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July 13, 1999

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Republic of Lithuania—Selected Issues and Statistical Appendix**

This paper provides background information to the staff report on the 1999 Article IV consultation discussions with the Republic of Lithuania, which was circulated as SM/99/170 on July 13, 1999.

Mr. Taube (ext. 38674) or Ms. Farahbaksh (ext. 34369) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Wednesday, July 21, 1999; and to the European Bank for Reconstruction and Development, the European Commission, the European Investment Bank, the Food and Agriculture Organization, the Organisation for Economic Cooperation and Development, and the United Nations Development Programme, following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Selected Issues and Statistical Appendix

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Approved by European II Department

July 13, 1999

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Lithuania: Basic Data

Social and demographic indicators (latest available data)	
Area (sq. km)	65,300
Population density (inhabitants per sq. km.)	56.68
Population (thousands)	3,701.3
Life expectancy at birth	
Men	65.0
Women	76.2
Infant mortality rate (per 1,000 births)	9.3
Hospital beds (per 1,000 inhabiants)	9.6
Physicians (per 1,000 inhabitants)	4.0

	1994	1995	1996	1997	1998
	(In percent of GDP)				
National accounts					
Domestic demand	106	112	110	111	112
Consumption	88	87	85	84	86
Gross investment	18	25	25	27	26
Current account balance	-2	-10	-9	-10	-12
GDP	100	100	100	100	100
	(Percentage change from previous period)				
Real GDP	-9.8	3.3	4.7	7.3	5.1
GDP (in millions of litai)	16,900	24,100	31,600	38,300	42,800
Consumer prices (end-period)	72.2	35.5	13.1	8.4	2.4
Real wages 1/	14.2	3.2	4.1	13.9	14.7
Labor market					
Total employment (thousands)	1,675	1,644	1,659	1,669	1,656
Of which: in state sector	645	600	555	539	517
Unemployment rate (in %) 2/	3.8	6.1	7.1	5.9	6.4
	(In millions of U.S. dollars)				
Balance of payments 3/					
Trade balance	-204	-698	-896	-1,147	-1,518
Current account balance	-94	-614	-722	-981	-1,298
	(Percentage change from previous period)				
Money and credit					
Broad money	63	29	-4	34	15
Credit to private sector	6	23	-4	19	17
Interest rate (in percent) 4/	29	26	15	12	17
	(In percent of GDP)				
General government finances					
Revenues	32.6	32.3	29.6	32.6	34.1
Expenditure and net lending	37.4	36.8	34.1	34.3	39.3
Financial balance	-1.2	-2.6	-2.5	-0.8	-4.3
Fiscal balance	-4.8	-4.5	-4.5	-1.8	-5.8

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

1/ Average wage deflated by consumer price index.

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

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

4/ Rates on 30-90 day credits. Data refer to end of period.

I. Introduction

This paper provides an overview of recent economic developments and policy issues as background to the staff report on the 1999 Article IV consultation with Lithuania.[2] It also includes updates for a number of statistical tables published in the IMF Staff Country Report No. 98/92.

- Economic developments in Lithuania recently have been dominated by a major slowdown in growth, in large part reflecting the adverse impact on exports following events in Russia in August 1998. Chapter II discusses macroeconomic developments and policies in detail.

- In the context of Lithuania's currency board arrangement, fiscal policies form the linchpin of macroeconomic policies. Taking a forward-looking perspective, Chapter III discusses the importance of fiscal prudence in maintaining sustainable fiscal and external positions over the medium term, and emphasizes that reining in budgetary spending will be a key challenge in the period ahead.

- Lithuania's sizeable current account deficit has raised questions about the adequacy of external competitiveness, especially against the background of the substantial real appreciation of the litas (which has been pegged to the U.S. dollar since 1994). Chapter IV reviews external competitiveness and concludes that Lithuania's competitiveness has remained adequate through early 1999, although there remains little room for further real appreciation and wage rises that are not related to productivity increases.

- During the first six years after regaining independence, Lithuania generally made impressive progress in structural reforms and the transition to a market economy. More recently, however, structural reforms in some areas have lost momentum and retrograde measures have been taken in a few areas following the Russia crisis, although good progress has been registered in privatization and competition policies. During the second half of 1998 and early 1999, the government has continued, or stepped up, direct and quasi-fiscal support to enterprises and certain sectors (notably, agriculture and energy). Chapter V provides an overview of progress in structural reforms, which should also be seen in the context of Lithuania's aspirations to become an EU member (Appendix II provides an overview of the status of Lithuania's EU membership bid).

- Lithuanian banks have recovered from the 1995/96 crisis; the economy is (slowly) remonetizing, there has been progress in bank consolidation, bank supervision and prudential regulation have improved considerably, and foreign participation in the financial sector has increased. Moreover, banks have weathered the Russia crisis relatively well due to their

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[2]This staff report is expected to be published in the context of the pilot project on releasing Article IV consultation reports.

limited direct exposure, although there are concerns about the increasing share of foreign-exchange denominated lending and the quality of credits provided to enterprises affected by export shortfalls and the slump in private domestic demand. Chapter VI gives an overview of the financial sector, with particular focus on prudential regulations.

II. Recent Economic Developments

A. GDP, Prices, and the Labor Market

1. Following strong real GDP growth in 1997 and the first half of 1998, Lithuania's **growth performance** suffered a serious setback in the second half of 1998 and early 1999.[3] This reflected primarily the impact of the crisis that erupted in Russia in August 1998. The reverberation of events in Russia on the Lithuanian economy have proven to be stronger than originally expected. The main mode of transmission has been through exports, which weakened economic growth considerably (see below). Agriculture, food processing, manufacturing, and transportation services were among the sectors most severely affected. Following the decline in exports, private domestic demand weakened notwithstanding an increase in government spending, further contributing to the slowdown in economic activity, especially in early 1999.

2. For 1998 as a whole, **real GDP growth** remained high at 5 percent, following 7.3 percent real growth in 1997. However, real GDP growth fell to close to zero year-on-year in the last quarter of 1998 and turned negative (-5.7 percent) in the first quarter of 1999 (Table 1). Data on external trade and industrial sales for April and May 1999 do not suggest that a recovery was under way in the second quarter of 1999.

3. **Inflation** remained low. Consumer prices rose by 2.4 percent during 1998 and as little as ½ percent during the 12 month period through June 1999 (Table 1). These trends reflected low or declining food prices as supplies were redirected from Russia to the domestic market, the appreciation of the litas (which is pegged to the U.S. dollar) against the West European currencies, and softer domestic demand. Producer prices declined by about 8 percent during 1998, and continued to fall the first two months of 1999, but rose moderately during the period March–May 1999, largely reflecting variations in prices of refined petroleum products.

4. **Wage and unemployment trends** over the past 1–1½ years provide evidence for the large degree of flexibility in the Lithuanian labor market. **Wage growth** had been very strong in 1997 and the first half of 1998, peaking at 32 percent year-on-year in January 1998, but slowed subsequently as the economy cooled down, to less than 8 percent in May 1999 (Table 17). Across sectors, growth in average wages was highest in health and education and lowest in agriculture during 1998 (Table 18). The official minimum wage rose by less than

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[3]For an analysis of developments prior to 1998, see IMF Staff Country Report No. 98/92.

8 percent in 1998. Recorded **unemployment** reached its highest post-independence level of 8½ percent in March 1999 before easing slightly, because of seasonality, to 7½ percent in June. (Labor market surveys indicate that the actual level of unemployment may be twice as high.) The structure of employment continued to shift further toward self-employment during 1998, while the shares of both formal private sector employment and public sector employment fell.

B. The Balance of Payments

5. The **current account** deficit widened during 1998, reaching 12 percent of GDP for the year as a whole (Table 22). The decline in exports, reflecting the impact of the crisis in Russia, was more pronounced than the fall in imports, especially during the latter part of 1998. During the first quarter of 1999, the current account deficit decreased to 9½ percent of GDP, as import demand weakened further. For 1998 as a whole, **recorded exports** dropped by 5½ percent, with large differences between the rates of growth for exports to CIS and non-CIS countries. Exports to the CIS, which had already started to show weaknesses in the second quarter of 1998, were 50 percent lower in the second half of 1998 compared with the same period a year earlier.[4] The decline in recorded exports in 1998 in large part reflected lower re-exports to CIS markets; excluding such re-exports, overall exports fell only by ½ percent.[5] By contrast, exports to the EU continued to grow strongly (at around 12 percent) in 1998. **Imports** grew only marginally during 1998, masking large differences in growth rates between the first and the second half of the year (plus 10 percent and minus 4 percent, respectively), reflecting also the impact of the crisis in Russia. Imports from the EU rose by 11 percent, and the share of the EU in total imports rose to more than 50 percent in 1998, providing further evidence of redirection of trade toward the West. The share of CIS imports dropped to less than 25 percent in the second half of 1998 (from 33 percent and 29 percent in 1996 and 1997, respectively).

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[4]As a consequence, the shares of export to the CIS declined markedly, from 46 percent in 1997 to 27 percent in the second half of 1998 and 21 percent in the first quarter of 1999. Agricultural exports (especially meat and dairy products) were most affected.

[5]Measurement problems may understate Lithuania's exports considerably, and it is possible that such understatement increased during 1998 as traders sought to evade customs duties levied by Russia. Underreporting of exports could explain a significant or substantial share of the relatively large positive errors and omissions items in the Lithuanian balance of payments in 1998 and previous years. Although trade data used in the balance of payments are adjusted to some extent to capture unrecorded exports, the adjustment may be inadequate. For example, staff estimates show that unrecorded exports of second-hand cars may have amounted to as much as US$100 million in 1998, compared with about US$60 million in 1997. Other factors that could explain the large positive errors and omissions include under-reporting of private transfers and financial inflows.

Table 1. Lithuania: Key Economic and Financial Indicators, 1995-99

	1995	1996	1997	1998	1999 Act./Est. 1/
	(Percentage changes from previous period)				
Real GDP	3.3	4.7	7.3	5.1	-5.7
Consumer prices					
Period average	39.5	24.7	8.8	5.1	2.4
End of period	35.5	13.1	8.4	2.4	0.6
Broad money	29.0	-3.5	34.1	14.5	20.1
Reserve money	35.0	2.2	32.4	28.8	15.9
Credit to private sector	23.0	-4.4	18.9	16.9	19.0
Currency in circulation	42.9	-0.4	33.5	10.4	13.7
Velocity of broad money	4.8	6.5	6.1	5.4	4.4
Money multiplier 2/	2.3	2.2	2.2	2.0	2.2
Deposit interest rate 3/	17.6	10.6	6.2	7.1	7.3
Lending interest rate 3/	26.2	14.7	12.2	16.7	15.9
	(Percent of GDP)				
Gross national saving	14.5	15.3	16.3	13.4	...
General government	2.4	0.2	2.0	-1.0	
Non-government	12.1	15.2	14.4	14.4	..
Gross investment	24.7	24.5	26.5	25.5	...
General government	3.8	2.7	2.7	2.7	...
Non-government	20.9	21.8	23.9	22.8	..
General government financial balance 4/	-2.6	-2.5	-0.8	-4.3	-7.0
General government net lending	1.9	2.0	1.0	1.5	-0.3
Consolidated general government fiscal balance 4/	-4.5	-4.5	-1.8	-5.8	-6.7
External current account balance (incl transfers)	-10.2	-9.1	-10.2	-12.1	-9.6
External debt 5/	13.7	21.3	25.7	26.3	...
Debt service (in percent of exports of goods and services)	2.5	8.1	10.6	17.3	...
	(In millions of litai at current prices)				
Gross domestic product	24,103	31,569	38,340	42,768	8,936
	(In millions of U.S. dollars)				
Gross domestic product	6,026	7,892	9,585	10,692	2,234
Current account (inc. transfers)	-614	-722	-981	-1,298	-1,179

Sources: Department of Statistics, Bank of Lithuania, and Fund staff estimates and projections.

1/ National accounts, budget, and current account data are preliminary actuals for the first quarter; monetary data are actuals for May, and inflation data are actuals for June.

2/ Level in final quarter of calendar year.

3/ In percent, weighted average of rates at commercial banks in December; 1-3 months' maturity

4/ 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 numbers. Also includes savings restitution payments.

5/ Includes public, publicly guaranteed, and private external debt

6. The balance of **net factor incomes** was negative in 1998, reflecting increased payments on external loans and profit remittances. By contrast, the **nonfactor services balance** improved in 1998, boosted by tourism and business services receipts, while the surplus in transfers remained broadly unchanged compared with 1997.

7. In the **financial and capital account** of the balance of payments, 1998 witnessed a sharp increase in foreign direct investment inflows, which covered about three-fourths of the current account deficit. Total FDI inflows amounted to more than US$S900 million and included receipts of US$510 million (almost 5 percent of GDP) from the sale of 60 percent of the shares of Lietuvos Telekomas to strategic Scandinavian investors. Foreign borrowing by the private sector, including trade credits, was lower than in 1997, while public sector borrowing continued to remain high. Specifically, the government returned to the Eurobond market relatively quickly after the Russian crisis, with two small bond issues in November and December 1998. This was followed by placement of a five-year euro 200 million bond issue in March 1999, at 475 basis points over the German bond with the same maturity.[6] Overall, the accumulation of external debt slowed compared to 1997 and the maturity structure remained favorable. In spite of the large current account deficit, the stock of private and public sector external debt increased moderately from 25½ percent of GDP at end-1997 to 26½ percent at end-1998.

8. Various indicators suggest that Lithuania's **external vulnerability** increased in the second half of 1998 in the aftermath of the crisis in Russia and tensions in other emerging markets. The current account deficit widened toward the end of 1998, external debt continued to rise, and access to foreign financing became more costly. However, subsequent developments suggest that external vulnerability has declined (Tables 31 and 32). In general, external competitiveness has remained adequate,[7] and export growth to Western markets has remained strong. The yield spread between Lithuania's 1997 Eurobond and the equivalent U.S. bond, which had risen sharply after the Russia crisis in mid-1998 to more than 700 basis points, fell back to less than 400 basis points in early June 1999. Short-term external financing during 1998 remained low, leaving Lithuania with a relatively small stock of short-term debt (slightly more than 2 percent of GDP). International reserves rose by US$400 million to almost US$1.5 billion at end-1998, improving the reserve coverage relative to short-term external debt and reserve money to 600 percent and 140 percent, respectively.

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[6]In early July 1999, the government placed a three-year euro 50 million Eurobond at 374 basis points over the five-year German bond.

[7]Chapter IV provides a detailed analysis of external competitiveness.

