance fund (DMBs)	26.2	30.1	35.8	58.4	39.0	55.9	45.0	73.9	48.7	87.0	98.7	154.0
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	2,286.9	3,725.1	3,120.0	2,506.2
	Flows, 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	182.4	172.3	143.5
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	1,438.3	-605.1	-613.9
Float between government deposits noncaptured through monetary accounts	0.0	0.0	0.0	-73.5	73.5	0.0	0.0	-24.0	6.0	0.0	0.0	0.0
Net domestic repayments to nonbanks	0.0	-43.5	0.0	-22.5	0.0	0.0	0.0	72.0	-72.0	0.0	0.0	0.0
Net domestic Financing (sum of lines 16-19)	-506.6	-234.2	183.3	496.1	-164.1	-127.9	39.3	406.1	-84.6	-1,255.8	777.4	757.4
Foreign Borrowing	992.4	61.3	535.4	35.7	760.8	14.8	90.6	102.9	166.7	1,376.7	26.5	64.6
Amortization by the central budget	41.0	127.0	571.1	220.3	41.5	111.9	164.0	304.6	51.1	276.1	873.4	181.7
Amortization by appropriation managers	23.5	61.1	23.0	55.7	12.6	12.0	26.0	16.5	21.7	11.5	31.0	24.7
Change in the government deposit abroad					526.7	-153.6	-193.7	-180.0	0.0	0.0	0.0	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	1,089.2	-877.9	-141.8
Net privatization proceeds	45.6	602.0	72.4	83.3	75.2	359.2	45.4	18.4	93.3	136.3	17.4	-1.9
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	102.6	-30.4	-83.1	613.7
Cumulative fiscal deficit	466.9	707.9	904.9	1,244.0	91.1	366.9	545.9	932.1	102.6	72.2	-10.9	602.8

Sources: Ministry of Finance; and staff estimates.

Table 2. Lithuania: Investment Projects from On-Lent Resources, 2001-02
(In thousands of litai)

