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Republic of Lithuania: 2000 Article IV Consultation and First Review Under the Stand-By Arrangement--Staff Report; Public Information Notice and News Brief on the Executive Board Discussion; and Statement by the Authorities of the Republic of Lithuania

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2000 Article IV consultation with the Republic of Lithuania and the first review under the Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the combined 2000 Article IV consultation with the Republic of Lithuania and the first review under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on November 22, 2000 with the officials of the Republic of Lithuania on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on December 26, 2000.** 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 Public Information Notice (PIN) and a News Brief, summarizing the **views of the Executive Board as expressed during its January 10, 2001 discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- a statement by the authorities of the Republic of Lithuania.

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

Letter of Intent by the authorities of the member country*
Supplementary Memorandum of Economic Policies by the authorities of the member country*
Technical Memorandum of Understanding*
Statistical Appendix and Tax Summary

* Also appended to Staff Report

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

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Staff Report for the 2000 Article IV Consultation and First Review Under the Stand-By Arrangement

Prepared by European II and Policy Development and Review Departments

Approved by Mohammad Shadman-Valavi and Liam Ebrill

December 26, 2000

- Discussions were held in Vilnius during August 29-September 12, 2000 and November 14-22, 2000. The new center-liberal coalition government, with a narrow majority in Seimas, was formed in October, following the legislative elections. The completion of the review was delayed so as to reach an understanding with the new government on the 2000-2001 policy package.

- The Fund staff team comprised P. Alonso-Gamo (head), S. George, V. Kramarenko, A. Schimmelpfennig (all EU2), and Q. Wang (PDR), and was assisted by M. Horton, the Fund's resident representative. Mr. A. Tornqvist, alternate Executive Director, attended some policy meetings.

- The mission met with President Adamkus, Seimas Chairman Paulauskas, the representatives of the previous government led by Prime Minister Kubilius and the new government led by Prime Minister Paksas, Bank of Lithuania (BoL) Governor Šarkinas, and representatives of the banking and business communities.

- On March 8, 2000, the Executive Board approved a 15-month Stand-By Arrangement in an amount of SDR 61.8 million (equivalent to 42.6 percent of quota). The authorities confirmed their intention to make no purchases under the arrangement.

- In the attached letter dated December 13, 2000 (Attachment I), the authorities request the completion of the first review and waivers for the noncompliance with two end-September performance criteria. Their request is supported by a Supplementary Memorandum of Economic Policies (SMEP, Attachment I), which the authorities intend to publish.

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

As a background to the upcoming Board discussions, a Statistical Annex will be forthcoming, while papers on "Pension Reform in the Baltics: Issues and Prospects" (SM/00/117) and on "Saving, Investment, and External Adjustment in the Face of Exogenous Shocks in the Baltics" (SM/00/121) have been issued.

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Attachments

Lithuania: Basic Data

Social and demographic indicators (latest available data)	
Area (sq. km)	65,300
Population density (inhabitants per sq. km.)	56.7
Population (thousands)	3,698.5
Life expectancy at birth	72.3
Men	67.1
Women	77.4
Infant mortality rate (per 1,000 births)	9.8
Hospital beds (per 1,000 inhabitants)	9.6
Physicians (per 1,000 inhabitants)	4.0

	1995	1996	1997	1998	1999
	(In percent of GDP)				
National accounts					
Domestic demand	111.8	109.8	110.6	111.9	110.3
Consumption	87.1	85.3	84.0	87.5	87.4
Gross investment	24.7	24.5	26.5	24.4	22.9
External balance of goods and services	-11.8	-9.8	-10.6	-11.9	-10.3
GDP	100	100	100	100	100
	(Percentage change from previous period)				
Real GDP	3.3	4.7	7.3	5.1	-4.2
GDP (in millions of litai)	24,100	31,569	38,340	42,990	42,535
Consumer prices (end-period)	35.5	13.1	8.4	2.4	0.3
Real wages 1/	3.2	3.3	13.4	12.8	4.9
Labor market					
Total employment (thousands)	1,644	1,659	1,669	1,649	1,648
Of which: in state sector	608	585	542	528	524
Unemployment rate (in %) 2/	6.1	6.2	6.7	6.9	10.0
	(In millions of U.S. dollars)				
Balance of payments 3/					
Trade balance	-698	-896	-1,147	-1,518	-1,405
Current account balance	-614	-723	-981	-1,298	-1,194
	(Percentage change from previous period)				
Money and credit					
Broad money	29.0	-3.5	34.1	14.5	7.7
Credit to private sector	23.0	-4.4	18.9	16.9	13.8
Interest rate (in percent) 4/	26.0	14.7	12.2	16.7	14.5
	(In percent of GDP)				
General government finances 5/					
Revenues	32.3	29.6	32.6	32.7	32.2
Expenditure and net lending	35.6	34.2	33.7	38.1	40.8
Financial balance 6/	-2.6	-2.5	-1.5	-4.4	-6.2
Fiscal balance 6/	-4.5	-4.5	-1.8	-5.9	-8.5

Sources: Lithuanian authorities; and Fund staff estimates.

1/ Average wage deflated by consumer price index.

2/ Calculated on the basis of registered unemployment; end of year.

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

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

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

6/ Including the discrepancy between monetary and fiscal data.

Executive Summary

The macroeconomic objectives for 2000 under the program were largely attained. The current account deficit of the balance of payments declined, reflecting fast export growth, while real GDP growth rebounded, after the recession experienced in 1999. Implementation of difficult adjustment measures stabilized the financial situation, and the government regained access to domestic and foreign capital markets on favorable terms. Structural reforms advanced significantly, including in energy sector restructuring, privatization, trade policy, deregulation, and budget and treasury management. Domestic demand remained weak, however, and unemployment increased. The litas has appreciated in real terms, but external competitiveness has been sustained due to growing productivity and substantial terms of trade gains. Despite revenue shortfalls, the government met the end-September performance criterion on the general government deficit, while the performance criterion on the clearance of expenditure arrears was missed due to the lack of legal means to impose payment discipline on the municipalities. Conditions in domestic and international financial markets warranted a slightly higher-than-assumed foreign borrowing. The reserve coverage of the currency board has increased and all performance criteria pertaining to the monetary sector were met.

Discussions on the appropriate fiscal stance were at the center of the policy dialogue with the authorities. There was broad agreement that it would be appropriate to increase modestly the fiscal deficit targets for 2000 and 2001, in light of the faster-than-envisaged current account adjustment, weak domestic demand, and the continued rise in unemployment. The fiscal adjustment in 2001 relies mainly on expenditure measures. A particular emphasis will be placed on the elimination of payments arrears. The authorities are preparing a medium-term fiscal strategy targeting a cyclically balanced budget by 2003 and a gradual reduction in the external current account deficit.

The staff and the authorities shared the view that the Currency Board Arrangement (CBA) continued to provide an anchor of stability for macroeconomic policies, and that the revision to the programmed fiscal adjustment was consistent with preserving the credibility of the CBA. In view of increasing economic integration with the euro area, and the prospective accession to the EU, the authorities intend to switch the peg of the litas from the dollar to the euro, with an announcement made in the second half of 2001, and the timing of the switch hinging on the prevailing euro/dollar rate.

The authorities expressed their determination to continue with the ambitious structural agenda, including the completion of the privatization of the three state-owned banks, further steps in restructuring the energy sector, changes to the tax legislation in line with EU requirements, and new measures to improve the business environment. Implementation of these measures would contribute to improved growth prospects.

The authorities also expressed interest in continuing their cooperation with the Fund, possibly under a new arrangement, after the end of the present stand-by arrangement in the second quarter of 2001.

I. INTRODUCTION

1. The 1999 Article IV Consultation was conducted by the Executive Board on July 27, 1999 (SM/99/170). In approving the present SBA (EBS/00/28) on March 8, 2000, Executive Directors commended the authorities' policy strategy, which aimed at returning to sustained economic growth and achieving a viable external position. They noted the benefits of Lithuania's currency board arrangement (CBA) and the authorities' decision to maintain this arrangement, eventually switching to a euro peg. They stressed, however, that the viability of this strategy would hinge on sustained fiscal adjustment, wage moderation, and determined implementation of structural reforms.

2. Relations with the Fund and World Bank are summarized in Appendixes I and II, respectively. A US$100 million Structural Adjustment Loan was approved by the Executive Board of the World Bank in June 2000, with the first tranche of US$50 million disbursed in July. Extensive technical assistance provided by the Fund is presented in Appendix III. The periodicity and timeliness of the most important statistics are adequate and presented in Appendix IV.[1] Appendix V describes the medium-term framework and alternative scenarios, and Appendix VI describes external and financial vulnerability.

3. Parliamentary elections were held on October 8. A center-liberal coalition government led by former Prime Minister Paksas was formed, relying on smaller parties for a majority in the 141-seat Seimas. The opposition includes a center-left group that was led in the elections by former President Brazauskas, which has more than one third of the seats, and the former ruling conservatives, who received just 9 seats, down from a majority in the previous Seimas.

II. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

4. **The macroeconomic objectives for 2000 under the program were largely attained.** The external current account deficit declined sharply, reflecting fast export growth, while real GDP growth rebounded, after the recession experienced in 1999. Implementation of difficult adjustment measures stabilized the financial situation, and the government regained access to domestic and foreign capital markets on favorable terms. Structural reforms advanced significantly, including in energy sector restructuring, privatization, trade policy, and budget and treasury management. Domestic demand remained weak, however, and unemployment increased (Tables 1-9).

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[1] Lithuania subscribes to SDDS since May 1996. On the basis of data provided by the authorities and reviewed by Fund staff, Lithuania meets the SDDS specifications for the coverage, periodicity and timeliness of the data, and for the dissemination of advance release calendars.

A. Macroeconomic Developments

5. **After a 4.1 percent decline in 1999, real GDP is expected to grow by about 2.3 percent in 2000, slightly above the program forecast** (Table 1 and Figure 1). The recovery was uneven, as, following 4.2 percent growth in the first quarter, growth was flat in the second quarter. Overall, during the first half of the year, exports were the major engine of economic activity, as real domestic demand contracted by an estimated 3 percent, owing to the fiscal tightening and a fall in investment. During the second half of 2000, industrial output and retail sales began to pick up, while export growth remained strong.

6. **Weak domestic demand and a real appreciation of the litas contributed to maintaining low inflation, despite oil price increases** (Figure 2). The year-on-year CPI was 1.3 percent at end-October 2000, and should amount to about 1 percent at year-end. Enterprise restructuring and labor shedding continued, and the **unemployment** rate rose from 10 percent at end-1999 to 12.1 percent at end-November 2000 (Box 1). This increase, coupled with the signaling effects of a reduction in public wages (which declined by 4.5 percent year-on-year in January-June), contributed to limiting overall **wage** growth to only 1.2 percent in January-August year-on-year.

7. **The fiscal adjustment for the first nine months of 2000 was impressive.** The deficit of the general government declined from 8 percent of GDP for the first nine months of 1999 to 3.1 percent of GDP for the corresponding period in 2000 (Table 2 and Figure 5). This fiscal adjustment was achieved despite a large revenue shortfall stemming from the erosion of the domestic tax base (Box 2), and the refusal of Seimas to adopt measures to reduce expenditures of the Social Insurance Fund (SoDra) by about 0.2 percent of GDP. Nonetheless, the general government deficit target for end-September was observed, as the state budget, the Road Fund and the Privatization Fund implemented significant additional expenditure cuts (of the order of 2.8 percentage points of GDP).

8. **Despite these efforts, some program targets were missed at end-September** (Table 8).[2] First, while expenditure arrears declined by 0.6 percent of GDP from end-1999 to end-September 2000, they remained 0.3 percent of GDP above the program target. This delay in clearance was mainly due to weak financial discipline of the municipalities, with the

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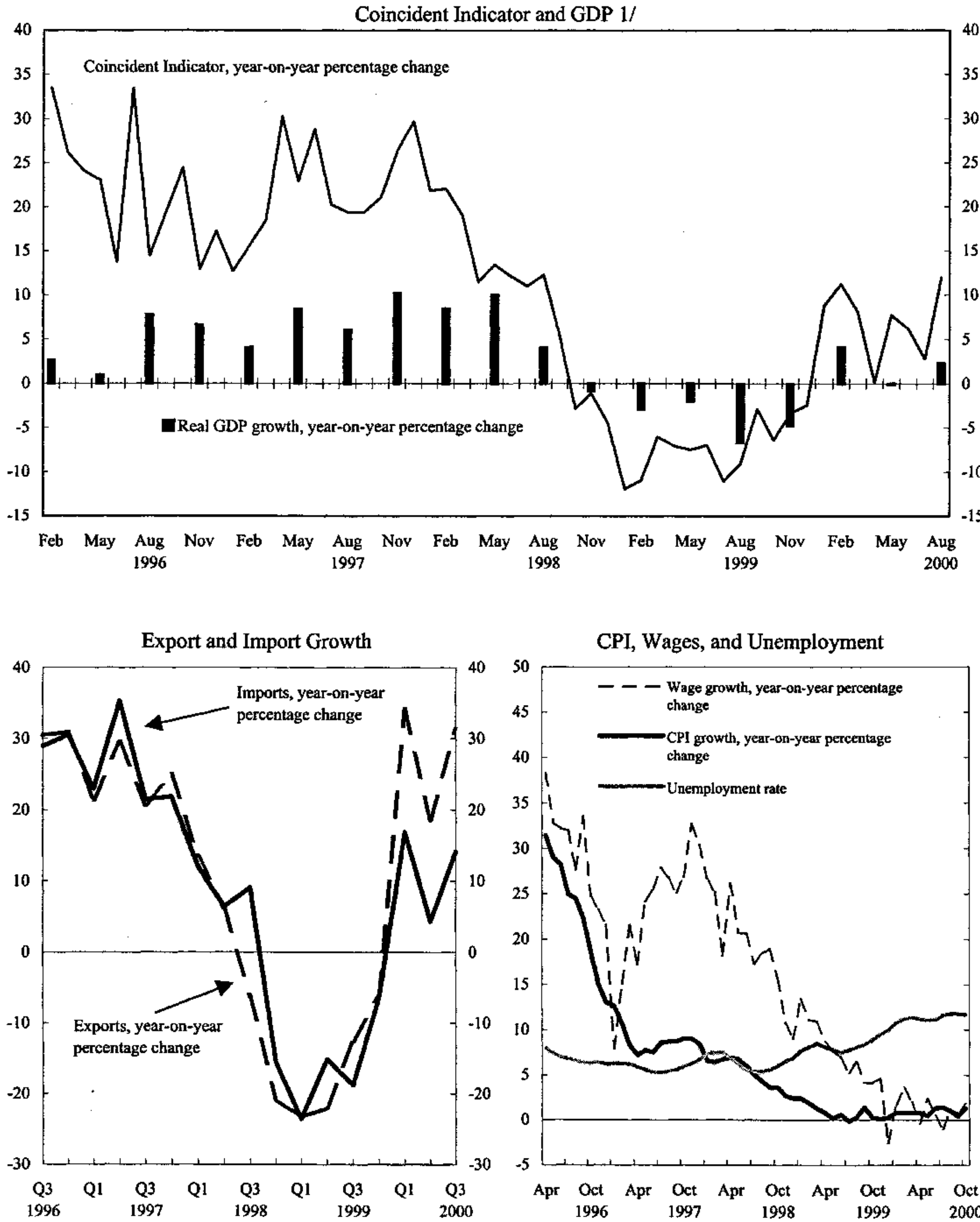
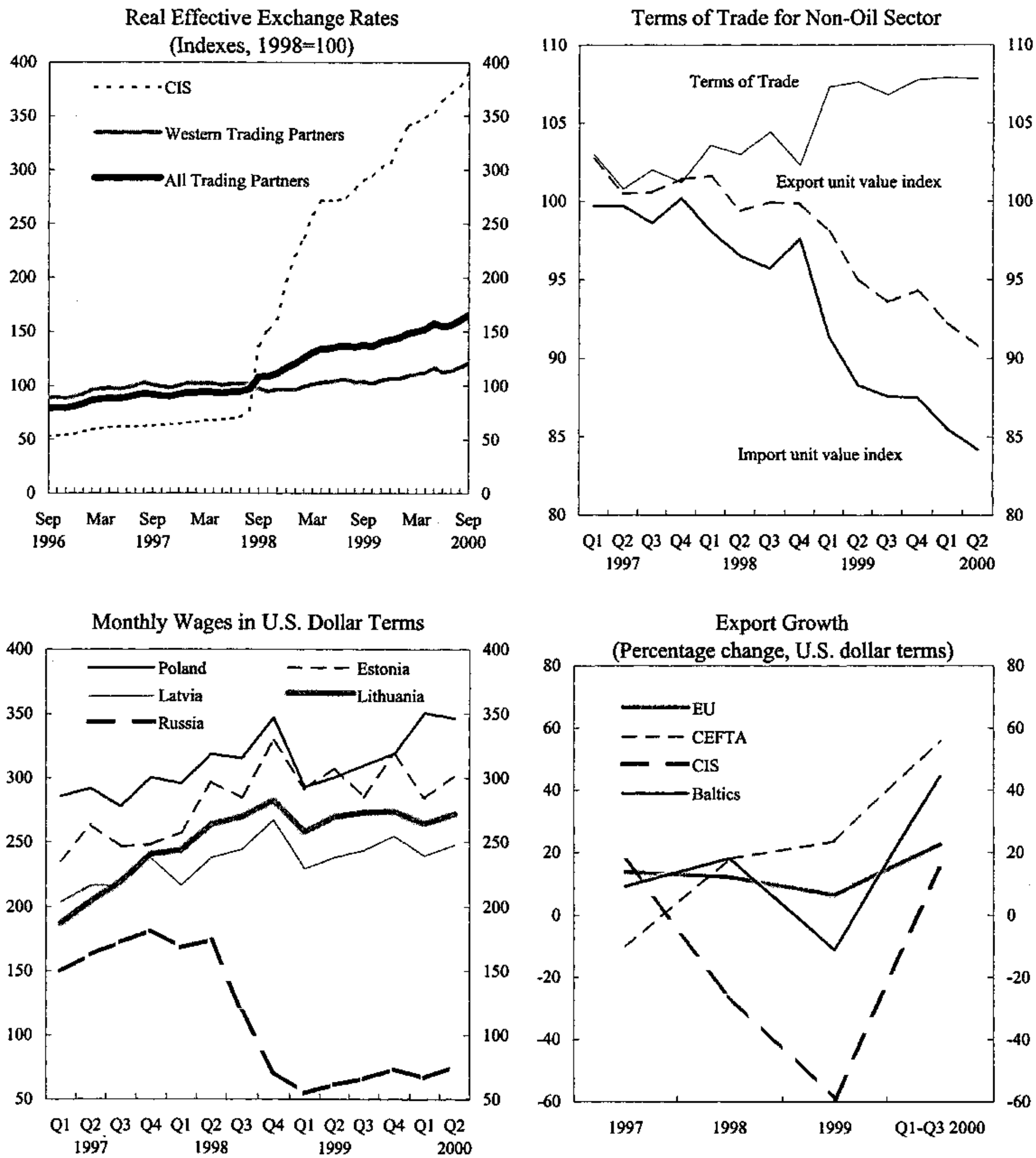
[2] At end-March, ceilings on the deficit of the general government, payments arrears and domestic guarantees (performance criteria) and net lending (indicative benchmark) were not observed. At end-June, ceilings on the general government deficit and arrears (performance criteria) and net lending (indicative benchmark) were not observed.

Figure 1. Lithuania: Selected Economic Indicators, 1996-2000



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

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



Sources: Lithuanian authorities; and Fund staff estimates.

Box 1. Developments in Employment and Unemployment

Lithuania, like other transition countries, saw radical changes in its economy. Unemployment increased to 6 percent in 1991–1995, when real GDP fell 40 percent cumulatively, and a quarter million jobs were lost (Figure 3). A further deterioration occurred in the aftermath of the Russian crisis. Despite a rebound of real GDP growth in 2000, unemployment continued rising, due to further restructuring of the economy.

The initial relocation of labor during the transition

The **structure of output and employment** changed dramatically from 1991 to 1999 (Figure 3). Industrial value-added shrank from 44 percent to about 31 percent of GDP; services increased from 41 percent to 60 percent; and agriculture fell from 14.6 percent to under 9 percent. Employment patterns mirrored these changes though agricultural employment hardly changed, as older and unskilled workers preferred to farm small plots of land received at independence rather than being unemployed, and technological restructuring lagged behind in this sector.

At the same time, a major shift of employment from the public sector to the private sector took place, with employment in the private sector increasing from 30 percent of the workforce in 1991 to almost 70 percent in 1999 (Figure 3). As expected, **productivity** improved somewhat during the transition given the overemployment of central planning times, with efficient labor shedding occurring especially in manufacturing (Figure 4).

The further rise of unemployment late in the transition

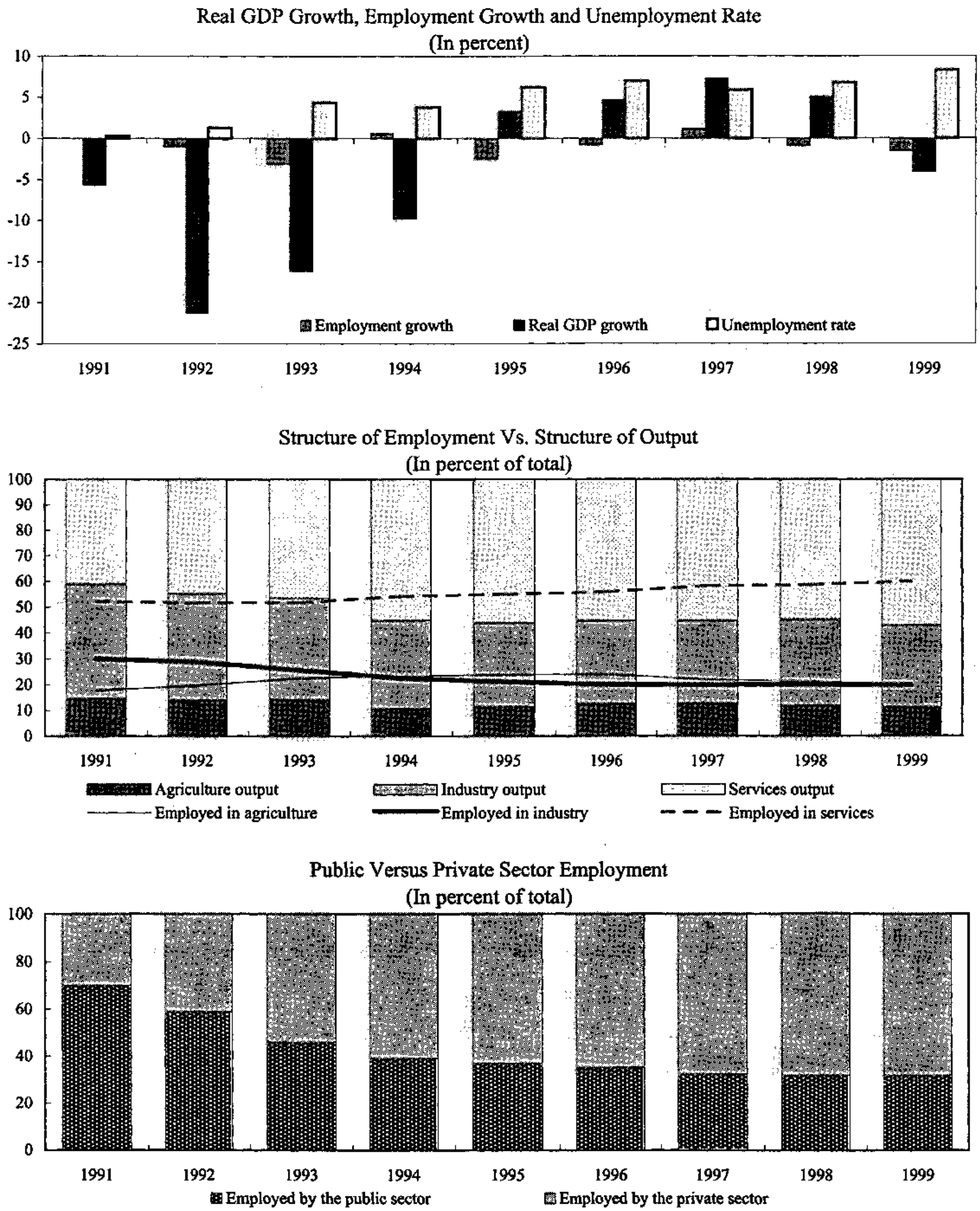
Unemployment increased at the beginning of transition, but remained mostly between 4 and 6 percent between 1993-98 (Figure 4). In 1999, unemployment rose into double digits reaching 12.1 percent in November 2000. The initial rise in unemployment was due to the first round of privatization and restructuring which led to state sector enterprise closings. As in other transition countries, the private sector was not immediately able to absorb these workers. The recent ratcheting up of unemployment happened in the wake of the Russian crisis, which had four important repercussions. First, the previously common black labor market, where construction and other such services were traded, collapsed. Second, agricultural restructuring, which was partly demand-induced from the crisis, got underway especially in Marijampole and Lazdijai where unemployment was above the national average. Third, Russian demand for small scale production of products, such as clothing, collapsed, affecting areas such as Siauliai, Plunge, Telsiai, Mazeikiai, and Akmene. Fourth, transportation services, including the use of Klaipeda seaport, fell. Other key factors were further hardening of budget constraints in subsequent rounds of restructuring and preparation for privatization of the energy companies (oil, gas, and utilities), banks, and other national flagship enterprises, and the real appreciation of the litas, forcing companies to reduce cost to stay competitive.

Unemployment increased differentially across regions, with the rural sectors such as Marijampole and Lazdijai facing a higher unemployment rate, even though in absolute terms unemployment is still higher in the denser urban centers such as Vilnius, Kaunas, and Klaipeda (Figure 4). **Regional mobility** remained limited, due to the prohibitively high price of housing in the cities, and the high price of transportation which made it difficult for workers to commute to the centers for jobs. **Semi-skilled and unskilled** workers suffered the brunt of the labor shedding and found themselves without the appropriate skills for newly-available jobs (Figure 4). **Longer-term unemployment** has not emerged as a problem as of yet, with almost half being unemployed less than six months in 1999. However, if the recently laid-off do not find opportunities in the immediate future because of sluggish growth, the duration of unemployment will likely lengthen (Figure 4).

The future of job creation in Lithuania

Even though unemployment has reached uncomfortable levels, Lithuania's economy may generate higher employment with more robust growth and a better business environment in the future. The new government program plans to reduce hiring and firing costs by easing notice time and severance pay requirements, liberalizing labor contracts, and eliminating work quotas and restrictions. The Labor Exchanges have been working actively with the unemployed to train and place them as well as to help them start their own businesses. Recently the exchanges have been using electronic information systems, as well co-coordinating with potential employers to provide appropriate job training. The public works program has been successful at providing short-term employment opportunities to the less qualified, where more than 23,000 (almost 16 percent of the unemployed) found such jobs in 1999. One concern may be that these programs provide disincentives for job search in the private sector. Also, labor costs are still high with payroll marginal tax rates at 34 percent, higher than the rates at which other inputs are taxed.