C. Fiscal Developments

9. Fiscal performance deteriorated considerably over the course of 1998, reflecting primarily large increases in budgetary expenditures and onlending operations, which were mostly financed through privatization proceeds.[8] The **fiscal deficit** rose sharply from 2 percent of GDP in 1997 and to 5¾ percent of GDP in 1998 (Tables 26 and 27).[9]

10. Overall **revenue performance** remained favorable during 1998; tax and nontax proceeds rose from 32½ percent of GDP in 1997 to 34 percent of GDP in 1998. This was primarily due to strong growth in **direct tax** collection. Specifically, payroll and personal income tax revenue increased markedly, accounting for 55 percent of total general government revenues in 1998 (Table 28). Officially recorded unemployment did not increase before early 1999, and growth of average wages remained relatively strong, especially relative to GDP, throughout 1998, which resulted in strong revenue growth from the personal income and payroll taxes. By contrast, revenue from the corporate profit tax continued to decline as a share of GDP (1.4 percent in 1998), primarily reflecting greater use of deductions again tax liabilities (e.g., reinvested profits).[10] Despite the strong performance of payroll tax revenues, SoDra's deficit increased by about LTL 120 million (0.3 percent of GDP) during 1998.

11. **Indirect revenue** collection remained broadly stable as a share of GDP in 1998, but fell short vis-à-vis budgetary targets. Despite increased excise tax rates, revenue collection did not increase relative to GDP in 1998. VAT revenue began to weaken in the last quarter of 1998, reflecting the slowdown in the economy. Other revenue, which is derived from property taxation, trade taxes, and other sources (e.g., dividends, fees, fines and penalties), remained broadly stable in 1998.

12. With the exception of increased excise tax rates, **tax policy** remained broadly unchanged during 1998 and the first quarter of 1999 (Appendix I provides a summary of the tax system). Tax revenue collection was boosted by improvements in **tax administration** in 1998, including through better information sharing between the Social Insurance Fund

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[8]The government extended a loan of US$64 million (½ percent of GDP) to the Mazeikiai oil refinery in September 1998, when a foreign lender exercised a put option following the Russian crisis. This loan was rolled over in December 1998 and March 1999. For further details on government support to enterprises see Chapter V.

[9]The IMF definition of the general government includes the state and local governments, as well as extra-budgetary funds such as the social insurance fund (SoDra), the Health Insurance Fund, and the Privatization Fund. The receipt of privatization proceeds is counted as financing, while the spending of such proceeds is counted against the deficit. On this basis, the original budget for 1998 had targeted a fiscal deficit of 3 percent of GDP.

[10]The effective corporate income tax rate has dropped sharply during the past five years.

(SoDra) and the State Tax Inspectorate (STI), closer collaboration between the STI and the Tax Police, concentration of payroll tax collection at SoDra's headquarters, and streamlining of regional tax services. Aiming at a further reduction in tax evasion and contraband activities, the government established an anti-smuggling committee in early 1999.

13. **Current expenditure** increased sharply during 1998, as privatization proceeds were used to finance various government programs, including subsidies to households, support for agricultural and other enterprises, and payments under the Savings Restitution Plan (SRP).[11] Also, outlays on unemployment benefits rose during the second half of the year, weakening the financial position of SoDra. The general government wage bill increased substantially, from 8¾ percent of GDP in 1997 to 10 percent of GDP in 1998. **Capital expenditures**, by contrast, remained below 3 percent of GDP in 1998.

14. In 1998, **the fiscal deficit was financed in large part through foreign borrowing and large privatization proceeds** (from the sale of Lietuvas Telekomas). The government issued Eurobonds equivalent to about LTL170 million in the last quarter of 1998, while around LTL350 million of foreign loans were disbursed during the year as a whole to finance the implementation of capital projects. A substantial part of gross privatization proceeds (totaling approximately LTL 2.3 billion or 5.3 percent of GDP) was used to finance current outlays, onlending operations, and the SRP.

15. The **fiscal deficit in the first quarter of 1999** amounted to 7 percent of period GDP, reflecting a significant weakening in revenue performance due to the crisis in Russia and the slowdown in economic activity, as well as further large SRP payments and net lending operations.[12] Revenue collection from the payroll and personal income tax slumped because of the deceleration in wage growth and rising unemployment. This resulted in a further deterioration of SoDra's financial position, as a deficit of LTL 150 million (1.7 percent of period GDP) was incurred. At the same time, VAT and excise tax revenue proceeds were lower than targeted under the budget because of the decline in imports and the slowdown in domestic activity. The fiscal deficit in the first quarter of 1999 was financed through privatization proceeds and foreign borrowing.

D. The Currency Board and Monetary Developments

16. The **currency board arrangement** has withstood pressures related to the crisis in Russia and tensions in other emerging markets during 1998 and in early 1999. Following the crisis in Russia, the Lithuanian authorities have halted implementation of their strategy to exit

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[11]The SRP compensates losses that State Bank depositors suffered during the hyperinflation in 1991-92.

[12]During the period February-April 1999, the government made SRP payments to households in the amount of LTL 900 million (approximately 2 percent of projected annual GDP).

the currency board over the medium term. For the time being, the authorities are determined to maintain this arrangement at the present exchange rate, and to lay out future exchange rate and monetary policies in a new Monetary Policy Program that will be drawn up in late 1999.

17. Under the currency board arrangement, Lithuania continued to benefit from large **foreign exchange inflows** through the middle of 1998. This was followed by sizeable **net sales of foreign exchange** to the banking system in the wake of the Russia crisis.[13] Through the automatic functioning of the currency board arrangement, these outflows initially led to an increase in interest rates, which was moderated from October 1998 onwards as the *government injected liquidity by using privatization proceeds held at the Bank of Lithuania* (BOL).[14] Also, interest rate spreads increased in the wake of the Russia crisis.[15] Throughout 1998 and the first five months of 1999, the foreign exchange coverage under the currency board remained comfortable, and stood at about 140 percent of litas liabilities at end-May 1999.

18. The **remonetization** process following the 1995/96 banking crisis has continued during 1998 and the first five months of 1999. Broad money grew by 14½ percent in 1998, while velocity fell from 6 at end-1997 to 5½ at end-1998.[16] Credit to the private sector grew by almost 20 percent in 1998, although it slowed somewhat in the second half of the year as banks became more cautious in their lending to enterprises following the crisis in Russia. Remonetization continued during the first five months of 1999, and growth in credits to the private sector began to accelerate again in March 1999. The BOL sought to moderate the liquidity impact of the use of privatization proceeds for SRP payments by stepping up the use of deposit auctions.[17] The government issued three savings bonds for the same purpose.

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[13]These were halted temporarily in December because of foreign exchange inflows of about US$55 million related to the purchase of a one-third stake in Vilnius bank, the largest commercial bank, by a Swedish bank. For details on developments in the banking system see Chapter VI.

[14]Interest rates on three-month treasury bills rose from 8¾ percent in July to 13⅓ percent in October 1998; they have since fallen back to about 10 percent. The average annual interest rate on loans with 1-3 months maturity rose from 12 percent in July 1998 to 19 percent in February 1999, before dropping to 13 percent in May 1999.

[15]A detailed analysis of interest rate developments is provided in Chapter VI.

[16]However, the degree of monetization of the economy remained low as broad money as a share of GDP stood at 20 percent at the end of 1998 (these shares were 28 percent in Estonia and 25 percent in Latvia).

[17]In addition to the deposit auctions, the BOL's monetary policy instruments include a

(continued...)

III. MEDIUM-TERM FISCAL ISSUES

19. A restrained fiscal policy will be essential in preserving a sustainable external position and preventing an excessive accumulation of public debt. This will be a challenging task over the next several years and require a careful assessment of expenditure priorities. Spending pressures will arise from the medium-term policy objective of European Union (EU) and NATO accession, the continuation of the Savings Restitution Plan, greater need for social transfers because of structural unemployment and the rising demand for old-age pensions, and land restitution. Moreover, fundamental reforms will be needed to avoid increases in implicit and explicit subsidies to public and quasi-public enterprises, notably in the energy and agricultural sectors. Given the need to close the fiscal gap, there is also limited latitude for government revenue reductions. This chapter discusses fiscal issues in a medium-term perspective. Sections A and B examine revenue and expenditure prospects and policies, respectively. These sections also highlight the reform agenda, and discuss measures that could be taken in order to ensure a sustainable fiscal position over time. Section C examines overall fiscal objectives from the perspectives of fiscal sustainability and external adjustment.

A. Revenue Prospects and Policies

20. The main factors that will affect revenue are the government's tax policy strategy, the growth performance of the economy, and the ability of the authorities to capture the revenue yield from the base. On current policies, the tax base is likely to shrink in the short-term because of economic slowdown. However, revenue would be expected to recover as economic growth resumes. It will also be affected by planned tax rate changes[18] and improvements in tax administration. Taking into account these factors, total revenue is projected not to change much as a share of GDP between 1999 and 2004. On balance, planned changes in tax rates would contribute to a 1 percentage point of GDP decline in overall revenue from 1999 to 2004, but this would be offset by a similar increase in revenue intake because of a projected increase in the tax base in relation to GDP and strengthening of tax administration.

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[17](...continued)
Lombard facility (primarily intended for overnight clearing purposes), repurchase operations, and reserve requirements.

[18]The government's tax policy strategy is guided by its medium-term objective of accession to the EU, which would require harmonization of taxation laws with EU directives, as well as the authorities' view that high tax rates are obstacles to growth and conducive to tax evasion.

21. The government plans to introduce a number of changes to the **tax system**, including: (i) reduction in the Corporate Income Tax (CIT) as of 2000, from 29 percent to 24 percent;[19] (ii) reduction in the Personal Income Tax (PIT) from the current level of 33 percent to 31 percent as of 2001 and 25 percent as of 2002, and unification of the PIT rate across most categories of incomes; (iii) introduction of a new real estate tax for properties above a certain nominal value; and (iv) increases in excise rates that would bring the rates in line with those of the EU (for example, excise rates on cigarettes and diesel fuel are scheduled to increase to 56 percent and 32 percent, respectively by 2001).

22. The main elements contributing to an expected reduction in overall revenue in 1999 are the declines in the **tax bases** for VAT and excises low growth in retail sales, in payroll tax due to declining wage growth, and income tax owing to an increase in unemployment. The medium-term scenario envisages some increases in these tax bases in relation to GDP with the turnaround in the economy. Also, tax policy changes will affect the tax bases. Specifically, the government has under consideration extending tax breaks to families with children, while, on the other hand, expanding the tax base to include farmers, lottery gains, interest gained on deposits, and dividends paid out to individuals. Also, the revenue intake may be helped by the revoking of all VAT preferences that are not applied in the EU.

23. Some revenue gains should follow from the ongoing strengthening of **tax administration**. In 1998 and early 1999, the authorities have taken steps that will likely result in enhanced tax collection, including the formation of an anti-smuggling unit and improvements in its information systems. The State Tax Inspectorate plans to increase staff training and improve its auditing process. Efforts also are underway to improve the revenue collection of the Customs Department, which is in charge of collecting revenues from the VAT, excises, and trade taxes. The STI in conjunction with the Labor Inspectorate, the Tax Police, and the Social Insurance Fund (SoDra) are coordinating efforts to increase the revenue intake from the payroll tax.

24. A goal of the government is to gradually reduce the burden of the government on the economy, by bringing down labor and capital taxes in the medium term. However, a comparison with other countries suggests that the current tax burden in Lithuania is lower than that of the OECD and Central European transition economies (Table 2). By international standards, marginal labor and capital tax rates and social security contribution rates are low in Lithuania (Tables 3 and 4). These considerations suggest that lowering of tax rates should not be a priority in the period ahead. Indeed, given the government's aim to close the fiscal gap and the expenditure needs discussed below, there is limited latitude for revenue reductions, and any tax reforms should be designed with a view not to reduce the revenue intake. One

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[19]The recent decline in the CIT effective tax rate is noteworthy, from 15 percent in 1994 to 7 percent in 1998, against a statutory rate of 29 percent. Greater use of deductions against CIT liabilities, specifically, exemptions of reinvested profits from taxes, are in part responsible for the decline in the effective CIT rate.

possible approach would be to leave the PIT and the CIT rates unchanged, which could result in an increase in revenue by about 1½ percentage point of GDP between 1998 and 2004.

B. Expenditure Prospects and Issues

25. Over the medium term, total expenditure could increase by as much as 3 percentage points of GDP, driven by a number of factors:

- The **upgrading of military defense** as part of the bid to become a NATO member is likely to entail significant budgetary costs.

- The **accession process to the EU** is expected to take several years, and will require implementation of the policies and programs identified in the *Accession Partnership* that was approved by the European Union on March 1998 (see Appendix II). Over the medium term, budgetary costs are likely to increase further due to the required increase in public sector investment on infrastructure, and restructuring of the energy sector. The recurrent expenditure burden on the budget is also likely to increase, reflecting the need to comply with EU standards and the creation of the necessary legal and institutional preconditions for EU membership.

- Based on the current policies, the government will continue to **compensate individuals for savings lost** at the start of the transition process.[20]

- As part of the **land reform and farm restructuring process**, restitution of land ownership and the settlement of claims is scheduled to re-start in 1999.

- **Social transfers** paid through the social insurance fund (SoDra), in the form of old-age, disability, and survivors pensions, unemployment and retraining benefits, family benefits and social assistance to low-income families, are expected to increase over time due to higher unemployment benefits, retraining benefits, and old-age pensions.

- The fiscal burden of the **pension system** is likely to grow. The system support ratio, defined as the number of contributing workers per pensioner was 56 percent in 1996 and is expected to decline rapidly, as employment growth lags the increase in pensioners. Meanwhile, the increase in the share of self-employed in the labor force is likely to reduce the average payroll contributions, since the self-employed are eligible for the full pension and only pay for the basic pension.

[20] According to the Savings Restitution Law, two-thirds of privatization proceeds are earmarked for restitution of savings lost by individuals to hyperinflation in the early transition period.

- Fundamental **reforms of enterprises in the energy and agriculture sectors**, are needed to avoid increases in subsidies. Both the Lithuanian Gas Company (LGC) and the Lithuanian Power Company (LPC) face financial difficulties. Significant cash injections may be required for the LPC to meet its financial obligations. Meanwhile, Lithuania may have to close the Ignalina nuclear power plant for safety reasons, which may entail large budgetary costs on top of any bilateral assistance for this purpose.[21] Regarding the agricultural and agro-processing sectors, the various support programs for export subsidies on agricultural goods, which was increased in the second half of 1998 in the wake of the Russian crisis, is expected to remain in place at least until end-1999. These subsidies are channeled in part through the Rural Support Fund, Market Support and Export Promotion Agency, Agriculture Guarantee Fund and Marketing Regulation Agency.

- **Public investment** would need to increase by at least 1 percentage point of GDP over the medium term, mainly in priority areas, including energy, transport, and environmental protection, reflecting in part the preparation of for EU and NATO membership.