Creditor	Reg. Nr.	2001 Year Prog.	2001 Year Act.	2001 Year Adjustor	2002 Q1 Prog.	2002 Q1 Act.	2002 Q2 Prog.	2002 Q2 Act.	2002 Q3 Prog.	2002 Q3 Act.	2002 Q4 Prog.	2002 Q4 Act.	2002 Year Prog.	2002 Year Act.	2002 Year Adjustor
I. Nonbudgetary organizations															
World Bank (Lithuanian Energy)	0019	28,000	30,870	14,000	11,388	8,298	0	2,336	0	438	0	0	11,388	11,072	5,378
World Bank (Klaipėda Water)	0020	12,480	5,983	0	2,000	1,851	0	1,981	0	379	0	0	2,000	4,211	1,000
World Bank (Šiauliai Water)	0032	840	125	0	0	0	0	0	0	0	0	0	0	0	0
World Bank (CJSC "Geoterma")	0033	6,300	3,674	524	0	325	0	1,179	0	0	0	0	0	1,503	0
World Bank (The Housing Credit Foundation)	0034	10,700	11,559	5,350	0	1,371	0	506	0	885	0	2,179	0	4,941	0
World Bank (Agriculture Sector)	0035	6,000	6,306	3,000	0	1,422	0	0	0	0	0	0	0	1,422	0
European Investment Bank (Lithuanian Railways)	0046.1	8,963	41,879	4,482	0	0	0	0	0	0	0	0	0	0	0
European Investment Bank (Lithuanian Railways)	0046.2	12,904	0	0	12,695	0	6,795	0	12,695	17,110	9,697	45,040	41,882	62,150	20,941
NIB (municipality 20 mln. EUR)	0052	73,442	50,698	13,977	0	6,875	0	5,973	0	2,141	0	2,003	0	16,992	0
European Investment Bank (municipality 15 mln. EUR)	0059	6,940	0	0	5,960	0	5,960	0	5,960	0	5,960	3,798	23,840	3,798	0
European Investment Bank (Panevėžio municipality - 6 mln. EUR)	0060	1,000	0	0	1,500	0	1,500	0	1,500	0	2,500	0	7,000	0	0
World Bank (municipality - 18,89 mln.EUR)	0066	31,120	39,025	15,560	1,500	1,212	1,500	1,552	1,885	467	1,500	198	6,385	3,429	237
World Bank (energy saving project - 20 mln. USD)	...	2,000	0	0	500	0	500	0	500	0	500	0	2,000	0	0
Lithuanian Railway (Pauostis)	...	0	4,000	0	0	0	0	0	0	0	0	0	0	0	0
EBRD (energy saving project for institutions 20 mln. USD)	...	0	0	0	2,000	0	2,000	0	2,000	0	2,000	0	8,000	0	0
Mazeikiu Nafta	...				0	0	0	0	0		0	0	0	0	0
Total		200,689	194,119	56,893	37,543	21,354	18,255	13,527	24,540	21,420	22,157	53,218	102,495	109,519	27,556
II. Budgetary organizations															
World Bank (Ministry of Social Security and Labor)	0042	4,661	368	0	0	0	2,630	0	2,630	0	0	1,230	5,260	1,230	0
Europe Social Development Fund (Ministry of Social Security and Labor)	0043	1,000	0	0	0	0	1,500	894	0	0	0	1,500	1,500	2,394	750
Europe Social Development Fund (Ministry of Social Security and Labor)	0058	5,459	2,556	0	0	0	0	0	0	0	0	0	0	0	0
Europe Social Development Fund (Ministry of Social Security and Labour)	0058.4		1,000		0	0	0	0	0	0	0	0	0	0	0
World Bank (health project -21 mln. USD)	0069	13,000	2,240	0	1,791	1,791	7,083	1,136	7,083	810	7,083	10,872	23,040	14,609	3,089
World Bank (education project - 25 mln. USD)	...	2,000	0	0	0	0	3,333	0	3,333	0	3,333	0	10,000	0	0
European Development Bank (School renovation project - 2,5 mln. USD)	0073	10,000	0	0	5,897	5,897	3	0	0	5,104	0	0	5,900	11,001	2,950
GS (High school renovation project)	...	10,000	10,000	5,000	0	0	0	0	0	0	0	0	0	0	0
GS Courts	...	2,000	1,963	963	0	0	0	0	0	0	0	0	0	0	0
GS Ministry of Health	...	29,000	29,122	14,500	0	0	0	0	0	0	0	0	0	0	0
GS Ministry of Health (health care)	...		7,000		0	0	0	0	0	0	0	0	0	0	0
GS Ministry of Health (other projects)	...		7,654		0	0	0	0	0	0	0	0	0	0	0
GS Ministry of internal affairs	...	10,884	10,884	5,442	0	0	0	0	0	0	0	0	0	0	0
GS Custom	...	6,830	6,830	3,415	0	0	0	0	0	0	0	0	0	0	0
Total		94,834	79,617	29,320	7,688	7,689	14,549	2,029	13,046	5,914	10,416	13,602	45,700	29,233	6,789
Total (I-II)		295,523	273,736	86,213	45,231	29,043	32,804	15,556	37,586	27,333	32,573	66,820	148,195	138,752	34,344

Source: Ministry of Finance.