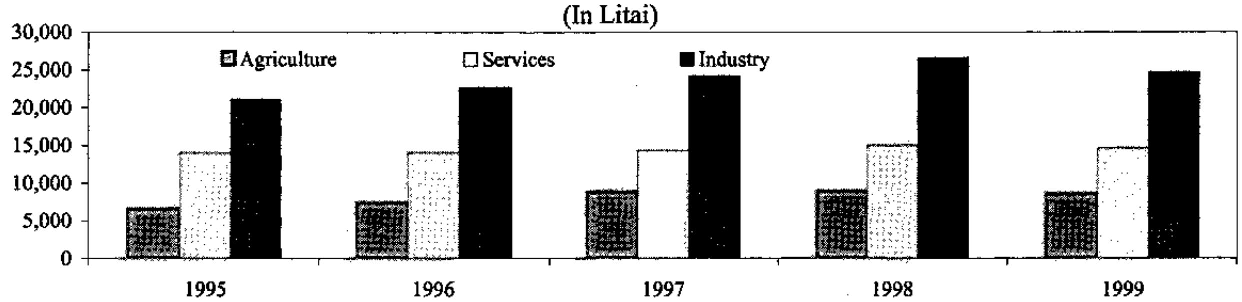
Figure 3. Lithuania: Output and Employment, 1991-1999



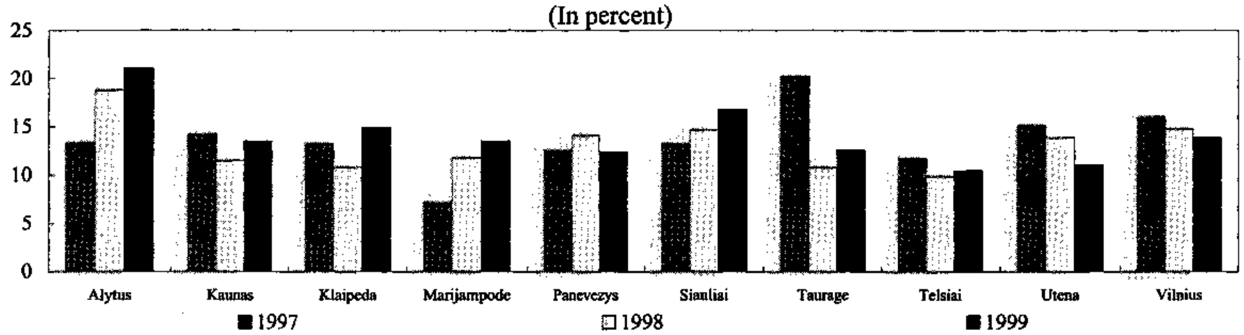
Source: Lithuanian authorities; and Fund staff estimates.

Figure 4. Lithuania: Productivity and Unemployment, 1995-1999
(In units as indicated)

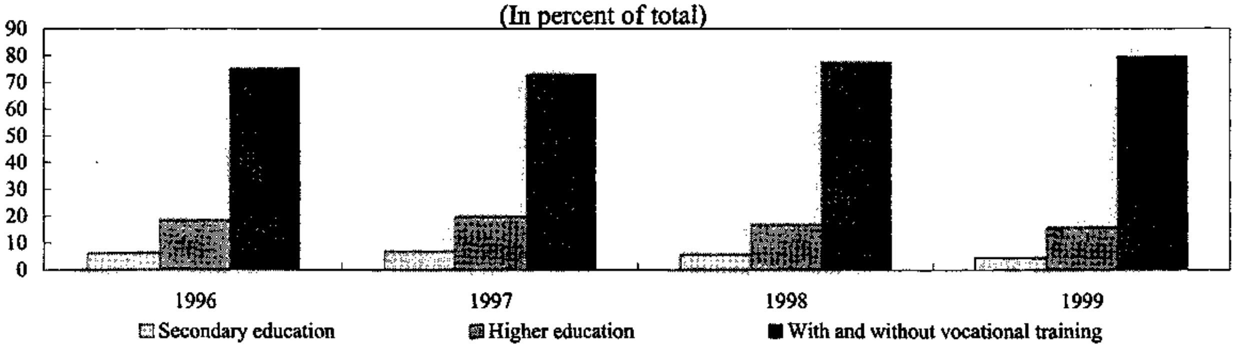
Labor Productivity by Sector
(In Litai)



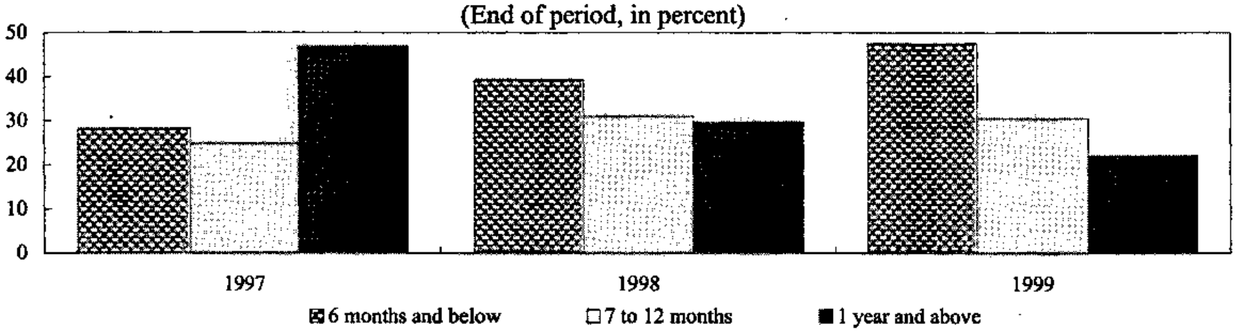
Unemployment by Regions
(In percent)



Unemployment by Education Level
(In percent of total)

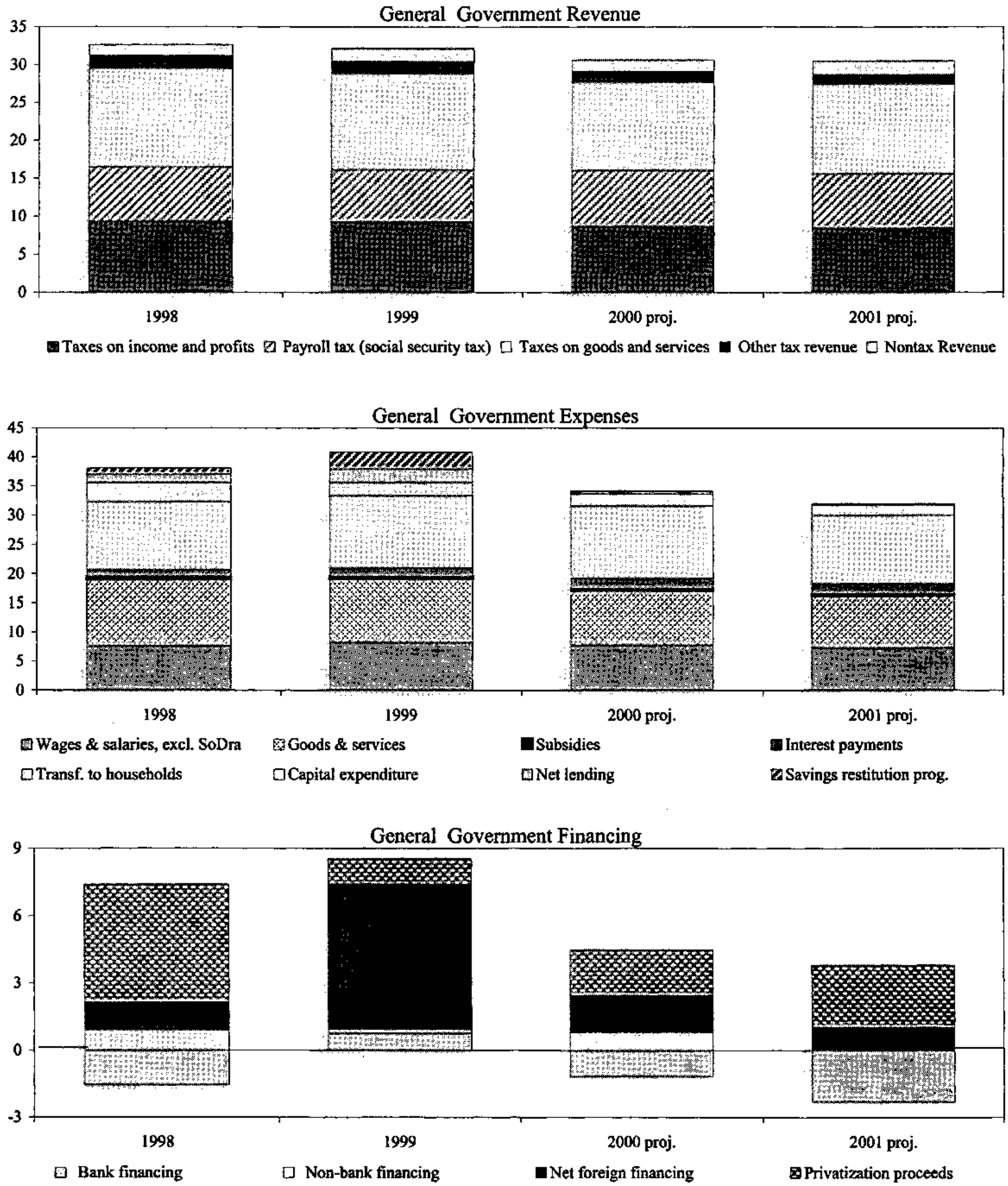


Duration of Unemployment
(End of period, in percent)



Source: Lithuanian authorities; and Fund staff estimates.

Figure 5. Lithuania: Fiscal Sector Indicators, 1998-2001
(In percent of GDP)



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

Box 2. The Revenue Shortfall in 2000

The revenue-to-GDP ratio is projected to be 1.8 percentage points of GDP below projections. Such a large shortfall was mainly explained by the structure of the tax system, oil price shocks, and sources of GDP growth. First, labor is more heavily taxed than capital in Lithuania, implying that a significant slowdown in labor income leads to the reduction in payroll tax revenue, which cannot be fully compensated by taxation of more rapidly growing capital income. Second, faster-than-expected external adjustment and a sharp decline in residential construction led to shortfalls in VAT. Third, excise revenue suffered from a price-related decrease in the consumption of petroleum products.

- The **payroll tax** rate was increased from 31 to 34 percent in 2000 in the expectation that the payroll tax revenue would increase by about 1 percentage point of GDP. In fact, current staff projections indicate that the payroll tax revenue would only increase by 0.5 percentage point of GDP, thus creating a revenue shortfall of around LTL 200 million. This sizable revenue shortfall is mainly attributable to the weakness of the tax base. The latter is mainly composed of the overall wage bill of employees under wage contracts who qualify for full pensions, and contributions of other labor market participants who only have to contribute a flat monthly lump sum (equal to one half of the basic pension) to qualify for a basic pension. The increase in the payroll tax combined with competitiveness pressures, due to the real appreciation of the litas, led to the stagnation of nominal wages. This together with higher-than-projected unemployment, and a shift toward temporary employment and self-employment, which are taxable at a lower rate, led to a decline in the taxable base. In particular, the number of employees under wage contracts and average taxable wage were 1.2 and 3.8 percent, respectively, below projections, which entirely explains the projected revenue shortfall of around 5 percent. Even though the number of contributors for the basic pension increased somewhat, it was not sufficient to compensate for the large shortfall from full pension contributors.

- The shortfall in **VAT** collection is estimated to be about LTL 220 million (0.6 percentage points of GDP below program projections), as domestic demand and residential construction were much weaker in terms of GDP than envisaged. Initially, VAT revenue was projected to increase by 5.5 percent in 2000. Currently, it is estimated that VAT revenue would decline by about 1 percent, while the tax base would inch up by 0.1 percent, implying that the effective rate of taxation would decline. The tax base consists of total consumption (+0.3 percent), residential construction (-14 percent), and investment of exempt sectors (assumed basically unchanged in the absence of recent data) minus wages and salaries of the public sector (+0.1 percent) and value added of exempt sectors (-0.3 percent). The shortfall stemming from demand factors is estimated at LTL 155 million (0.4 percent of GDP). The reduction in the effective rate of taxation is estimated to result in a revenue shortfall of around LTL 65 million (0.1 percent of GDP). This could be in part explained by a shift of consumers to retail outlets with turnovers below the taxable minimum (in open market places) and the discontinuation of tax offsets. The former factor was largely beyond the control of the authorities, while the latter reflected the inability to recover tax arrears when offsets became forbidden.

- **Excises** are levied in litas per physical unit, implying that their collection is sensitive to sales volumes but not to prices. Consumption of gas oil and kerosene are estimated to be below program assumptions by about 25 and 8 percent, respectively, in 2000, due to a price-driven decline in demand and a partial substitution of gas oil by liquefied gas that is not taxable. The petroleum excises revenue shortfall is estimated at LTL 170 million (0.4 percent of GDP). In view of rising international oil prices and its negative impact on domestic demand, the government decided not to start taxing liquefied gas. The revenue collection on alcohol was slightly better than programmed, while revenue shortfalls on account of tobacco products were minor. The overall shortfall in excise revenue is estimated at LTL 225 million (0.6 percentage points of GDP below the program projections).

central government lacking the legal means or leverage to intervene.[3] Second, the performance criterion on contracting and guaranteeing external debt was met, but the sub-ceiling on 1 to 5 year maturity was not observed by a small margin, due to a €75 million eurobond issue in August, made following consultation with Fund staff. The government was thus able to take advantage of favorable market conditions, obtaining sufficient liquidity to cope with possible market disturbances in the run-up to the October elections.[4]

9. **Fiscal adjustment was key to achieving a significant reduction in external imbalances.** The external current account deficit declined substantially faster than envisaged, from 11.1 percent of GDP in the first half of 1999 to 4.2 percent of GDP in the first half of 2000 (Table 3). The main factor was the decline in the trade deficit. Exports grew briskly, outstripping import growth, as domestic demand contracted (Figure 2). Exports of goods and services increased by 28.4 percent in the first nine months of 2000 (by 22.6 percent to the European Union (EU)), indicating sustained external competitiveness, despite the continued appreciation of the litas in real effective terms (Box 3 and Figure 6). For the year as a whole, the external current account deficit is projected to decline to around 6.9 percent of GDP, compared with 11.2 percent in 1999. A more favorable composition of net capital inflows[5] contributed to the improvement of the liquidity position of Lithuania, as net short-term assets (including currency and deposits), improved by US$240 million (to 14 percent of GDP) in the first half of 2000. The external debt ratio to GDP is projected to rise from 42.6 percent at end-1999 to 44.2 percent at end-2000.[6]

[3] The political calendar also complicated the reduction of local government arrears, as municipal elections were held in March, with new local officials coming into office prior to the parliamentary elections that were held in October.

[4] The August eurobond was issued at a spread of 243 basis points over the German benchmark bond.

[5] The sale of a further 25 percent of shares of the Lietuvos Telekomas via a public offering (about US$100 million from nonresidents) and the February and August eurobond issues (totaling €325 million) represented the two major sources of nonresidents' capital inflows. Lithuania's investments abroad were largely undertaken by the BoL and commercial banks.

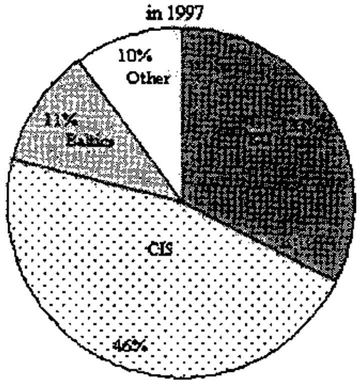
[6] Financial sector external debt would decline from 5.4 percent of GDP at end-1999 to 5.3 percent at end-2000, while other private debt would increase from 14.5 percent of GDP to 15.2 percent during the same period.

Box 3. Export Performance and External Competitiveness

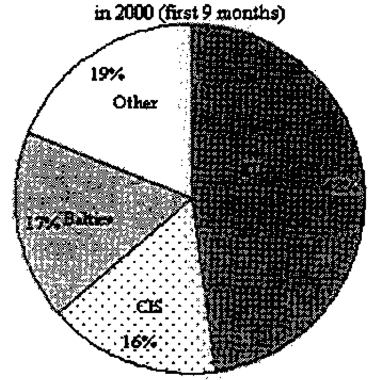
Lithuania's export performance has been strong despite the continued real appreciation of the litas. This suggests that the real appreciation of the litas, as shown by the CPI-based real effective exchange rates, may reflect the effect of significantly faster productivity growth than in trading partner countries, or the Balassa-Samuelson effect. Lithuania's external competitiveness has been sustained by a number of factors, including improved productivity, terms of trade gains, and declining prices of domestic intermediate and capital goods.

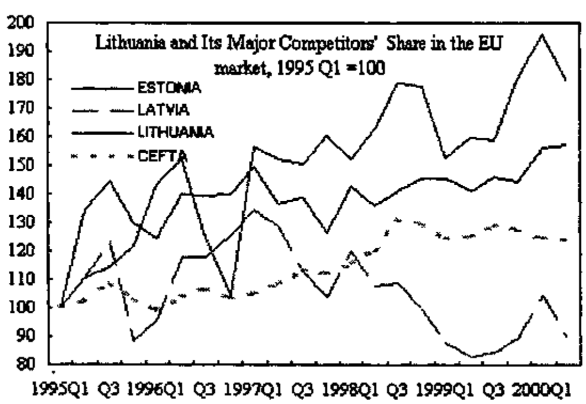
After a severe setback in the wake of the Russian crisis, Lithuania's **exports** have made a strong recovery since the first quarter of 1999. In particular, during the first nine months of 2000, exports (in U.S. dollar terms) registered a remarkable year-on-year growth of 24 percent. The recovery has been primarily fueled by strong penetration into EU markets, as exports to Common Wealth of Independent States (CIS) market stabilized. Exports to other markets have also been on a steady upward trend. During the first nine months of 2000, Lithuania's exports to EU markets accounted for 48 percent of its total exports, in comparison with a pre-crisis level of 33 percent in 1997, and the two other Baltic countries are about to supersede the CIS countries as Lithuania's second largest export market. In contrast, exports to CIS countries accounted for less than 16 percent of total exports during the same period of time, down from a pre-crisis level of 46 percent registered in 1997. Export shares to other major trading blocs are also on the rise, noticeably to the Central European Free Trade Area (CEFTA), the United States and European Free Trade Area (EFTA). Moreover, Lithuania's export performance relative to its Baltic competitors and CEFTA countries has been fairly good.

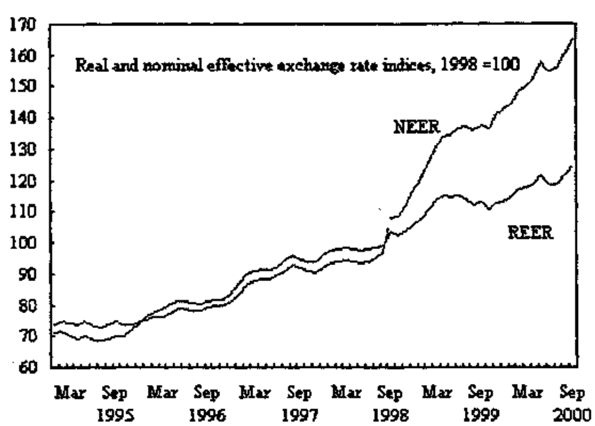
Lithuania's export structure by region of destination in 1997



Lithuania's export structure by region of destination in 2000 (first 9 months)







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

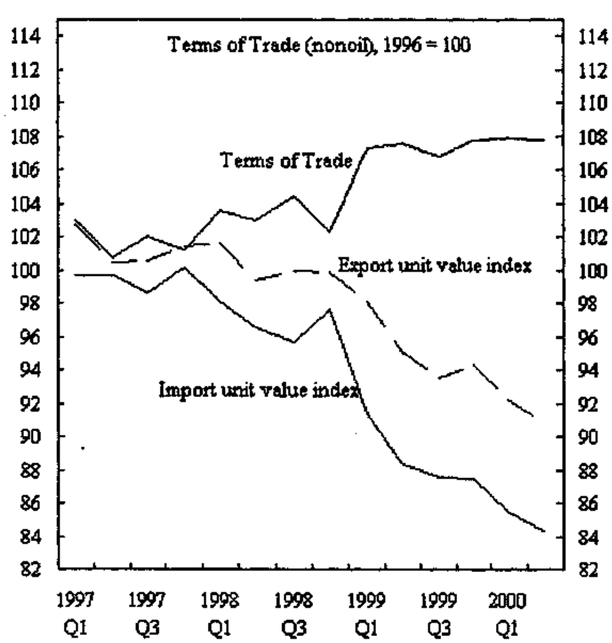
Box 3. Export Performance and External Competitiveness (continued)

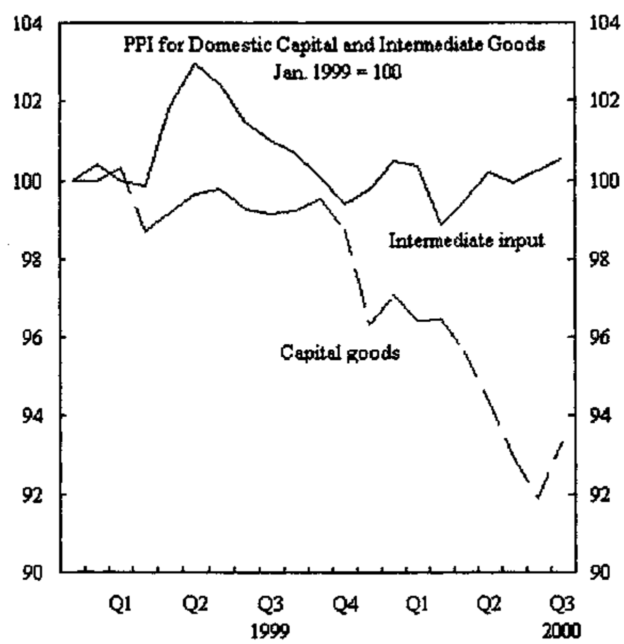
CPI-based real effective exchange indexes show that the litas has been appreciating in real as well as nominal terms with respect to all major groups of trading partners since 1995. The post-crisis appreciation of the currencies in the CIS countries explained the temporary real depreciation that took place during September 98 – March 99, and the index reverted back to the upward trend thereafter.

Developments in labor productivity, terms of trade (ToT), and producer price indices (PPI) for domestic intermediate input and capital goods indicate that falling prices of intermediate inputs and capital goods have generated **costs savings**. During the first nine months of 2000, the total wage bills of those employed under labor contracts decreased by 4 percent, while nominal GDP was estimated to have increased by 5 percent, indicating an increase in labor productivity. Excluding the impact of oil prices, the decline in export prices has been more than offset by an even faster decline in import prices, resulting in significant gains in Lithuania's ToT. The gains may have been even more significant for exporters who primarily export to the CIS area, since they enjoyed the combination of cheaper imported inputs and rising export prices in litas terms due to the real appreciations experienced in that area. Exporters have also benefited from cheaper domestic intermediate inputs and capital goods. The PPI for intermediate and capital goods that were sold domestically declined by about 2.5 and 6.3 percent, respectively, during the 16- month period between June 1999 and October 2000.

Firms which have been successful in increasing their exports to the EU markets in the last year mentioned a number of **factors that contributed to their good performance**, such as improved productivity, labor shedding, wage bill cuts, cheap inputs from the euro area, product quality upgrade, and better marketing. Moreover, a range of structural reforms implemented by the government improved the business environment and labor market flexibility, giving firms more leverage in undertaking measures that help maintain their competitiveness.

A recent survey of business confidence points to the high likelihood that the currently good export performance will continue. In the survey, the top one hundred companies in the manufacturing sector answered questions regarding their current and expected level of export orders. In the third quarter of 2000, over 60 percent of exporters regarded their current level of export orders as normal or above normal, and 70 percent expected the level of export orders in the next 3-4 month to remain unchanged, while those exporters who expected their export orders to increase or decrease accounted for 20 and 10 percent, respectively.

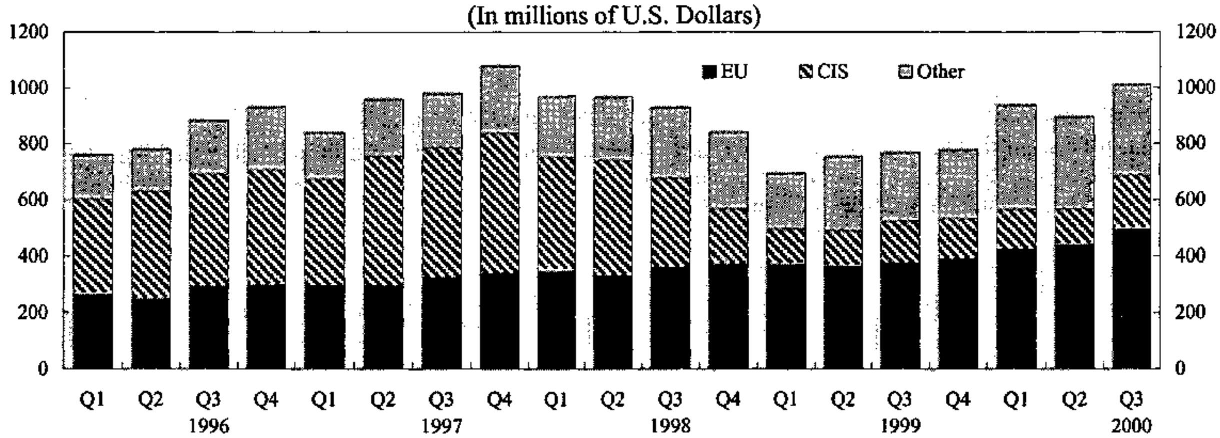




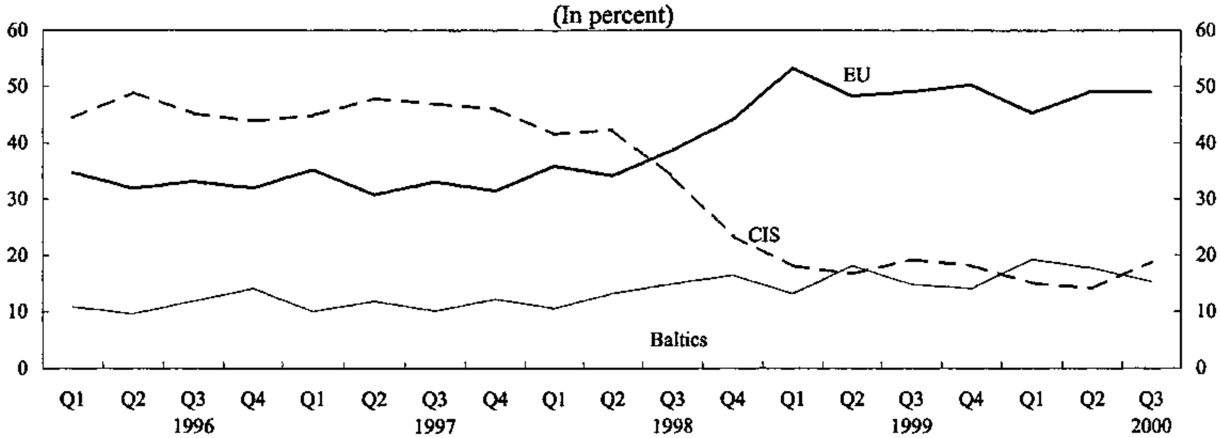
Sources: Lithuanian Department of Statistics; and Fund staff estimates.

Figure 6. Lithuania: Exports, 1996-2000

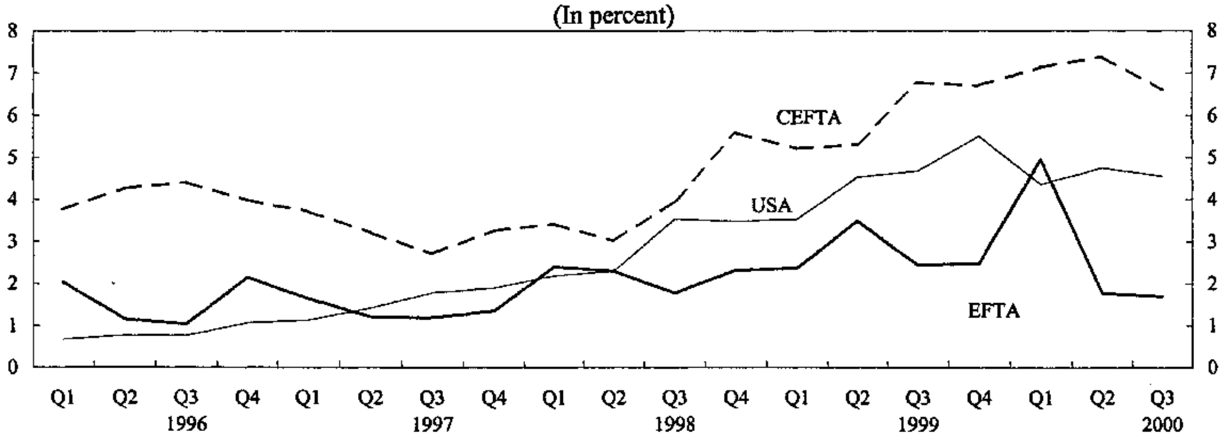
Total Exports
(In millions of U.S. Dollars)



Export Share by Market of Destination
(In percent)



Export Share by Market of Destination
(In percent)



Source: Lithuania Department of Statistics.