26. This overview shows that the achievement of overall fiscal objectives will require a careful assessment of expenditure and its composition, and will involve difficult choices. A rationalization of the size, staffing, and functions of the general government would help improve efficiency, reduce the government work force, and lead to saving in the medium term. Meanwhile, streamlining of social benefits and increased allocations for means-tested social benefits would help improve the targeting of transfers. The long-run sustainability of SoDra can be addressed by increasing the pension eligibility age and changing the indexation mechanism to keep pensions within available resources. Reform of the social system could be supplemented by the introduction of a three-tier pension system, including private pension schemes, as is envisaged by the newly approved Law for Private Pensions.

27. Expenditure management could be helped through a number of structural reforms. These include the approval of the revised Budget Law that will be presented to Seimas shortly that would, among other things, (i) incorporate extrabudgetary funds—including the Privatization Fund, but excluding the Health Insurance Fund and SoDra—in the budget by 2002; and (ii) set limits on line ministries' end-year spending and includes carry-over provisions, to avoid the end-year spending surge that has complicated budget management in recent years. Also, reforms of the energy sector would help reduce both implicit and explicit government subsidies. Such reforms could include the liberalization of the energy prices, privatization of parts of the LPC and LGC, removal of energy subsidies, and improved corporate governance.

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[21]Ignalina is the world's largest RBMK (Chernobyl-style) facility, producing enough energy to supply has 80 percent of the local market.

C. Fiscal Objectives and Sustainability

28. Several objectives would guide fiscal policy in the years ahead. First, the authorities' overriding short-term objective is a reduction in the current account deficit. Recognizing that fiscal policy is a key instrument for achieving external adjustment in the short run, the authorities adopted a balanced budget for the national government for 1999 and intend to do the same for 2000.[22] Second, actions will be needed to ensure a sustainable government debt position, a sustainable fiscal position is traditionally judged in terms of the criterion of stabilizing net public debt in relation to GDP at a level that does not require excessive interest cost.[23] As long as the real interest rate on public debt exceeds real GDP growth rate, a primary fiscal surplus would be required to offset the growth in the debt ratio induced by interest payments.[24] The larger the wedge between the interest rate and the real GDP growth rate, the larger the primary surplus needed to stabilize the debt-to-GDP ratio. This implies that a country for which the primary balance is negative, such as Lithuania, will need to undertake fiscal consolidation in order to stabilize the public debt ratio.

29. A mechanical medium-term projection—based on annual real GDP growth of 5–6 percent, annual inflation of 2–3 percent, an annual nominal interest rate of 10 percent on

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[22]The Fund's definition of the general government includes the state and local governments, as well as major extra-budgetary funds, notably the Social Insurance Fund, the Health Insurance Fund, and the Privatization Fund. Also, the Fund's definition of the fiscal deficit counts privatization receipts as financing and the use of privatization proceeds on government outlays (including for savings restitution) against the deficit. Under this definition, the fiscal position in 1999 and 2000 will be in deficit to the extent that the government undertakes net lending operations and spends privatization proceeds on off-budget items.

[23]The government has adopted a debt-based rule that requires that total debt public debt and external government debt do not exceed 24 percent and 16 percent of GDP, respectively, by 2001. As Lithuania is aiming for EU membership, the Maastricht criteria relating to fiscal policy may also be relevant, requiring the authorities to maintain the general government fiscal deficit under 3 percent of GDP, and the debt stock below 60 percent of GDP.

[24]The change in nominal government debt evolves over time according to the following equation: $\Delta d = -p + (r - g)\, d_{t-1} / (1 + g) + a$, where d is the ratio of stock of debt to GDP in period t, p is the primary balance (i.e., before interest payments) to GDP, r is the real interest rate on government debt, g is the real GDP growth rate, and a is the ratio of other items that affect government indebtedness, such as privatization receipts and seigniorage.

domestic debt and 8 percent on foreign debt, respectively, and primary fiscal deficits based on current policies as described above[25]—suggests that the annual fiscal deficits could be as high as 5 percent of GDP over the medium term, and that the public debt stock could rise to over 30 percent of GDP by 2004 and continue rising thereafter. Interest payments would increase from 1.2 percent of GDP in 1998 to 3.2 percent in 2004. This underscores that the debt-to-GDP ratio may not be on a sustainable trajectory, and that interest payments are likely to exert excessive pressures on the budget. Under these conditions, real GDP growth would slow down, further exacerbating the problem. Also, this scenario may not be consistent with the government's own debt strategy. In sum, major fiscal measures are needed to limit the government debt-to-GDP ratio over the medium term.

30. The size of the fiscal adjustment needed depends upon the level of public debt considered sustainable. A fiscal deficit of 4½–5 percent of GDP in 1999 and 0–1 percent of GDP in 2000 followed by a fiscal balance in subsequent years would be consistent with reducing the debt-to-GDP ratio gradually over the medium term (Table 5). Given the medium-term spending pressures discussed above, it will be important to achieve fiscal adjustment early on. The need for fiscal adjustment in the short term is further reinforced by the importance of reducing the current account deficit. In this context, external sustainability would require a significant up-front fiscal correction, since structural reforms needed to increase non-government saving take time to have the desired effect.

[25]The projections also assume that the oil refinery complex will be privatized in 1999, while the state-owned banks, (the Savings Bank and the Agricultural Bank) will be privatized in 2000, with the proceeds assumed to be coming in gradually.

Table 2 . Comparative Levels of Tax Revenue: Selected OECD Countries and Lithuania 1/
(In percent of GDP)

	Total	Income and Profits	Social Security/ Payroll	Goods and Services	Property and other
CEE countries					
Czech Republic	40.5	9.5	17.0	13.5	0.5
Hungary	40.3	9.0	13.5	16.8	0.6
Poland	42.1	12.4	13.1	15.0	1.2
Slovak Republic	40.6	11.2	14.6	...	...
Slovenia	45.2	7.7	16.6	...	...
OECD countries					
Canada	36.8	17.4	6.0	9.1	3.8
Mexico	16.3	4.1	2.5	4.9	3.1
United States	28.5	13.5	7.0	4.9	3.1
Australia	31.1	17.5	2.1	8.7	2.8
Japan	28.4	10.4	10.4	4.4	3.2
New Zealand	35.8	21.1	0.3	12.3	2.0
Denmark	52.2	31.4	1.6	17.1	1.7
France	45.7	8.2	19.7	12.5	2.3
Germany	38.1	10.8	15.5	10.6	1.1
Ireland	33.7	13.8	4.5	13.4	1.6
Italy	43.2	14.9	14.8	11.2	2.3
Netherlands	43.3	11.7	17.1	12.4	1.9
Norway	41.1	15.0	9.6	15.6	0.9
Portugal	34.9	10.0	9.0	14.9	0.9
Spain	33.7	9.8	12.1	9.8	1.9
Sweden	52.0	21.3	15.5	11.8	2.0
Switzerland	34.7	13.1	13.0	6.2	2.4
Turkey	25.4	6.7	4.0	9.7	0.5
United Kingdom	36.0	13.2	6.2	12.7	3.8
Lithuania (1996)	29.6	8.5	8.3	2.9	9.9
Lithuania (1998) 2/	32.9	7.0	12.4	11.6	1.9
OECD Total	37.7	13.4	9.8	12.0	1.9
OECD Europe low tax regime 3/	34.6	12.0	9.0	11.4	2.1

Sources: OECD, Revenue Statistics, 1965-97; and Fund staff estimates.

1/ 1996 data unless otherwise specified.

2/ From 1997 contributions to the Health Insurance Fund are reclassified from income tax to payroll tax.

3/ Unweighted average of United Kingdom, Spain, Portugal, Ireland and Switzerland.

Table 3. Lithuania: Top Marginal Personal Income Tax and Corporate Income Tax Rates for Selected Countries, 1997

	PIT Rate	CIT Rate
OECD-22 average [1/]	43	...
OECD-7 average [1/,2/]	49	...
Bulgaria	50	56
Czech Republic	40	39
Estonia	26	26
Hungary	42	18
Latvia [3/]	25	25
Poland	44	38
Romania [4/]	60	38
Slovak Republic	42	40
Slovenia	50	25
Ukraine	40	30
Lithuania	33	29

Sources: Deloitte Touche Tohmatsu International (1997) and Owens (1997).

1/ Based on data for 1995.

2/ United States, Japan, Germany, France, Italy, United Kingdom, and Canada.

3/ Flat rate that applies to all taxable income.

4/ Salary tax.

Table 4. Lithuania: Social Security Contribution Rates for Selected Countries, 1997 1/

Country	Employers	Employees	Total
Bulgaria	42.0	12.0	54.0
Czech Republic	36.0	12.5	37.5
Estonia	...	...	33.0
Hungary 2/ 3/	43.0	11.5	54.5
Latvia	28.9	8.1	37.0
Poland	48.2	--	48.2
Romania	30.0	4.0	34.0
Slovenia	15.9	22.1	38.0
Lithuania	22.5	1.0	23.5

Source: Deloitte Touche Tohmatsu International (1997).
1/ All contributions are made on gross salaries unless otherwise indicated.
2/ Employers also pay a fixed contribution of Ft 3,600 per employee
3/ Employers contributions are based on gross salaries and other remuneration paid.

Table 5.: Lithuania: Medium Term Fiscal Framework

	1996	1997	1998	1999	2000	2001	2002	2003	2004
				Projections					
				(In percent of GDP)					
Total revenue	29.6	32.6	34.1	34.3	35.0	35.3	35.4	35.6	35.7
Tax revenue	28.8	31.9	33.5	33.4	34.2	34.5	34.5	34.7	34.8
of which:									
Income and profits 1/	8.5	6.7	7.0	6.8	6.9	6.8	6.8	6.8	6.8
Profit	1.9	1.6	1.4	1.1	1.0	1.0	1.0	1.0	1.0
Income	6.6	5.1	5.7	5.7	5.8	5.8	5.8	5.8	5.8
Payroll tax 1/	8.3	11.5	12.9	13.0	13.5	13.6	13.7	13.8	13.9
Excises	2.6	3.0	3.1	3.2	3.2	3.3	3.3	3.3	3.3
VAT	7.2	8.7	8.4	8.6	8.7	8.7	8.7	8.7	8.7
Non-tax revenue	0.8	0.7	0.7	0.9	0.9	0.9	0.9	0.9	0.9
Expenditure and net lending	34.2	34.3	39.3	39.0	35.9	35.3	35.4	35.6	35.7
Expenditure	32.2	33.3	37.9	39.0	36.3	35.7	35.4	35.6	35.7
Current expenditure	29.4	30.7	34.1	34.4	32.6	32.0	32.1	32.1	31.9
of which:									
Wages and Salaries 2/	9.6	8.7	9.9	10.5	10.0	10.2	10.3	10.4	10.4
Goods and services 2/	7.7	9.7	11.9	11.5	11.1	10.4	10.4	10.3	10.3
Interest	0.9	0.8	1.2	1.4	1.2	1.0	0.8	0.7	0.6
Capital expenditure	2.7	2.7	2.7	2.5	2.3	2.5	2.8	3.1	3.2
Savings restitution	...	...	1.0	2.1	1.4	1.2	0.5	0.4	0.6
Financial balance	-2.5	-0.8	-4.3	-4.7	-1.3	-0.4	0.0	0.0	0.0
Net Lending	2.0	1.0	1.5	0.0	-0.4	-0.4	0.0	0.0	0.0
Fiscal balance	-4.5	-1.8	-5.8	-4.7	-0.9	0.0	0.0	0.0	0.0
Financing	4.5	1.8	5.8	4.7	0.9	0.0	0.0	0.0	0.0
Foreign	3.3	1.6	1.3	3.4	-0.1	0.0	-0.9	-0.6	-1.2
Domestic	1.1	0.0	-0.7	-0.7	-1.9	-1.9	-0.8	-0.2	1.2
Gross privatization receipts	0.1	0.3	5.3	2.1	2.9	2.0	1.7	0.8	0.1
Memorandum Items:									
Primary balance	-3.6	-1.0	-4.7	-3.3	0.3	1.0	0.8	0.7	0.6
Government consumption	17.3	18.4	21.8	22.0	21.1	20.6	20.7	20.7	20.7
Domestic debt stock	4.0	5.6	5.9	5.0	3.4	1.5	0.9	0.9	2.2
Foreign debt stock	11.0	10.7	11.1	14.3	13.3	12.2	10.4	8.9	7.0
Total debt stock	15.0	16.2	17.0	19.3	16.7	13.7	11.3	9.8	9.2
Nominal GDP (LTL millions)	31,569	38,340	42,768	43,666	46,813	50,817	55,127	59,827	65,113

Sources: Data provided by the Lithuanian authorities; and Staff Projections.

1/ From 1997, contributions to the Health Insurance Fund are excluded from income tax and included in payroll tax

2/ From 1997, expenditures of the Health Insurance Fund are excluded from wages and salaries and included in goods and services.

IV. External Competitiveness

A. Introduction

31. Lithuania's sizeable external current account deficit has raised questions about the adequacy of external competitiveness, particularly in light of the substantial real appreciation of the litas over the last several years. The key question posed in this chapter is whether the real appreciation, which started at the inception of the currency board arrangement (CBA) in April 1994, is best understood as a catch-up process from an undervalued level, combined with an appreciating equilibrium rate—in this view, the current account deficit would be a reflection of the underlying restructuring of the economy—or whether the use of the CBA peg for disinflation purposes has entailed a loss of competitiveness, that would make the current account deficit a source of concern.

32. Since an exchange rate assessment based on a macroeconomic balance approach is not feasible for Lithuania at this point, this chapter assesses competitiveness on the basis of a range of indicators, including effective exchange rates, U.S. dollar wages, unit labor costs, and export performance. The chapter concludes that, while there is no strong evidence of a significant loss of competitiveness from the real appreciation of the litas, the various competitiveness indicators suggest that the convergence of the real exchange rate and the U.S. dollar wage toward their equilibrium level is near completion. In other words, there is little room for additional real appreciation and wage increases that are not related to improvements in fundamentals such as productivity increases.

B. Effective Exchange Rates and Relative Unit Labor Costs

33. Real effective exchange rate indices (REER) and relative unit labor costs (RULC) are among the most frequently used competitiveness indicators. The REER is considered an important determinant of exports and imports, notwithstanding the shortcomings discussed below. The interest in RULC indicators is motivated by the observation that labor is often the main production input; its relative cost in two countries after adjusting for productivity differences is an indicator of profitability and hence of external competitiveness.