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

Nr.	Creditor	Reg. Nr.	2002 year Prog.	Q1 Prog.	Q2 Prog.	Q3 Prog.	Q4 Prog.
	I. Nonbudgetary organisations						
1	World Bank (Lithuanian Energy)	0019	11,388	11,388	0	0	0
2	World Bank (Klaipėda Water)	0020	2,000	2,000	0	0	0
3	World Bank (Šiauliai Water)	0032	0	0	0	0	0
4	World Bank (CJSC "Geoterma")	0033	0	0	0	0	0
5	World Bank (The Housing Credit Foundation)	0034	0	0	0	0	0
6	World Bank (Agriculture Sector)	0035	0	0	0	0	0
7	European Investment Bank (Lithuanian Railways)	0046.1	0	0	0	0	0
8	European Investment Bank (Lithuanian Railways)	0046.2	41,882	12,695	6,795	12,695	9,697
9	NIB (municipality 20 mln. EUR)	0052	0	0	0	0	0
10	European Investment Bank(municipality 15 mln. EUR)	0059	23,840	5,960	5,960	5,960	5,960
11	European Investment Bank (Panevėžio municipality - 6 mln. EUR)	0060	7,000	1,500	1,500	1,500	2,500
12	World Bank(municipality - 18,89 mln.EUR)	0066	6,385	1,500	1,500	1,885	1,500
		...					
13	World Bank (energy saving project - 20 mln. USD)	...	2,000	500	500	500	500
14	Lithuanian Railway (Pauostis)	...	0	0	0	0	0
15	EBRD (energy saving project for institutions 20 mln. USD)	...	8,000	2,000	2,000	2,000	2,000
	Total (1-15)		102,495	37,543	18,255	24,540	22,157
	II. Budgetary organisations						
1	World Bank (Ministry of Social Security and Labour)	0042	5,260	0	2,630	2,630	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	1,791	7,083	7,083	7,083
6	World Bank(education project - 25 mln. USD)	...	10,000	0	3,333	3,333	3,333
6. I	European Development Bank (School renovation project - 2,5 mln. USD)	0073	5,900	5,897	3	0	0
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)						
11	GS Ministry of Internal affairs	...	0	0	0	0	0
12	GS Custom	...	0	0	0	0	0
	Total (1-12)		45,700	7,688	14,549	13,046	10,416
	TOTAL (I+II)		148,195	45,231	32,804	37,586	32,573

Source: Ministry of Finance.

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

(In millions of Litai)