10. **The notable fiscal and external adjustment led to increased confidence in the litas and stabilization of domestic financial markets in 2000.** All performance criteria for end-September pertaining to the BoL were met (Table 8). Reliance on external financing for the fiscal deficit and increased confidence in the litas led to a sizable decline in 3-month treasury bill interest rates from their peak levels of 17.4 percent in November 1999 to 8.6 percent in October 2000 (Figure 7). Moreover, the government was able to lengthen the maturity of many treasury securities issues to three years, contributing to the deepening of financial markets. In the run-up to the elections, sales of foreign exchange by the BoL intensified, but treasury bill rates in the secondary market remained below 9 percent, as the government refrained from new issues.

11. **Growth in credit to the private sector remained sluggish, despite the decrease in lending rates[7] and the relaxation of reserve requirements.[8]** Weak domestic demand and election uncertainties dampened credit growth, and led to an accumulation of foreign assets by commercial banks (Table 4 and Figure 7). In addition, the privatization-related restructuring of the Agricultural Bank and Savings Bank, as well as the consolidation of the current market leader Vilnius Bank with a weaker mid-sized bank, slowed down credit growth. Banking supervision continued to be appropriate, and the prudential indicators of the banking system remained adequate as all banks complied with prudential requirements (Appendix VI). More stringent capital adequacy requirements were introduced in June 2000 in compliance with ECB standards. Thus, while observance of the capital adequacy ratio remained more than adequate, it declined somewhat from end-1999 to end-September 2000.[9]

B. Structural Reforms

12. **Significant progress was achieved in fiscal management.** A new organic budget law was passed by Seimas in July, which provides for the consolidation of most extrabudgetary funds into the state budget, strengthened expenditure and debt management

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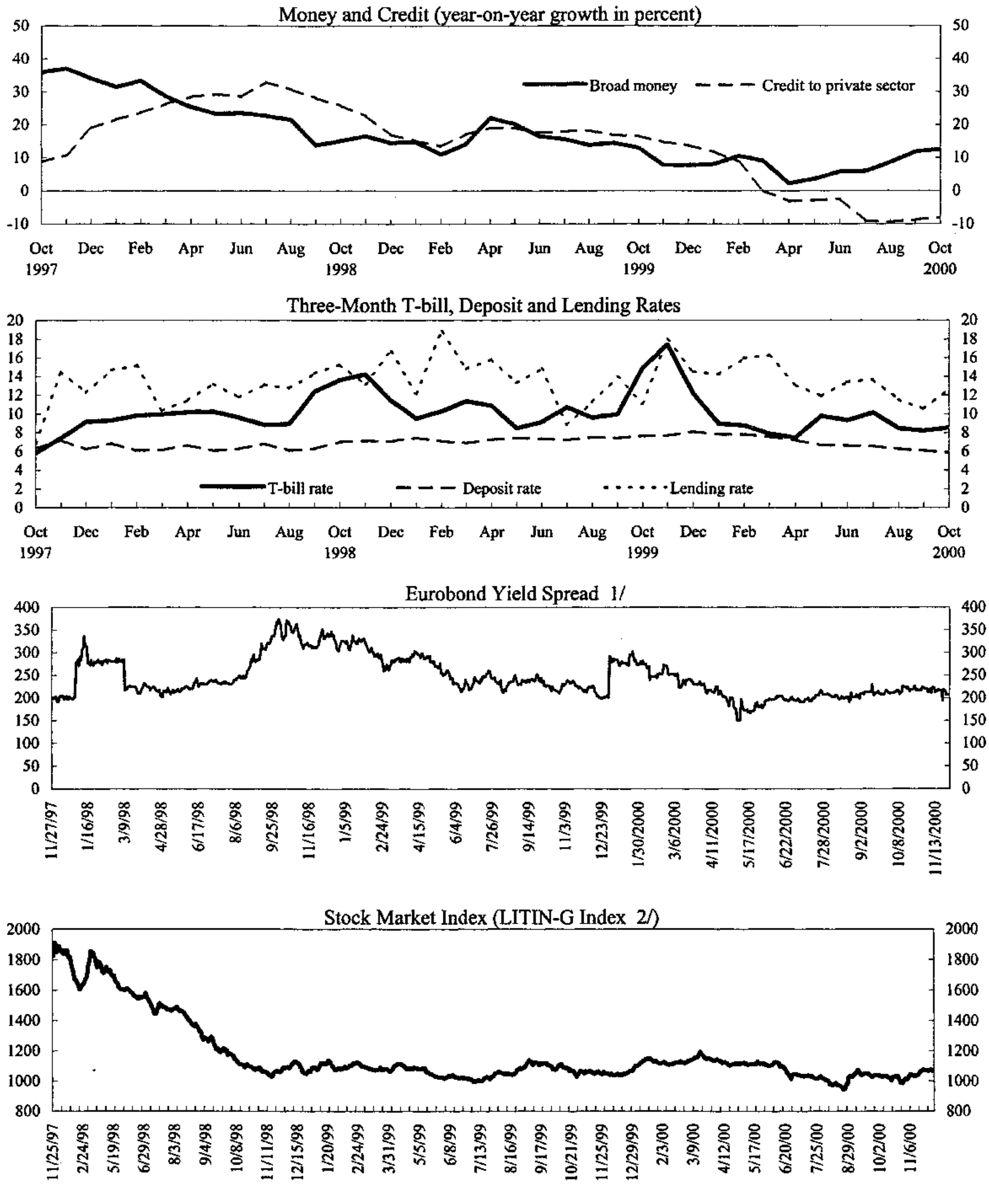
[7] Lending rates on loans in national currency with maturity of 3 months declined from a peak of 18 percent in November 1999 to 10.5 percent in September 2000.

[8] After consultation with Fund staff, the BoL announced that the required reserves ratio would be decreased from 10 to 8 percent beginning October 14, 2000.

[9] In June 2000, Seimas passed new regulations on large risk exposures and reduced limits on open foreign exchange positions, in line with ECB requirements.

Figure 7. Lithuania: Financial Indicators, 1997-2000



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

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

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

procedures, and enhanced transparency.[10] It also requires that the government prepare consolidated general government three-year projections with the submission of the draft national budget. Treasury operations were modernized, the functionality of the treasury was established, and several pilot projects in report preparations and payments for budgetary organizations were implemented. A government resolution transferred the responsibility for the public investment program from the Ministry of Economy to the Ministry of Finance, thereby consolidating the management of the central government capital expenditure. In addition, the Sunset Commission prepared reorganization plans to streamline the operations of ministries and budgetary organizations with a view to achieving budgetary savings.[11]

13. **Privatization moved forward in the telecommunications and banking sectors.** In the aftermath of the privatization of Mazeikiu Nafta Oil Company, the authorities have significantly improved the transparency of all privatization operations, relying on the advice of international consultants, and ensuring that no fiscal costs would be entailed.[12] The sale of a further 25 percent of shares of Lietuvos Telekomas via a public offering was completed in May.[13] A number of other large companies, including GeoNafta (oil exploration), were privatized. The privatization of two out of three state-owned banks proved more challenging than originally envisaged, with only single bidders responding to the tenders. The almost completed sale of government shares of the Agricultural Bank collapsed in mid-November. The tender for the privatization of the Saving Bank was completed in early October, with only one bidder. By contrast, the privatization of the Development Bank is at an advanced stage. Foreign ownership of the banking system is increasing, as the Swedish bank SEB intends to increase its share in Vilnius Bank from 41 to 100 percent by year-end.

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[10] Only four extrabudgetary funds are envisaged under the new Law: SoDra, Health Insurance Fund, Privatization fund, and Ignalina Nuclear Power Plant Closure Fund. The Road Fund will be integrated into the state budget in 2002. The budgets of all extrabudgetary funds are subject to Seimas approval.

[11] The government established in early 2000 the Sunset Commission to examine the efficiency of public institutions, with a view to limiting spending. At the same time, it established the Sunrise Commission, with private sector participation, to prepare plans for improving the business environment.

[12] The controversial privatization of Mazeikiu Nafta was completed in late 1999, with significant upfront budgetary costs and additional sizable contingent liabilities. The details of the privatization agreement were summarized in Box 1, EBS/00/28.

[13] The government had intended to sell 35 percent, but scaled this offer back when market prices proved lower than expected, reflecting a worldwide downturn for technology stocks.

14. **Progress was made in restructuring the electricity and gas sectors, laying the basis for privatization.** Appropriate pricing policies were adopted at the beginning of 2000, with substantial increases in utility tariffs.[14] An advisor for the privatization of the Lithuanian Power Company (LPC) was hired in July, and the Law on Electricity, consistent with EU requirements, was passed in mid-July. The recently passed Law on Gas envisaged the separation of distribution and transmission assets before privatization. An advisor for the privatization in the gas sector has been hired. On the other hand, Mazeikiu Nafta could not secure a long-term supply agreement with Russian oil companies, and supply interruptions occurred in 2000, resulting in the conversion of LTL 140 million of Mazeikiu Nafta's debt to the state budget into a subsidy, in line with the terms of the privatization agreement.[15] Due to the lack of secured crude oil supplies, investments for the modernization of Mazeikiu Nafta have been delayed.

15. **All trade restrictions introduced after the Russian crisis in 1998 were removed effective November 1, 2000.** The remaining export taxes which relate to raw hides and skins will be abolished effective January 1, 2001. Lithuania officially joined the WTO in December 2000.[16] EU accession negotiations have advanced, with 16 chapters (out of 30) of the *Acquis Communautaire* being opened, of which five have been completed. The EU accession report of November 2000 gives a positive assessment of Lithuania's progress in this regard.

16. **At the beginning of 2000, a program for the improvement of the business environment was initiated by the Sunrise Commission.** The commission prepared a number of programs and draft laws for Seimas approval, with a view to simplifying taxation rules, reducing licensing requirements, revising bankruptcy legislation, rendering the labor market more flexible, and settling issues related to land ownership and land restitution. However, election-related uncertainties prevented Seimas from passing some of the submitted drafts before end-November 2000, slowing down the process of deregulation.

[14] As of January 1, 2000, electricity tariffs were increased by 20 percent and gas prices were increased by 4.9 percent.

[15] This conversion will reduce interest payments to the budget by about LTL 10 million in 2000. The authorities limited expenditure on Mazeikiu Nafta to LTL 88 million in line with the program. No new loan guarantees were provided to Mazeikiu Nafta in 2000, though there are provisions in the privatization agreement for an additional US$118 million of loan guarantees.

[16] The anti-crisis measures that were removed included increased import tariffs and import reference prices for selected products, mainly in agriculture. Lithuania has a very liberal trade regime with an average tariff of 7.5 percent, a maximum tariff of 100 percent, 17 tariff bands, and virtually no quantitative restrictions. Lithuania has a rating of 1 on a scale from 1 to 10 based on the Fund's Trade Restriction Index.

III. Policy and Program Discussions

17. **The authorities' strategy in 2000 of maintaining the currency board arrangement, reducing the fiscal deficit, and accelerating the implementation of structural reforms, led to an impressive turnaround.** The new government reiterated its commitment to the Fund-supported program and recognized the need to continue fiscal consolidation and structural reforms, in order to maintain a sustainable external position, improve the economy's growth prospects, and achieve further progress in EU accession preparations.

18. **Discussions on the appropriate fiscal stance were at the center of the policy dialogue with the authorities.** The fiscal adjustment originally programmed for 2000 was ambitious, with a targeted reduction in the general government budget deficit from 8.5 percent of GDP in 1999 to 2.8 percent of GDP in 2000. Given the faster-than-envisaged external current account adjustment, weak domestic demand, revenue shortfalls and the continued rise in unemployment, there was broad agreement that it would be appropriate to increase modestly the fiscal deficit targets for 2000 and 2001. The revised fiscal deficit targets are consistent with the authorities' external adjustment objectives. The staff and the authorities also shared the view that the CBA continued to provide an anchor of stability for macroeconomic policies, and that the revision to the programmed fiscal adjustment was consistent with preserving the credibility of the CBA.

19. **The authorities expressed their determination to continue with the ambitious structural agenda**, including the completion of the privatization of the three state-owned banks, further steps in restructuring the energy sector, changes to the tax legislation in line with EU requirements, and new measures to improve the business environment, with a view to improving growth prospects. The authorities also expressed interest in continuing their cooperation with the Fund, possibly under a new arrangement, after the expiration of the present stand-by arrangement in the second quarter of 2001.

A. Macroeconomic Framework and External Sector Prospects

20. **Assumptions underlying the macroeconomic framework presented in EBS/00/28 were modified to reflect the faster-than-envisaged external adjustment and the slightly slower fiscal deficit reduction.** Macroeconomic policies in 2001 would aim at strengthening economic recovery, maintaining low inflation, and reducing the external current account deficit. It is expected that the economic recovery would continue to be underpinned by growing exports to western markets and maintaining market shares in CIS markets. Real GDP growth is expected to accelerate to about 3.2 percent. Inflation would remain in the 1-2 percent range, underpinned by wage restraint in the public and private sectors, and some decline in oil prices.

21. **In 2001, the external current account deficit is projected to narrow slightly to around 6.8 percent of GDP.** Exports are projected to grow by 7.4 percent in U.S. dollar

terms, decelerating from a projected 22.3 percent in 2000, as the strong growth in 2000 reflected in part a return of exports to their pre-crisis levels. It is expected that the relative share of exports to the EU and Central European Free Trade Area (CEFTA) would continue to increase (Box 2).[17] Imports volumes are projected to pick up, reflecting some revival of domestic demand.

22. **The staff expressed concern over growing reliance on public sector external borrowing and a significant decline in nonprivatization-related foreign direct investment (FDI).** Falling levels of investment in 2000 may have reflected delays in planned projects, as investors waited for a clear strengthening of the recovery, and some easing of the prevailing bureaucracy and red-tape. Consistent with the authorities' privatization program and the planned improvements to the business environment, the revised program for 2001 envisages higher inflows of FDI, a lower level of foreign borrowing by the government, as well as a substantial increase in privatization-related FDI.

23. **The medium-term macroeconomic framework envisages a gradual pick-up in GDP growth and low inflation, combined with a continued reduction in the current account deficit** (Tables 3, 5 and 10). *Real GDP* growth would pick up from 3.2 percent in 2001 to 4–5 percent a year over the medium term. This is a conservative growth path, and determined implementation of reforms could lead to an improvement of the investment climate, resulting in a faster pace of investment and growth. The recovery would be led mainly by continued export growth to western markets and advanced transition countries, and increased efficiency of private investment. *Inflation* would remain between 2-3 percent, reflecting faster productivity growth than in trading partner countries.[18] Fiscal adjustment will continue to underpin the external current account adjustment. Specifically, the scenario envisages that the *general government fiscal deficit* would be reduced from a projected 3.3 percent in 2000 to 1.4 percent in 2001, and that the budget would be in balance from 2003 onwards.[19] This fiscal adjustment, together with continued export recovery, would help achieve a gradual reduction in the *current account deficit* from 6.9 percent in 2000 to 5.5 percent in 2005. Following the recent increase, external debt is projected to decrease over the medium term to 33 percent of GDP in 2005, reflecting a lower current account deficit and higher nonprivatization-related FDI inflows. The debt service ratio would peak at 17 percent of exports in 2002, declining to 15.6 percent by 2005.

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[17] The program is based on the assumption of a euro/dollar exchange rate of $0.85 for €1.

[18] Some inflation and real exchange rate appreciation is to be expected, owing to the Balassa–Samuelson effect.

[19] This scenario does not account for changes in tax policy, implementation of a pension reform, the investment program, and medium-term costs of EU and NATO accession, because the government is still developing a strategy for these reforms.

B. Fiscal Policy

The Objectives for 2000

24. **The staff and the authorities shared the view that an increase in the general government deficit target by about LTL 250 million (0.5 percent of GDP) to 3.3 percent of GDP would be consistent with the revised macroeconomic framework.** To achieve the revised deficit target, the government made significant expenditure cuts compared with the program, as well as reallocations (Table 2). In order to offset revenue shortfalls equivalent to 1.8 percentage points of GDP, as well as the nonimplementation of steps to reduce SoDra expenditure (0.2 percent of GDP) and larger-than-foreseen defaults on guaranteed loans (0.3 percent of GDP), additional expenditure savings of about 1.8 percentage points of GDP were required to achieve the revised deficit target. Savings were obtained on interest expenditure (0.2 percent of GDP), while transfers to households by the state budget turned out to be 0.1 percent of GDP lower than expected. Further cuts were made in expenditure on goods and services of the state budget, road maintenance, and the health insurance fund.

25. **The authorities intend to eliminate expenditure arrears of the central government by end-2000, and reduce expenditure arrears of municipalities by 30 percent from end-September to end-December 2000,** with a view to their full elimination by mid-2001.[20] To this end, specific provisions in the 2001 budget law and the Law on Budgetary Organizations are made (see SMEP, paragraph 14). The authorities also agreed not to resort to offsetting operations.

The 2001 Budget

26. **Whereas the initial program targeted a balanced budget for 2001, a number of considerations call for some revision.** First, external adjustment has proceeded faster than expected, reducing the needed magnitude of fiscal adjustment, while domestic demand has turned out to be weaker. Second, the deficit at the level of SoDra appears to be structural rather than cyclical under the current benefit structure. Since the reform of the pension system requires time, a modest deficit at the level of SoDra will be unavoidable in the short run, even if appropriate measures to limit this deficit (see below) are taken promptly. Third, given the availability of foreign financing from other IFIs for capital investment of 0.5 percent of GDP, it would be possible to run a small general government deficit without crowding out domestic financing of the private sector, while maintaining net external public debt at acceptable

[20] The performance criterion on general government arrears was replaced with the performance criterion on central government arrears for end-December 2000 and end-March 2001 because municipalities are autonomous entities and the central government has the control over their budgetary procedures, but not over their spending decisions.

levels. At the same time, external sustainability considerations and recognition of certain medium-term fiscal costs call for further fiscal consolidation.

27. **Therefore, the authorities and staff believe that a deficit of 1.4 percent of GDP, would be consistent with the macroeconomic policy objectives.** Privatization proceeds equivalent to 2.8 percent of GDP and net external financing amounting to 1.0 percent of GDP would exceed financing needs, with the balance reflected in an increase of deposits of the privatization fund at the BoL. In the event that external developments turn out to be worse than projected, the authorities stand ready to tighten fiscal policy as needed in consultation with the staff.

28. **Given the revenue shortfalls in 2000, and uncertainties about a pick-up in revenue despite the projected acceleration of growth, revenue projections for 2001 are conservative.** The government expressed its strong preference for lowering the tax burden over the medium term to stimulate output. In this context, no major tax measures are proposed. Under the revised program, an excise tax on liquefied gas will be introduced. At the same time, a proposed reduction in the VAT rate on household heating will result in a revenue loss of 0.1 percent of GDP. The authorities had also intended to reduce temporarily the VAT on residential construction. The staff strongly discouraged them and suggested that a targeted social assistance program would be preferable to the selective reduction in VAT rates, which are distortionary, costly and difficult to administer. The authorities concurred with this approach, and opted for a mortgage lending support program. On balance, the pick-up in domestic demand is projected to lead to an increase in consumption taxes by 0.2 percent of GDP. Payroll tax revenue and personal income tax will decline by 0.2 percent of GDP each due to sluggish wage growth. Overall, general government revenue is projected to decline from 30.6 percent of GDP in 2000 to 30.5 percent of GDP in 2001.

29. **Given the cautious revenue projections and the need for fiscal consolidation, expenditure restraint will be needed, in particular at the state budget level.**[21] To this end, further restructuring of budgetary organizations will be implemented, on the basis of the ongoing work of the Sunset Commission. To contain the deficit of SoDra, measures to reduce expenditure will be implemented (see SMEP, paragraph 12), and the indexation of benefits will be revised, limiting pension increases. Expenditure commitments of the municipalities and the Health Insurance Fund will be cut back in line with the projected decline in revenue. Net lending will be curtailed, and further efforts to consolidate capital expenditures of the central government will be implemented, redirecting capital spending toward social infrastructure (education and health). Finally, provisioning for possible defaults on government guarantees was increased by 0.2 percent of GDP, and the authorities undertook to redouble collection efforts, and tighten the procedures for selecting projects, with a view to

[21] The reduction in the ratio of expenditure to GDP would amount to 2.2 percentage points of GDP, bringing the cumulative two-year adjustment to 8.8 percentage points of GDP.

reducing exposure to contingent liabilities. In the event revenue were to exceed projections, the government would keep the initial expenditure commitments in the first half of 2001, and the appropriateness of fiscal targets would be reconsidered in the second half of 2001. The extent to which additional revenue would be spent rather than used to reduce the deficit would depend on economic developments, especially the extent to which the external current account deficit might be lower than foreseen, as well as on the medium-term fiscal policy objectives.

30. **The general government deficit target for the first quarter of 2001 was set at LTL 271 million (2.6 percent of GDP).** The first quarter deficit target as a percent of GDP is higher than the annual target due to seasonality. Yet, it represents a deficit reduction of 2.3 percentage points of GDP compared with the first quarter of 2000.

31. **The government intends to conduct a thorough analysis of medium-term fiscal priorities by end-March 2001, costing different options.** On the revenue side, the government will assess the impact of the contemplated reduction in the personal income and corporate income taxes, and possible offsetting revenue measures, including higher excises, a gradual elimination of VAT exemptions, and new municipal taxes. The expenditure restructuring plan will take into account potential costs associated with the pension reform, EU and NATO accession, and the Ignalina nuclear power plant closure. The staff underscored that, in view of the balanced budget objective and medium-term fiscal costs, the scope for tax reductions would be limited, and alternative sources of revenue would have to be found to offset the revenue losses to the municipalities and the Health Insurance Fund.

32. **The authorities recognized that the medium-term fiscal challenges should be addressed through further improvements to fiscal management, the tax system, tax administration, and expenditure restructuring.** The government expressed its commitment to complete the treasury project by early 2001. The establishment of the reserve stabilization fund in line with the recommendations of the July 2000 FAD TA mission will be completed by end-March 2001(indicative structural benchmark). In the meantime, all new privatization proceeds are to be deposited with the Privatization Fund (PF) account at the BoL and the remaining balance of the PF account with the Agricultural Bank will be transferred to the BoL upon the completion of the privatization of this bank. A new action plan on the merger of the state tax inspectorate and SoDra's payroll tax collection agency will be prepared by end-March 2000. The authorities also indicated that the savings restitution program would be postponed further to after 2002, and the privatization receipts that had been originally earmarked for this program would be used for pension reform.

C. The Currency Board Arrangement

33. **The currency board has constituted a linchpin of macroeconomic stability.** With a changing political environment and pressures for spending, the desire to maintain the currency board has encouraged adjustment. Developments in 1999 demonstrated that the credibility of the CBA needs to be underpinned by an appropriate fiscal stance, and any

imbalances have to be quickly corrected. While the authorities are concerned about the impact of the continued real effective appreciation of the litas on growth and employment, they are of the view that it does not pose an immediate risk to the stability of the CBA, given continued export growth, flexible wages, and stable financial markets. The staff broadly agreed with this assessment, in particular, following discussions with exporters regarding their efforts to improve competitiveness and progress in gaining market shares in the EU (Box 3). Moreover, the BoL also underscored that it was unlikely that the successful adjustment achieved in 2000 would have materialized without the CBA.

34. **Looking ahead, in order to support the CBA, the new government decided to adopt a tight fiscal stance and an ambitious agenda of structural reforms, to gain credibility and improve competitiveness through wage moderation and productivity growth.** In the meantime, the situation in financial markets and trade developments will continue to be closely monitored. Moreover, the scope for further rapid productivity gains in the short run appears to be narrow and a further appreciation of the dollar vis-à-vis the euro might erode support in Lithuania for the CBA. Should any pressures on the CBA arise, the authorities stand ready to consult with the staff and tighten policies as needed. Finally, in view of increasing economic integration with the euro area, and the prospective accession to the EU, the authorities intend to switch the peg of the litas from the dollar to the euro, with an announcement made in the second half of 2001, and the timing of the switch hinging on the prevailing euro/dollar rate.

35. **The authorities expressed their satisfaction with the declining interest rates and the overall situation in the financial sector.** They expressed their preference to continue to rely on foreign financing of a portion of the budget deficit to remove pressure from domestic interest rates. The staff endorsed the strategy, but pointed out, however, that in the event external borrowing conditions became more unfavorable following a shift in market sentiment, a tighter fiscal stance would be needed, in order to restore confidence and limit the impact on domestic interest rates. New official borrowing has been conducted in euros, reflecting the planned repegging.

36. **The staff shared the authorities' view that the reduction in required reserves from October 2000 would not have a substantial impact on liquidity.** The withdrawal of required reserves in foreign currency and sales of a portion of required reserves in local currency to the BoL would contribute to the projected further increase in net foreign assets of banks by LTL 175 million in the short run, and it is expected that credit growth would initiate a modest recovery only by year-end. The BoL agreed with the staff recommendation that the gradual reduction in required reserves should be accompanied with the phasing-in of the remuneration of the required reserves in line with ECB practices. The BoL recognized that both measures should be phased in with due regard to credit and balance-of-payments developments. No more changes to reserve requirements will be implemented during the program period. Although broad money growth in 2000 is projected to be 2.3 percentage points above the initial target, this is attributable to an increase in foreign currency deposits, and it does not affect the achievement of the program's macroeconomic objectives.

37. **The monetary program for 2001 is based on the assumptions of a further decline in broad money velocity and the sterilization of most privatization proceeds at the BoL** (Table 4). A slight reduction in commercial banks' net foreign assets and modest domestic financing of the budget would leave sufficient room for a recovery of credit growth to the private sector. Financial sector health is improving further, with more stringent standards and supervision being enforced, and the ongoing consolidation in the banking system (Appendix VI). The merger of Vilnius Bank and Hermes Bank, as well as preparations for the privatization of the three state-owned banks led banks to follow a conservative lending strategy and adversely affected private sector credit growth in 2000. The expected completion of privatization of the three state-owned banks in 2001, together with a strengthening of the activities of foreign banks operating in Lithuania, should foster competition in the banking system and contribute to the projected revival of credit to the private sector.

D. Structural Issues

38. **The authorities expressed their determination to continue the privatization program in the financial and energy sectors and improve the business environment,** in order to make Lithuania attractive for investment and improve the economy's growth prospects. Moreover, they reiterated their determination to conduct privatization operations in a transparent manner, relying on the advice of qualified consultants. The financial sector reform is key to improving resource allocation and increasing private savings. The government, together with the BoL, is committed to complete the ongoing privatization of the three remaining state banks in the near future, in order to strengthen the banking system and foster competition. The government plans to complete the sale of its stake in the Development Bank and Saving Bank in early 2001. The negotiations on the privatization of the Agricultural Bank collapsed mainly due to a change in the investment strategy of the prospective buyers. The government plans to announce a new privatization tender by end-March 2001, and some buyers have already expressed an interest. During 2001, to improve the legal framework of the financial sector, the authorities will submit to Seimas a new Law on the BoL and Law on Commercial Banks consistent with ECB requirements, as well as amendments to the Law on Public Trading in Securities in line with EU directives. The authorities expressed an interest in participating in the Financial Sector Assessment Program in 2001-2002.