Nominal and real effective exchange rates

34. The real effective exchange rate is often proxied in applied work by the CPI index of a country relative to a weighted average of the CPI indices of its trading partners, where all prices are expressed in a common currency.[26] It is important to note that an appreciating REER may not indicate a loss of competitiveness if it is a consequence of an improvement in fundamentals, such as a relative productivity increase in the tradable sector. Thus,

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[26] A drawback of this indicator is that the price index should ideally include only tradables while the CPI index also includes nontradables.

understanding the source of the appreciation is crucial for interpreting REER changes. In other words, the REER conveys useful information only to the extent that it can be compared with an estimate of the equilibrium exchange rate. Unfortunately, precise estimates of the latter are not readily available, and the different estimation strategies found in the literature are usually not applicable to transition economies.[27]

35. Notwithstanding these shortcomings, the REER is the most frequently used competitiveness indicator. Table 8 and Figure 2 show trade-weighted nominal (NEER) and real effective exchange rate indices for the litas with respect to all trading partners, the European Union (EU), Russia, the Commonwealth of Independent States excluding Russia (CIS), the Central and Eastern European countries (CEE), and the Baltics. Since December 1994, the litas has been steadily appreciating in real terms, with a cumulative real appreciation of 63 percent in April 1999 with respect to all trading partners. A regional disaggregation of Lithuania's trading partners show that the real appreciation was the largest vis-à-vis Russia (81 percent) and the EU (80 percent). The real appreciation vis-à-vis the EU was continuous until the end of 1997; during 1998, the Litas depreciated vis-à-vis the EU, before it again appreciated in late 1998/early 1999. The appreciation with respect to Russia reflects mainly the large devaluation of the ruble in August 1998; in the subsequent period, relative prices vis-à-vis Russia have adjusted somewhat, but not enough to neutralize the nominal devaluation of the ruble.

36. The real appreciation of the litas vis-à-vis the EU may largely reflect the convergence of the REER toward its equilibrium value. Empirical evidence suggests that there was undershooting in the first stage of the transition, followed by relative productivity gains in the tradable sector (the Balassa-Samuelson effect).[28] The real appreciation with respect to the CIS (excluding Russia), the CEE, and the Baltics, on the other hand, raises more concern because there is no strong evidence of initial undervaluation of the litas with respect to these currencies, nor compelling evidence of an equilibrium real exchange rate appreciation caused by a change in fundamentals (such as a relative productivity gain in Lithuania's tradable sector).

37. From mid-1995, the REER appreciation of the litas vis-à-vis all trading partners and the CIS has reflected mainly the appreciation of the U.S. dollar, to which the litas is pegged under the currency board arrangement, against the currency of Lithuania's trading partners (Figure 3). The main source of the real appreciation vis-à-vis the EU was inflation differentials.

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[27] While an estimate of the equilibrium exchange rate for the Litas is not available, an estimate of the equilibrium U.S. dollar wage is provided below.

[28] See Halpern and Wyplosz (1997) and Krajnyàk and Zettelmeyer (1998).

Relative unit labor costs

38. Relative unit labor costs (RULC) measures the cost of labor normalized by productivity relative to partner countries, expressed in the same currency. In this chapter, RULC is measured as the wage rate relative to GDP per capita in nominal terms in Lithuania divided by the same ratio in the partner countries. The higher the RULC index, the lower is the competitiveness of Lithuania's labor force. Figure 4 shows the RULC with respect to Estonia and Latvia. In the period from 1994:Q4 to 1996:Q4, the RULC indices indicate a modest loss of competitiveness with respect to Estonia and a gain in competitiveness with respect to Latvia. Starting in the second quarter of 1997, the RULC with respect to both countries edged upwards, reflecting mainly the increased wage growth in Lithuania. It should be noted that the RULC may have declined more recently, reflecting the declining growth in Lithuanian wages following the Russian crisis.

C. Equilibrium U.S. Dollar Wages

39. While developments in average wages measured U.S. dollars suggest an erosion of the competitive wage advantage that Lithuania had in 1994, Lithuania's U.S. dollar wage was still lower than that of Estonia and Poland in March 1999 (Figure 4). The more pertinent issue is how the actual wage compares to its equilibrium level. In two recent papers, Halpern and Wyplosz (1997) and Krajnyàk and Zettelmeyer (1998), respectively H-W and K–Z hereafter, provide estimates of the equilibrium U.S. dollar wage, defined as the wage level compatible with internal and external balance, for a large sample of countries, including transition economies.

40. The approach pursued by H-W and K–Z is inspired by the way macroeconomic practitioners often form a judgement on the competitiveness of a country, which is by comparing the country's average U.S. dollar wage with that of its competitors. The advantage of adopting the U.S. dollar wage as a competitiveness indicator is that it is readily available for most countries, and is easy to interpret and compare across countries.

41. The methodology in K–Z consists of regressing the U.S. dollar wage for a panel of 85 countries on a set of "fundamentals." The fundamentals include Purchasing Power Parity (PPP) GDP per capita, secondary school enrollment as a proxy for the stock of human capital, and the share of the agricultural sector (jointly with PPP GDP per capita) as a proxy for the level of development.[29] The data period begins in 1990, the earliest starting date of economic

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[29]More specifically, the estimated equations have the following general form:

$$w_{\$i,t} = \sum_{j=1}^{3} a_j x_{ij,t} + a_4 oecd + \sum_{\tau=1}^{T} a_{\tau+4} cee_{i,t} + \sum_{\tau=1}^{T} a_{\tau+9} fsu_{i,t} + \mu_i + \epsilon_{i,t}$$

(continued...)

transition in Eastern Europe, as defined by the first comprehensive attempt to liberalize prices and open the formerly planned economies; the end point is 1995, which is the last year for which the data were available for all countries in the sample. The sample includes 15 transition economies, all OECD countries, and countries in Africa, Asia, and Latin America.

42. K–Z found that in 1995 Lithuania still had significant room for increases in the U.S. dollar wage before it would reach its equilibrium level. To assess whether this still held true in 1998 the data for Lithuania have been extended and the equilibrium U.S. dollar wage computed from 1994 to 1998, using the estimated equations in K–Z.[30] As in K–Z, estimates have been made for three different normalizations of GDP, i.e., GDP divided by population, GDP divided by employment, and GDP divided by labor force. The updated calculations suggest that the ratio of the actual to the equilibrium U.S. dollar wage ranged from 94 percent (when GDP is normalized by employment) to 104 percent (when GDP is normalized by labor force) in 1998 (Table 2).[31] In other words, the estimates indicate that while the litas is not clearly overvalued, there is little room for additional wage increases that are not related to improvements in fundamentals.[32]

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[29](...continued)
where $w_{\$i,t}$ is the actual dollar wage for country i, in year t; x_j, j=1,..,3 denotes the economic determinants of equilibrium wages; oecd, $cee_{i,t}$,$fsu_{i,t}$ are dummy variables that capture factors specific to OECD, Central and Eastern Europe, and former Soviet Union countries, respectively; μ_i stands for unmeasured country-specific factors; and $\epsilon_{i,t}$ represents a time-varying idiosyncratic disturbance. All variables, except dummy variables, are in logs.

[30]Some potential pitfalls should be stressed. First, the updated data presented here are different from the original data used by K–Z, as GDP and other variables have been revised several times so that the data differ for the overlapping years (1992–95). Second, using K–Z equilibrium U.S. dollar wage equations implicitly makes the strong assumption that these equations are stable over time. Thus, the estimates of the equilibrium wage should be interpreted with caution.

[31] The normalization by employment yields the best fit. Furthermore, theoretical arguments point to employment as the more appropriate normalization variable.

[32] The differences between these estimates and K–Z estimates arise from the differences in the data sets since the estimated equilibrium U.S. dollar wage equations used for updating the equilibrium dollar wage were taken from K–Z.

D. Export Performance

Export market shares

43. Perhaps the most direct measure of competitiveness is the market share of a country's exports. Figure 4 provides calculations of the market share of Lithuania for three markets, namely the EU, Russia, and Germany. The following points emerge:

(i) Lithuania has increased its share in all three markets since 1994, with the largest gain in the German market, where its market share has more than doubled since the first quarter of 1994. The German market share drives the EU market share;

(ii) the bulk of this market share gain in the German and EU markets occurred from the first quarter of 1994 to mid-1996, with these market shares remaining broadly unchanged thereafter;

(iii) there is an increase in the EU market share in the last two quarters of 1998, which may indicate some reorientation of Lithuanian exports from the Russian market. The increase in the EU share did not come from an increase in the German market, suggesting further penetration into the markets of other EU countries; and

(iv) the shares in the Russian market are more volatile, especially from 1994 to 1996. Interestingly, the substantial decline in the Lithuanian share in the Russian market preceded the crisis, and the following pick-up coincided with an appreciating real exchange rate vis-à-vis Russia which suggests that nonprice effects have been important determinants of trade in the Russian market since the Russian crisis broke.

Export growth

44. Lithuania's recorded exports fell by 5½ percent in U.S. dollar terms in 1998, which may raise questions about competitiveness. However, this decline followed very strong export growth in 1996 and 1997 (of 26 percent and 23 percent, respectively). Also, the main factor behind the decline in 1998 was that exports to Russia and the CIS fell by 50 percent during the second half of 1998, or 26 percent for the whole year. Russia's share in total exports dropped sharply from about 25 percent in 1996 and 1997 to 5 percent in the last quarter of 1998. During the same period, the CIS share fell from around 45 percent to 15 percent. Moreover, these numbers may overstate the actual decline in exports, because: (i) excluding re-exports, exports fell only by ½ percent in 1998 (re-exports accounted for 17 percent of total exports in 1997 and 13 percent in 1998); and (ii) undervaluation of exports to Russia is believed by the authorities to have increased in 1998.

45. By contrast, exports to the EU, the other Baltic countries, and the rest of the world continued to perform well during the whole 1998, growing at 12 percent, 18 percent, and 22 percent, respectively. Consequently, the share of exports to the EU rose from 33 percent in

1996 and 1997 to 50 percent in the last quarter of 1998. Exports to the CIS continued to perform poorly in the first quarter of 1999 with a decline of 66 percent with respect to the first quarter of 1998 while exports to the EU grew by 7 percent during the same period.

E. Conclusions

46. The various competitiveness indicators reviewed here suggest that, while the litas is not clearly overvalued, the convergence of the real exchange rate and U.S. dollar wage toward their equilibrium levels is near completion. In particular, there is little room for additional wage increases that are not related to improvements in fundamentals. The large current account deficit combined with the significant decline in exports to Russia and the rest of the CIS countries increases the vulnerability of the Lithuanian economy. There are some signs of reorientation of Lithuania's export to the EU market, which may dampen the negative effect from the Russian crisis. However, the growth forecasts of the EU economies are relatively modest. Consequently, a competitive real exchange rate is crucial for achieving external balance, and in view of the uncertain external environment and the relatively large current account deficit, adequate fiscal policy restraint and productivity improvements through structural reform will be central to keeping inflation low and maintaining the competitiveness of the Lithuanian economy.

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Table 6: Nominal and Real Effective Exchange Rate Indices, 1994-99

	1994	1995	1996	1997	1998 Mar.	1998 Jun.	1998 Oct.	1998 Dec.	1999 Jan.	1999 Feb.	1999 Mar.	1999 Apr.
All trade partners												
NEER	100.0	109.6	120.4	137.8	141.7	142.2	176.7	199.0	207.8	217.2	229.5	234.8
REER	100.0	101.2	111.6	127.1	130.6	130.0	144.6	148.7	152.2	156.1	162.1	163.3
EU												
NEER	100.0	92.8	96.4	108.8	111.6	109.9	105.2	103.8	104.4	107.7	110.7	112.4
REER	100.0	122.8	142.0	170.4	177.9	175.4	166.1	165.0	167.8	173.0	177.2	179.8
Russia												
NEER	100.0	136.4	163.4	175.4	179.8	182.4	425.3	592.3	656.7	675.8	695.4	729.5
REER	100.0	79.9	88.8	93.1	94.5	95.5	153.5	174.7	180.3	178.2	178.0	181.4
CIS												
NEER	100.0	148.9	184.7	291.9	315.8	337.5	463.6	759.0	890.9	1099.8	1425.7	1478.7
REER	100.0	65.6	67.0	80.0	81.9	82.2	95.4	100.6	106.9	120.5	143.9	141.2
CEE												
NEER	100.0	104.4	122.9	157.7	156.6	157.0	159.0	155.3	157.6	168.5	174.6	176.6
REER	100.0	118.2	130.5	151.6	146.2	145.2	145.3	141.3	142.2	151.1	154.9	155.6
BALTICS												
NEER	100.0	96.1	100.3	108.5	109.8	110.1	107.0	104.2	104.3	106.5	108.4	108.9
REER	100.0	104.3	108.2	117.1	119.9	118.8	114.0	111.6	112.6	114.7	118.3	116.9

Note : Nominal and real effective exchange rates (NEER and REER) are based on December 1994. The yearly figures give the index level in December of the corresponding year. The weights in the computation of the NEER and REER reflect the share of Lithuania's exports plus imports to each country in 1998, except for the CIS, CEE, and BALTICS where the trade weights in January 1999 were used.

Source : Fund staff estimates.