	2001			2002									
	Year	Year	Year	Q1		Q2		Q3		Q1-Q3			Year
	Prog.	Act.	Adjustor	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Adjustor	Prog.
Total	229.7	228.3	83.7	111.0	74.3	111.0	127.8	111.0	142.6	333.1	344.7	110.7	444.1
Ministries	162.0	130.8	49.8	43.3	43.8	43.3	46.8	43.3	43.1	129.9	133.7	49.4	173.2
Ministry of National Defense	75.8	67.6	29.7	19.5	23.4	19.5	26.2	19.5	9.4	58.4	59.0	29.2	77.8
Ministry of Culture	8.3	7.0	2.8	3.4	1.7	3.4	2.7	3.4	4.4	10.1	8.8	3.8	13.4
Ministry of Social Security and Labor	9.7	6.9	2.0	1.4	0.6	1.4	1.1	1.4	2.2	4.1	3.9	1.8	5.5
Ministry of Health	39.5	22.9	3.2	5.4	7.3	5.4	5.2	5.4	4.8	16.2	17.3	8.1	21.6
Ministry of Education and Science	28.8	26.4	12.0	2.2	6.1	2.2	3.4	2.2	8.6	6.5	18.1	3.2	8.6
Ministry of Environment	0.0	0.0	0.0	0.1	0.0	0.1	0.9	0.1	0.3	0.2	1.2	0.1	0.3
Ministry of Finance	0.0	0.0	0.0	2.0	0.1	2.0	0.0	2.0	1.4	6.1	1.5	0.0	8.1
Ministry of Interior Affairs	0.0	0.0	0.0	4.5	2.5	4.5	2.6	4.5	3.4	13.6	8.5	1.7	18.1
Ministry of Agriculture	0.0	0.0	0.0	3.2	0.6	3.2	1.5	3.2	2.0	9.7	4.1	0.0	12.9
Ministry of Communications	0.0	0.0	0.0	0.1	0.0	0.1	0.5	0.1	1.7	0.2	2.2	0.1	0.3
Ministry of Justice	0.0	0.0	0.0	0.4	1.3	0.4	1.1	0.4	1.9	1.1	4.3	0.5	1.4
Ministry of Economy	0.0	0.0	0.0	0.9	0.1	0.9	0.9	0.9	0.4	2.6	1.4	0.1	3.4
Ministry of Foreign Affairs	0.0	0.0	0.0	0.5	0.1	0.5	0.7	0.5	2.6	1.4	3.4	0.7	1.8
Government Bodies	0.0	0.0	0.0	1.3	1.0	1.3	1.4	1.3	1.3	3.8	3.7	1.8	5.0
Projects of Municipalities	0.0	0.0	0.0	13.3	0.0	13.3	0	13.3	0.0	39.9	0.0	0.0	53.2
Regions	40.0	48.6	20.0	12.9	7.4	12.9	0.2	12.9	4.3	38.8	11.9	0.0	51.7
Departments, Services, and Inspectorates	8.2	8.5	4.1	7.6	4.9	7.6	7.0	7.6	10.0	22.8	21.9	10.5	30.4
Department of Sciences and Studies under the Ministry of Education and Science	8.2	0.9	0.0										...
Enterprises and Organizations	0.4	0.4	0.2	23.1	7.6	23.1	59.9	23.1	71.7	69.3	139.2	34.7	92.4
Education, culture and other institutions and organizations	19.2	40.0	9.6	9.6	9.6	9.6	12.5	9.6	12.2	28.7	34.3	14.3	38.2
Science and studies	19.1	40.0	9.6	8.6	8.4	8.6	9.5	8.6	11.3	25.8	29.2	12.9	34.4
Public enterprises: translation, documentation and information center	0.0	0.0	0.0	1.0	1.2	1.0	3.0	1.0	0.9	2.9	5.1	1.4	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	Act.	Q3	Act.	Q4	Act.
Total	319	217	315	237	314	232	312	247	315	197	312	210	312	214	312	216.1
Special agencies	270	178	255	180	252	169	250	183	250	137	250	150	250	164	250	166.7
Agricultural marketing agency	230	165	230	165	230	154	230	171	220	125	220	142	220	154	220	152.4
of which: SAPARD program cofinancing	20	-	20	-	20	-	30	-	30	-	30	-	30	-	30	7
Export and import credit insurance agency	40	14	25	15	22	15	20	13	15	4	15	1	15	2	15	3
Investment and business guarantee agency (SoDra)	-	-	-	-	-	-		-	15	7	15	7	15	8	15	12
Other	49	39	60	57	62	63	62	64	65	60	62	60	62	50	62	49

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	Jul. 1	Oct. 1
Total outstanding payment obligations	594	470	443	317	236	264	238	224	200	245	310	268
(in percent of annual GDP)	1.4	1.0	1.0	0.7	0.5	0.6	0.5	0.5	0.4	0.5	0.6	0.5
State government	125	81	86	65	17	18	15	8	0	6	0	4
Wages and salaries	8	5	7	3	2	3	3	0	0	1	0	0
Other expenditure	118	77	80	62	15	15	12	8	0	5	0	4
Municipalities	155	233	237	183	195	245	218	188	200	238	266	209
Wages and salaries	14	21	11	7	10	12	11	10	6.8	5	4	4
Other expenditure	140	212	225	176	185	233	206	178	193	233	262	205
SoDra	0	0	0	0	0	0	0	0	0	0	0	0
Pensions, wages and salaries	0	0	0	0	0	0	0	0	0	0	0	0
Other expenditure	0	0	0	0	0	0	0	0	0	0	0	0
Health Insurance Fund	0	14	55	23	23	0	5	29	0	0	44	55
Wages and salaries	0	0	0	0	0	0	0	0	0	0	44	0
Other expenditure	0	14	55	23	23	0	5	29	0	0	0	55
Privatization Fund	0	3	0	0	0	1	0	0	0	0	0	0
Wages and salaries	0	0	0	0	0	0	0	0	0	0	0	0
Other expenditures	0	3	0	0	0	1	0	0	0	0	0	0
Rural Support Fund	231	129	62	19	0	0	0	0	0	0	0	0
Wages and salaries	0	0	0	0	0	0	0	0	0	0	0	0
Other expenditure	231	129	62	19	0	0	0	0	0	0	0	0
Road Fund	83	10	4	28	2	0	0	0	0	0	0	0
Wages and salaries	0	0	0	0	0	0	0	0	0	0	0	0
Other expenditure	83	10	4	28	2	0	0	0	0	0	0	0
Memorandum item:												
Nominal GDP	42,655	45,148	45,148	45,148	45,148	47,958	47,958	47,958	47,958	50,704	50,704	50,704