39. **The restructuring of the energy sector has laid the basis for its privatization.** The authorities will take necessary legal steps to complete the restructuring of the distribution assets of the electricity sector by end-March 2001 and bring them to the point of sale (SMEP, paragraph 19). The authorities and World Bank staff consider the current level of electricity tariffs as adequate for cost recovery, although further improvements in the structure of prices for gas and electricity are needed. After the completion of the separation of the distribution assets from transmission assets of the Lithuanian Gas Company, a gas distribution company would be brought to the point of sale in February of 2001. The authorities expect that the privatization of gas and electricity distribution networks over the next two years could generate around 4 percent of GDP in gross receipts.

40. **The authorities have adopted a strong agenda for agricultural sector reform, supported by World Bank SAL, which is crucial to maintaining fiscal restraint.** During 2000, the authorities have substantially reduced subsidies to the agricultural sector by eliminating price support for grain, meat and milk. The authorities will aim to avoid the reintroduction of production supports and target instead social assistance to poor farmers and rural investment. Cuts in agriculture spending were a major electoral issue and there have been pressures on the new government to restore some subsidies to the sector. The government reiterated its commitment to comply with the restructuring plan for the Agricultural Marketing Agency and Rural Loan Guarantee Fund with a view to limiting budgetary outlays and facilitating the implementation of EU SAPARD programs (SMEP, paragraph 20). All these measures are part of the SAL conditionality.

41. **The government expressed its firm commitment to make rapid progress in EU accession negotiations.** The forthcoming opening of four more chapters in the negotiations of the *Acquis Communautaire*, including on trade and economic and monetary union, will lead to further unification of trade and customs regulations, as well as many aspects of macroeconomic policymaking, with the EU requirements.

42. **The Sunrise Commission will continue preparing the Program for the Improvement of the Business Environment.** This program envisages the implementation of legal steps needed to simplify customs clearance, sales and purchases of land, restitution of ownership rights, and labor market regulations (SMEP, paragraph 21). Moreover, the new Bankruptcy Law and Company Restructuring Law are expected to be approved by Seimas by end-December.

IV. Staff Appraisal

43. **Much has been accomplished in the course of 2000.** At the end of 1999, Lithuania was in the midst of both a political crisis, with its third government in six months, and a year-long recession; an unsustainable fiscal expansion contributed to large current account deficits and increased external debt; structural reforms were lagging; confidence in the currency board was eroded, and access to capital markets became difficult. Despite political pressures associated with local and parliamentary elections and a change of government, the authorities continued to implement firmly their adjustment and reform program throughout 2000, keeping it broadly on track. Mainly as a result of their policy efforts, the external current account deficit has declined sharply; real GDP growth has resumed; inflation remains subdued; and confidence in Lithuania's policymaking has been restored, allowing for renewed access to domestic and international capital markets at low spreads. Significant progress has also been registered on the overarching objectives of EU and NATO accession. The adjustment represented a considerable political challenge, however, with expenditure cuts and utility tariff increases, while the recovery of domestic demand has been slower than expected, and unemployment has reached a very high level.

44. **Even though Lithuania's external vulnerability has been reduced, policy slippages or a loss of the reform momentum could lead to a rapid change in perceptions of market participants.** Thus, a firm macroeconomic stance will be needed in 2001 to consolidate the external adjustment and bolster confidence further, while the reform momentum should be maintained, so as to promote economic recovery and a decline in unemployment.

45. **An ambitious fiscal adjustment based on expenditure restraint has been at the core of the authorities' strategy.** The staff recognizes that very strong efforts were made to meet the fiscal targets in 2000 and that substantial fiscal consolidation was achieved. In view of the larger-than-expected external adjustment and the erosion of the domestic tax base, the staff and the authorities agreed that a modification of the fiscal targets for end-2000 and 2001 was warranted. A further sizable reduction in the overall deficit of the general government is targeted for 2001.

46. **The authorities are to be commended for taking difficult political decisions in the preparation of the 2001 budget.** In particular, bold measures to redress the finances of SoDra deserve to be praised. The authorities ought to be strongly cautioned, however, against extending support or preferential tax treatments to selected sectors or companies, which are distortionary, costly, and difficult to administer. In this regard, the staff welcomes the authorities' decision to reject proposals to reduce VAT on residential construction, opting instead for targeted support programs. In view of the increasing defaults on government guarantees, the authorities should also limit their extension and tighten eligibility. Finally, the authorities should monitor revenue closely over the course of 2001. Expenditure targets should only be increased in the event that revenue turns out to be consistently higher by a large margin in the first half of the year, the external current account deficit is significantly smaller than projected, and such increases are consistent with the medium-term fiscal objectives.

47. **Impressive progress was registered in fiscal structural reforms in 2000,** with the passage of the Organic Budget Law in July, improvements in tax administration, and the envisaged completion by early 2001 of the reform of the treasury system. However, the persistence and growth of municipal arrears have resulted in the nonobservance of program performance criteria, and prompt corrective actions in this area are required. The staff welcomes the legal steps that are being taken by the authorities to ensure the clearance of remaining municipal arrears by mid-2001, while abstaining from offset operations.

48. **The staff welcomes the authorities' plan to prepare a comprehensive medium-term fiscal framework, in order to determine priorities, address future expenditure pressures, and seek ways to achieve the medium-term goal of a balanced budget.** The government intends to simplify and reduce certain taxes over a number of years. Public finance will come under substantial pressure in the coming years, however, including from pension reform and the potential costs of EU and NATO accession. Under these circumstances, in the staff's view, there may be limited scope for measures that would entail

revenue losses. Finally, appropriate consideration should be given to the need to preserve a balance between the taxation of capital and labor, if employment-creating growth is to be promoted.

49. **The authorities intend to maintain the currency board arrangement** and, given the reorientation of trade flows toward the EU, plan to announce in the second half of 2001 a switch to a euro peg, with the timing of the switch hinging on the prevailing euro/dollar rate. Some technical assistance may be needed for the preparation of the switch. The staff shares the authorities' view that the currency board has constituted a linchpin of stability for macroeconomic policies, providing an incentive for adjustment and an effective defense against spending pressures and populist programs. Despite the adjustment costs imposed by the real appreciation of the litas, the shared view is that the benefits have outweighed the costs, as the positive turnaround of 2000 might have been difficult to achieve under a different regime. For the future, the viability of the currency board will hinge on continued fiscal consolidation, and a strengthening of external competitiveness through wage moderation and productivity growth stemming from structural reforms, particularly if the U.S. dollar remains strong vis-à-vis the euro. The authorities are urged to monitor closely developments in the balance of payments, financial markets, and indicators of external competitiveness, and to stand ready to revise the policy stance if balance of payments pressures were to emerge.

50. **This year has witnessed a breakthrough in structural reforms that were long-delayed—in energy restructuring, and telecommunications and banking privatization—and which should be completed.** Particularly impressive has been progress in restructuring the gas and electricity sectors and in moving LPC and Lithuanian Gas toward privatization, with the advice of international investment banks. The staff underscores that the fundamental reforms of the electricity and gas companies should be accompanied by appropriate pricing policies. More needs to be done, however, to follow through with plans to deregulate the economy by passing relevant laws.

51. **The staff welcomes the authorities' determination to conduct the privatization process transparently, and without giving preferential treatment to individual investors,** which is critical in avoiding doubts about governance and in gaining public support for these policies. In this connection, the establishment by Seimas of a reserve stabilization fund in line with the recommendations of Fund staff, should help ensure the efficient and accountable management of privatization proceeds. In view of financial constraints, the staff supports the authorities' decision to limit the scope of the savings restitution program and devote more resources to finance the pension reform and debt repayments.

52. **Bank privatization, a strengthened legal framework and effective banking supervision should enhance the efficiency of financial intermediation and increase the confidence in the domestic financial system.** The authorities are encouraged to move ahead

swiftly with the privatization of the three remaining state-controlled banks, which should result in efficiency gains and intensified competition.

53. **Further improvements in bankruptcy legislation, as well as the reforms planned in the energy and agricultural sectors, would help boost efficiency and reduce the scope of government support.** The government's Sunset and Sunrise Commissions prepared measures to address a wide range of structural and strategic issues, and the staff hopes that specific action plans will be implemented in the coming months. In particular, deregulation is crucial to improving Lithuania's business environment and competitiveness, while labor market liberalization should contribute to reducing unemployment, which remains an important priority.

54. **The government's commitment to liberalizing the trade regime is commendable.** This year has witnessed major progress in this area, as negotiations for WTO accession were completed, and significant progress was registered in negotiations for accession to the EU. The decision to reverse the trade restrictions that were introduced in the wake of the Russian crisis, as well as to abolish the remaining export taxes, is particularly welcome.

55. **Lithuania's statistical base is generally adequate, and the quality and timeliness of data are adequate for conducting effective surveillance and macroeconomic analysis.** The authorities have subscribed to SDDS since May 1996. Further improvements in the consolidation of general government operations statistics remain a priority, and progress in this regard is expected to be made in 2001.

56. **Under its current arrangement with the Fund, Lithuania is subject to the transitional procedures governing safeguard assessments.** These procedures require the BoL to demonstrate, by providing certain documentation to Fund staff, that it publishes annual financial statements that are independently audited in accordance with internationally accepted standards (the "external audit mechanism"). The BoL cooperated fully in providing Fund staff with the required documentation. The staff has reviewed the documentation and noted that the BoL publishes, within three months of the end of the financial year, annual financial statements that are audited by an international accounting firm. Based on this review, the staff has concluded that the BoL external audit mechanism meets internationally accepted standards.

57. **While the program targets are achievable, the authorities' strategy has risks.** First, the strategy relies heavily on the achievement of a major fiscal adjustment. As further expenditure cuts are implemented, the government will need strong resolve to oppose pressures to increase spending or to provide support or tax benefits to certain sectors, especially in the face of sluggish growth and high unemployment. Second, a host of key legislative proposals are before Seimas, and passage of these initiatives is essential to enable further reforms to proceed during 2001. There may be significant tests for the ruling coalition, with its narrow majority in the Seimas. Third, the likely continuing strength of the litas and adverse external developments may also pose additional challenges for economic

policy-making. A further appreciation of the U.S. dollar would have an adverse effect on competitiveness and growth, potentially eroding support for the currency board. Moreover, pressures in international financial markets might reduce the government's access to foreign financing on favorable terms, which could drive up interest payments. Given the authorities' commitment to the currency board, the government would have to reconsider the fiscal stance, while continuing to make swift progress in structural reforms and privatization so as to promote competitiveness and employment-creating growth, were external pressures to arise.

58. **Nonetheless, the staff considers that the authorities' program is strong and the passage of the 2001 budget and SoDra measures, a prior action, demonstrates their resolve and capacity to implement it.** Despite some deviations in program targets in 2000, the macroeconomic objectives under the program remain attainable, and the staff supports the authorities' request for waivers. Overall, the stance of macroeconomic policies remains appropriate, and the staff is confident that the authorities would modify polices quickly and appropriately in response to adverse external or domestic shocks. The staff also trusts that the authorities will make their best efforts to speed up the implementation of their structural reform and privatization programs. Thus, the staff supports the completion of the first review under the stand-by arrangement.

59. It also proposed that the next Article IV consultation with Lithuania take place on the standard 12-month cycle.

V. Proposed Decision

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

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

2. The letter from the Prime Minister of the Republic of Lithuania and the Governor of the Bank of Lithuania dated December 13, 2000 and its attached Supplementary Memorandum of Economic Policies and Technical Memorandum of Understanding shall be attached to the Stand-By-Arrangement, and the letter dated February 22, 2000 shall be read as supplemented and modified by the letter dated December 13, 2000 and its attached memoranda.

3. Accordingly, the performance criteria set out in paragraphs 3(a)(i) through 3(a)(v) of the Stand-By-Arrangement for the Republic of Lithuania for December 31, 2000 and March 31, 2001 shall be as specified in Table 1 of the Supplementary Memorandum of Economic Policies and in the Technical Memorandum of Understanding annexed to the letter dated December 13, 2000.

4. The Fund decides that the first review contemplated in paragraph 3(c) of the Stand-By-Arrangement for the Republic of Lithuania is completed, and that the Republic of

Lithuania may make purchases up to a cumulative amount of SDR 41.2 million under the arrangement through January 16, 2001 and thereafter in accordance with the provisions of the arrangement, notwithstanding the unavailability of the information necessary to assess the observance of end-December 2000 performance criteria specified in paragraph 3(a) of the arrangement, (a) on condition that the information provided by the Republic of Lithuania on the implementation of the measures specified in paragraph 5 of the letter dated December 13, 2000 is accurate and (b) on the further condition that, with respect to the purchases subject to the performance criteria specified above, (i) the Republic of Lithuania has accurately represented that such information is unavailable, and (ii) the information provided by the Republic of Lithuania on performance under the end-September, 2000 performance criteria specified in paragraph 3(a) of the arrangement is accurate.

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

	1996	1997	1998	1999 Q1	1999 Q2	1999 Year
National income, prices, and wages						
Nominal GDP (in millions of litai) 1/	31,569	38,340	42,990	9,332	11,087	42,535
GDP (in millions of U.S. dollars) 1/	7,892	9,585	10,748	2,333	2,772	10,634
Real GDP growth (year-on-year, in percent) 1/	4.7	7.3	5.1	-2.9	-2.0	-4.2
Average CPI (year-on-year change, in percent)	24.7	8.8	5.1	1.9	0.5	0.8
End-of-period CPI (year-on-year change, in percent)	13.1	8.4	2.4	1.3	0.6	0.3
GDP deflator (year-on-year change, in percent)	25.1	13.2	6.7	2.3	4.6	3.3
Average monthly wage (in U.S. dollars)	155	196	232	258	270	253
Unemployment rate (in percent) 2/	6.2	6.7	6.9	8.5	7.5	10.0
Saving-investment balance (in percent of GDP)						
Gross national saving	15.3	16.3	12.3	9.4	12.8	11.7
General government	0.2	1.7	-0.7	-7.0	-7.9	-4.0
Non-government	15.2	14.6	13.0	16.4	20.7	15.7
Gross national investment	24.5	26.5	24.4	17.4	26.4	22.9
General government	2.7	2.7	3.3	2.0	2.3	2.3
Non-government	21.8	23.9	21.1	15.5	24.1	20.7
Foreign saving	9.2	10.2	12.1	8.0	13.6	11.2
General government (in percent of GDP)						
Financial balance	-2.5	-1.5	-4.4	-8.6	-8.5	-6.2
Net lending	2.0	0.3	1.5	0.2	3.2	2.4
Fiscal balance 3/	-4.5	-1.8	-5.9	-8.8	-11.7	-8.5
External sector						
Current account balance						
in percent of GDP	-9.2	-10.2	-12.1	-8.0	-13.6	-11.2
in millions of U.S. dollars	-723	-981	-1,298	-188	-378	-1,194
Gross official reserves (in millions of U.S. dollars) 4/	834	1,063	1,460	1,467	1,342	1,242
External debt (in percent of GDP) 5/	30.2	34.0	34.8	35.7	35.8	42.6
Debt service (in percent of exports of GNFS)	6.8	10.7	18.3	19.8	20.6	20.0
Exchange rate (litai/euro, period average)	...	...	...	4.30	4.12	4.18
Real effective exchange rate (1995=100, "+"=appreciation) 6/	114	132	142	157	156	160
Money and credit						
Reserve money (year-on-year change, in percent)	2.2	32.4	28.8	12.3	7.6	-4.0
Broad money (year-on-year change, in percent)	-3.5	34.1	14.5	14.0	16.5	7.7
Private sector credit (year-on-year change, in percent)	-4.4	18.9	16.9	17.0	17.5	13.8
Money multiplier	2.2	2.2	2.0	2.1	2.2	2.2
Cash-deposit ratio	0.5	0.5	0.5	0.5	0.5	0.4
Foreign currency deposits/ litas deposits	0.6	0.5	0.6	0.6	0.6	0.8

	2000 Q1 *EBS/00/28*	2000 Q1 Act.	2000 Q2 *EBS/00/28*	2000 Q2 Act.	2000 Year *Adj. EBS/00/28*	2000 Year Proj.
National income, prices, and wages						
Nominal GDP (in millions of litai) 1/	9,015	9,997	10,873	11,218	43,664	44,530
GDP (in millions of U.S. dollars) 1/	2,254	2,499	2,718	2,805	10,916	11,133
Real GDP growth (year-on-year, in percent) 1/	1.6	4.2	2.3	0.0	2.1	2.3
Average CPI (year-on-year change, in percent)	0.9	0.8	1.0	0.9	2.2	1.0
End-of-period CPI (year-on-year change, in percent)	1.2	0.8	1.6	1.3	3.1	1.6
GDP deflator (year-on-year change, in percent)	-1.4	2.9	2.3	2.2	0.1	2.3
Average monthly wage (in U.S. dollars)	...	264	...	272	...	...
Unemployment rate (in percent) 2/	...	11.4	...	11.1	...	...
Saving-investment balance (in percent of GDP)						
Gross national saving	6.4	12.0	14.3	15.8	13.4	15.0
General government	-2.5	-2.6	-1.1	-0.3	-0.7	-0.9
Non-government	8.9	14.6	15.4	16.1	14.5	16.0
Gross national investment	14.6	14.8	24.7	21.4	22.6	21.9
General government	1.3	1.5	1.8	2.2	2.0	2.0
Non-government	13.3	13.4	22.9	19.2	20.9	19.9
Foreign saving	8.2	2.8	10.4	5.6	9.1	6.9
General government (in percent of GDP)						
Financial balance	-3.9	-3.8	-3.1	-2.7	-2.7	-2.8
Net lending	0.8	1.1	-0.1	0.1	0.1	0.5
Fiscal balance 3/	-4.7	-4.9	-2.9	-2.8	-2.8	-3.3
External sector						
Current account balance						
in percent of GDP	-8.2	-2.8	-10.4	-5.6	-9.1	-6.9
in millions of U.S. dollars	-185	-70	-282	-155	-997	-768
Gross official reserves (in millions of U.S. dollars) 4/	1,445	1,382	1,380	1,424	1,615	1,297
External debt (in percent of GDP) 5/	42.6	43.9	44.2	44.8	44.3	44.2
Debt service (in percent of exports of GNFS)	...	14.0	...	14.3	20.3	15.2
Exchange rate (litai/euro, period average)	...	3.82	...	3.82	...	...
Real effective exchange rate (1995=100, "+"=appreciation) 6/	...	166	...	170	...	...
Money and credit						
Reserve money (year-on-year change, in percent)	6.6	-2.8	1.3	-6.5	1.8	-9.3
Broad money (year-on-year change, in percent)	8.1	9.1	2.6	5.8	7.2	9.5
Private sector credit (year-on-year change, in percent)	7.3	0.0	5.4	-2.4	12.7	7.5
Money multiplier	2.2	2.4	2.2	2.5	2.3	2.6
Cash-deposit ratio	0.4	0.4	0.4	0.4	0.4	0.4
Foreign currency deposits/ litas deposits	0.8	0.8	0.8	0.8	...	0.8

	2001 Year *EBS/00/28*	2001 Year Proj.
National income, prices, and wages		
Nominal GDP (in millions of litai) 1/	46,326	47,135
GDP (in millions of U.S. dollars) 1/	11,581	11,784
Real GDP growth (year-on-year, in percent) 1/	4.0	3.2
Average CPI (year-on-year change, in percent)	2.0	1.3
End-of-period CPI (year-on-year change, in percent)	2.4	1.9
GDP deflator (year-on-year change, in percent)	2.1	2.5
Average monthly wage (in U.S. dollars)	...	...
Unemployment rate (in percent) 2/	...	...
Saving-investment balance (in percent of GDP)		
Gross national saving	15.1	15.5
General government	1.8	0.5
Non-government	13.3	15.0
Gross national investment	23.5	22.1
General government	1.8	1.8
Non-government	21.7	20.4
Foreign saving	8.4	6.7
General government (in percent of GDP)		
Financial balance	0.0	-1.3
Net lending	0.0	0.1
Fiscal balance 3/	0.0	-1.4
External sector		
Current account balance		
in percent of GDP	-8.4	-6.7
in millions of U.S. dollars	-973	-784
Gross official reserves (in millions of U.S. dollars) 4/	1,713	1,673
External debt (in percent of GDP) 5/	45.7	42.6
Debt service (in percent of exports of GNFS)	19.2	12.4
Exchange rate (litai/euro, period average)	...	...
Real effective exchange rate (1995=100, "+"=appreciation) 6/	...	...
Money and credit		
Reserve money (year-on-year change, in percent)	...	5.6
Broad money (year-on-year change, in percent)	...	8.0
Private sector credit (year-on-year change, in percent)	...	7.6
Money multiplier	...	2.7
Cash-deposit ratio	...	0.4
Foreign currency deposits/ litas deposits	...	0.8

Source: National authorities; and Fund staff estimates and projections.
1/ GDP for 1999 has been substantially revised by the Statistical Office since EBS/00/28 has been published.
2/ Registered unemployment, end-of-period.
3/ The program adjuster was 0.2 percent of GDP for Q 1 2000 and 0.3 percent of GDP for Q 2 2000.
4/ Including valuation changes. Gross official reserves reported here differ from the monetary survey because here reverse repos involving major currencies in both legs are included.
5/ External liabilities minus equity investment in Lithuania.
6/ CPI-based, trade-weighted real exchange rate against 21 major trading partners in 1999.

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

	1998	1999	2000				2001
		Prel.	Prog. 1/	Proj.	Jan.-Sep.		Proj.
					Prog.	Prel. Est.	
	(In millions of Litai)						
Revenue	14,036	13,690	14,136	13,643	10,450	9,922	14,397
Tax revenue	13,433	12,958	13,566	12,980	10,028	9,371	13,553
Taxes on income and profits	4,017	3,971	3,825	3,885	2,778	2,800	4,009
Payroll tax (social security tax)	3,063	2,894	3,469	3,262	2,633	2,353	3,333
Taxes on goods and services	5,596	5,385	5,583	5,173	4,173	3,752	5,581
Other tax revenue	756	709	689	660	444	466	630
Nontax Revenue	603	732	570	663	422	551	844
Expenditure and net lending	16,362	17,352	15,361	15,209	11,442	11,035	15,076
Expenditure	15,734	16,346	15,229	14,965	11,398	10,742	15,013
Current expenditure	14,326	15,389	14,363	14,065	10,800	10,177	14,184
Wages and salaries, excl. contributions to SoDra	3,290	3,514	3,391	3,471	2,505	2,540	3,498
Goods and services 2/	4,899	4,624	4,506	4,154	3,480	2,913	4,202
Transfers to households	4,977	5,244	5,283	5,493	3,858	4,019	5,514
Subsidies	202	150	285	137	268	87	100
Interest payments 3/	507	650	863	800	662	609	845
Savings restitution program	450	1,207	36	10	27	10	25
Capital expenditure	1,408	957	865	900	598	565	830
Discrepancy	190	-27	0	-91	0	-91	0
Financial balance	-1,888	-2,629	-1,093	-1,231	-948	-730	-616
Net lending 4/	628	1,006	132	244	44	293	63
Lending	1,017	1,381	382	475	233	478	353
o/w Mazeikiai Oil Company	240	800	86	88	86	88	0
Repayments	389	-375	-250	-231	-189	-186	-290
Fiscal balance (deficit (-)) 4/	-2,516	-3,635	-1,225	-1,475	-992	-1,023	-679
Financing	2,516	3,635	1,225	1,475	992	1,023	679
Net domestic	-286	392	-889	-164	-1,206	-547	-1,088
Bank financing	-666	326	-1,089	-520	-1,326	-853	-1,107
Monetary Authorities	-635	602	-1,339	-622	-1,496	-692	-1,339
Commercial Banks	-31	-276	250	102	170	-161	233
Non-bank financing	380	66	200	357	120	306	19
Net foreign	535	2,762	606	739	1,063	850	467
Borrowing	1,005	3,441	1,504	1,584	1,435	1,584	1,160
Amortization	470	680	898	846	372	735	693
Privatization proceeds	2,267	481	1,508	900	1,135	720	1,300
	(In percent of GDP)						
Revenue	32.7	32.2	32.4	30.6	32.5	29.7	30.5
Tax revenue	31.2	30.5	31.1	29.1	31.2	28.1	28.8
Taxes on income and profits	9.3	9.3	8.8	8.7	8.6	8.4	8.5
Payroll tax (social security tax)	7.1	6.8	7.9	7.3	8.2	7.0	7.1
Taxes on goods and services	13.0	12.7	12.8	11.6	13.0	11.2	11.8
Other tax revenue	1.8	1.7	1.6	1.5	1.4	1.4	1.3
Nontax Revenue	1.4	1.7	1.3	1.5	1.3	1.6	1.8
Expenditure and net lending	38.1	40.8	35.2	34.2	35.6	33.0	32.0
Expenditure	36.6	38.4	34.9	33.6	35.5	32.2	31.9
Current expenditure	33.3	36.2	32.9	31.6	33.6	30.5	30.1
Wages and salaries, excl. contributions to SoDra	7.7	8.3	7.8	7.8	7.8	7.6	7.4
Goods and services 2/	11.4	10.9	10.3	9.3	10.8	8.7	8.9
Transfers to households	11.6	12.3	12.1	12.3	12.0	12.0	11.7
Subsidies	0.5	0.4	0.7	0.3	0.8	0.3	0.2
Interest payments 3/	1.2	1.5	2.0	1.8	2.1	1.8	1.8
Savings restitution program	1.0	2.8	0.1	0.0	0.1	0.0	0.1
Capital expenditure	3.3	2.3	2.0	2.0	1.9	1.7	1.8
Discrepancy	0.4	-0.1	0.0	-0.2	0.0	-0.3	0.0
Financial balance	-4.4	-6.2	-2.5	-2.8	-3.0	-2.2	-1.3
Net lending 4/	1.5	2.4	0.3	0.5	0.1	0.9	0.1
Lending	2.4	3.2	0.9	1.1	0.7	1.4	0.7
o/w Mazeikiai Oil Company	0.6	1.9	0.2	0.2	0.3	0.3	0.0
Repayments	0.9	-0.9	-0.6	-0.5	-0.6	-0.6	-0.6
Fiscal balance (deficit (-)) 4/	-5.9	-8.5	-2.8	-3.3	-3.1	-3.1	-1.4
Financing	5.9	8.5	2.8	3.3	3.1	3.1	1.4
Net domestic	-0.7	0.9	-2.0	-0.4	-3.8	-1.6	-2.3
Bank financing	-1.5	0.8	-2.5	-1.2	-4.1	-2.6	-2.3
Non-bank financing	0.9	0.2	0.5	0.8	0.4	0.9	0.0
Net foreign	1.2	6.5	1.4	1.7	3.3	2.5	1.0
Privatization proceeds	5.3	1.1	3.5	2.0	3.5	2.2	2.8
Memorandum Items:							
Public and publicly guaranteed debt, mln. LTL	9,614	12,069	12,976	12,855	...	...	14,241
In percent of GDP	22.4	28.4	29.7	28.9	...	...	30.2
Public and publicly guaranteed net debt, mln. LTL	7,629	10,694	...	10,941	...	...	11,159
In percent of GDP	17.7	25.1	...	24.6	...	...	23.7
GDP, in mln. LTL	42,990	42,535	43,664	44,530	32,125	33,392	47,135

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

1/ Program revenue and expenditure numbers reported in EBS/00/28 were adjusted to reflect the elimination of government employer contributions to SoDra from revenue and expenditure and the incorporation of the Road Fund and three other extra-budgetary funds into the general government. General government revenue and expenditure under the program are different from the passed budgets of all levels of the general government by LTL 140 million.

2/ For the program of 2000, the provisioning of defaults was reclassified from "goods and services" to "net lending".

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

4/ Program numbers and projections for 2000 are reported without the program adjustor to net lending and deficit for higher-than-expected project lending. The adjustor for nine months of 2000 is LTL 77 million. The budgeted amount of provisioning of defaults of 102 million is included for the program numbers and projections for 2000.