Table 7: Computation of the Equilibrium Dollar Wage for Lithuania, 1992-98

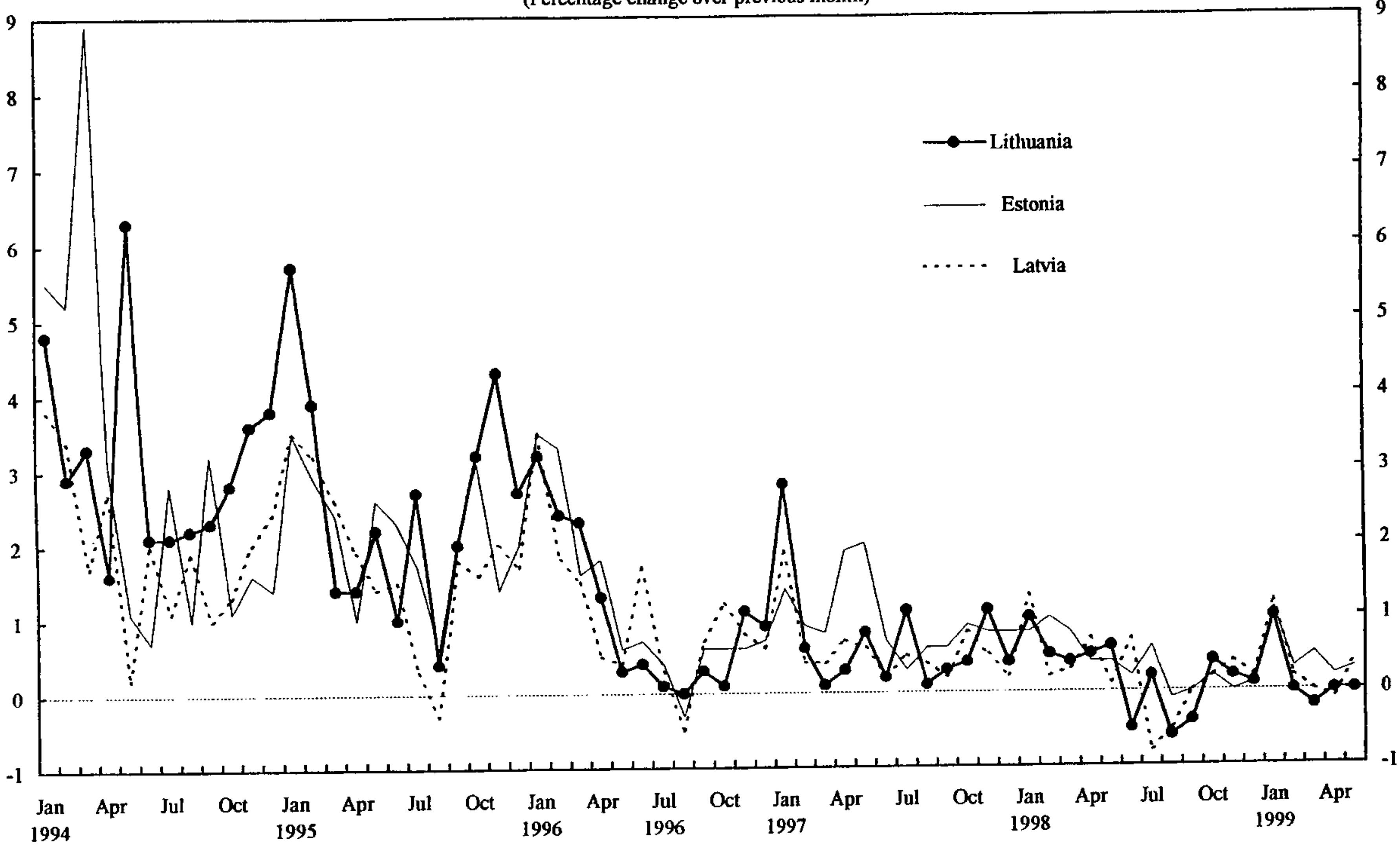
	1992	1993	1994	1995	1996	1997	1998
			GDP normalized by Population				
Equilibrium wage in US$	263	230	223	232	244	261	279
Actual wage/Equilibrium wage (in percent)	13	19	41	56	71	82	95
Actual wage/Equilibrium wage in K-Z	9	27	46	64	...	...	...
			GDP normalized by Employment				
Equilibrium wage in US$	244	222	237	242	247	260	281
Actual wage/Equilibrium wage (in percent)	14	20	39	53	70	82	94
Actual wage/Equilibrium wage in K-Z	10	28	45	63	...	...	...
			GDP normalized by Labor Force				
Equilibrium wage in US$	242	211	207	214	220	237	256
Actual wage/Equilibrium wage (in percent)	14	21	44	60	78	90	104
Actual wage/Equilibrium wage in K-Z	11	32	53	74	...	...	...

Note: This table provides three estimates of Lithuania's equilibrium wage in US$ using the estimated equations in Krajnyák and Zettelmeyer (1998). The three estimates correspond to three different normalization of GDP (GDP over population, GDP over employment, and GDP over labour force). GDP is in PPP terms and is taken from the WEO database. The table also provides the ratio of the actual wage to the equilibrium wage. For comparison purposes, this ratio as computed by Krajnyak and Zettelmeyer (K-Z) for 1992-95 is also provided.

Source: Krajnyák and Zettelmeyer (1998), Lithuanian authorities, and Fund staff estimates.

Figure 1. Baltic Countries: Consumer Price Index, 1994-99

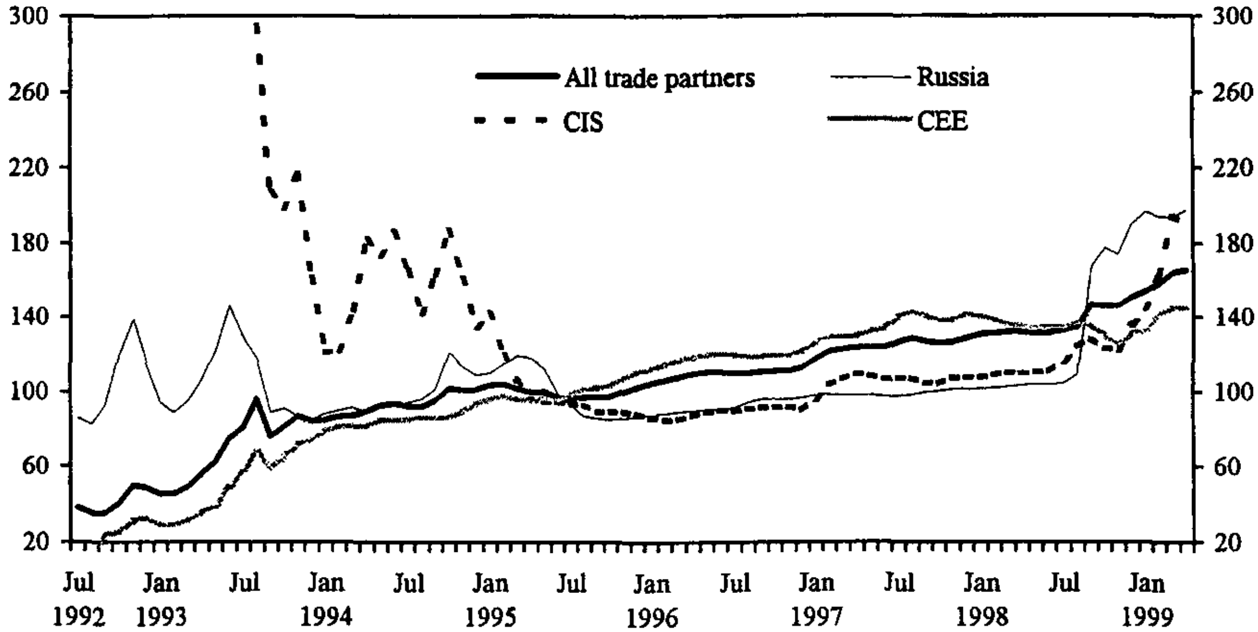
(Percentage change over previous month)



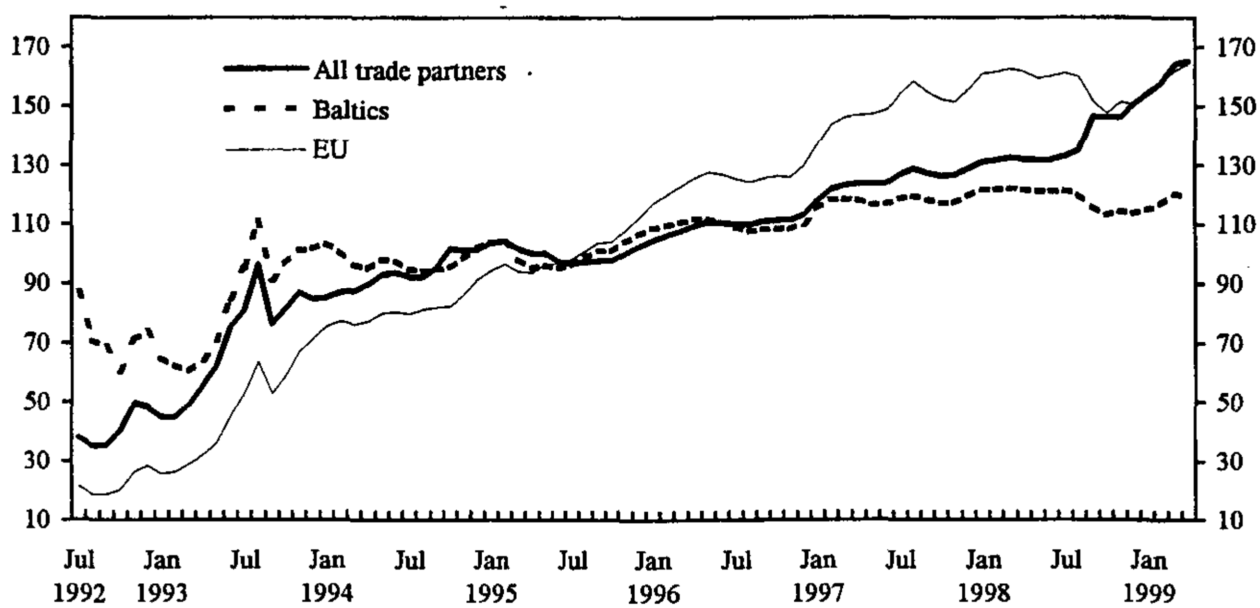
Sources: Country authorities.

Figure 2. Lithuania: Comparison of Real Effective Exchange Rates With Respect to Russia, CIS, CEE, Baltics and EU, 1992-99
(Index 1995=100)

With Russia, CIS and CEE

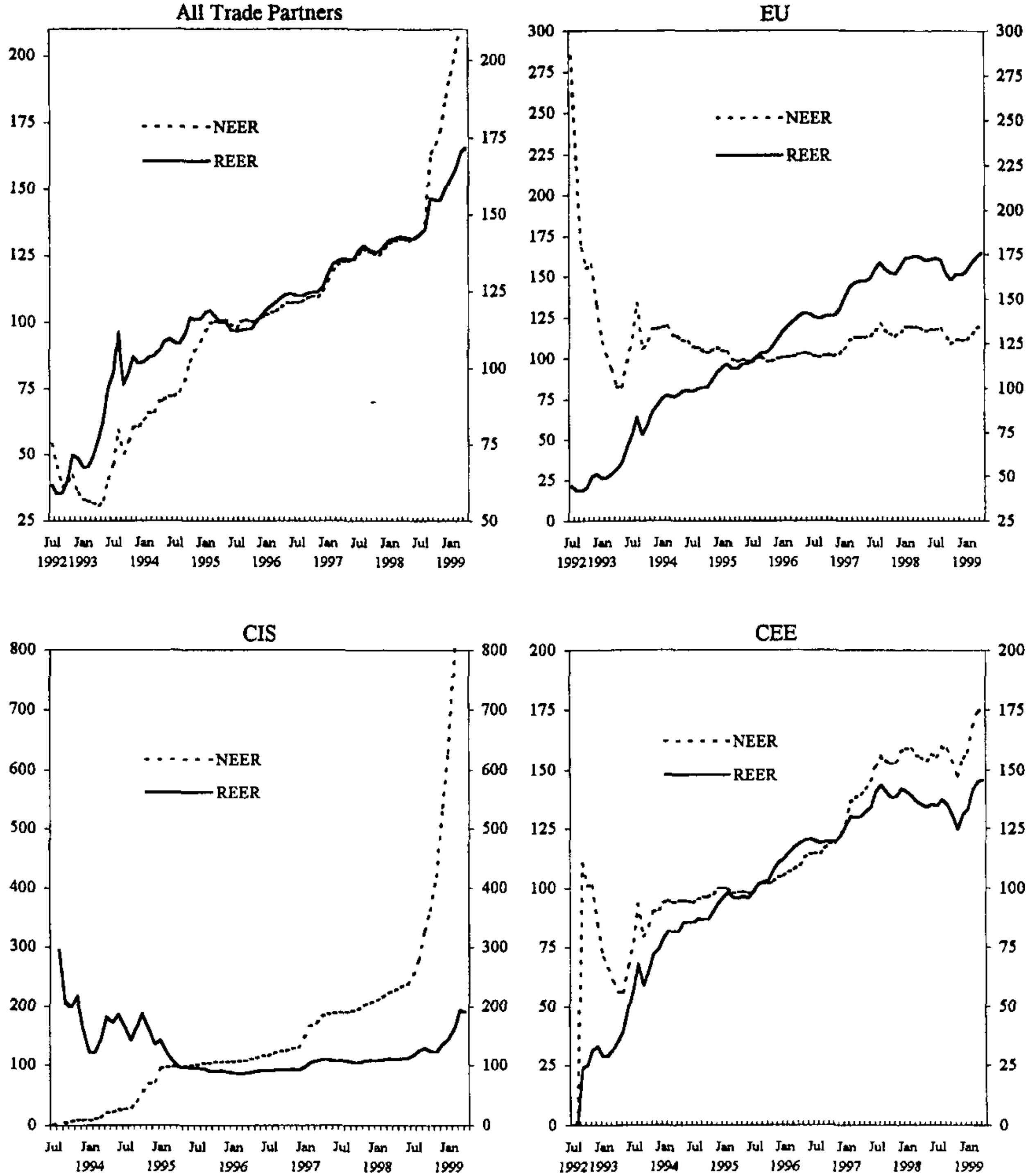


With Baltics and EU



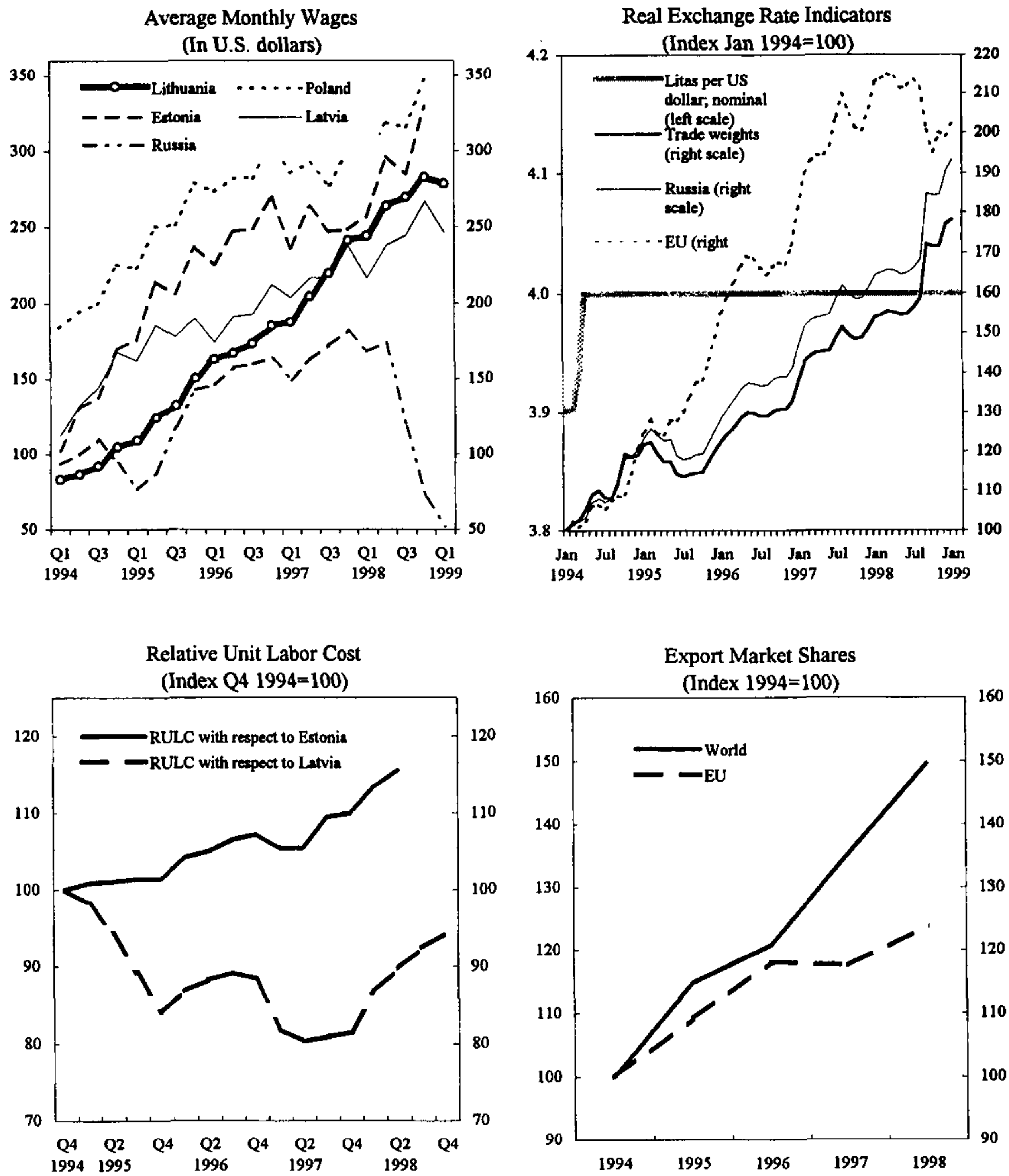
Source: INS and staff calculations.