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	8.0	2.0
Lithuania - Corridor IX track renewal project	AB "Lietuvos geležinkeliai"	EBRD	216.0	54.0
2002				
Q1	...	...	0.0	0.0
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	...	282.5	75.0
Eurobonds	Ministry of Finance	...	1,381.1	366.7
Q3				
Public sector energy management programme	Public sector	NIB	34.5	9.8
Q4				
Reconstruction of Quays	"Klaipėdos valstyb. jūrų uostų direkcija"	...	15.0	4.6

Source: Ministry of Finance.

Statement by Vilhjalmur Egilsson, Executive Director for Republic of Lithuania and Stasys Kropas, Advisor to Executive Director
February 26, 2003

We thank the staff for a very thorough report. The authorities concur with the assessment of the economic developments and the challenges they are facing. The authorities agree with the conclusion that the current Stand-By arrangement has been successful and instrumental in helping to make difficult economic policy choices in a final phase of preparing for EU and NATO accession, and that it has also helped to further consolidate public finances, improve the functioning of the market economy and enhance market confidence during the litas repegging.

As the current Stand-By arrangement comes to an end, the authorities would like to express their gratitude to the staff, Management and the Executive Board for their advice and support. Although the authorities decided not to request a new arrangement with the Fund, they would like to continue to rely on the Fund's advice in coping with challenges which lie ahead. After the successful conclusion of the negotiations, Lithuania has been invited to become a member of the EU and NATO, and the near future certainly is challenging. Fiscal pressures related to the initial EU accession expenditures in a preelection period, and the EU membership referendum, scheduled for May 11, 2003, call for carefully weighted policy choices. The authorities are looking forward to fully use the opportunities of the new surveillance procedures during the Article IV consultation.

Economic developments and outlook

The macroeconomic situation has improved further since the second review of the program, as the Lithuanian economy has shown strong resilience in face of the global economic downturn. Most macroeconomic indicators for 2002 were better than expected under the program. The progress in structural reforms in previous years provided a solid basis for the good economic performance in 2002. Real GDP growth, supported by healthy exports and a rebound in domestic demand, reached 5.9 percent and exceeded even the most optimistic expectations. The growth stemmed from the rise in value added in telecommunications, agriculture, construction, financial intermediation, hotels and domestic trade sectors. The abolition of the tax exemptions for a reinvested profits did not affect the investment negatively. Strong productivity growth and wage restraint have helped to maintain the country's competitiveness and supported the robust export growth of 10.2 percent. The external market shares increased, with growing sales to the EU, the largest export market. According to Bank of Lithuania's preliminary estimates, the external current account deficit was 4.4 percent of GDP and accelerating FDI growth (21.9 percent) more than comfortably financed the deficit.