Table 3. Lithuania: Balance of Payments, 1996-2005

	1996	1997	1998	1999	2000		2001	2002	2003	2004	2005
					EBS/ 00/28	Proj.			Proj.		
					(In millions of U.S. dollars)						
Current account	-723	-981	-1,298	-1,194	-997	-768	-784	-796	-813	-843	-871
Trade balance	-896	-1,147	-1,518	-1,405	-1,314	-1,009	-1,065	-1,103	-1,121	-1,180	-1,225
Exports (f.o.b.)	3,413	4,192	3,962	3,147	3,571	4,033	4,370	4,715	5,155	5,634	6,140
Imports (f.o.b.)	4,309	5,340	5,480	4,551	4,885	5,043	5,434	5,818	6,276	6,814	7,365
Non-factor services, net	121	134	241	305	364	381	404	433	452	497	537
Credits	798	1,032	1,109	1,092	1,134	1,148	1,194	1,270	1,364	1,491	1,625
Debits	677	897	868	786	770	767	790	837	912	994	1,089
Factor income, net	-91	-198	-255	-258	-377	-265	-301	-357	-392	-440	-489
Current transfers, net	144	230	235	163	330	126	177	231	248	280	307
Capital and financial account	651	1,080	1,442	1,057	1,388	749	1,196	990	1,017	1,050	1,065
Capital transfers, net	6	4	-2	-3	5	4	6	5	5	5	5
Financial account	646	1,076	1,444	1,061	1,383	745	1,190	985	1,012	1,045	1,060
Direct investment, net 1/	152	328	921	478	710	355	650	624	576	555	525
Portfolio investment, net 2/	188	188	-53	506	430	429	231	131	139	146	200
Other investment, net	306	560	575	77	243	-39	309	229	297	344	335
Net errors and omissions	54	170	285	-42	0	86	0	0	0	0	0
Financing	17	-269	-429	179	-391	-67	-411	-193	-204	-207	-194
Fund financing	32	-31	-30	-17	-21	-12	-35	-41	-42	-33	-26
Change in official reserves (- =increase)	-15	-238	-399	196	-370	-55	-376	-152	-162	-174	-169
Official reserves and external debt											
Gross official reserves 3/	834	1,063	1,460	1,242	1,615	1,297	1,673	1,825	1,988	2,162	2,330
External debt 4/	2,385	3,258	3,739	4,525	4,833	4,924	5,016	4,991	5,061	5,180	5,291
Public and publicly guaranteed	1,297	1,407	1,670	2,383	2,587	2,583	2,821	2,842	2,789	2,869	2,982
Private	1,088	1,852	2,069	2,142	2,249	2,341	2,196	2,149	2,272	2,311	2,310
Short-term debt											
On a remaining maturity basis	1,258	1,725	1,728	1,664	1,757	1,560	1,882	1,958	2,109	2,212	...
On an original maturity basis	886	1,030	1,040	1,066	...	1,087	1,099	1,137	1,211	1,301	1,371
Of which:											
Trade credit	453	671	572	692	...	769	819	869	919	969	1,019
Debt service 5/	285	561	925	846	955	787	689	1,020	1,076	1,173	1,210
					(In percent of GDP, unless otherwise indicated)						
Current account	-9.2	-10.2	-12.1	-11.2	-9.1	-6.9	-6.7	-6.3	-6.0	-5.7	-5.5
Trade balance of goods and services	-9.8	-10.6	-11.9	-10.3	-8.7	-5.6	-5.6	-5.3	-4.9	-4.6	-4.3
Financial account	8.2	11.2	13.4	10.0	12.7	6.7	10.1	7.8	7.4	7.1	6.7
Direct investment, net	1.9	3.4	8.6	4.5	6.5	3.2	5.5	5.0	4.2	3.8	3.3
Portfolio investment, net	2.4	2.0	-0.5	4.8	3.9	3.9	2.0	1.0	1.0	1.0	1.3
Other investment, net	3.9	5.8	5.4	0.7	2.2	-0.4	2.6	1.8	2.2	2.3	2.1
External debt 4/	30.2	34.0	34.8	42.6	44.3	44.2	42.6	39.7	37.2	35.2	33.3
Public and publicly guaranteed	16.4	14.7	15.5	22.4	23.7	23.2	23.9	22.6	20.5	19.5	18.7
Private	13.8	19.3	19.3	20.1	20.6	21.0	18.6	17.1	16.7	15.7	14.5
Short-term external debt											
On a remaining maturity basis	15.9	18.0	16.1	15.6	16.1	14.0	16.0	15.6	15.5	15.0	...
On an original maturity basis	11.2	10.7	9.7	10.0	...	9.8	9.3	9.0	8.9	8.8	8.6
Of which:											
Trade credit	5.7	7.0	5.3	6.5	...	6.9	7.0	6.9	6.8	6.6	6.4
Debt service, in percent of exports of GNFS 5/	6.8	10.7	18.3	20.0	20.3	15.2	12.4	17.0	16.5	16.5	15.6
Memorandum items:											
Nominal GDP (millions of U.S. dollars)	7,892	9,585	10,748	10,634	10,916	11,133	11,784	12,586	13,587	14,709	15,908
Exports of GNFS (yearly percentage change)	31.9	24.1	-2.9	-16.4	8.2	22.3	7.4	7.6	8.9	9.3	9.0
Imports of GNFS (yearly percentage change)	27.8	25.1	1.8	-15.9	4.7	8.9	7.1	6.9	8.0	8.6	8.3

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

1/ The difference between the current projection of FDI for 2000 and the projection under the original program is primarily due to the lower-than-expected privatization-related FDI and reclassification of a portion of privatization-related inflow in the amount of US$150 million from FDI into equity portfolio inflow.

2/ The forecast for 2000 reflects the assumption that banks will use the envisaged reduction in reserve requirements to increase their foreign assets.

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

4/ External liabilities minus equity investment.

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

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

	1998	1999	2000						2001
	Dec.	Dec.	Mar.	Jun.	Sep.	Sep.	Dec.	Dec.	Dec.
						EBS/00/28		Proj.	Proj.
	(in millions of Litai)								
Monetary Authority									
Net Foreign Assets	4,836	4,054	4,292	4,722	4,538	5,516	5,647	4,385	5,931
Net Domestic Assets	-575	35	-596	-979	-763	-1,451	-1,486	-676	-2,015
Net credit to government	-947	-326	-951	-1,269	-1,015	-1,812	-1,847	-948	-2,287
Credit to banks	52	30	29	28	23	30	30	24	24
Credit to private sector	7	6	6	6	6	6	6	6	6
Credit to nonbank financial institutions	7	20	20	20	20	20	20	20	20
Other items, net	305	305	300	237	203	305	305	222	222
Reserve Money	4,260	4,088	3,696	3,743	3,774	4,064	4,160	3,709	3,916
Currency outside the central bank	3,036	2,972	2,723	2,810	2,785	3,021	3,123	2,883	3,095
Currency outside banks	2,800	2,739	2,552	2,644	2,637	2,664	2,748	2,683	2,895
Cash in vaults of banks	236	233	170	167	149	357	375	200	200
Deposit money banks' deposits	1,212	1,109	965	923	978	1,029	1,024	818	813
Reserves in litai	868	445	508	477	516	613	611	413	426
Required reserves in foreign currency	344	436	457	445	462	416	412	397	379
Private and nonmonetary financial institutions	13	7	8	10	10	14	14	8	8
Monetary Survey									
Net Foreign Assets	4,292	3,656	4,494	4,906	5,202	4,783	4,865	4,674	6,111
Monetary authority	4,836	4,054	4,292	4,722	4,538	5,516	5,647	4,385	5,931
Banks and nonbank financial institutions	-544	-398	202	184	665	-732	-782	289	180
Net Domestic Assets	4,035	5,316	4,391	4,429	4,652	4,541	4,753	5,149	4,493
Net claims on government 1/	-505	39	-598	-737	-145	-1,277	-1,232	-482	-1,560
Monetary authority	-947	-326	-951	-1,269	-1,015	-1,812	-1,847	-948	-2,287
Banks 2/	441	365	353	532	870	535	615	466	727
Credit to nonfinancial public enterprises	352	437	508	476	485	437	437	470	450
Credit to private sector 2/	4,874	5,545	5,239	5,410	5,108	6,080	6,248	5,958	6,409
Credit to nonbank financial institutions	470	468	452	487	493	468	468	480	482
Other items, net	-1,155	-1,168	-1,206	-1,202	-1,289	-1,168	-1,168	-1,277	-1,288
Broad Money	8,327	8,972	8,885	9,335	9,854	9,324	9,618	9,823	10,604
Currency outside banks	2,800	2,739	2,552	2,644	2,637	2,664	2,748	2,683	2,895
Deposits	5,527	6,233	6,333	6,691	7,218	6,660	6,870	7,140	7,709
In national currency	3,520	3,509	3,471	3,666	3,959	...	...	3,948	4,263
In foreign currency	2,007	2,725	2,862	3,025	3,259	...	...	3,192	3,446
Memorandum items:									
Reserve money (yearly percent change)	28.8	-4.0	-2.8	-6.5	-2.0	5.5	1.8	-9.3	5.6
Broad money (yearly percent change)	14.5	7.7	9.1	5.8	11.8	5.8	7.2	9.5	8.0
Private sector credit (yearly percent change) 2/	16.9	13.8	0.0	-2.4	-8.8	8.6	12.7	7.5	7.6
Money multiplier	2.0	2.2	2.4	2.5	2.6	2.3	2.3	2.6	2.7
Currency-deposit ratio	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Foreign currency deposits/ lita deposits	0.6	0.8	0.8	0.8	0.8	...	...	0.8	0.8
Velocity of broad money 3/	6.0	4.9	...	...	...	...	4.8	4.7	4.6
Gross official reserves, in US$ mln. 4/	1,462	1,244	1,295	1,391	1,337	1,593	1,614	1,297	1,673
GDP, mln. LTL	42,990	42,535	...	...	...	...	43,664	44,530	47,135

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

1/ Excludes local government deposits; includes counterpart funds.

2/ DMBs' net claims on government include government lending funds of LTL 270 million and corresponding claims on private sector that were removed from balance sheets in July, 2000. If excluded, private sector credit would only fall by 4 percent in September, 2000.

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

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

Table 5. Lithuania: Macroeconomic Framework, 1996-2005

	1996	1997	1998	1999	2000			2001	2002	2003	2004	2005
					Q1	Q2	Proj.			Proj.		
	(In percent of GDP, unless otherwise indicated)											
Gross national saving	15.3	16.3	12.3	11.7	12.0	15.8	15.0	15.5	16.0	16.4	16.6	16.9
General government	0.2	1.7	-0.7	-4.0	-2.6	-0.3	-0.9	0.5	1.3	2.0	2.0	2.0
Non-government	15.2	14.6	13.0	15.7	14.6	16.1	16.0	15.0	14.7	14.4	14.7	14.9
Gross national investment	24.5	26.5	24.4	22.9	14.8	21.4	21.9	22.1	22.3	22.4	22.4	22.4
General government	2.7	2.7	3.3	2.3	1.5	2.2	2.0	1.8	2.0	2.0	2.0	2.0
Non-government	21.8	23.9	21.1	20.7	13.4	19.2	19.9	20.4	20.3	20.4	20.4	20.4
Foreign saving 1/	9.2	10.2	12.1	11.2	2.8	5.6	6.9	6.7	6.3	6.0	5.7	5.5
General government financial balance 2/	-2.5	-1.5	-4.4	-6.2	-3.8	-2.7	-2.8	-1.3	-0.7	0.0	0.0	0.0
General government net lending	2.0	0.3	1.5	2.4	1.1	0.1	0.5	0.1	0.0	0.0	0.0	0.0
Consolidated general government fiscal balance 2/	-4.5	-1.8	-5.9	-8.5	-4.9	-2.8	-3.3	-1.4	-0.7	0.0	0.0	0.0
Current account balance	-9.2	-10.2	-12.1	-11.2	-2.8	-5.6	-6.9	-6.7	-6.3	-6.0	-5.7	-5.5
External debt 3/	30.2	34.0	34.8	42.6	43.9	44.7	44.2	42.6	39.7	37.2	35.2	33.3
Debt service (in percent of exports of GNFS)	6.8	10.7	18.3	20.0	14.0	14.3	15.2	12.4	17.0	16.5	16.5	15.6
Nominal GDP (in million Litai)	31,569	38,340	42,990	42,535	9,997	11,218	44,530	47,135	50,345	54,347	58,835	63,631
Real GDP growth (in percent)	4.7	7.3	5.1	-4.2	4.2	0.0	2.3	3.2	3.8	4.4	4.8	5.0
Average CPI inflation (in percent)	24.7	8.8	5.1	0.8	0.8	0.9	1.0	1.3	2.6	3.0	3.0	3.0
End-of-period CPI inflation (in percent)	13.1	8.4	2.4	0.3	0.8	1.3	1.6	1.9	3.0	3.0	3.0	3.0

Source: National 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.

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

Table 6. Lithuania: Schedule of Available Purchases Under the Stand-By Arrangement, 2000-2001

Amount of Purchase	Availability	Contingent On
SDR 10.3 million (7.1 percent of quota)	March 6, 2000	Board Approval
SDR 10.3 million (7.1 percent of quota)	May 15, 2000	Unavailable
SDR 10.3 million (7.1 percent of quota)	September 15, 2000	Unavailable
SDR 10.3 million (7.1 percent of quota)	November 15, 2000	Unavailable
SDR 10.3 million (7.1 percent of quota)	February 15, 2001	Observance of end-December 2000 performance criteria and completion of first review 1/
SDR 10.3 million (7.1 percent of quota)	May 15, 2001	Observance of end-March 2001 performance criteria and completion of second review 1/

Source: Fund staff calculations.

1/ In addition to other clauses in the arrangement.

Table 7. Lithuania: Indicators of Financial Obligations to the Fund, 2000-2008

	2000	2001	2002	2003	2004	2005	2006	2007	2008
					Projections				
Obligations from existing drawings 1/									
Debt Service to the Fund (in millions of SDRs)	2.6	34.8	37.5	35.7	27.5	20.6	11.1	4.4	0.0
Repurchases (in millions of SDRs)	2.6	26.7	31.1	31.1	24.6	19	10.4	4.3	0.0
Charges (in millions of SDRs)	0.0	8.1	6.4	4.6	2.9	1.6	0.7	0.1	0.0
In percent of exports GNFS	0.1	0.8	0.8	0.7	0.5	0.4	0.2	0.1	0.0
In percent of external debt service	0.4	6.7	4.9	4.4	3.2	2.3	1.1	0.4	0.0
In percent of gross official reserves	0.3	2.7	2.7	2.4	1.7	1.2	0.6	0.2	0.0
Exports GNFS, in millions of US$	5,181	5,564	5,985	6,519	7,126	7,765	8,387	9,058	9,782
External debt service, in millions of US$	787	689	1,020	1,076	1,173	1,210	1,307	1,411	1,524
Gross official reserves, in millions of US$	1,297	1,673	1,825	1,988	2,162	2,330	2,516	2,718	2,935
US$/SDR exchange rate	1.3	1.3	1.3	1.3	1.3	1.4	1.4	1.4	1.353
Quota, in millions of SDR	144	144	144	144	144	144	144	144	144
External debt, in millions of US$	4,924	5,016	4,991	5,061	5,180	5,291	5,715	6,172	6,666
GDP in millions of US$	11,133	11,784	12,586	13,587	14,709	15,908	17,180	18,555	20,039
Obligations from existing and prospective drawings 2/									
Debt Service to the Fund (in millions of SDRs)	2.6	36.8	41.1	39.3	46.5	53.6	27.0	4.4	0.0
Repurchases (in millions of SDRs)	2.6	26.7	31.1	31.1	40.1	49.9	25.9	4.3	0.0
Charges (in millions of SDRs)	0.0	10.1	10.0	8.2	6.4	3.7	1.1	0.1	0.0
In percent of exports GNFS	0.1	0.9	0.9	0.8	0.9	0.9	0.4	0.1	0.0
In percent of external debt service	0.4	7.1	5.4	4.9	5.3	6.0	2.8	0.4	0.0
In percent of gross official reserves	0.3	2.9	3.0	2.6	2.9	3.1	1.5	0.2	0.0
Memorandum items:									
Fund credit outstanding									
Without drawings under the proposed stand-by arrangement									
In millions of SDRs	147.1	135.0	103.9	72.8	48.2	29.2	18.8	14.5	0.0
In millions of US$	195.1	178.4	138.2	97.4	64.8	39.5	25.4	19.6	0.0
In percent of quota	102.0	93.6	72.0	50.5	33.4	20.2	13.0	10.0	0.0
In percent of external debt	4.0	3.6	2.8	1.9	1.3	0.7	0.4	0.3	0.0
In percent of GDP	1.8	1.5	1.1	0.7	0.4	0.2	0.1	0.1	0.0
Exchange rate US$/SDR	1.3	1.3	1.3	1.3	1.3	1.4	1.4	1.4	1.4
With drawings under the proposed stand-by arrangement									
In millions of SDRs	147.1	196.8	165.7	134.6	94.5	44.6	18.7	14.4	0.0
In millions of US$	195.1	260.1	220.3	180.0	127.1	60.3	25.3	19.5	0.0
In percent of quota	102.0	136.5	114.9	93.3	65.5	30.9	13.0	10.0	0.0
In percent of external debt	4.0	5.2	4.4	3.6	2.5	1.1	0.4	0.3	0.0
In percent of GDP	1.8	2.2	1.8	1.3	0.9	0.4	0.1	0.1	0.0

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

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

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

Table 8. Lithuania: Performance Criteria, Benchmarks and Indicative Targets Under Stand-By Arrangement, January 2000 - March 2001 1/

Variables and Periods	Performance Criteria/ Indicative Targets		Outcomes	
	Unadjusted	Adjusted		
I. Maintenance of exchange rate under currency board arrangement			Observed	
Duration of the stand-by arrangement				
II. Full foreign exchange cover for currency board liabilities (in percent of reserve money)				
Duration of the stand-by arrangement				
March 31, 2000	100	...	156	
June 30, 2000	100	...	165	
September 30, 2000	100	...	142	
III. Minimum level for total reserve deposits of banks with the Bank of Lithuania, calculated as for the reserve maintenance period and expressed as a percentage of eligible commercial bank liabilities:				
Through October 13	8	...	Observed	
From October 14	6	...	...	
IV. No accumulation of external payments arrears by the Government			Observed	
V. Ceilings on general government fiscal balance; 2/ 3/ cumulative from January 1, 2000 to:	(In millions of Litai)			
March 31, 2000	426	441	487	
June 30, 2000	746	791	803	
September 30, 2000	992	1069	1023	
December 31, 2000 (initial target)	1225	...	...	
December 31, 2000 (revised target)	1475	...	...	
March 31, 2001 (initial target)	1225	...	...	
March 31, 2001 (revised target)	1746	...	...	
VI. Ceilings on general government net lending; 2/ cumulative from January 1, 2000 to:				
March 31, 2000	72	87	111	
June 30, 2000	58	103	118	
September 30, 2000	44	121	293 4/	
March 31, 2001 (initial target)	30	...	...	
December 31, 2000 (revised target)	243	...	...	
March 31, 2001 (initial target)	30	...	...	
March 31, 2001 (revised target)	262	...	...	
VII. Ceilings on stock of general government guarantees for domestic borrowing:				
December 31, 1999 (actual)	593	...	593	
March 31, 2000	547	...	565	
June 30, 2000	527	...	499	
September 30, 2000	487	...	451	
December 31, 2000 (initial target)	456	...	...	
December 31, 2000 (revised target)	489	...	...	
March 31, 2001 (initial target)	350	...	...	
March 31, 2001 (revised target)	489	...	...	
VIII. Ceilings on stock of outstanding general government payment obligations:				
December 31, 1999 (actual)	590	...	593	
March 31, 2000	443	...	470	
June 30, 2000	295	...	443	
September 30, 2000	148	...	317	
December 31, 2000 (initial target)	0	...	...	
December 31, 2000 (revised target) 5/	0	...	...	
March 31, 2001 5/	0	...	...	
	(In millions of U.S. Dollars)			
IX. Floors on net foreign exchange coverage of the currency board arrangement:				
March 31, 2000	-127	...	-85	
June 30, 2000	-127	...	-69	
September 30, 2000	-127	...	-60	
December 31, 2000	-127	...	...	
March 31, 2001	-127	...	...	
X. Ceilings on contracted public and publicly guaranteed medium- and long-term external debt; cumulative from January 1, 2000, until:	All maturities	1-5 yr maturity	All maturities	1-5 yr maturity
March 31, 2000	359	288	282	261
June 30, 2000	429	308	300	277
September 30, 2000	594	327	528	357
December 31, 2000 (initial target)	703	395	...	...
December 31, 2000 (revised target) 6/	703	470	...	...
March 31, 2001 (initial target)	723	405	...	...
March 31, 2001 (revised target) 6/	996	670	...	...
XI. Ceilings on the outstanding stock of external government debt with maturity of less than one year; 7/				
duration of the standby arrangement	0		0	

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

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

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

3/ The end-March ceiling will be increased by the amount that the actual investment projects included in the attached quarterly list exceeds the program target of LTL 27 million (with a maximum adjustment of LTL 27 million on a project-by-project basis).

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

5/ Applies to the central government.

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

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

Table 9. Lithuania: Structural Benchmarks Under
Stand-By Arrangement

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

Table 10. Lithuania: External Sector Indicators Under Alternative Scenarios, 2001-2005

	2001	2002	2003	2004	2005
Baseline scenario					
Real GDP growth (percentage change)	3.2	3.8	4.4	4.8	5.0
Current account balance (in percent of GDP)	-6.7	-6.3	-6.0	-5.7	-5.5
Debt service/exports of goods and services (in percent)	12.4	17.0	16.5	16.5	15.6
Gross official reserves/short-term debt (in percent)	89.3	93.6	94.7	98.1	...
External debt (in percent of GDP)	42.6	39.7	37.2	35.2	33.3
Scenario A - Export growth lower by 3 percentage points per year compared with the baseline scenario					
Real GDP growth (percentage change)	2.5	2.6	3.0	3.3	3.5
Current account balance (in percent of GDP)	-6.8	-6.7	-6.7	-6.8	-6.7
Debt service/exports of goods and services (in percent)	12.8	18.0	17.9	18.4	17.8
Gross official reserves/short-term debt (in percent)	89.2	91.8	90.8	91.7	...
External debt (in percent of GDP)	43.0	40.5	38.8	37.7	36.6
Scenario B - Foreign direct investment lower by 30 percent compared with the baseline scenario					
Real GDP growth (percentage change)	3.0	3.2	3.8	3.9	4.1
Current account balance (in percent of GDP)	-6.7	-6.3	-6.2	-6.2	-6.2
Debt service/exports of goods and services (in percent)	12.5	17.2	16.9	17.0	16.2
Gross official reserves/short-term debt (in percent)	86.6	87.3	85.2	85.2	...
External debt (in percent of GDP)	44.3	42.7	41.5	40.7	40.0
Scenario C - Interest rates 200 basis points higher					
Real GDP growth (percentage change)	3.1	3.5	4.0	4.3	4.6
Current account balance (in percent of GDP)	-7.2	-6.6	-6.3	-6.2	-6.0
Debt service/exports of goods and services (in percent)	14.2	18.8	18.1	18.0	17.1
Gross official reserves/short-term debt (in percent)	88.6	91.8	91.8	94.0	...
External debt (in percent of GDP)	43.5	41.6	40.2	39.2	38.2

Source: Fund staff estimates and projections.

FUND RELATIONS
(As of September 30, 2000)

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

II. **General Resources Account:**	**SDR Million**	**Percent of Quota**
Quota	144.20	100.0
Fund holdings of currency	299.87	208.0
Reserve position in Fund	0.02	0.0

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Holdings	0.71	N.A.

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
Extended arrangements	123.34	85.5
Systemic Transformation	32.34	22.4

V. **Latest Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-by	03/08/2000	06/07/2001	61.80	0.00
EFF	10/24/1994	10/23/1997	134.55	134.55
Stand-by	10/22/1993	10/24/1994	25.88	5.18

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

	Overdue	**Forthcoming**				
	9/30/2000	**2000**	**2001**	**2002**	**2003**	**2004**
Principal		8.6	26.7	31.1	31.1	24.6
Charges/Interest		2.2	7.8	6.2	4.4	2.8
Total		10.8	34.5	37.3	35.5	27.4

VII. **Exchange Arrangement**:

The currency of Lithuania is the litas. Since April 1, 1994, the litas has been pegged to the U.S. dollar at LTL 4 per U.S. dollar under a currency board arrangement.

VIII. **Resident Representative**:

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

IX. **Consultation Cycle**:

Lithuania is on the 12-month consultation cycle.

LITHUANIA: WORLD BANK RELATIONS

1. Lithuania joined the World Bank in July 1992. Since then, the Bank's assistance to Lithuania has concentrated on reforms in key areas such as maintaining macroeconomic stabilization to build and maintain investor confidence, reducing government involvement in business activities, and enforcing the basic legal tenets necessary for private activity. Moreover, the Bank is working with the government to strengthen key financial institutions to facilitate the appropriate provision of credit and movement of capital, as well as assisting in reorienting the social safety net, public services, infrastructure, and the energy sector to the needs of a market economy.

2. The table below provides a summary of IBRD loans as of October 18, 2000. It includes 15 projects and SALs with commitments totaling US$448.3 million equivalent and disbursements on all Bank projects in Lithuania amounting to US$280.31 million. A Structural Adjustment Loan II for the period July 1, 2000-June 30, 2001 in the amount of US$100 million approved in July 2000. Preparation of other operations is proceeding in the areas of infrastructure, education, and municipal services.

3. Projects supported by IFC amount to US$60.7 million as of September 2000. The held portfolio is US$35.9 million and includes the following projects: (1) modernization and expansion of a privatized, export-oriented wool mill (US$11.6); (2) modernization of a color picture tubes factory (US$15 million); (3 and 4) construction of a margarine production plant (US$1.025 million) and an asphalt production plant (US$1.7 million) (both are sub-projects of a line of credit to support SMEs); and (5) upgrading of fabric forming and finishing operations of a wool worsted fabric producer (US$6.6. million). The Board has approved the following projects of US$24.75 million: (1) the provision of long-term funding to a bank to provide term finance to corporate clients (including SMEs) and mortgage loans (US$20 million); (2) modernization of production facility and financial restructuring of a plywood and particleboard manufacturer (US$2.75 million); and (3) expansion, modernization and financial restructuring of a paperboard mill (US$2 million).

4. Lithuania is a member of MIGA, which has so far not issued any guarantees, but has four applications pending. Government representatives have participated in MIGA-sponsored meetings on investment promotion, and Lithuania is an active user of MIGA's Internet-based information dissemination facilities. FIAS has completed a study of administrative barriers to investment.

5. The first World Bank Country Economic Memorandum (CEM) was published in April 1993. A Public Expenditure Review was conducted in 1993/94 and was the basis for a donor meeting on public investments in May 1995. The Bank also has prepared an informal enterprise and financial sector study, a private sector assessment, a comprehensive energy sector review, a study of nuclear energy alternatives commissioned by the G-7, an agricultural review, a municipal finance study, a social insurance/social policy note, and an informal note on transport. In 1998, the Bank completed a multi-sectoral collection of policy notes, and a Country Assistance Strategy (CAS) for 1999-2001, which were discussed by the Board on May 11, 1999. A Macro Financial Vulnerability Study was completed in 1999.