Figure 3. Lithuania: Effective Exchange Rates With Respect to All Trade Partners, EU, CIS and CEE, 1992-99
(Index 1995=100)



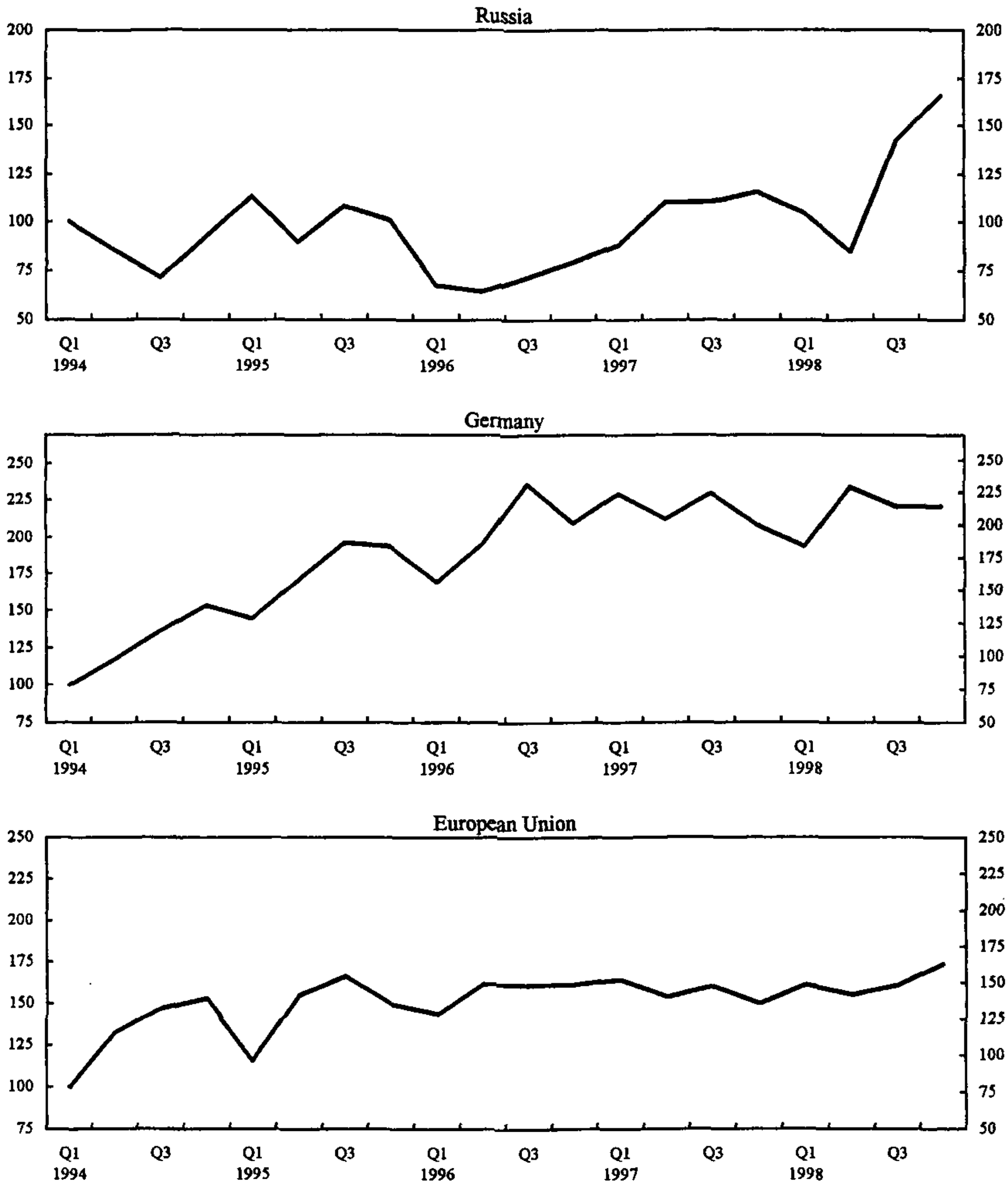
Source: INS and staff calculations.

Figure 4. Lithuania: External Competitiveness Indicators, 1994-99



Source: IFS; country authorities; and Fund staff calculations.

Figure 5. Market Shares of CIS, Baltics, LTU and CEE in Four Markets, 1994-98
(Index Q1 1994 = 100)



Sources: WEO database and Fund staff calculations.

V. Structural Reforms

A. Introduction and Overview

47. This chapter provides an overview of structural reforms during 1998 and early 1999 with a particular focus on privatization, legal framework, reforms in energy and agriculture, and trade policy.[33] Structural reforms in these and other areas are important for creating conditions for high, sustained growth of GDP, promoting nongovernment saving, and reducing the current account deficit. Structural reforms are also important to facilitate compliance with EU directives with the ultimate objective of joining the EU (see Appendix II for an overview of the status of Lithuania's EU accession).

48. During the first 6 years after regaining independence, Lithuania made much progress in structural reforms and transition to a market economy. Important "first-generation" structural reforms—liberalizing external trade and the foreign exchange market, freeing prices, wages, and interest rates, privatizing housing and small and medium-sized enterprises, and putting in place a market-conform legal framework—were largely completed, thereby establishing the basic tenets of a market economy. Structural policies, combined with generally prudent fiscal policies that have underpinned the currency board regime, helped stabilize the economy and achieve positive economic growth from 1995 onwards, although nongovernment saving remained low and the current account deficit increased.

49. Since mid-1998, however, progress in structural reforms has been more modest, and in some areas retrograde steps have been taken. With the exception of privatization and competition policies, the government recently has not followed through with structural reforms to increase the role of the private sector and improve the efficiency in the allocation of resources. As a result, nongovernment saving has remained low, which contributed to a further widening of the current account deficit in 1998. Specifically, following the August 1998 crisis in Russia the government stepped up implicit and explicit support to individual enterprises and sectors.[34] As discussed in greater detail below, such direct and quasi-fiscal support has included the (ii) provision of loans at preferential terms and credit guarantees; and (ii) increased protection of agricultural producers and others through higher import tariffs and increased domestic support.[35] More broadly, progress has been limited in 1998 and early 1999

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[33]For a discussion of structural reforms in the financial sector, see Chapter VI. Fiscal issues are discussed in Chapter III.

[34]Such support has contributed to a pronounced deterioration in the fiscal performance during the second half of 1998 and early 1999 (see Chapters II and III).

[35]In addition, Government Resolution No. 1122, approved on September 17, 1998, included a number of additional measures, such as changes in public procurement requirements in favor

(continued...)

as regards deregulation, enforcing business exit through bankruptcy, and reforms in two important sectors of the economy, energy and agriculture.

B. Privatization

50. The first privatization phase (1991-95) focused on small- and medium-sized enterprises, and apartments and houses, which were sold against vouchers via auctions and share subscriptions. The vast majority of agricultural enterprises (kolkhozes and sovkhozes) were also privatized against vouchers during this period. By the end of this phase, the share of the private sector in GDP is estimated to have risen to about 65 percent (from 15 percent of the market). While voucher privatization was broad-based and involved large parts of the Lithuanian population, foreign participation was limited.

51. A new privatization law came into force in September 1995, marking the beginning of the second privatization phase—cash privatizations.[36] This phase got off to a slow start as many initial offerings did not generate sufficient interest due, in part, to the low participations offered and the relative unattractiveness of the enterprises that were put on the market. Only about 50 out of the nearly 400 enterprises included in the 1996 privatization list were sold. The bulk of the remaining enterprises were included in the 1997 list, which contained more than 800 offerings, and, importantly, also included 14 large "strategic" enterprises, mainly in the telecommunications, energy, and transport sectors.[37] Special procedures were adopted for the privatization of the "strategic" companies, including the requirement for the SPF to offer

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[35](...continued)
of domestic producers.

[36]This Law on the Privatization of State and Municipal Property introduced five possible methods of sales: public subscriptions of shares through the National Stock Exchange or the Privatization Agency; public auctions; open tenders; sales through direct negotiations; and leases with a purchase option. The law did not discriminate against foreign buyers, nor did it envisage special concessions to potential buyers. A new Privatization Law became effective in December 1997. It provided better specificity on privatization methods, defined the use of privatization proceeds (including, for example, the financing of payments under the Savings Restitution Plan), and replaced the Lithuanian State Privatization Agency by the State Property Fund (SPF). The SPF has a broader mandate than its predecessor that includes the sale of property owned by municipality on their behalf.

[37]Including Lithuanian Fuel, Mazeikiai Refinery, Lithuanian Airlines (including a subsidiary, Air Company Lithuania, Klasco (Klaipeda Stevedoring Company), Lisco (Lithuanian Shipping Company), Klaipedos Smelte, Remontas Shipyard Company, Levite Shipping Company, State Insurance Company, Lithuanian Television Center, and GeoNafta. Lithuanian Airlines and Levite Shipping Company have since been removed from this list.

public tenders to prepare each strategic enterprise for privatization by retaining independent consultants, before the tender for privatization is announced.

52. Following the establishment of the SPF and the inclusion of "strategic" enterprises in the privatization list, privatization gathered speed. In 1998, about 350 enterprises were sold for a total of LTL 2.3 billion (about 5½ percent of GDP), including the sale of a 60 percent stake in Lietuvas Telekomas to a Scandinavian consortium for LTL 2 billion (US$510 million), which is the most important privatization project since independence.[38] The sale of large enterprises continued in early 1999 as a majority stake of Klaipeda Stevedoring Company was purchased by a consortium of Estonian, German, and Lithuanian investors for LTL 200 million (Table 37). Privatization is expected to receive a further boost later in 1999 and early 2000 through the planned sales of stakes in the largest energy sector enterprise and the two remaining state-owned banks.

C. Legal and Regulatory Framework

Competition policy

53. Lithuania's competition policies have been progressively transformed from an instrument of price control into one that is focused on anti-trust legislation, incidences of unfair competition and abuse of dominant market positions, monitoring of government subsidies, and consumer protection. Reform of competition policies has generally been guided by EU directives. The State Competition and Consumer Protection Office (SCCPO) has been entrusted with enforcing competition laws and regulations. Its main responsibility is to investigate infringements of the Competition Law, including abuse of a dominant market position, agreements among economic entities that hinder competition, restrictions established by central or local government agencies, unfair competition, and market concentration. The SCCPO generally undertakes investigations upon notification, but may take initiative to investigate specific cases. In 1997, the SCCPO investigated a total of 44 cases and imposed 36 fines totaling LTL 800,000. During 1998, 107 investigations were undertaken, with penalties totaling LTL 560,000 being charged in 23 of these cases.

54. Competition legislation and regulations have been brought more in line with EU requirements, especially through the new Law on Competition, which became effective in April 1999. One of the main objectives of this law is to make the governing body of the SCCPO, the Competition Council (consisting of five members), more independent of the government and lobby groups. Under this law, the members of the Council will be appointed by the President. As under the previous law, a dominant market position is defined as an entity having a market share of more than 40 percent. However, the new law stipulates that under

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[38]This investment sharply increased the total amount of foreign direct investment in Lithuania (Tables 33 and 34).

certain circumstances, a share of less than 40 percent could also be considered a dominant market position, warranting an investigation by the SCCPO.

55. In line with EU directives, the SCCPO is also monitoring government subsidies that may distort competition. Enterprises and government institutions are required to provide information on subsidies, including guarantees, above a certain threshold. A data bank has been established on government support, including information on providers, beneficiaries, and type of support.

Regulatory framework

56. Businesses in Lithuania face restrictions and regulations that hamper new enterprise startups and complicate the operations of existing ones. Regulations appear to be particularly onerous in tax administration and access to land. Licensing requirements and labor regulations are considered less of a problem by both domestic enterprises and foreign investors.[39] Corruption and rent-seeking are also generally not considered a major impediment by entrepreneurs, although there have been concerns about the lack of transparency and political interference in direct negotiations with strategic foreign investors. There is a general perception among investors that existing laws and regulations are vague, contradictory, and subject to frequent change. Such an environment provides incentives for increased informal sector activities and tax evasion, especially for small- and medium-sized enterprises, which are put at a relative disadvantage compared with large firms.

57. Although licensing requirements are generally not perceived to be hampering businesses, there are a number of areas where they remain onerous. For example, construction permits are required from at least 10 different government entities, with multiple approvals from most of these entities at different stages of the construction process. Also, some license fees may be relatively expensive.[40] In some cases there is a large difference between the license fee for domestic manufacturing, usually set at reasonable rates, and the import license, which may be much higher. Finally, enterprises with at least one foreigner as a founder or shareholder must be registered with the Ministry of Economy while fully Lithuanian-owned enterprises must only register with local authorities.

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[39] Perceptions of entrepreneurs as reported here are based on the results of enterprise surveys held in 1994 and 1997. For further details see World Bank (1998), "*Lithuania: An Opportunity for Economic Success.*"

[40] The most prominent example is the license to import alcoholic beverages, which costs over US$100,000. Only two firms currently hold such a license.