Lithuania, for the first time since the beginning of the transition, experienced some deflation. The litas appreciated against the US dollar and the sharp decline in food prices were the main factors, and average inflation for 2002 was 0.3 percent. Despite the challenges, the authorities consider that the outlook in the near term is broadly favorable. The preparation for the EU accession has strengthened the country's economic structure and its growth prospects, and is a key driving force behind the country's reform efforts. The authorities expect the economy to expand by 5.3 percent in 2003. As the bank credits grow and disposable income continues to rise, domestic demand is expected to be the engine of growth, supported by continued strong exports. The inflation rate for 2003 is expected not to exceed 2.5 percent.

Fiscal policy and structural issues

The fiscal outcome was better than expected under the program. The 2002 general government budget deficit, which according to preliminary estimates stood at 1.2 percent of GDP, was the lowest since 1997.

Despite the shrinkage of the tax revenue base, overall revenue growth was higher than expected. General government revenue collection was slightly above the planned level, with municipal revenues also exceeding the targets, although the revenues of the 2002 state budget fell slightly below the target. Part of the explanation was the reduction of the VAT rate on several items, but there were also technical difficulties with the transition to a new taxation system and collection deficiencies. Improvements in tax administration are still on the government's priority list. Preparations are ongoing for the introduction of a general household income and assets declaration in 2004. Together with the improvements in information technology that are under implementation, it should lead to an improvement in the capacity and efficiency of the tax authorities.

After the reform, the tax system has become more comprehensive, internally consistent, and broadly harmonized with EU requirements. Some amendments introduced by Parliament to the initial government proposals, and delays in the introduction of the real estate tax, explain the failure to reach the reform's objective of revenue neutrality in 2003.

The 2003 budget envisages a large increase in expenditure to meet the initial costs of the EU accession. Therefore, the budgeted fiscal deficit of 2 percent of GDP for 2003 represents a temporary deterioration. However, the authorities are committed to achieving a structurally balanced budget in the medium term and to adhere to the requirements of a monetary integration framework.

Progress has been reached in improving financial management of municipalities and the social security system, although the pension reform finally approved by Parliament was far less ambitious than initially envisaged by the government. Due to short-term cost considerations, the government coalition agreed to start with the a scaled-down version of the reform, which is to incorporate the voluntary second pillar based on supplementary matching government contributions and tax incentives, but postpone for some time the solution of the problem related to the aging population.

The authorities introduced important measures aimed at strengthening the financial position of the health sector. However, these measures are of a short-term nature and do not address the inherited fundamental structural problems. The government intends to develop a long-term plan for hospital restructuring.

Monetary and exchange rate policy

Monetary and financial conditions remain very positive. Interest rates are at historical lows, while the increased efficiency of financial intermediation has led to further monetization and private credit growth. The ratio of non-performing loans has been falling and a rapid growth of deposits is being registered. The authorities do not see immediate reasons for concern given the low initial level of financial intermediation and the robustness of the banking system, but nonetheless they remain vigilant. Foreign exchange reserves are growing and remain at a comfortable level, and the BOL made an early repurchase of an amount equivalent to SDR 39.2 million of the obligations outstanding under an earlier EFF.

Lithuania's experience with the currency board arrangement has been favorable. The transparency of policies and discipline under the CBA have supported the transformation from a centrally planned economy into a market economy. In the last few years, Lithuania has achieved budgetary consolidation, solid economic growth and low inflation, and has put its economy on a convergence path with the EU economies. Lithuania complied with the economic Maastricht criteria in 2002. As regards participation in the ERM-2, the authorities intend to join the mechanism as soon as possible following the EU accession. The clear goal of Lithuania's membership in the EMU is the adoption of the euro. An objective of participation in the ERM-2 is to ensure that a country enters the euro zone at an appropriate rate. In the case of Lithuania, the CBA has been viable for a number of years. Output and export growth are robust, while the economy has proven to possess the necessary flexibility in adjusting relative prices and wages and reallocing resources. The authorities strongly believe that CBA is the most conducive framework for achieving real and nominal convergence and should be preserved in its present form (including a zero fluctuation band within the ERM-2) until the adoption of the euro. The authorities believe that their current exchange rate strategy is viable with the support of appropriate fiscal and structural policies, and have appreciated the Fund's advice on this matter during the successive programs.