World Bank Loans Approved by the Board

(As of October 18, 2000, in millions of U.S. dollars)

	Commitments	Disbursements
Rehabilitation Loan/1 (effective October 1992)	60.0	58.8
SAL I (effective October 1996)/2	80.0	80.0
Power Rehabilitation and Restructuring (effective November 1995)	26.4	15.8
Environment (Klaipeda) (effective May 1995)	7.0	3.94
EFSAP (effective December 1995)	25.0	20.93
Environment (Siauliai) (effective December 1996)	6.2	5.88
Agricultural Development Project (effective August 1996)	30.0	7.35
Klaipeda Geothermal (effective October 1996)	5.9	4.23
Energy/Housing Pilot (effective November 1996)	10.0	6.56
Highway Project (effective September 1996)	19.0	19.0
Social Policy (effective January 1998)	3.7	2.22
Municipal Development (not yet effective)	20.1	---
Health Project (effective May 17, 2000)	21.2	0.91
SAL II (effective July 28, 2000)	98.5	54.69
Klaipeda Port (not yet effective)	35.3	---
Total	448.3	280.31

Source: The World Bank.

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

2/ Loan closed in June 1998.

LITHUANIA: TECHNICAL ASSISTANCE FROM THE FUND, 1997-2000

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	inistry 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–present	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

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 and balance of payments data tend to complicate the analysis of economic developments.

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

National accounts

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

Price data

4. The Consumer Price Index (CPI) was first compiled in May 1992. Revisions and improvements in its compilation and several recalculations updating its weights have taken place since then, with technical assistance from the Fund. New weights were introduced in January 1997 and the new consumption bundle, thanks to experience gained through the consumption survey, better reflected the expenditure pattern in Lithuania. In January 1999,

the weights were revised based on the 1997 Household Expenditure Survey and a harmonized CPI prepared under an EU pilot project. The monthly CPI is available in the second week of the following month. Since January 1996 the producer price index is calculated according to the Laspeyres formula. Data on investment or tradable goods price indices are not yet available.

Public finance

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

Money and banking

6. The accounts of the BoL for the end of each month are available in the second week of the following month, while the consolidated accounts of banking institutions are available within the month following the month of reference. The sectorization and classification of the accounts accord with Fund methodology.

External sector

7. The Bank of Lithuania (BOL) is responsible for compiling the balance of payments (BOP), the international investment position and the international reserves statistics. The BOL compiles the BOP 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 BOP statistics to meet the requirements of the European Union (EU) following Lithuania's application for membership of the EU.

8. STA assigned a balance of payments statistics advisor during the period October 1999-October 2000, who also covered Latvia. The mission concluded that the methodology used to compile Lithuanian BOP statistics is, for the most part, sound and that the BOL has made progress in developing a monthly BOP series and in its compilation of travel and transfers. It also found that it has significantly reduced the errors and omissions item, to less than 2 percent of GDP for the second quarter of 2000. During that period BOL made improvements in several areas, most notably, in refining its technique for estimating travel expenditures, drawing upon additional data sources for private transfers and further developing its methodology for adjusting the value of exports from warehouses. As a result of work undertaken to produce monthly statistics, the BOL has also developed the methodology and data sources needed for compiling monthly balance of payments series.

The new monthly surveys draw heavily on existing sources (available survey, administrative and other), as well as new monthly surveys of banks and a sample of non-financial enterprises. In addition, it has incorporated an additional source, by setting a new monthly international transactions reporting system. The new framework was set up on a pilot basis in November 2000 and should reach an acceptable level in 2001.

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

10. As a subscriber to the Special Data Dissemination Standard, Lithuania is among the 41 countries to disseminate its international reserves in the framework of the *Operational Guidelines-Data Template on International Reserves and Foreign Currency Liquidity*. The reporting format and the dissemination timeliness are compliant with the IMF requirements.

Publications of statistics

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

- Lithuania's metadata for data categories defined by the Special Data Dissemination Standard are posted on the IMF's Dissemination Standards Bulletin Board (DSBB);

- the Bank of Lithuania 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 Department of Statistics' 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.

Survey of Reporting of Main Statistical Indicators
(As of September 30, 2000)

	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	10/31/00	10/31/00	10/31/00	10/31/00	10/31/00	10/31/00	09/30/00	Q2 2000	Q2 2000	Q2 2000	Q2 2000	Q2 2000
Date received	11/00	11/00	12/07/00	12/07/00	12/07/00	12/06/00	10/25/00	08/29/00	08/29/00	08/06/00	08/30/00	08/26/00
Frequency of data	D	M	M	M	M	M	M	M	Q	M	Q	M
Frequency of reporting	D	M	M	M	M	M	M	M	Q	M	Q	M
Source of data	C	A 1/	A 1/	A 1/	A 1/	A 1/, C	C	A 1/, C	A 1/ C	A 1/	A, N 1/	A
Mode of reporting	E	C,E	C,E	C,E	C,E	C,E	E	C,E	C,E	C	C	V
Confidentiality	C	C	C	B	C	C	C	C	C	C	C	C
Frequency of Publication	D	M	M	M	M	M	M	M	Q	M	Q	M

Sources: A--direct reporting by Central bank, Ministry of Finance, or other official agency; C--commercial service; N--official publication or press release.
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—MEDIUM-TERM MACROECONOMIC FRAMEWORK

The baseline medium-term macroeconomic framework prepared by the staff is based on the following key assumptions:

- **Exports of goods and nonfactor services,** which have registered a remarkable growth so far in 2000, are projected to grow by 7.4 percent (in U.S. dollar terms) in 2001; annual export growth would accelerate gradually to over 9 percent by 2005. The projected deceleration of exports beyond 2000 reflects that the exceptionally strong export growth in 2000 was largely due to a return of exports to their pre-crisis levels. Since the Russian crisis, Lithuanian exporters have made great efforts in diversifying their exports from the CIS to the western market. In the medium term, Lithuania is expected to continue to benefit from such a diversification strategy in western markets and recapture some markets in the CIS area, which resumed growth and saw their currencies appreciate against the litas in real effective terms. However, this scenario does not assume a major recovery of exports to the CIS area. The growth of **imports of goods and nonfactor services** would decelerate in 2001 and 2002 and accelerate thereafter. The initial slowdown reflects mainly the projected lower oil prices and a moderate recovery of domestic demand.
- Lithuania is assumed to maintain **access to international financial markets** at reasonable rates, due to sound economic policies and continued fiscal adjustment. Nonprivatization-related FDI would pick up in 2001, and maintain a similar magnitude throughout the medium term, as the business environment improves. This scenario does not factor in the potential large amount of FDI related to expanding the Mazikiai Oil Company, since the relevant agreement has yet to be finalized.
- Assuming no major external shocks, Lithuania intends to **keep the present exchange arrangement**, and the strengthening of medium-term competitiveness would be achieved through structural reforms and productivity growth.
- A **major upfront fiscal adjustment** was undertaken during 2000 and would continue in 2001. The fiscal deficit would be reduced from 8.5 percent of GDP in 1999 to 3.3 percent of GDP in 2000, and to 1.4 percent of GDP in 2001, primarily through expenditure restraint. The fiscal accounts are envisaged to remain balanced over the cycle from 2003 onwards. The fiscal scenario does not incorporate the cost of pension reform or EU accession, since concrete plans have not been finalized.
- Implementation of **structural reforms** will proceed vigorously, as described in the SMEP and the main text of the staff report.
- Based on these assumptions, **real GDP** would increase by 2.3 percent in 2000 and 3.2 percent in 2001. Growth would remain in the range of 3.8-5 percent annually over the medium term (Table 5). In the early years, GDP growth would be underpinned primarily by continued growth in exports. The pick-up in private consumption would initially be slower because of the adverse effects of the fiscal adjustment on real income of households.

- **Consumer price inflation** would remain low over the medium term in the 2-3 percent range, slightly above inflation in trading partner because of the Balassa-Samuelson effect.
- The **current account deficit** is projected to narrow progressively over the medium term, falling to about 5.5 percent of GDP in 2005. National saving is projected to rise steadily, initially as a result of fiscal adjustment and, from 2003 onwards, on account of a modest recovery in non-government saving, underpinning the current account adjustment. Foreign exchange reserves would increase continuously over the medium term, covering an increasing share of imports and short-term external debt. **External debt** as a share of GDP would also decline gradually to about 33 percent of GDP by 2005, or 10 percentage points down from the level in 2000. The debt service ratio is projected to decline at a rather slow pace, reflecting debt repayments.

Effects of External Shocks

Table 10 illustrates the potential impact on external indicators of adverse external shocks; specifically, lower export growth, less foreign direct investment, and higher interest rates. The scenarios do not provide for any policy feedback and, as such, they would tend to overstate the potential impact of each individual shock. Besides the policy response, the actual outcome would depend on the strength of the shocks and to what extent they occur simultaneously.

Export growth could be lower than projected under the baseline scenario because of lower-than-expected economic growth in western trading partners or because structural reforms fail to deliver the necessary degree of external competitiveness. The external debt indicators are sensitive to the export growth assumptions. For example, if exports increased by 3 percentage points per year less than under the baseline scenario, the current account deficit would, ceteris paribus, remain at over 6.5 percent of GDP per year over the medium term. Under this scenario, and without a policy correction, external debt would reach a level of 36.6 percent of GDP by 2005, 3.3 percentage points higher than under the baseline scenario.

Foreign direct investment inflows may not be forthcoming as projected, or **access to external borrowing** could become more limited and expensive. Under such circumstances, external debt service payments would increase considerably compared with the baseline scenario. For example, if foreign direct investment flows were 30 percent below the level of the baseline scenario, external borrowing would need to be increased substantially to provide adequate financing of slightly higher current account deficits, as exports would be more negatively affected than imports. Compared with the baseline scenario, external debt service payments and external debt would be significantly higher. **An increase in interest rates** would have a similar effect except for a more significant negative impact on the debt service ratio.

LITHUANIA–EXTERNAL AND FINANCIAL VULNERABILITY

Standard indicators suggest that Lithuania's external position, following a deterioration in the second half of 1999, improved in the first half of 2000, mainly on account of significant reduction of the current account deficit, while the domestic financial system continued to be stable.

The external solvency position improved in the first half of 2000 (Table 11).

- The current account deficit declined sharply in first half of 2000, falling to a moderate 4.2 percent of GDP in the first half of 2000 from 11.1 percent in the same period of 1999. Rapid recovery of exports growth was the major contributing factor to this significant improvement in the current account balance.

- After a sharp contraction in 1999, both exports and imports registered positive growth in the first half of 2000. In particular, the increase (year-on-year) in exports of goods and non-factor services in the first two quarters was an impressive 29 and 20 percent, respectively. The recovery was primarily fueled by a strong penetration into the EU markets, as exports to CIS markets stabilized. Exports to other markets were also on a steady upward trend. The relatively slow recovery in imports reflected sluggish domestic demand and a tight fiscal policy.

The liquidity position strengthened in the first half of 2000, as foreign exchange reserves rose quickly. The external debt ratios increased slightly, reflecting an increase in external borrowing, as Lithuania regained access to international capital market on favorable terms.

- Gross international reserves at end-September, 2000 were 8.6 percent (US$107 million) higher than at end-1999, as most of the privatization proceeds of US$ 180 million were sterilized.

- Total external debt rose moderately from 42.6 percent of GDP at end-1999 to 44.7 percent at end-June, 2000, and the ratio of public and publicly guaranteed debt to GDP rose from 22.4 percent of GDP to 23.2 percent of GDP during the same period.

- Despite the government revenue shortfall, debt-service-to-tax revenue dropped to 22.1 percent in first half of 2000 from 26.1 percent in 1999.

- The external debt service ratio declined from 20 percent of exports in terms of goods and non-factor services in 1999 to about 14 percent in the first half of 2000. This significant decline reflected to a large extent the expansion in exports.

- The maturity structure of external debt remained largely unchanged, with the ratio of short-term debt (on an original maturity basis) to total external debt falling marginally from 10 percent in 1999 to 9.8 percent at end-June 2000. Short-term debt on a remaining maturity basis as a percent of gross international reserves dropped from 133 percent at end-1999 to 126 percent at June-2000, suggesting a strengthened ability to service debt falling due over the coming year in the event of a sudden lack of access to foreign capital. The ratio of reserves-to-short-term debt corrected for the current account deficit net of foreign direct investment rose sharply to 0.77 at end-June 2000, while the ratios of gross reserves to broad money (0.62) and reserve money (1.50) remained high.

- Lithuania managed to regain access to international financial markets on reasonable terms in the first half of 2000. Lithuania's access to international financial markets had become difficult in the wake of the August 1998 crisis in Russia and tensions in other emerging markets. While the Lithuanian government was able to return to international markets relatively quickly after the Russian crisis, the costs were higher. With unchanged investment grade rating (BBB-), the spread of the 5-year Eurobond issued in 1997 over the benchmark U.S. treasury bond fell from an average of 239 basis points in 1999 to an average of 180 basis points in the first half of 2000. In February 2000, the government issued a 5-year €250 million eurobond at 281 basis points over the comparable German bond, while the August issue of €75 saw a reduced spread of 243 points.

Banking indicators improved from 1997, and there was further consolidation in the domestic financial sector in 2000. However, the impending privatization of three state banks as well as ongoing consolidation of commercial bank balance sheets resulted in a cautious lending strategy, and hence a declining growth of private sector credit by 4 percent in September, 2000.[1] (Table 12).

- Even though commercial banks' excess reserves at the BoL fell, especially from the high level reached in 1998, they remained high at 14.5 percent of total reserves in September of 2000.

- The share of non-performing loans in total loans decreased from the peak of 28.3 percent at the end of 1997 to 12.5 percent in 1999, but increased in 2000, to16.5 percent in June, and stood at 14 percent in September 2000, as banks cleaned up their balance sheets and used more stringent criteria to define non-performing loans.

- The risk-based capital adequacy ratio remained adequate at 16.7 percent in September, 2000 (compared with a statutory minimum of 10 percent). Banks became more conservative as they used a risk-based weighting of assets to calculate capital adequacy, according to Basle methodology , and made more adequate provisions for non-performing loans, after writing off a considerable portion of bad loans.

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[1] Growth of credit to the private sector does not include reclassified loans of LTL 270 million.

- Total bank capital relative to total liabilities (the leverage ratio) remained adequate at 10.4 percent in September, 2000.

- The share of loans collateralized by real estate is the lowest since 1997 at 9.3 percent of loans to the private sector.

Table 11. Lithuania: Indicators of External and Financial Vulnerability, 1998-2000

	1998	1999					2000			
	Year	Mar.	Jun.	Sep.	Dec.	Year	Mar.	Jun.	Latest	Date
Financial indicators										
State debt (domestic and foreign, in percent of GDP) 1/	22.4	24.4	25.1	25.3	28.4	28.4	30.5	29.3	28.7	Q3/2000
Broad money (year-on-year change in percent)	14.5	14.0	16.5	14.5	7.7	7.7	9.1	5.8	11.8	Q3/2000
Broad money in percent of gross official reserves	142.6	138.8	164.5	170.8	180.6	180.6	160.7	163.8	184.3	Q3/2000
Private sector credit (year-on-year change in percent)	16.9	17.0	17.5	16.8	13.8	13.8	0.0	-2.4	-8.8	Q3/2000
External indicators										
Current account balance in percent of GDP	-12.1	-8.0	-13.6	-8.7	-14.2	-11.2	-2.8	-5.6	-5.6	Q2/2000
Exports of GNFS (in millions of U.S. dollars)	5,071	983	1,062	1,117	1,076	4,238	1,267	1,272	1,272	Q2/2000
Exports of GNFS (year-on-year change in percent)	-2.9	-23.4	-22.0	-12.6	-6.2	-16.4	29.0	19.7	19.7	Q2/2000
Imports of GNFS (year-on-year change in percent)	1.8	-23.6	-15.1	-18.7	-6.4	-15.9	16.5	1.8	1.8	Q2/2000
Capital and financial account balance in percent of GDP	13.4	10.6	7.6	7.4	14.4	9.9	7.0	5.8	5.8	Q2/2000
Gross official reserves (in millions of U.S. dollars) 2/	1,460	1,467	1,342	1,290	1,242	1,242	1,382	1,424	1,349	Q3/2000
Gross official reserves/short-term debt 3/	0.85	0.91	0.83	0.76	0.75	0.75	0.79	0.79	0.79	Q2/2000
Gross official reserves/short-term debt corrected for current account deficit net of FDI	0.69	0.87	0.73	0.70	0.64	0.52	0.77	0.77	0.77	Q2/2000
Gross official reserves/ broad money	0.70	0.72	0.61	0.59	0.55	0.55	0.62	0.61	0.55	Q3/2000
Gross official reserves/reserve money	1.37	1.54	1.34	1.34	1.22	1.22	1.50	1.52	1.43	Q3/2000
Gross official reserves in months of imports of GNFS over the following year	3.3	3.2	2.9	2.7	2.6	2.6	2.8	3.2	3.0	Q3/2000
Net foreign assets of financial sector (in millions of U.S. dollars) 4/	-120	-91	-125	-145	-79	-79	69	66	163	Q3/2000
Total external debt (in millions of U.S. dollars) 5/	3,739	3,833	3,869	4,036	4,525	4,525	4,741	4,845	4,845	Q2/2000
in percent of GDP	34.8	35.7	35.8	37.7	42.6	42.6	43.9	44.7	44.7	Q2/2000
in percent of exports GNFS (over the last four quarters)	73.7	80.4	86.5	93.7	106.8	106.8	104.8	102.4	102.4	Q2/2000
of which: Public sector debt (in millions of U.S. dollars)	1,670	1,881	1,884	1,920	2,383	2,383	2,552	2,501	2,501	Q2/2000
in percent of GDP	15.5	17.5	17.4	17.9	22.4	22.4	23.6	23.1	23.1	Q2/2000
of which: Short-term external debt (in millions of U.S. dollars) 3/	1,728	1,614	1,616	1,692	1,664	1,664	1,745	1,798	1,798	Q2/2000
in percent of gross international reserves	118.3	110.0	120.5	131.2	133.9	133.9	126.3	126.3	126.3	Q2/2000
in percent of GDP	16.1	15.0	15.0	15.8	15.6	15.6	16.2	16.6	16.6	Q2/2000
External interest payments in percent of exports GNFS	3.2	4.1	3.5	3.8	3.6	3.7	4.9	4.0	4.0	Q2/2000
External amortization payments in percent of exports GNFS	15.1	15.7	17.1	16.9	15.1	16.2	6.0	10.3	10.3	Q2/2000
Debt service as percent of tax revenue	29.1	26.1	26.6	27.8	24.0	26.1	24.4	22.1	22.1	Q2/2000
Debt service as percent of exports of GNFS	18.3	19.8	20.6	20.7	18.7	20.0	14.0	14.3	14.3	Q2/2000
Real effective exchange rate (year-on-year change in percent, "+" = appreciation) 6/	9.6	13.6	14.2	6.3	4.2	4.2	3.3	3.2	9.9	9/30/00
Financial market indicators										
Stock market index, end period 7/	1,089	1,067	1,014	1,079	1,089	1,089	1,137	1,046	1,036	Q3/2000
Market capitalization (listed shares, percent of GDP)	10.0	10.7	10.0	10.6	10.7	10.7	10.3	14.4	14.1	Q3/2000
Foreign currency debt rating 8/	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	12/1/00
Spread of benchmark bonds (basis points, end of period) 9/	331	279	227	239	210	239	229	194	211	12/4/00
Memorandum items:										
GDP (in millions of U.S. dollars)	10,748	2,333	2,772	2,850	2,679	10,634	2,499	2,805	2,805	Q2/2000
Nominal exchange rate (litai/U.S. dollar, end-of-period)	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	Q2/2000
Nominal exchange rate (litai/euro, end-of-period)	...	4.3	4.1	4.3	4.0	4.0	3.8	3.8	3.5	Q3/2000

Sources: Bank of Lithuania, Ministry of Finance, Department of Statistics, National Stock Exchange of Lithuania, Bloomberg, Baltic News Service, and Information Notice System.
1/ Public and publicly guaranteed debt.
2/ Gross official reserves reported here differ from the monetary survey because here reverse repos involving major currencies in both legs are included.
3/ On a remaining maturity basis.
4/ Deposit money banks.
5/ External liabilities minus equity investment in Lithuania.
6/ CPI-based REER against the 21 major trading partners in 1999.
7/ LITIN-G price index, calculated for all issues that have been quoted in the current trading list in the past three months, excluding treasury bills and shares of investment companies.
8/ S&P investment grade rating.
9/ Monthly average spread of 5-year Eurobond (US$200 million) issued in July 1997 above the rate on U.S. treasury bills maturing July 31, 2002.)

Table 12. Lithuania: Indicators of Financial Sector Vulnerability, 1997-2000
(In percent, unless otherwise indicated)

	1997	1998	1999				2000		
			Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
Private sector credit (yearly percentage change) 1/	18.9	16.9	17.0	17.5	16.8	13.8	0.0	-2.4	-4.0
Commercial bank reserves (in percent of deposits) 2/	15.7	26.2	20.5	17.9	18.2	21.5	17.9	16.3	15.6
Cash	4.0	4.3	3.8	3.4	3.1	3.7	2.7	2.5	2.1
Reserves held at the BOL	11.6	21.9	16.6	14.5	15.1	17.8	15.2	13.8	13.6
of which: Excess reserves (in percent of total reserves)	29.3	40.1	24.8	12.0	17.0	30.2	14.3	14.6	14.5
Official risk indicators 3/									
Share of non-performing loans in total loans 4/	28.3	12.9	12.2	10.9	9.1	12.5	15.1	16.5	14.0
Risk-weighted capital asset ratio (capital over risk-weighted assets) 5/	10.8	23.8	22.7	22.6	22.1	17.4	18.0	16.4	16.7
Leverage ratio 6/	5.9	14.9	14.8	15.2	14.7	11.1	11.1	10.3	10.4
Share of private sector credit collateralized by real estate	12.9	12.0	...	...	11.3	10.3	10.7	10.5	9.3

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

1/ Excludes reclassified loans of LTL 270 million, which was removed from banks' books in July, 2000. If this amount is included, private sector credit growth falls by 8.8 percent in September, 2000.

2/ Excludes central government deposits.

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

4/ Includes loans overdue for 31 days. The classification of loans may be adjusted according to the borrower's standing, loan restructuring and refinancing (See Resolution on the Board of the Bank of Lithuania on the Approval of the Regulations for Classification of Doubtful Assets, April 24, 1997 No. 87).

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

6/ Defined as the ratio of total capital to total liabilities; an increase in the ratio indicates improvement.

December 13, 2000

Mr. Horst Koehler
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A.

Dear Mr. Koehler:

1. The overarching objective of Lithuania's economic policies is to lay the basis for sustained economic growth through macroeconomic stabilization and a continuation of the transition to a fully functioning market economy. Membership in the European Union and NATO remains our central policy goal, while accession to the WTO is expected to be completed in the coming months.

2. The implementation of the economic program supported by the stand-by arrangement (SBA) that was approved by the Fund's Executive Board in March 2000 has brought significant positive results. However, despite our best effort, two end-September 2000 performance criteria were not observed. The performance criterion for the reduction of general government expenditure arrears was not met, due to delays in arrears clearance by municipalities, which are autonomous from the central government in implementing their budgets. To correct this problem, a number of legal steps are being taken to compel municipalities to clear expenditure arrears. Moreover, the ceiling on contracting and guaranteeing external debt with maturity in excess of one year up to and including 5 years for end-September was missed, due to the additional eurobond issue which was justified by the situation in domestic and international financial markets and was undertaken in consultation with the Fund staff. Therefore, we request waivers for the nonobservance of the two above-mentioned performance criteria for end-September 2000.

3. The attached Supplementary Memorandum of Economic Policies (SMEP) lays out the concrete policy measures planned for remainder of the term of the SBA. During this period and for 2001 as a whole, the key goal will be a continued strengthening of macroeconomic stability, notably through a further adjustment of the external current account deficit. The economic policy strategy will be based on continued fiscal consolidation, maintaining the currency board arrangement in its present form, and a furthering of the progress made already in 2000 in structural reforms, improving the business environment and on privatization.

4. In support of the policies detailed in the SMEP, we request completion of the first review under the stand-by arrangement along with the waivers requested for the two above mentioned performance criteria. We do not envisage at this time making purchases under the arrangement, but could do so if economic circumstances were to be more adverse than expected. We understand that the Fund staff will monitor the program on the basis of

quarterly performance criteria for end-December and end-March, and a second program review will take place in the first half of 2001, as described in the SMEP.

5. In advance of the Executive Board's consideration of the first program review, one prior action will have been taken: Seimas approval of budgets for 2001 for the national government, the social insurance fund (SoDra), and the other extrabudgetary funds consistent with the general government budgetary framework described in the SMEP.

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

7. In line with our commitment to transparency in economic policies, we authorize the Fund to publish this letter and the SMEP following Executive Board approval of the program.

Yours sincerely,

/s/	/s/
Rolandas Paksas	Reinoldijus Šarkinas
Prime Minister	Governor, Bank of Lithuania

Attachment: Supplementary Memorandum of Economic Policies

SUPPLEMENTARY MEMORANDUM OF ECONOMIC POLICIES

I. INTRODUCTION

1. The key economic objectives of the new Lithuanian government are to promote sustained economic growth and complete the transition to a fully-functioning market economy, with a view to EU accession. Together with the Bank of Lithuania (BoL), the government is committed to the policy framework supported by the stand-by arrangement (SBA) agreed with the IMF in late-1999 and approved by the Fund's Executive Board in March 2000, and in order to attain its objectives, it will maintain sound financial policies, accelerate structural reforms, and seek to improve the business environment.

2. The economic program supported by the precautionary SBA is being implemented with positive results. A substantial reduction in the general government budget deficit and a strengthening of budgetary management have contributed to financial stabilization, enhanced credibility of the currency board arrangement, and faster-than-expected external adjustment. Economic growth has resumed, after the very deep recession experienced in 1999, mainly owing to the good export performance. Significant progress has been registered in a wide range of structural reforms, in particular with the restructuring of the energy sector, while progress in privatization and trade reforms should lay the ground for improved economic performance in the medium term. Confidence in Lithuania's policy-making has been renewed, access to markets on favorable terms has been restored, and inflation remains subdued. However, the economic adjustment this year has been difficult, with expenditure cuts and utility tariff increases, while the recovery of domestic demand has been slower than expected, and unemployment has reached a high level. The government's economic program aims at consolidating the economic gains achieved so far and addressing remaining weaknesses.

3. The economic program supported by the SBA remains broadly on track. The implementation of the 2000 budget posed challenges during the first nine months, given revenue shortfalls largely resulting from the erosion of tax bases attributable to weak domestic demand. In particular, the revenue of the Social Insurance Fund (SoDra) has been undermined by high unemployment and lower-than-expected nominal wages. In addition, measures agreed under the program to limit SoDra's expenditures and to strengthen SoDra's budget in the medium term were submitted to Seimas in late 1999 and again in 2000 but were not approved. Nevertheless, despite revenue shortfalls and expenditure pressures, the performance criterion on the general government fiscal balance was observed at end-September. However, the performance criterion for the reduction of general government expenditure arrears has not been met, mainly due to delays in arrears clearance by municipalities, which are autonomous from the central government in implementing their budgets.

4. All structural benchmarks under the program have been implemented. The new Organic Budget Law was passed by Seimas in July 2000. The Agricultural Bank was brought

to the point of sale in May 2000, and the Savings Bank in October 2000. The hiring of privatization advisors in gas and electricity sectors, as well as the passage of the Law on Gas and the Law on Electricity, led to the preparation of restructuring and privatization strategies in these sectors. Moreover, temporary trade restrictions introduced in the wake of the Russian financial crisis in late 1998 were abolished as of November 1, 2000. Finally, necessary steps are being taken to establish a reserve stabilization fund for the management of privatization receipts, in line with the recommendations of the IMF technical assistance mission that visited Vilnius in July.