58. Access to non-agricultural land has remained difficult for most foreign and Lithuanian companies.[41] Following a constitutional amendment in 1996 and the adoption of a government resolution in late 1998, the sale of such land to domestic and certain foreign legal entities is now permitted, upon approval by municipal administrations.[42] In March 1999, the first foreign company purchased a plot of land for industrial purposes. However, such sales are expected to accelerate because of a recent government resolution that established the unlimited and equal participation of domestic and foreign legal and physical persons in open auctions for nonagricultural land. However, procedures for the purchase of nonagricultural land have remained unclear. For example, companies interested in participating in land auctions need to obtain prior approval of the county administration, but the criteria for such approval are not well specified. Moreover, responsibilities of county and municipal administrations regarding the leasing of land and buildings are not clearly defined. Land restitution complicates the process further because a potential buyer of land must receive certification from the municipality that there are no outstanding claims on the property. Although the government since January 1, 1999 does not any longer accept new claims, there is a significant caseload of outstanding unprocessed claims. However, the government intends to speed up the land restitution and compensation process, aiming to complete all claim procedures by the end of the year 2000.[43]

Bankruptcy

59. A new Bankruptcy Law became effective in the fall of 1997 with the main objectives of streamlining bankruptcy procedures and improving the prioritization of creditor claims. The law introduced the so-called "zero-order" principle, which applies in most EU countries, and proclaimed that creditors' claims secured by mortgage shall be fulfilled independently of any other creditors. It also specified a number of deadlines for the concrete stages of bankruptcy procedures. For example, it introduced a maximum period of two months for the completion of a bankruptcy case at court.[44] Following the enactment of the law, the average time required for completing a bankruptcy case at court has been reduced to less than 1½ months. A revised Bankruptcy Law was presented to Parliament in May 1999 and it is expected to be approved by Seimas this fall. The new law, inter alia, aims at (i) simplifying asset sales and auction procedures; (ii) giving greater powers to liquidation commissions; and (iii) broadening the scope of bankruptcy to enterprises that fall in arrears in wage payments.

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[41]Policies pertaining to agricultural land are discussed further below.

[42]The permission is limited to entities from EU, OECD, and NATO member countries; those from other countries can only lease land.

[43]As of May 1999, ownership rights extended to 2.34 million hectares of land, forest, and water, equivalent to about 60 percent of the area indicated in citizens' claim applications.

[44]For further details on this new law, see IMF Staff Country Report No. 98/92.

60. During the period 1993–June 1999, about 420 bankruptcy cases were initiated, and most of these were handled by courts (Table 36). However, only about 20 percent of these cases were finalized, generally through liquidation, and most cases were comleted after the new Bankruptcy Law had become effective in October 1997. In the first half of 1999, bankruptcy proceedings were initiated for a comparatively large number of enterprises, and the authorities expected that many more cases would be initiated later this year, reflecting the impact of the Russia crisis and the slowdown in growth in the Lithuanian economy.

D. Sectoral Reforms: Energy

61. Energy is a key sector in the Lithuanian economy, but it is at the same burdened with large financial and operational problems that have contributed importantly to fiscal and other macroeconomic imbalances in recent years. The range of problems include structural financial difficulties in the parastatals that supply electricity and gas (Lithuanian Power Company, LPC; Lithuanian Gas Company, LGC), weak corporate governance in the oil sector, and overcapacity in electricity production relating to the Ignalina nuclear power facility. Moreover, energy sector reforms have drifted over the past 1–1½ years as the authorities have not been able to adapt and implement a sectoral policy reform program.

62. In the first years after independence was regained, reforms in the energy sector focused on liberalizing retail prices of oil products, increasing the role of private enterprises in the sector and thus fostering competition, and reducing the overuse of energy. Energy sector reforms accelerated after a new government took office at the end of 1996. For example, the Energy Price Commission (EPC) was established with the objective of functioning as an autonomous arbiter of heat, gas, and electricity prices. In mid-1997, new energy tariffs became effective, and the district heating networks, previously part of LPC, were handed over to municipalities.[45] [46] Also, a number of measures were put into place to deal with delinquent customers, including increased use of cutoffs and improved budgeting in public organizations, which resulted in a reduction in the stock of arrears to the energy sector.

63. Energy sector liberalization and restructuring has since made little progress. Electricity and gas tariffs have not been raised since mid-1997, and they currently do not appear to cover costs. The restructuring of LPC has stalled, and its lack of management autonomy and operational inefficiency have remained key problems. However, the new government that took office in May/June 1999 is considering proposals to separate LPC's electricity generation and distribution, and privatize the restructured distribution companies. Arrears to the energy sector from domestic consumers have remained low, although outstanding payments from local and central government budgetary organizations have increased somewhat in the first

[45]Electricity and district heating tariffs were raised by 10 percent and 25 percent, respectively.

[46]Also, two combined heat and power plants (in Vilnius and Kaunas) were separated from the LPC.

half of 1999 (Table 16). Electricity payment arrears from Belarus are much larger and have contributed importantly to the deteriorating financial performance of LPC. As regards the Ignalina Nuclear Power Plant, which covers more than 80 percent of Lithuania's electricity demand and has a large overcapacity, the government is in the process of devising a strategy for its decommissioning.[47] Its closure will have large budgetary implications.

64. In the oil sector, the government intends to enter into an agreement with a strategic investor on the purchase of a 66 percent stake in the conglomerate that comprises the Mazeikiai refinery, the Butinge off-shore terminal, and the pipeline.[48] However, reliance on direct negotiations with a foreign strategic investor have raised concerns over transparency. Oil exports through the recently completed Butinge terminal could provide a strong boost to foreign exchange earnings, while at the same time allowing a possible diversification of crude oil imports. However, for the time being the oil sector is burdened with financial problems, and repayments of foreign loans have been taken over by the government. In September, the government lent US$654 million to the Mazeikiai refinery as a foreign lender exercised a put option; the government's loan has since been rolled over twice. In April 1999, the government borrowed US$75 million abroad, which were on-lent to the Mazeikiai concern as it had to repay another foreign loan.

E. Sectoral Reforms: Agriculture

65. The agricultural sector experienced fundamental changes in the ownership and policy framework in the early transition years. Most of the 1,000 state farms and collectives were dissolved, and their land and assets privatized. (Small family farms have since become the predominant form of production.) Input and output prices were deregulated, subsidies on inputs removed, and quantitative trade restrictions replaced by tariffs. However, following a steep decline in agricultural output during the first few years of the transition, the government reintroduced a variety of measures to support farmers in 1994–95.[49] Import tariffs on agricultural products drifted upwards and domestic support mechanisms were strengthened for main agricultural products during that period. In 1996–97, the government implemented a number of key reforms. Specifically, agricultural export taxes were mostly eliminated, earlier import tariff increases were reversed, agriculture was made subject to the standard VAT rate

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[47]Installed electricity production capacity is more than three times peak demand. Given this overcapacity, there is a large potential for exports.

[48]The agreement was approved by Seimas in June 1999.

[49]Agriculture's contribution to GDP has declined sharply since independence (to less than 10 percent in 1998), but the sector continues to provide employment and income to about 20 percent of the labor force.

of 18 percent,[50] the Baltic Free Trade Area was extended to agricultural products, and domestic budgetary support to the sector was reduced.[51] The Rural Support Fund (RSF) was established, incorporating all previous "off-budget" support funds and investment programs. In this context, the list of products receiving support was shortened significantly, support prices for commodities that continued to receive support were cut in real terms, and limits on the production volumes eligible for price support or direct subsidies were tightened (e.g., the grain quota for 1997 was set one third below that of 1996).

66. More recently, against the background of declining world commodity prices and, especially, the crisis in Russia in August 1998 which has given rise to a sharp decline in agricultural exports, the government has introduced a number of retrograde measures. In November 1998, import tariffs on selected agricultural commodities were raised, in some cases by substantial margins. Binding minimum import prices were also raised on a selective basis. Direct and implicit budgetary support to agriculture was increased, as subsidies and investment grants expanded, and tax relief was provided to individual food processing enterprises.[52] For 1998 as a whole, it is estimated that direct budgetary support to agriculture rose by 25 percent in nominal terms, which is equivalent to a real increase of about 20 percent.[53]

67. Ownership of agricultural land has proven to be a politically sensitive issue. After regaining independence, Lithuania decided to follow the policy of restitution with the objective of returning all property that had been confiscated during the Soviet period to previous owners. Priority was given to those willing to farm. (Claims that cannot be honored through restitution are settled through cash compensation.) However, the slow progress in the land restitution process has hampered the process of consolidating small farms and the development of an agricultural land market.

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[50]It had previously benefitted from a preferential rate of 9 percent.

[51]Lithuanian farmers are also protected through binding reference prices for imports, which are inconsistent with WTO requirements. Imports from Estonia and Latvia are exempted from such reference prices through the Baltic Free Trade Agreement.

[52]Additional support to agriculture is being provided through the Small and Medium Business Promotion Fund, which is expanding its activities following a government resolution passed in May 1999. It includes the compensation of up to 50 percent of loan interest payments for a period of a maximum of three years. Also, agricultural enterprises benefit from a preferential profit tax of 10 percent (compared with the 29 percent standard rate), and for farmers who derive 50 percent or more of their income from agriculture a zero income tax rate is applied.

[53]This included LTL 76 million (0.2 percent of annual GDP) outlays financed from privatization proceeds.

68. Agricultural land cannot be bought by domestic and foreign legal entities, and there remain upper limits on the amount of land that can be owned by individuals.[54] Also, only registered land can be legally sold or leased. All this has hampered the evolution of a market for agricultural land, the restructuring in the sector (especially the much needed consolidation of small holdings), and the development of an agricultural credit market as land cannot be used as collateral.

F. Trade Policies

69. Lithuania has maintained a relatively liberal external trade regime, despite the recent policy reversals, which included increases in import tariffs on selected goods and the intensification of a few other restrictions (see below).[55] Lithuania does not have non-tariff barriers on exports, and the government plans to abolish the few remaining exports tariffs (on hides and skins, and lumber) effective January 1, 2001. Nontariff barriers on imports are limited to licensing requirements for a few groups of products (petroleum, alcohol, and tobacco), and some recently intensified restrictions on public procurement. Shuttle trade regulations were tightened effective February 1999, when lower limits for the importation of petrol, alcohol, and tobacco, and some food products by individual travelers were introduced.

70. Except for agricultural products, Lithuania's tariff regime continues to be characterized by low average rates and moderate dispersion. Following the increase in tariffs on a number of agricultural products, fertilizer, and a few other items in the fall of 1998, the average tariff rate for all products rose marginally from 4.5 percent in April 1998 to 5.3 percent in May 1999 for imports from most-favored nation countries (Table 25).[56] However, the average tariff on agricultural goods increased from 11.3 percent to 14.4 percent during the same period.

71. In July 1998, a general Law on Customs Tariffs became effective. The law defines the types of customs duties that may be applied, instances of customs duty application, and procedures for establishing, approving, and applying tariffs.

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[54]A constitutional amendment designed to remove the restriction on agricultural land ownership by legal persons was submitted to a referendum in early 1997. The amendment passed, but the result was invalid due to low voter turnout. The restriction has thus remained in place.

[55]Despite these reversals, Lithuania continues to receive the most favorable rating (one on a scale from one to ten) on the IMF's trade restrictiveness index.

[56]Subsequently, the government raised the duty on oil imports from Eastern countries from 5 percent to 15 percent.

72. Negotiations with the WTO and bilateral trade partners have continued, with the remaining issues relating to domestic support and protection for agriculture. The Lithuanian authorities hope to be able to finalize the WTO ratification process by mid-2001.

VI. STRUCTURE AND DEVELOPMENT OF THE FINANCIAL SECTOR

A. Introduction and Overview

73. This chapter provides an overview of recent financial sector developments, with particular focus on the regulatory framework, and draws some policy conclusions as regards further development of the financial system. Lithuania's financial sector has undergone dramatic changes since the start of transition, especially following the banking crisis in 1995/96. Financial deepening, measured both by the assets of the commercial banking system and broad money, has increased since 1996, although it is not yet back at pre-crisis levels (Table 8). Commercial bank consolidation has made progress during 1998 and foreign investors have recently shown renewed interest in Lithuanian banks. Major policy initiatives since 1995 have included the establishment of a workout unit for bad loans (Turto Bank) in 1996, setting up a uniform deposit insurance scheme for household deposits in 1997, continued improvements in financial sector supervision, and amendments of laws and regulations in line with EU directives.

74. This chapter is organized as follows. Section B provides an overview of recent developments in the banking sector. Section C discusses banking supervision and prudential regulations. Section D gives an overview of the deposit insurance. Sections E, F and G discuss the credit unions, insurance-sector, and capital markets, respectively. Section H concludes.

B. The Banking System: Recent Developments

75. The commercial banking system has gone through a major consolidation since the banking crisis in 1995–96. The loan to deposit ratio declined from 96½ percent at the end of 1995 to 69 percent at the end of 1997, but increased to 81 percent in April 1999, mainly due to a significant rise in lending in foreign exchange. Following the 1995-96 crisis, the banking system as a whole has succeeded in increasing its capital, and in 1998 all locally incorporated commercial banks reported profits for the first time since the banking crisis.

Table 8. Lithuania: Developments in the Commercial Banking System, 1995-99

	1995	1996	1997	1998	April 1999
			(Number)		
Number of commercial banks 1/	12	12	11	10	10
Majority state-owned	3	3	3	2	2
Majority privately owned	9	9	8	8	8
			(Percent of GDP)		
Assets of commercial banking system 2/	27.8	22.6	23.8	25.2	...
Loans of commercial banks	15.1	10.9	10.8	12.0	...
Deposits of commercial banks	15.6	13.1	15.6	15.6	...
Household deposits of commercial banks	6.7	4.7	5.8	7.0	...
			(Annual growth rate, percent)		
Loans of commercial banks	0.5	-5.5	20.8	24.1	32.1
Litai	5.4	-8.0	9.4	-9.1	3.0
Foreign exchange	-8.7	-0.2	43.4	74.7	65.1
Deposits of commercial banks	5.1	9.8	45.3	11.0	20.1
Litai	13.1	5.6	51.6	5.6	22.3
Foreign exchange	-5.4	16.4	36.4	19.7	16.7
			(Percent)		
Loan to deposit ratio	96.6	83.1	69.1	77.2	80.8
Litai	108.3	94.4	68.1	58.6	54.9
Foreign exchange	78.3	67.2	70.6	103.0	121.5
Memorandum items:					
Broad money (M2 in percent of GDP)	23.3	17.2	18.9	19.5	...
Currency outside BOL (percent of broad money)	35.3	36.9	37.5	36.5	35.2
Currency outside the BOL (percent of GDP)	8.2	6.3	7.1	7.1	...
Nominal GDP (million litas)	24,103	31,569	38,430	42,768	...

Source: Bank of Lithuania.