Financial sector issues

The financial sector is sound, profitable, experiencing healthy growth and continues to benefit from the implementation of the recommendations of the FSAP and the EU peer review. The authorities intend to strengthen the supervision practices further by bringing the rules on loan provisioning in line with the best international practices and strengthening the legal protection of supervisors. In the area of AML, the government intends to widen the coverage of institutions subject to reporting requirements of financial transactions. The amendment of the law on payments and the new law regulating the settlements finality in the Payment and Securities Systems that are expected to be passed by Parliament, will enhance the legal basis of the payments and settlement system and will harmonize the legislation with EU requirements. The planned insurance regulations will put FSAP's recommendations in this area concerning corporate governance, consumer rights and audit in place.

Other structural issues

Over the program period, the authorities continued to concentrate their efforts on structural reform issues. The overhaul of the tax system, improvements in municipal financial management, health care and social systems, and strengthening of the administrative capacity to use the EU funds effectively were on the top of the authorities' reform agenda.

Important steps for enhancing labor market flexibility were taken by passing a new labor market code. The level of unemployment is on a decreasing trend. The unemployment rate went down from 13.2 percent in March 2001 to 10.9 in December 2002. However, there is no easy solution for unemployment as the persistent high ratio of long-term unemployment highlights the structural nature of the problem. The government intends to improve the business environment further by reducing excessive bureaucratic procedures, adjusting the legal framework and facilitating the activities of SMEs. The unemployment insurance law submitted to Parliament should improve the social safety net and increase protection of the unemployed.

The government is committed to finalize the reforms in the energy sector. Following the restructuring and establishment of the market models for electricity and gas, the negotiations on privatization are now well advanced .

Our Lithuanian authorities would like to reiterate their determination to continue the prudent policy course aimed at taking the EU convergence process further.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 03/24
FOR IMMEDIATE RELEASE
February 27, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Third Review of Lithuania Under Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Lithuania's economic performance under its 19-month SDR 86.52 million (about US$119 million) Stand-By Arrangement (see Press Release No. 01/36). Completion of this review enables Lithuania to draw an additional amount equivalent to SDR 12.36 million (about US$17 million) from the IMF, bringing the total IMF resources potentially available to Lithuania to SDR 74.16 million (about US$102 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.

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

"Directors welcome the successful program implementation under the Stand-By Arrangement, with all performance criteria having been met. Macroeconomic performance in 2002 was remarkable, with a rapid pace of real GDP growth and the rate of inflation falling close to zero, a lower-than-programmed general government fiscal deficit, and falling unemployment. The sound monetary framework under the currency board arrangement has contributed to macroeconomic stability and enhanced credibility.

"Further progress was made in structural reforms in 2002, covering tax reform, municipal finances, the Health Insurance Fund, and the energy sector, as well as financial sector reforms in line with Financial Sector Assessment Program recommendations.

"The macroeconomic outlook for 2003 is positive, with real GDP growth expected to remain strong, although the external current account deficit is expected to widen somewhat owing to higher oil prices. A small increase in the fiscal deficit target will be temporary, related primarily to one-time EU accession-related expenditures.

"In the coming years, fiscal discipline will be crucial to achieve the government's medium-term objective of a structurally balanced budget and to support the currency board arrangement. The government is committed to completing its privatization program and other structural reforms geared to improving the business environment and enhancing competitiveness. Additional measures will be introduced to strengthen the financial situation of municipalities and the Health

Insurance Fund, and to ensure that there is sufficient administrative capacity for the effective and transparent use of EU transfers in the coming years," Mr. Sugisaki said.