II. The Government Program for the Fourth Quarter of 2000 and 2001

A. Macroeconomic Outlook

5. The macroeconomic outlook for 2000 and 2001 has been modified in light of unforeseen developments this year. In 2000, the economy is projected to grow by around 2.3 percent, in line with expectations, although growth is expected to continue to be driven by a strong export performance. Exports grew by approximately 28 percent in the first nine months of 2000 relative to the same period in 1999, despite the real appreciation of the litas. By contrast, domestic demand remained weak during the first half, showing a modest recovery only as of the third quarter. Hence, the current account deficit is expected to be contained to below 7 percent of GDP, compared with an initial target of 9.1 percent. Period-average inflation is projected at around 1.0 percent and the unemployment rate would remain at nearly 12 percent.

6. For 2001, the continuation of the fiscal adjustment and structural reforms will be crucial to maintaining the credibility of the currency board arrangement (CBA), improving competitiveness of the economy, and ensuring a further strengthening of medium-term external sustainability. The program projection of real growth for 2001 has been revised from 4 percent to 3.2 percent, given the slow pick-up in domestic demand. The current account deficit is projected to decline further to 6.8 percent of GDP (compared with an earlier projection of 8.4 percent), with exports growing by 6.4 percent. Inflation is expected to remain below 2 percent, and unemployment would decline.

7. Over the medium term, the government is committed to pursuing prudent macroeconomic policies and deepening structural reforms in order to ensure sustained, high-quality growth and reduce unemployment. The government aims at achieving a cyclically balanced budget by 2003, which, together with an improvement of external competitiveness as structural reforms bear fruit, would contribute to a steady reduction of the current account deficit and a further strengthening of Lithuania's external sustainability.

B. Currency Board Arrangement

8. **The currency board arrangement will continue to anchor macroeconomic policies**, providing a stable monetary framework, helping to keep inflation low and bolstering confidence. Accordingly, no changes in the current arrangement are envisaged during the

program period. External competitiveness has been sustained by productivity increases, favorable conditions in partner countries, terms of trade gains and a reduction in the cost of imported inputs from the euro-zone, helping Lithuanian producers to cope with competitiveness pressures emanating from the real appreciation of the litas. Further improvements in external competitiveness will be achieved through increases in productivity associated with advances in structural reforms, a pick-up in investment, and improvements to the business environment.

9. The original targets for end-December 2000 and end-March 2001 on gross and net international reserves coverage of the CBA remain appropriate, while the required reserve ratio was reduced from 10 to 8 percent in October, consistent with the objective of reaching EU levels over the medium term. No further reductions of the reserve requirements are scheduled by the BoL at this time.

C. Fiscal Policy and Budget Management

10. Fiscal policy is the major instrument of macroeconomic management under the CBA. A revision of the fiscal deficit targets for both 2000 and 2001 appears warranted in light of the revised macroeconomic conditions in 2000 and 2001, in particular the faster-than-envisaged external adjustment. For 2000, an **increase in the program target for the general government deficit from 2.8 percent of GDP to 3.3 percent of GDP** (compared with 8.6 percent of GDP in 1999) would be consistent with maintaining macroeconomic stability and furthering the ambitious external objectives. In light of revenue shortfalls estimated at 1.8 percentage points of GDP, the failure of the Seimas to adopt the agreed package of SoDra expenditure measures (0.2 percent of GDP), and initially non-budgeted defaults on government-guaranteed loans (0.3 percent of GDP), the government has undertaken a number of expenditure measures to ensure the achievement of the revised deficit target for 2000. In addition to savings in interest expenditure attributable to lower interest rates (0.2 percent of GDP), and savings on transfers to households (0.1 percent of GDP), the government is reducing expenditure of the state budget and extra-budgetary funds by 1.3 percent of GDP, and the administrative expenditure of SoDra. In the event that revenue shortfalls were greater than foreseen, the government will implement additional offsetting expenditure cuts, primarily at the level of the state budget, without incurring additional expenditure arrears.

11. **For 2001, a general government fiscal deficit of 1.4 percent of GDP,** compared with an initial program target of a balanced budget, has been submitted to Seimas. In establishing this target, a number of considerations have been weighed. First, the fast external adjustment has reduced the needed magnitude of fiscal adjustment. Second, a modest deficit for SoDra may be unavoidable in the short term, even if remedial measures are taken promptly. Finally, given the availability of foreign financing from some IFIs and privatization proceeds, it would be possible to run a small general government deficit without crowding out domestic financing of the private sector, while maintaining net external public debt at acceptable levels. At the same time, external sustainability considerations and recognition of

certain medium-term fiscal costs, such as pension reform, the costs of EU and NATO accession, and environmental programs, call for maintaining a tight fiscal stance.

12. A range of revenue and expenditure measures is envisaged for 2001 to achieve the targeted reduction in the fiscal deficit. We believe that the scope for additional revenue measures in 2001 is limited. Nonetheless, the government will submit the budget with a proposal to introduce an excise tax on liquefied gas. Moreover, in early 2001, the government will submit to Seimas a proposal to increase the excise tax on cigarettes and raise certain alcohol excises to bring them closer to EU levels. Expenditure measures include a further reduction in net lending, purchases of goods and services and the rationalization of capital spending. In addition, the government is firmly committed to implementation of expenditure cuts by SoDra, including: (i) accelerating the increase in the pension age – a key measure to achieve long-term financial viability; (ii) increasing the number of days of sick leave paid by employers; (iii) limiting the entitlement of working pensioners to a reduced pension; and (iv) freezing the basic pension. In order to strengthen the finances of the Health Insurance Fund, the government intends to reduce the coefficient of reimbursement by 5 percent by end-December. The government will also examine the introduction of other measures for the Health Insurance Fund, such as service copayments and rationalization of facilities. The program target on the general government deficit for the first quarter of 2001 has been set at LTL 271 million (2.6 percent of the estimated quarterly GDP), reflecting seasonality. Yet, this target represents a deficit reduction of 2.3 percent of GDP compared with the first quarter of 2000. At the same time, the government targets an increase in expenditure on education and limited support for district heating and residential construction. Recognizing the tight fiscal situation, no other forms of new support will be provided—in particular via tax benefits—to other sectors or companies.

13. As a result of restored confidence in Lithuania's economic policies and a prudent debt management policy, the fiscal deficit can be financed domestically and internationally at significantly reduced interest rates. In 2001, the government intends to pursue a cautious, carefully planned and well-timed debt strategy that would aim to limit exposure to market sentiments in both domestic and international capital markets, thereby avoiding sharp increases of borrowing costs, while lengthening the maturity of government securities. The spending of privatization proceeds will be limited to LTL 181 million (0.4 percent of GDP). The medium-term sustainability of public debt is expected to improve in 2001, as net public and publicly guaranteed debt is expected to decline from 24.6 percent of GDP in 2000 to 23.7 percent of GDP in 2001, mainly on account of the sterilization of a large part of privatization proceeds at the BoL, and the continuation of policies of reduction in domestic and external contingent liabilities. In particular, in view of the increase in defaults on direct ("on-lending") and budgetary guaranteed loans to domestic enterprises, the government will limit the concession of such guarantees and tighten the conditions for eligibility, while redoubling its collection efforts. The government will make its best effort to refrain from providing guarantees for additional borrowing by Mazeikiu Nafta in 2001.

14. The government will eliminate central government arrears by end-December 2000. To this end, the government will provide any necessary bridge financing to the Privatization Fund and revise the budget of the Health Insurance Fund. More time will be needed, however, to resolve the issue of nonpayment by municipalities. The 2001 Budget Law will require that municipalities allocate necessary appropriations to clear the arrears outstanding at end-December 2000. Moreover, the government will submit to Seimas by end-December 2000 a draft Law on Budgetary Organizations, defining responsibilities of appropriation managers of municipal and state budgets, and penalties for incurring expenditure arrears. The government targets the reduction of municipalities' expenditure arrears by about 30 percent from end-June to end-December and their full elimination by end-June 2001. The government recognizes the risks to financial discipline posed by the use of mutual debt settlements ("offsets"), and will refrain from such settlements, including in relations with municipalities and extra budgetary funds. The government will continue monitoring the reduction of arrears on a monthly basis at the level of the Prime Minister's Office.

15. The government will continue its efforts in strengthening budgetary management, improving tax administration, and revising tax legislation. The treasury project envisaging the creation of a single treasury account and direct payments for budget organizations is expected to be completed on schedule by early 2001. The government will adopt an action plan on the integration of the SoDra's payroll collection unit and the State Tax Inspectorate by end–December 2000. This action plan will envisage a gradual integration of the two agencies to be completed by end-2001. The government will submit to Seimas a new draft law on tax administration by end-March 2001.

16. To enhance transparency and effectiveness of management of privatization proceeds, the government will set up a reserve stabilization fund (RSF) by end-March 2001. The use of RSF resources will be determined in the context of the consolidated budget. To this end, a draft decision of Seimas on the creation of the RSF will be submitted to Seimas by end-March. This draft decision will outline a transparent framework of operations of the RSF, including provisions on: (i) asset management by the BoL, with special attention paid in the BoL annual audit to the operation of this fund, (ii) a clear definition of authorized expenditure items of the RSF, (iii) Seimas approval of all inflows and outflows of the RSF in the context of the approval of the national budget, and (iv) a requirement to publish annual reports and results of the audit of the RSF. The operational guidelines for the RSF will be approved by the government.

17. In order to determine medium-term fiscal priorities, assess the impact of proposed tax reforms, address future expenditure pressures, and seek ways to achieve the medium-term goal of a balanced budget (before the diversion of a portion of the payroll tax to a mandatory privately funded pension scheme), the Ministry of Finance, on behalf of the government, will prepare a comprehensive study on tax reform and expenditure restructuring by end-March 2001. On the revenue side, this study will incorporate an analysis of the proposals to reduce the personal income tax and eliminate the corporate income tax, as well as potential revenue gains from higher excises, the elimination of exemptions, and additional taxes. Attention will

be paid to the need to maintain an adequate level of resources for municipalities, and alternative sources of tax revenue will be explored, including a municipal real estate tax. Furthermore, appropriate consideration will be given to the need to preserve a balance between the taxation of capital and labor, in order to promote employment-creating growth. On the expenditure side, the study will define ways to restructure expenditure with a view to addressing potential costs of EU and NATO accession, the Ignalina power plant closure and pension reform.

D. Structural Policies

18. Financial sector reforms are geared toward fostering competition in the banking sector and development of capital markets and nonbank financial institutions. The government is determined to complete the privatization of three state-owned banks—Savings Bank, Agricultural Bank, and Development Bank—in an expedient and transparent manner. The sale of the Development Bank is being completed; negotiations are ongoing with one bidder for the Savings Bank, and after the withdrawal of the consortium bidding for the Agricultural Bank, a new privatization tender should be announced by end-March 2001. The government and the Bank of Lithuania reaffirm their commitment to privatize these remaining state-owned commercial banks, with a view to improving the functioning of the banking system. The new law on the Bank of Lithuania, which ensures the autonomy and accountability of the BoL in line with ECB requirements, has been submitted to Seimas, with the support of government. Laws governing capital markets and nonbank financial institutions will be prepared for parliamentary consideration in 2001, and a new commercial banking law is also under preparation. In order to promote the development of capital markets, amendments to the Law on Public Trading in Securities in line with EU directives will be submitted to Seimas consideration by early 2001.

19. The government attaches great importance to the continuation of the energy sector restructuring with a view to privatizing major energy companies. Concerning the Lithuanian Power Company (LPC), the government has proposed to Seimas an amendment of the Law on Reorganization of LPC that would allow the restructuring and privatization of the company to proceed. It is expected that the amendment would be approved by Seimas by end-December 2000. The approval of the restructuring plan prepared with the support of an international investment bank by the shareholders of LPC will take place by end-January 2001, and the registration of the LPC successor companies (transmission, generation and distribution) is expected by end-February. The tender for the privatization of a majority stake of the distribution network of LPC will be announced by end-March 2001. Electricity tariffs will not be reduced during the pre-privatization period. For Lithuanian Gas, expressions of interest from potential participants in the privatization will be sought in early December 2000, with the announcement of a tender for privatization of the company to be made by February 1, 2001. Gas tariffs for households are expected to be adjusted further, to bring them more in line with tariffs charged to other customers. The government will conduct a review of Mazeikiu Nafta's investment program and action plan to deal with obligations

excluded from the privatization and investment agreements, with a view to limiting potential fiscal costs in the medium term.

20. Considerable progress was made in 2000 to rationalize government agricultural programs and financial support to agriculture, with a view to EU accession. The changes have aimed to reduce the government's role in price support and market intervention. The new government intends to continue these policies, with government support to the sector targeted to investment, including with EU cofinancing, and income support.

21. One of the key objectives of the new government is to improve substantially the business environment in Lithuania: to promote economic growth, to seek higher employment, to reduce red tape and to abolish excessive government regulation. At the beginning of this year, the Program for Business Environment Improvement (the "Sunrise Program") was initiated. This program will be continued and deepened. Tax administration procedures will be simplified, including in the context of forthcoming tax reforms. The program also envisages the simplification of procedures of customs clearance, sales and purchase of land, restitution of ownership rights, coordination of construction projects, as well as the reform of labor relations and labor contracts, and actions in regard to bankruptcies and company insolvency. A comprehensive plan of actions to resolve the problems of insolvent companies has been approved. The revised Company Bankruptcy and Company Restructuring Laws are expected to be approved by Seimas by end-December 2000. The new bankruptcy law is expected to facilitate the bankruptcy process and to permit the state to increase the number of initiated bankruptcy proceedings to 1,200 next year, with technical assistance and training from EU-PHARE. The government will undertake measures to liberalize the labor market, by reducing firing and hiring costs and by increasing labor contract flexibility, with a view to fostering a more dynamic labor market and encouraging employment growth. Amendments to the law on labor contracts have already been submitted for Seimas consideration.

22. The WTO accession negotiations were completed in mid-2000, with an official announcement on December 8, 2000, and the accession treaty is expected to be ratified by the Seimas in early 2001. The temporary trade measures introduced as a response to the Russian crisis have been removed, and the remaining export taxes have been abolished, with effect from January 1, 2001. The other remaining trade protection measures will be reduced over time in line with the provisions under the WTO accession agreement, including import duties on some agriculture and petroleum products.

E. Program Monitoring

23. The adoption of the laws on the national budget, SoDra, the Health Insurance Fund, and the Privatization Fund for 2001, consistent with program commitments, will constitute a prior action for the completion of the first review. The program is monitored on the basis of quarterly quantitative performance criteria and benchmarks and a set of structural policy benchmarks for end-December 2000 and end-March 2001 consistent with the revised economic program (specified in the attached tables), and the second review by the Fund's

Executive Board. The definitions of program targets are provided in the Technical Memorandum of Understanding (Annex).

24. The second review will be based on end-December 2000 outcomes and is expected to be completed by end-March 2001. The review will focus on the implementation of fiscal and structural measures envisaged under the program, as well as progress in the preparation of a medium-term fiscal strategy.

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

Variables and Periods	Performance Criteria/ Indicative Targets: Unadjusted	Performance Criteria/ Indicative Targets: Adjusted	Outcomes
I. Maintenance of exchange rate under currency board arrangement			Observed
Duration of the stand-by arrangement			
II. Full foreign exchange cover for currency board liabilities (in percent of reserve money)			
Duration of the stand-by arrangement			
March 31, 2000	100	...	156
June 30, 2000	100	...	165
September 30, 2000	100	...	142
III. Minimum level for total reserve deposits of banks with the Bank of Lithuania, calculated as for the reserve maintenance period and expressed as a percentage of eligible commercial bank liabilities:			
Through October 13	8	...	Observed
From October 14	6	...	...
IV. No accumulation of external payments arrears by the Government			Observed
		(In millions of Litai)	
V. Ceilings on general government fiscal balance; 2/ 3/ cumulative from January 1, 2000 to:			
March 31, 2000	426	441	487
June 30, 2000	746	791	803
September 30, 2000	992	1069	1023
December 31, 2000 (initial target)	1225	...	...
December 31, 2000 (revised target)	1475	...	...
March 31, 2001 (initial target)	1225	...	...
March 31, 2001 (revised target)	1746	...	...
VI. Ceilings on general government net lending; 2/ cumulative from January 1, 2000 to:			
March 31, 2000	72	87	111
June 30, 2000	58	103	118
September 30, 2000	44	121	293 4/
March 31, 2001 (initial target)	30	...	...
December 31, 2000 (revised target)	243	...	...
March 31, 2001 (initial target)	30	...	...
March 31, 2001 (revised target)	262	...	...
VII. Ceilings on stock of general government guarantees for domestic borrowing:			
December 31, 1999 (actual)	593	...	593
March 31, 2000	547	...	565
June 30, 2000	527	...	499
September 30, 2000	487	...	451
December 31, 2000 (initial target)	456	...	...
December 31, 2000 (revised target)	489	...	...
March 31, 2001 (initial target)	350	...	...
March 31, 2001 (revised target)	489	...	...
VIII. Ceilings on stock of outstanding general government payment obligations:			
December 31, 1999 (actual)	590	...	593
March 31, 2000	443	...	470
June 30, 2000	295	...	443
September 30, 2000	148	...	317
December 31, 2000 (initial target)	0	...	...
December 31, 2000 (revised target) 5/	0	...	...
March 31, 2001 5/	0	...	...
		(In millions of U.S. Dollars)	
IX. Floors on net foreign exchange coverage of the currency board arrangement:			
March 31, 2000	-127	...	-85
June 30, 2000	-127	...	-69
September 30, 2000	-127	...	-60
December 31, 2000	-127	...	...
March 31, 2001	-127	...	...

X. Ceilings on contracted public and publicly guaranteed medium- and long-term external debt; cumulative from January 1, 2000, until:	Performance Criteria: All maturities	Performance Criteria: 1-5 yr maturity	Outcomes: All maturities	Outcomes: 1-5 yr maturity
March 31, 2000	359	288	282	261
June 30, 2000	429	308	300	277
September 30, 2000	594	327	528	357
December 31, 2000 (initial target)	703	395	...	...
December 31, 2000 (revised target) 6/	703	470	...	...
March 31, 2001 (initial target)	723	405	...	...
March 31, 2001 (revised target) 6/	996	670	...	...

XI. Ceilings on the outstanding stock of external government debt with maturity of less than one year: 7/	Unadjusted	Adjusted	Outcomes
duration of the standby arrangement	0		0

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

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

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

3/ The end-March ceiling will be increased by the amount that the actual investment projects included in the attached quarterly list exceeds the program target of LTL 27 million (with a maximum adjustment of LTL 27 million on a project-by-project basis).

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

5/ Applies to the central government.

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

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

Table 2. Lithuania: Structural Benchmarks Under
Stand-By Arrangement

Action	Timing	Status
1. Take legal steps required for the establishment of Reserve Stabilization Fund	June 30, 2000	end-March 2001
2. Present draft Organic Budget Law to Seimas	March 31, 2000	Adopted by Seimas at end July
3. Engage advisors for privatization of Lithuanian Power Company	April 1, 2000	Done
4. Bring Agricultural Bank to the point of sale	April 30, 2000	Done
5. Bring Savings Bank to the point of sale	September 30, 2000	Done
6. Abolish all remaining export taxes	December 31, 2001	Done
7. Reverse the temporary anti-crisis measures provided for in Government Resolution No. 1122, 1998	November 1, 2000	Done
8. Bring an electricy distribution company to the point of sale	March 31, 2001	

REPUBLIC OF LITHUANIA

TECHNICAL MEMORANDUM OF UNDERSTANDING FOR THE 2000/2001 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 1=US$0.25 will be maintained throughout the period of the stand-by arrangement.

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 shall not be permitted to be below required

reserve deposits of the banking system, as defined in paragraph 6, by more than 2 percentage points of eligible liabilities, as defined in paragraph 6.

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

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

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

8. International reserve assets and liabilities shall be valued in U.S. dollars using the Bank of Lithuania's official rates prevailing at each test date. For the period of the program, monetary gold will be valued at US$ 252.8 per ounce.

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) Litas 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]

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

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.

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, Net Lending, Guarantees for Domestic Borrowing, and Arrears

16. The general government encompasses the national government (comprising the state and municipal governments) and the extrabudgetary funds. The extrabudgetary funds include the Social Insurance Fund (SoDra), Health Insurance Fund, Privatization Fund, Road Fund, Ignalina Closure and Decommissioning Fund, Privatization Fund for Housing, General Support for Construction or Purchase of Housing, Bankruptcy Fund, Fund for Small and Medium-Sized Firms, and Agricultural Reform Fund. The central government encompasses the general government excluding municipalities.

17. The general government fiscal deficit is defined, on a cash basis, as the sum of the general government financial deficit and general government net lending, as defined in 22.

18. The general government balance is defined, on a cash basis, as the negative sum of:

(i) the change in the stock of net claims of the domestic and foreign banking systems and other residents and nonresidents on the general government;

less the sum of

(i) net privatization proceeds;[2] and

(ii) change in the stock of debt claims in relation with bank rescue operations mentioned in paragraph 20 (ii) (Table 1).

19. The general government balance shall be measured excluding valuation gains and losses on all foreign currency denominated assets and liabilities arising from exchange rate fluctuations.

20. The change in the stock of net claims of the domestic and foreign banking systems on the consolidated general government is defined as the change in the stock of claims of these banking systems on the general government less the change in the stock of all deposits of the general government with these banking systems. The claims of these banking systems on the general government include (i) bank loans to general government, (ii) securities or bills issued by the general government held by banks, with the exception of those issued in

[2] 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.

relation with bank rescue operations, and (iii) overdrafts on the current accounts of the general government with banks.

21. Deposits of the general government include (i) deposits with banks, and (ii) securities issued by banks held by the general government. They exclude the acquisition of equity in banks.

22. General government net lending consists of lending operations by the general government to government and non-government entities, less repayments. Lending operations include:

(i) loans extended to government and non-government entities, comprising total disbursements of all government loans (including by nonbanks) and purchases of equity, including in relation with bank rescue operations except the purchases mentioned in footnote 2, less repayments of those loans. For the purpose of assessing the observance of the ceilings on the general government fiscal balance and net lending, 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) 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. The ceilings assume disbursements of LTL193 million in 2000; and

(ii) payments of interest or amortization on debts of others, which generate equivalent claims against the original debtors.

23. The implementation of general government investment projects carried out by budgetary organizations, including but not limited to the Ministry of Defense, is specified in Table 3 (to be submitted upon approval of the budget by Seimas) on a quarterly project-by-project basis, assuming a 50 percent implementation rate of the total annual commitment. The performance criterion on the fiscal deficit for the first quarter of 2001 will be adjusted by the amount equal to the excess of the actual appropriations over the programmed quarterly amount for every project. 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.

24. 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, the Export and Import Credit Insurance Agency, and SoDra. The performance criteria apply to the stock of outstanding government guarantees, which will be adjusted downwards by the amount of government guarantees used and cancellation of guarantees issued for reasons other than expiry. The performance criteria shall be applied on the basis of an outstanding stock of general government guarantees of LTL 593 million at end-1999 (Table 4).

25. 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. A full inventory of the stock of outstanding payment obligations of the general government as of December 31, 1999 has been established by the Ministry of Finance. Such an inventory will be updated monthly (Table 5).[3] In the context of the first program review, the quantitative indicative targets on the general government fiscal balance set out in Table 1 in the MEP may be revised in light of any revision to the end-1999 estimate of the stock of arrears. The presumption is that the indicative targets would be adjusted downwards by the absolute amounts of any reduction in the estimate of general government arrears outstanding at end-1999 from the current estimate of LTL 590 million. In case the revised estimate of general government arrears at end-1999 is higher than LTL 590 million, both the indicative targets on the general government fiscal balance and on the stock of outstanding payment obligations would remain as specified in Table 1 in the MEP.

III. Performance Criteria on Contracting and Guaranteeing of External Debt of or on behalf of the General Government and of the Bank of Lithuania

26. External debt limits apply to the contracting of medium- and long-term external debt denominated in foreign currency, including issuance of bonds in foreign currency, or with a foreign currency guarantee, of original maturities of more than one year that are contracted or guaranteed by the general government, the Bank of Lithuania or other agencies on behalf of the general government, with sub-ceilings on such debt of maturities of one year and up to and including five years.[4] Excluded from the limits are use of IMF resources. Other balance of payments support and loans to the government of maturity of longer than one year are covered by these limits, including lending from official creditors and foreign banks (Table 6). Guarantees of foreign currency-denominated borrowing of the Agricultural Marketing Agency, the Export and Import Credit Insurance Agency, and SoDra covered under paragraph 24 and foreign currency borrowing of municipalities from resident banks which is

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[3] Except for municipalities, for which the table will be provided on a quarterly basis.

[4] 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 on August 24, 2000 by the Executive Board of the IMF (Decision No. 6320-(79/140), but also to commitments contracted or guaranteed for which value has not been received.

not guaranteed by the central government are excluded from the limits defined in paragraph 26.

27. The general government will not accumulate external payments arrears on any expenditure item or external debt as defined paragraph 25, and will not contract or guarantee external debts with a maturity of less than one year, with the exception of normal import-related credits, which are defined to include liabilities on the correspondent accounts with central banks of countries of the FSU and short-term credit lines of resident banks to municipalities. Transactions subject to these ceilings 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

28. 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

29. *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 monetary survey;
- the structure of bank assets and liabilities;
- the currency exchange between the Bank of Lithuania, commercial banks, and the general government.

30. In line with SDDS requirements, the data on international reserves of the Bank of Lithuania will be provided to the Fund on the 7th 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 14th 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 28 will be provided to the Fund on the 24th day after the end of each month at the latest throughout the program period in the agreed format.

General government budget implementation and financing

31. 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).[5]

32. 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.

33. *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.

34. 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

35. *On an monthly basis*, the Ministry of Finance and the Bank of Lithuania will provide information on:[6]

- short-term and long-term external debt stock of the public and private sector[7] including non-concessional loans from multilateral organizations; and

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

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

- external debt service for short-term and long-term external debt of the public sector.

36. 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.

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

December 18, 2000

//s//	//s//
Mr. M. Jonikas Vice Minister of Finance Ministry of Finance	Mr. A. Kregzde Vice Governor Bank of Lithuania

[7] 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.

Table1. Lithuania: General Government Financing, 1999-2000

	1999	2000		
	Q4	Q1	Q2	Q 3
	Stocks, millions of litai (end of period)			
Domestic Credit to Government				
Short term loans and advances to central government (DMB)	41.5	41.5	41.5	7.6
Long term loans and advances to central government (DMB)	129.3	121.6	118.0	135.0
Claims on municipal governments (DMBs)	212.3	214.2	203.1	239.4
Claims on social insurance fund (DMBs)	157.8	228.0	243.4	234.6
Government securities (DMBs)	816.1	825.3	887.0	1,150.1
Government securities (OBIs)	19.1	19.2	19.2	19.2
Savings bonds	52.1	75.6	87.3	113.8
Treasury Bills (at issue value)	1,101.1	1,220.3	1,327.1	1,463.0
Held by DMBs	485.3	524.4	611.4	556.2
Held by OBIs	14.8	18.7	23.1	28.1
Held by Nonbanks	601.1	677.2	692.6	878.7
Total adjusted credit to government	1,694.1	1,901.1	2,020.4	2,193.4
Government Deposits				
Central government deposits (BOL)	302.1	927.9	1,246.9	994.4
Central government deposits (DMB)	556.9	672.6	723.4	906.3
Central government deposits (OBIs)	145.1	132.7	104.6	105.6
Municipal government deposits (DMBs)	98.1	108.0	119.6	194.9
Privatization funds (DMBs)	197.0	225.3	174.6	151.9
Social insurance fund (DMB)	76.4	26.2	30.1	35.8
Float between government accounts				
General government deposits	1,375.6	2,092.8	2,399.2	2,388.9
Net-domestic credit to general government	318.5	-191.7	-378.8	-195.5
of which: bank credit to general government	-334.7	-944.5	-1,158.7	-1,188.1
Memorandum item:				
Government lending funds (DMBs), excluding privatization	358.4	333.0	-25.0	48.0
	Flows, millions of litai (end of period)			
Net domestic Financing (change in net-domestic credit to government)	-576.8	-510.2	-187.1	183.3
Net lending	504.7	110.6	6.8	175.4
Borrowing (Foreign loans disbursed)	1,869.3	987.5	61.3	535.4
Amortization (- Repaid foreign loan principal)	276.1	36.5	127.0	571.1
Net flows of funds	1,593.2	951.0	-65.7	-35.7
Net privatization proceeds	36.4	45.8	602.0	72.4
Financial deficit (- indicates surplus)	548.2	411.6	342.3	44.6
Cumulative financial deficit	2,629.0	411.6	753.9	798.5
General government fiscal deficit (-indicates surplus)	1,052.9	486.6	316.2	220.0
Adjustment for repayments to nonbanks	0.0	0.0	-33.0	0.0
Cumulative fiscal deficit	3,635.4	486.6	802.8	1,022.7

Sources: Ministry of Finance; and Fund staff calculations.

Table 2. Lithuania: Investment Projects Financed by Official Bilateral and Multilateral Lenders, 2000
(In millions of Litai)

Project	Lender	MOF No.	Planned Disbursement 2000 (MOF) 2/
1 Lithuanian Energy (Power Rehabilitation)	WB	0019	36.5
2 Klaipeda Water	WB	0020	8.5
3 Bank of Lithuania (EFSAP)	WB	0021.1	1.0
4 Klaipeda State Seaport Authority (Klaipeda Port Project)	WB		...
5 Siauliai Water	WB	0032	10.0
6 CJSC "Geotherma" (Klaipeda Geothermal)	WB	0033	9.7
7 Housing Credit Foundation (Energy Efficiency/Housing Pilot)	WB	0034	16.8
8 Agriculture Sector (Private Agriculture Development)	WB	0035	38.0
9 Via Baltika	EIB	0036	33.6
10 Via Baltika	EBRD	0037	17.5
11 Lithuanian Roads	EIB	0038	1.2
12 Via Baltika	NIB	0039	5.6
13 Ministry of SS and Labor (Social Policy and Community Services)	WB	0042	6.0
14 Ministry of SS and Labor (Housing Provision for Returning Deportees)	ESDF 1/	0043	3.0
15 Lithuanian Railways	EIB	0046.1	38.0
16 Lithuanian Railways	EIB	0046.2	2.3
17 State Border Control System	KfW	0050	7.6
18 Lithuanian Roads	EIB	0053	63.3
19 Municipalities (Environment Investment Project and Other Mun. Projects)	NIB	0052	20.0
20 Ministry of Social Security and Labor (Social Services Infrastructure)	ESDF 1/	0058	1.5
21 Via Baltika	JEXIM	0023.3	9.4
22 Panevezys Municipality (Waste Water Treatment)	EIB	0060	5.0
23 Municipalities (Municipal Development Project)	WB	0066	20.0
24 Municipalities (Municipal Investment Project)	EIB	0059	10.0
25 Ministry of Health (Heatlh Project)	WB	0069	8.2
Total			372.7
Net Lending Indicative Target			

Sources: Technical Memorandum for Standby Arrangement; Ministry of Finance.
1/ European Social Development Fund
2/ Projected to be equlally distributed over quarters.

Table 2 (continued). Lithuania: Investment Projects Financed by Official Bilateral and Multilateral Lenders
(In thousands of Litai)

Nr.	Creditor	Reg. Nr.	2001	2001 Q1	Q2	Q3	Q4
1	World Bank (Lithuanian Energy)	0019	28,000	7,000	7,000	7,000	7,000
2	World Bank (Klaipėda Water)	0020	6,400	3,200	3,200		
6	World Bank (Šiauliai Water)	0032	6,800	1,700	1,700	1,700	1,700
7	World Bank (CJSC "Geoterma")	0033	6,000	3,000	3,000		
8	World Bank (The Housing Credit Foundation)	0034	14,000	3,500	3,500	3,500	3,500
9	World Bank (Agriculture Sector)	0035	27,800	6,950	6,950	6,950	6,950
14	World Bank (Ministry of Social Security and Labor)	0042	4,661	1,165	1,165	1,165	1,165
15	Europe Social Development Fund (Ministry of Social Security and Labor)	0043	2,536	634	634	634	634
16	European Investment Bank (Lithuanian Railways)	0046.1	26,440	6,610	6,610	6,610	6,610
17	European Investment Bank (Lithuanian Railways)	0046.2	25,304	8,326	6,326	5,326	5,326
19	NIB (municipality 20 mln. EUR)	0052	40,000	10,000	10,000	10,000	10,000
20	Europe Social Development Fund (Ministry of Social Security and Labor)	0058	5,459	1,365	1,365	1,365	1,365
21	European Investment Bank(municipality 15 mln. EUR)	0059	7,600	1,900	1,900	1,900	1,900
22	European Investment Bank (Panevėžio municipality - 6 mln. EUR)	0060	1,000	250	250	250	250
23	World Bank (municipality -18,89 mln EUR	0066	68,000	17,000	17,000	17,000	17,000
24	World Bank (health project -21 mln. USD)	0069	20,000	2,500	5,000	7,500	5,000
	New projects						
25	World Bank (Education project 25 mln USD)		2,000	0	0	2,000	0
26	World Bank (Energijos taupymo 8 mln. USD)		8,000	2,000	2,000	2,000	2,000
27	Soc. Development Fund (School renovation project 12,5 mln.USD)		20,000	0	6,000	6,000	8,000
	Total		320,000	77,100	83,600	80,900	78,400

Table 3. Lithuania: State Budget Expenditures on Investment Projects Financed from Borrowed Resources, 2001
(In millions of Litai)

	2001				
	Year	Q1	Q2	Q3	Q4
Total	207.75	51.94	51.94	51.94	51.94
Ministries	140.01	35.00	35.00	35.00	35.00
Ministry of National Defense	53.76	13.44	13.44	13.44	13.44
Ministry of Culture	8.32	2.08	2.08	2.08	2.08
Ministry of Social Security and Labor	9.72	2.43	2.43	2.43	2.43
Ministry of Health	39.47	9.87	9.87	9.87	9.87
Ministry of Education and Science	28.75	7.19	7.19	7.19	7.19
Regions	40.00	10.00	10.00	10.00	10.00
Departments, Services, and Inspectorates	8.20	2.05	2.05	2.05	2.05
Department of Sciences and Studies under the Ministry of Education and Science	8.20	2.05	2.05	2.05	2.05
Enterprises and Organizations	0.37	0.09	0.09	0.09	0.09
Education, culture and other institutions and organizations	19.17	4.79	4.79	4.79	4.79
Science and studies	19.13	4.78	4.78	4.78	4.78
Public enterprises: translation, documentation and information center	0.04	0.01	0.01	0.01	0.01

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

	2000							2001
	Q1	Limit	Q2	Limit	Q3	Limit	Q4 Limit	Q1 Limit
Total	564.8	547.0	498.5	527.0	450.9	487.0	489.0	489.0
Special agencies	251.8	290.0	228.2	290.0	242.5	270.0	283.0	270.0
Agricultural marketing agency	240.4	260.0	215.0	255.0	230.5	225.0	233.0	230.0
of which: SAPARD program cofinancing	-	-	-	-		-	-	20.0
Export and import credit insurance agency	11.5	30.0	13.2	35.0	12.0	45.0	50.0	40.0
SoDra	176.9	177.0	175.0	177.0	175.0	177.0	177.0	177.0
Other	136.1	80.0	95.3	60.0	33.3	40.0	29.0	42.0
Lithuanian Gas	61.7	0.0	61.7	0.0	0.0	0.0	0.0	0.0
Lithuanian Power Company	40.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ministry of Agriculture	7.5	0.0	7.5	0.0	7.4	0.0	0.0	0.0
Panevėžio Stiklas	11.9	0.0	11.8	0.0	11.7	0.0	0.0	0.0
Other	15.1	0.0	14.4	0.0	14.2	0.0	0.0	0.0

Table 5. Lithuania: Stock of General Government Outstanding Payment Obligations, 1999-2000
(In millions of Litai, unless otherwise indicated)

	1999	2000		
	Dec. 31	Apr. 1	Jul. 1	Oct. 1
Total outstanding payment obligations	593.9	470.4	443.1	317.2
(in percent of annual GDP)	1.4	1.1	1.0	0.7
State government	125.4	81.4	86.0	64.6
Wages and salaries	7.9	4.9	6.5	3.1
Other expenditure	117.5	76.5	79.5	61.5
Municipalities	154.5	233.3	236.6	182.5
Wages and salaries	14.3	21.2	11.3	6.6
Other expenditure	140.2	212.1	225.3	175.9
SoDra	0.0	0.0	0.0	0.0
Pensions, wages and salaries	0.0	0.0	0.0	0.0
Other expenditure	0.0	0.0	0.0	0.0
Health Insurance Fund	0.0	14.4	55.1	23.4
Payments to health care providers	0.0	0.0	0.0	0.0
Wages and salaries	0.0	0.0	0.0	0.0
Other expenditure	0.0	14.4	55.1	23.4
Privatization Fund	0.0	2.8	0.0	0.0
Wages and salaries	0.0	0.0	0.0	0.0
Other expenditures	0.0	2.8	0.0	0.0
Rural Support Fund	230.7	128.8	61.9	19.0
Wages and salaries	0.0	0.0	0.0	0.0
Other expenditure	230.7	128.8	61.9	19.0
Road Fund	83.3	9.7	3.5	27.7
Wages and salaries	0.0	0.0	0.0	0.0
Other expenditure	83.3	9.7	3.5	27.7
Memorandum item:				
GDP	42,649	44,530	44,530	44,530

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

Table 6: Newly Contracted Public External Loan Guarantees for Project Loans from Official Lenders (IFIs) in 2001 and Planned Disbursements

Name of the Project	Spending Agency	Source of Financing	State Guarantee		Disbursements		Outstanding at 12/31/00	
			in LTU mn.	in US$ mn.	in LTU mn.	in US$ mn.	in LTU mn.	in US$ mn.
2000								
Track rehabilitation in transportation corridor IX	Lithuanian Railway	EBRD	216.00	54.00			216.00	54.00
		EIB	67.40	16.85	53.00	13.25	14.40	3.60
Reconstruction of Klaipeda seaport entrance	Klaipedos Seaport	World Bank	112.00	28.00	25.00	6.25	87.00	21.75
Reconstruction of quays		EIB	45.00	11.25	15.00	3.75	30.00	7.50
Implementation of gas project #2	SC Lietuvos dujos	EIB, KF	120.00	30.00	90.00	22.50	30.00	7.50
Modernization of the Kaunas district heating system	Kaunas City (Municipality)	EBRD	168.00	42.00	29.20	7.30	138.80	34.70
Total			728.40	182.10	212.20	53.05	516.20	129.05
2001								
Eurobonds	Ministry of Finance	World Bank	0	0	800.00	200.00	...	...
Projects	Ministry of Finance	World Bank	0	0	8.00	2.00	...	...
Total			0	0	808.00	202.00	...	...

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/6
FOR IMMEDIATE RELEASE
January 22, 2001

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

IMF Concludes Article IV Consultation with Lithuania

On January 10, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Lithuania.[1]

Background

Lithuania made significant progress in establishing a market economy since independence was regained in 1991. Even though the radical restructuring and privatization resulted in negative growth for the first three years, the economy rebounded from 1995 on. Macroeconomic policies have been underpinned by a currency board arrangement since 1994, where the litas has been pegged to the U.S. dollar, providing a framework for strong fiscal discipline.

At the end of 1999, in the wake of the Russian crisis, Lithuania was in the midst of both a political crisis, with its third government in six months, and a year-long recession; an unsustainable fiscal expansion contributed to large current account deficits and increased external debt; structural reforms were lagging; confidence in the currency board was eroded, and access to capital markets became difficult. Local and parliamentary elections and a change of government took place in 2000, but the authorities continued to implement firmly their adjustment and reform program throughout the year. As a result, the external current account deficit declined sharply; real GDP growth resumed; inflation remained subdued; and confidence in Lithuania's policy making was restored, allowing for renewed access to domestic and international capital markets at low spreads. Structural reforms advanced significantly, including in energy sector restructuring, privatization, trade policy, deregulation, and budget

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the January 10, 2001 Executive Board discussion based on the staff report.

and treasury management. Significant progress has also been registered on the overarching objectives of EU and NATO accession. The adjustment represented a considerable political challenge, however, with expenditure cuts and utility tariff increases, while the recovery of domestic demand has been slower than expected, and unemployment has reached a very high level.

Real GDP grew by 2 percent in the first half of 2000, and is expected to grow by 2.3 in the year, fueled mainly by export growth, even as domestic demand remained weak. Impressive fiscal adjustment from a deficit of 8 percent of GDP in the first nine months of 1999 to a deficit of 3.1 percent of GDP in the first nine months of 2000 was achieved, in spite of revenue shortfalls from the erosion of the domestic tax base and non-acceptance by Parliament (Seimas) of some expenditure measures. The fiscal deficit is likely to be 3.3 percent of GDP for the year. The strong fiscal adjustment was key to the significant reduction in the current account deficit, which fell from 11.1 percent in the first half of 1999 to 4.2 percent of GDP in the first half of 2000. The faster than envisaged external adjustment was powered by export growth of 28.4 percent in the first nine months of 2000, which indicated sustained external competitiveness despite the continued real appreciation of the litas, and weak import growth. The current account deficit will likely remain under 7 percent of GDP in 2000.

The currency board has constituted a linchpin of macroeconomic stability. Even with a changing political environment, the currency board has encouraged adjustment. Developments in 1999 demonstrated that the credibility of the CBA needed to be underpinned by an appropriate fiscal stance, and any imbalances had to be quickly corrected. Given continued export growth with success of exporters to improve competitiveness and gain market share in the EU, as well as flexible wages, and stable financial markets, the CBA continues to provide a sound anchor for credible macroeconomic policies in Lithuania.

The notable fiscal and external adjustment led to increased confidence in the litas and stabilization of domestic financial markets in 2000, with interest rates declining. Consolidation progressed in the financial sector, as the prudential indicators of the banking system remained adequate as all banks complied with prudential requirements.

Significant progress was achieved in several areas of structural reform. To improve fiscal management, a new organic budget law, which provides for the consolidation of most extrabudgetary funds into the state budget, strengthened expenditure and debt management procedures, and enhanced transparency, was passed by Seimas in July. Privatization moved forward in the telecommunications and banking while progress was made in restructuring the electricity and gas sectors, laying the basis for privatization. In early 2000, a program for the improvement of the business environment was initiated by the Sunrise Commission. The commission prepared a number of programs and draft laws for Seimas approval, with a view to simplifying taxation rules, reducing licensing requirements, revising bankruptcy legislation, rendering the labor market more flexible, and settling issues relating to land ownership and land restitution. Even as subsidies were reduced substantially to the agricultural sector, the World Bank SAL is supporting further ambitious agricultural reform.

All trade restrictions introduced after the Russian crisis in 1998 were removed effective November 1, 2000. Lithuania joined the WTO in December 2000. EU accession negotiations have advanced, with 16 chapters (out of 30) of the *Acquis Communautaire* being opened, of which five have been completed. The EU accession report of November 2000 gives a positive assessment of Lithuania's progress in this regard.

Executive Board Assessment

Executive Directors were pleased to note that growth has resumed while inflation remains low, the current account deficit has declined faster than expected, financial markets have stabilized, access to capital markets has been restored, and the credibility of the currency board arrangement has been maintained. Directors considered that this commendable improvement in economic conditions during 2000 was attributable in large measure to the determined implementation of an ambitious fiscal adjustment and structural reform agenda. They stressed the importance of maintaining these policies in order to sustain growth, reduce unemployment, and maintain a viable external position over the medium term.

Directors commended the authorities' determined fiscal policies in 2000, which had substantially reduced the general government deficit. Although an even larger adjustment had been programmed, Directors regarded the outturn as appropriate, in light of the faster-than-expected reduction in the current account deficit, revenue shortfalls due to changes in the structure of output, weak domestic demand, and rising unemployment. Directors commended the authorities for taking difficult steps to reduce expenditures, including the passage of a comprehensive package of expenditure measures for the Social Insurance Fund (SoDra).

Looking to the year ahead, Directors considered that the further reduction in the fiscal deficit targeted for 2001—to 1.4 percent of GDP—is consistent with the authorities' macroeconomic objectives. They underscored the need to monitor revenue closely over the year and to improve tax and customs administration. Directors considered that expenditure restraint, especially at the state budget level, will also be necessary to meet the fiscal objectives. They noted that it was possible that improved external competitiveness could result in a stronger fiscal performance than budgeted. Were this to be the case, Directors stressed that any incremental budgetary resources should be allocated with a clear sense of medium-term budgetary priorities, including the need to improve the tax system. Expenditure targets should only be increased in the event that revenue turns out to be consistently and substantially higher than forecast in the first half of the year, the current account deficit is significantly smaller than projected, and the increases are consistent with medium-term fiscal consolidation. They looked forward to the approval by the legislature of a number of fiscal reforms, and stressed the need for timely implementation of plans to clear the arrears of municipalities by mid-2001, and to collect payments on guaranteed external debt from delinquent debtors.

Directors welcomed the authorities' commitment to prepare a comprehensive medium-term fiscal framework and to achieve a cyclically balanced budget by 2003. They emphasized the need for determined policy implementation to achieve this goal, especially in light of the authorities' intention to limit the increase in the tax burden. Directors emphasized that there was little scope for revenue to decline further relative to GDP, given the many medium-term expenditure pressures, including from costs of European Union and NATO accession, as well as pension reform. Any revenue losses from simplification or elimination of taxes should be offset by compensating revenue measures. Many Directors emphasized the need to reduce the burden of payroll taxation, which acted as a deterrent to job creation. They viewed action to redistribute the burden of taxation away from labor income as a priority, especially in view of the level of unemployment.

Directors welcomed the new organic budget law. They encouraged the authorities, building on their progress to date, to complete the modernization of treasury operations by early 2001 and to set up a reserve stabilization fund for transparent management of privatization proceeds by end-March, 2001.

Directors noted that the currency board arrangement has been a linchpin of stability and continues to serve Lithuania well. They fully supported the authorities' intention to maintain the currency board arrangement, and to announce in the second half of 2001 their plans regarding the switch to a euro peg. Directors urged the authorities to monitor closely developments in the balance of payments, financial system, and indicators of external competitiveness, and to stand ready to revise the policy stance if balance-of-payments pressures were to emerge.

Directors commended the authorities for recent improvements in banking supervision, and encouraged the passage of new legislation on the Bank of Lithuania and commercial banks, as well as the Law on Trading of Securities. Directors urged the authorities to complete the privatization of the two state-owned banks as soon as possible to foster competition in the banking system, and create conditions for a revival of sustainable credit growth. Directors welcomed the authorities' request to participate in the Financial Sector Assessment Program.

Directors noted the significant progress made in restructuring the energy sector and privatization of the telecommunications and banking sectors. They urged the authorities to proceed with determination in completing their privatization program, and welcomed their decision to begin the privatization of gas and electricity distribution companies in 2001. Directors also noted that privatization, notably in the energy sector, should be accompanied by establishment of a pricing and regulatory regime.

Directors underscored the need to improve the business environment so as to make Lithuania more attractive to domestic and foreign investors. In this regard, the passage of legislation pertaining to bankruptcy, the labor market, and land legislation should be given priority. Directors considered that structural reforms should also address the problem of high unemployment, including through measures to make the labor market as flexible as possible.

Directors welcomed the authorities' commitment to trade liberalization, and Lithuania's recent accession to the WTO.

Directors commended the authorities' commitment to improve transparency and data dissemination.

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

Republic of Lithuania: Selected Economic Indicators

	1996	1997	1998	1999	2000 1/
Real Economy		*Changes in percent*			
Real GDP	4.7	7.3	5.1	-4.2	2.3
CPI (period average)	24.7	8.8	5.1	0.8	1.0
Unemployment rate (in percent) 2/	16.4	14.1	13.3	14.1	...
Domestic saving (in percent of GDP)	16.0	16.6	12.1	10.8	13.8
Domestic investment (in percent of GDP)	24.5	26.5	24.4	22.9	21.9
Public Finance		*In percent of GDP*			
General government balance	-4.5	-1.8	-5.9	-8.5	-3.3
General government external debt	16.4	14.1	15.5	22.4	23.2
Excluding government assets held abroad	...	...	...	...	...
Including government assets held abroad	...	...	...	...	...
Money and Credit		*Changes in percent*			
Base money	2.2	32.4	28.8	-4.0	-9.3
Broad money	-3.5	34.1	14.5	7.7	9.5
Domestic credit to nongovernment	-6.7	21.7	26.9	13.3	7.1
Balance of Payments		*In percent of GDP*			
Trade balance (goods and services)	-11.3	-10.6	-11.9	-10.3	-5.6
Current account	-9.2	-10.2	-12.1	-11.2	-6.9
Gross international reserves (in millions of U.S. dollars)	834	1,063	1,460	1,242	1,297
Exchange Rate					
Exchange rate regime		*Currency Board Arrangement*			
Present		LTL 4 =US$1			
Real effective exchange rate (1995=100) 3/	114	132	142	160	...

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

1/ Program projections.

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

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

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

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News Brief No. 01/4
FOR IMMEDIATE RELEASE
January 10, 2001

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

IMF Completes First Lithuania Review

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Lithuania's performance under a 15-month, SDR 61.8 million (about US$81 million) stand-by arrangement. This opens the way for release of SDR 41.2 million (about US$54 million) from the arrangement, which the authorities, however, are not expected to request as they have treated the stand-by as precautionary.

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

"The Lithuanian authorities' strategy of achieving an orderly current account adjustment through fiscal tightening and structural reforms in the context of the currency board arrangement brought significant positive results in 2000—economic growth resumed while inflation remained low, the current account deficit declined faster than expected, confidence in the currency board was maintained, and financial markets stabilized. Growth was export-led, as competitiveness was sustained through productivity growth and terms-of-trade gains, despite a further real appreciation of the litas. Structural reforms advanced significantly, including in the areas of energy sector restructuring, privatization, trade policy, and budget and treasury management. However, domestic demand remained weak and unemployment continued to rise.

"Fiscal policy will continue to be the main instrument of economic policy under the currency board arrangement. Following the major consolidation in 2000, the program fiscal deficit target of 1.4 percent of GDP for 2001 is consistent with the authorities' macroeconomic objectives. The authorities plan to clear municipal arrears by mid-2001. They also plan to complete the treasury modernization project by early 2001, and to set up a reserve stabilization fund to manage privatization receipts in a transparent manner by end-March 2001.

"The authorities' goal of a cyclically balanced budget by 2003 will be instrumental in achieving a sustainable external position and bolstering confidence in economic policies. The achievement of this objective will require a significant restructuring of expenditure to accommodate increases related to possible EU and NATO accession, and pension reform.

"The currency board arrangement has served Lithuania well and will continue to anchor macroeconomic policies. The financial system remains stable and banking supervision is functioning well. The privatization of the remaining two state-owned banks will foster competition in the banking sector and should help promote sustainable credit growth to the private sector," Mr. Sugisaki said.

Statement by Åke Törnqvist, Alternate Executive Director
for the Republic of Lithuania
January 10, 2001

My Lithuanian authorities wish to thank the staff team for a fruitful dialogue and for balanced policy advice The program under the current SBA has contributed importantly to the substantial improvement of Lithuania's economic situation, as described in the comprehensive and well-written staff report. My authorities have requested that the report be published. Growth has resumed, and a major external adjustment has been achieved. Confidence in Lithuania's economic policies increased, leading to improved access to financial markets.

Economic developments and policies in 2000

The Lithuanian authorities had to conduct their economic policy under challenging conditions. Domestic demand was weaker than expected, and unemployment continued to rise, causing an erosion of the tax base. The necessary external adjustment had to be made under a real and nominal currency appreciation. The authorities' task was not made easier by the political changes associated with parliamentary and municipal elections.

In spite of the challenges, the program was implemented steadfastly by the previous government, and the new government, which took office in late October, has already demonstrated its commitment. The cornerstone of the program is fiscal adjustment. The results so far are characterized as impressive by the staff. The authorities did not hesitate to take difficult political decisions that were required to achieve the results. The initial general government fiscal deficit target for 2000 was not fully met, but there is agreement between the staff and the authorities that the large reduction of the budget deficit which has been achieved is adequate in view of a faster than expected external adjustment.

The stabilization effort was supplemented by substantial progress on the structural front. The staff talks about a breakthrough in the key areas of energy restructuring and privatization of telecommunications and banking. These developments were assisted by a strengthening of the political consensus on the need for structural reforms in response to the Russian crisis. The trade regime was liberalized and the WTO accession negotiations were completed.

Policies for 2001

The European Commission regarded Lithuania as a country with a functioning market economy in the last report on Lithuania's progress toward EU accession. Nevertheless, the key objectives of the new government are to strengthen the market economy functioning, and to promote sustainable economic growth. To this end, the government will continue to strengthen macroeconomic and structural policies and is fully committed to implementing the program.

Fiscal policy and budget management

Fiscal adjustment will continue to be the cornerstone of the program. The Seimas (Parliament) has adopted a tight budget for 2001, implying a general government fiscal deficit of 1.4 percent of GDP, in line with the revised program. The budget includes a wide range of measures with emphasis on the expenditure side. Among them are structural reforms aimed at strengthening the finances of the Social Insurance Fund (SoDra). These reforms are politically difficult, but the government is firmly committed to implementing them.

The government will continue its efforts in strengthening budgetary management, improving tax administration and revising tax legislation. To enhance the transparency and effectiveness of management of privatization proceeds, the government will set up a reserve stabilization fund, as recommended by a technical mission from the IMF.

In order to determine medium-term fiscal priorities, assess the impact of proposed tax reforms, address future expenditure pressures and seek ways to achieve the medium-term goal of a balanced budget, the Ministry of Finance will prepare a comprehensive study on tax reform and expenditure restructuring.

The government recognizes the importance of resolving the issue of non-payment by municipalities. The end-September 2000 performance criterion for reduction of general government expenditure arrears was not met, although the stock of expenditure arrears was significantly reduced each quarter. This was due to delays in arrears clearance by municipalities, which are autonomous from the central government, while executing their budgets. In order to speed up clearance of expenditure arrears in municipal budgets, the legal framework has to be improved. The government is submitting several proposals to the Seimas in this regard, but it is a sensitive issue that requires a political consensus.

Currency board

The currency board arrangement has served as an anchor for macroeconomic policies and will continue to do so. No changes in the current arrangement are envisaged during the program period. No further reductions of the minimum reserve requirements of the Bank of Lithuania are foreseen.

Structural reforms

Improving the business climate in Lithuania to promote investment is a priority for the new government. This will be done by reducing bureaucratic barriers for the establishment and functioning of private business, enhancing bankruptcy procedures and providing incentives for fair market competition. The government is also planning to increase labor market flexibility.

The government attaches great importance to the continuation of energy sector restructuring with a view to privatizing major energy companies. The Seimas has adopted an amendment to the Law on the Reorganization of the Lithuanian Power Company that will allow the restructuring and privatization of the company to proceed.

Financial sector reforms will continue. The government is determined to complete the privatization of the three state-owned banks. The new law on the Bank of Lithuania has been submitted to the Seimas, and is expected to be passed in February. Laws regulating capital markets and financial institutions will be submitted this year.

The Lithuanian authorities have put EU membership at the center of their economic and political agenda. The strategic objective of Lithuania for early integration into the economic structures of the EU has created an additional motivation for the expansion of the reforms. The challenges associated with EU accession overlap with those relating to the PSBA-supported program. In May 2000, the Lithuanian government and the European Commission signed a Joint Assessment of Economic Policy Priorities. This document, which is fully consistent with the program, outlines medium-term structural reform commitments of the government.

Both the Joint Assessment of Economic Policy Priorities and the Fund-supported program provide a solid external framework to domestic policies. The authorities highly value the support of the IMF, and are interested in continuing their cooperation with the Fund under a new arrangement. They are also interested in participating in the Financial Sector Assessment Program for 2001-2002.