1/ In addition, two foreign banks (Polish Kredyt Bank and Societe Generale) have established branches in Lithuania and four foreign banks (Bank Polska Kasa Opieki SA-Grupa Pekao SA, Kontakt, CA IB Investmentbank Aktiengeschellschaft, and Norddeutsche Landesbank Girozentrale) have established representative offices. In May 1996 the BOL licensed a subsidiary of a foreign bank. There also exist two specialized banks, the Development Bank and Turto Bank (the asset management company for bad loans).

2/ Locally incorporated commercial banks and branches of foreign banks. From December 1997, including claims on other banking institutions. Total assets of the commercial banking system, the two specialized banks, and the credit unions accounted for 27.7 percent of GDP at the end of 1998.

76. The number of banks more than halved from 28 in early 1994 to 12 at the end of 1995.[57] Private banks ran into difficulties from late 1994, and in 1995 the state banks also experienced liquidity and solvency problems. Under World Bank auspices, and consistent with IMF advice, the authorities closed the smaller private banks. Two banks had their licenses revoked in 1997 and 1998 (Tauro Bank and State Commercial Bank). Ten locally incorporated commercial banks are currently operating in Lithuania. In May 1999, the BOL licensed a subsidiary of a foreign bank. The second largest privately owned bank (Hermis Bank) was given permission to buy the much smaller Industry Bank. In addition, two foreign banks have branches in Vilnius, four foreign banks have established representative offices, and two other banking institutions have restricted licenses.[58]

77. The commercial banking system in Lithuania is segmented into three distinct groups: the two state-owned banks (Savings Bank and Agricultural Bank) with about 45 percent of total assets of the commercial banking system; the two largest privately owned commercial banks (Vilnius Bank and Hermis Bank) with about 40 percent of total assets; and the remaining six locally incorporated commercial banks and the two branches of foreign banks. Foreign investors play important roles in several of the privately owned commercial banks, including the two largest ones.[59] The BOL issued in May 1999 a regulation preventing mergers that might result in one bank having a market share exceeding 40 percent.[60]

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[57]For an historical overview of the banking system in Lithuania, see Chapter 1 in World Bank (1998), *Lithuania—An Opportunity for Economic Success*; SM/96/128 (6/12/96); and SM/97/149 (6/13/97).

[58]The Lithuanian Development Bank is operating under a special law, but is in the process of being licensed as a commercial bank. Turto Bank, a de facto loan recovery agency, was created from the shell of a failed bank in November 1996, and is governed by a special law. Subsequently, Turto Bank has received bad loans from several banks, including the State Commercial Bank and Agricultural Bank in 1998; it is also participating in the bankruptcy proceedings of several banks. The recovery process is somewhat impeded by the time needed for criminal investigations, including cases of money laundering, and liquidation procedures. Additional information can be found on Turto Bank's web-site (www.turtas.lt).

[59]In December 1998, SEB (a large Swedish bank) acquired 32 percent of Vilnius Bank (SEB currently controls 36 percent). At the same time, SEB also acquired ownership stakes in a bank in Latvia and one in Estonia, thus integrating Vilnius Bank into a pan-Baltic banking group. Foreign investors currently own about 91 percent of Vilnius Bank and 55 percent of Hermis Bank.

[60]In 1998, Vilnius Bank, which account for about 25 percent of total assets, made a takeover bid for a substantial share of Hermis Bank, which accounts for about 15 percent of total assets. The bid was withdrawn in April 1999, but an agreement between the two banks

(continued...)

78. The assets of the commercial banking system have resumed their growth following the banking crisis. Bank lending grew by 24 percent in 1998, and after a slowdown towards the end of 1998, it has picked up again, increasing by 32 percent in April 1999 compared with April 1998. The shares of long-term loans and of loans denominated in foreign exchange rose during this period; loans in foreign exchange accounted for 58½ percent of total loans at end-April 1999, compared with about 47 percent a year before. This strong rise reflects generally lower interest rates on foreign exchange denominated loans and the fact that the BOL liberalized lending in foreign exchange in October 1997.

79. On the liabilities side, deposits increased by 20 percent from April 1998 to April 1999. In particular, the share of time deposits and the share of deposits denominated in foreign exchange rose. The loan to deposit ratio thus increased from 73½ percent to almost 81 percent during this period. The loan to deposit ratio in litai, however, declined from 65 percent to 55 percent, while the ratio in foreign exchange increased from 86 percent to 121½ percent.[61] This, in part, reflects interest rate developments, the fact that commercial banks have a portfolio of treasury bills (in litai), and the fact that banks moved from having net foreign assets to having net foreign liabilities in early 1998. The banks thus increasingly rely on foreign funding. After the Russian crisis in August 1998, the banking system has continued to succeed in attracting foreign funding, but at higher interest rates, which have been passed on to borrowers (Figure 6).

80. Off-balance sheet liabilities increased substantially, by 26 percent, during 1998, amounting to almost 13 percent of total bank liabilities by the end of the year. The increase during 1998 in part reflects increased activities of state-owned banks in foreign exchange contracts. Foreign exchange contracts account for about 55 percent of all off-balance sheet liabilities, while undrawn credit facilities and guarantees account for approximately 25 percent and 12½ percent, respectively. Foreign exchange sale contracts are to a large extent matched by foreign exchange purchase contracts, thus limiting the net open position in foreign exchange.

81. In 1998, all locally incorporated banks reported profits for the first time since the 1995-96 banking crisis, although external auditors of some banks recommended additional provisions for bad loans. Profits before tax of locally incorporated banks accounted for about 0.8 percent of total assets compared to -0.7 percent in 1997 (0.2 percent excluding the State

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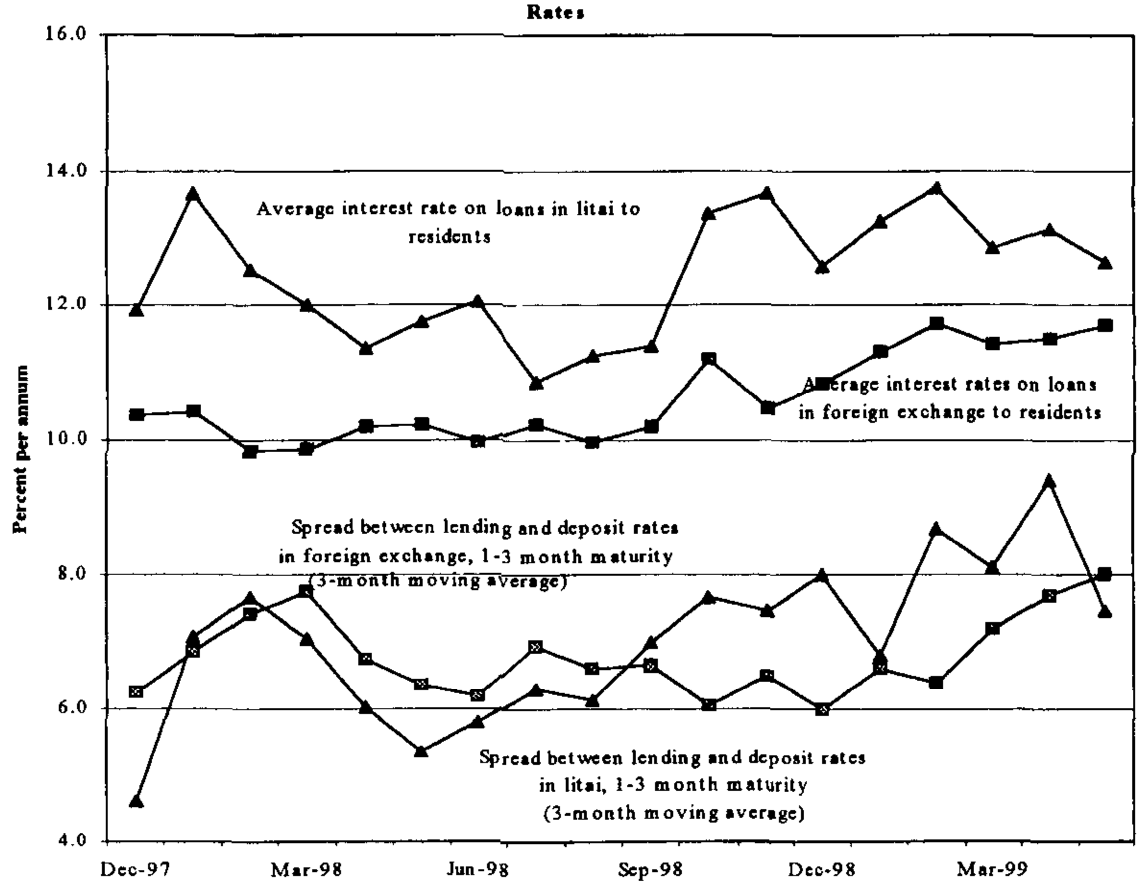
[60](...continued)
regarding a possible merger has since been announced.

[61]In April 1999, deposits grew 6½ percent, concentrated in demand deposits in litai, in part as a result of large payments under the SRP.

Figure 6: Average Interest Rates on Loans and Spread between Lending and Deposit Rates



Source: Bank of Lithuania.

Commercial Bank). The average spread between bank lending and deposit rates has increased since mid-1998, in part reflecting increased credit risk (Figure 6).[62]

C. Banking Supervision and Prudential Regulations

82. The BOL, which is responsible for supervision of banks and credit unions, has made substantial progress toward effective banking supervision since the banking crisis in 1995-96. The BOL has also come a long way toward compliance with EU requirements (see Box), and the Board of the BOL resolved in December 1998 that the BOL will implement the Core Principles for Effective Banking Supervision approved by the Basle Committee on Banking

[62]The relatively high spread is attributable to unremunerated required reserves (10 percent reserve ratio) and the deposit insurance premium on household deposits (1.5 percent).

Supervision.[63] Since October 1998, all commercial banks reportedly comply with all prudential requirements.

Banking supervision

83. The capacity and operational autonomy of the BOL's Credit Institutions Supervision Department have improved over the past two years. The Department currently has 65 staff members compared with 55 at the end of 1997 and 17 at the end of 1993. The Board of the BOL, however, occasionally determines to ease the recommended sanctions. The BOL has established informal contacts with the Securities Commission and the State Insurance Supervisory Authority to facilitate supervision on a consolidated basis. Agreements with a view to share information are currently being negotiated with relevant foreign banking supervisors.

Prudential regulations

84. The Law on Commercial Banks and bank regulations have continuously been amended with a view to ultimately ensure compliance with EU directives and the Core Principles for Effective Banking Supervision. Banks have been subject to International Accounting Standards (IAS) since 1996. Because IAS leave some flexibility to the banks, the BOL requires that banks specify their methodology in an explanatory letter and cannot change their accounting practice without notifying the BOL. The BOL has issued rules for specific provisions, but relies on IAS regarding general provisions.[64] If there is a conflict between the credit institution and the BOL regarding the required level of provisioning, the BOL has the authority to require additional provisions. Annual financial statements are audited by internationally recognized auditors, whose statements are published. For the first time, the 1998 annual financial statements had to be audited on a consolidated basis. Banks and their credit undertakings are supervised on a consolidated basis, based on EU sectorial definitions. Supervision on a consolidated basis has become increasingly important since banks have established leasing and insurance subsidiaries.

85. Since January 1997 banks have been subject to a 10 percent capital requirement of risk-weighted assets to cover credit risk, using EU methodology. The BOL expects to adopt the EU capital adequacy directive by the end of 2000.[65] Large exposures above 10 percent of own funds are reported to the BOL regularly, and the maximum exposure to one borrower or

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[63]Resolution No. 244 of the Board of the Bank of Lithuania of December 17, 1998.

[64]Regarding accrued interest on nonperforming loans, a bank board may decide not to accrue interest on loans when the borrower fails to pay interest for a period exceeding that fixed by the resolution of the board.

[65]Currently, banks' trading books are reported not to exceed 5 percent of their total business.

group of borrowers is 25 percent. However, in contrast to the EU directive on large exposures, there is not yet a cumulative limit on all large exposures. The centralized database for loans, which registers all loans above LTL 50,000, has been expanded to include loans to subsidiaries. The methodology for calculating the liquidity ratio has recently been strengthened.

Banking sector indicators

86. The commercial banking system has succeeded in building up its capital base and improving the quality of its loan portfolio, and has become profitable. The direct effects of the Russian crisis in August 1998 are reportedly limited. The capital adequacy ratio of locally incorporated commercial banks reportedly increased from 10.8 percent at the end-1997 to 23.8 percent at end-1998, and improved further to 22.7 percent at end-March 1999. This reflects an increase in liable capital of some banks. The leverage ratio was reported to be 14.8 percent at end-March 1999 (Table 9).

87. The quality of the loan portfolio has increased significantly. The share of nonperforming loans declined from 22.2 percent of total loans at end-1997 (excluding State Commercial Bank) to 12.2 percent at end-March 1999 (Figure 7). Moreover, specific provisions of locally incorporated banks declined from 18.5 percent of total loans to 5.6 percent during the same period. The improvement of the quality of the overall loan portfolio should be seen in context of the robust economic growth during the first half of 1998, the closure of the State Commercial Bank in March 1998, and the transfer of bad loans of the Agricultural Bank to the workout unit. It also reflects the fact that the BOL has reviewed banks' credit policies for corporate customers and issued rules regarding credit assessment of retail loans. The BOL has also adopted regulations requiring banks to write off loans that have been classified as losses for two quarters (effective January 1, 1999). The exposure to the construction and real estate sector is relatively modest (less than 7 percent of all loans, see Table 10). About 11.5 percent of all loans are collateralized by real estate. Finally, banks reportedly comply with the prudential regulation for large exposures and lending to connected borrowers.

Box 1: Summary of Prudential Regulations of Commercial Banks

Type	Requirements
Accounting standards	International Accounting Standards (IAS) required since 1996. In 1998, financial statements were for the first time audited on a consolidated basis
Minimum capital	Euro 5 million since January 1, 1998.
Capital adequacy ratio	10 percent of risk-weighted assets. EU and BIS methodology used since January 1997. Definition of Tier II capital clarified in 1999. Capital requirements for market risks expected to be implemented by the end of 2000.
Provisioning	
Specific:	Loan classification based on past days due and risk, while provisioning also takes collateral into account: Standard (less than 7 days past due); Watch (7-30 days past due); Substandard (31-90 days past due, 20 percent provisioning); Doubtful (91-180 days past due, 40 percent provisioning); and Loss (more than 180 days past due, 100 percent provisioning). Loans classified as loss for more than six months must be written-off (effective 1999).
General:	According to IAS. General provisions formed from profits after tax.
Maximum lending to single borrower	25 percent of own funds. Large exposures of 10 percent and above reported regularly. No regulation regarding sectorial concentration, but monitored by the BOL. No cumulative limit for all large exposures.
Maximum connected lending	Lending to connected persons and insiders, including the auditor, is limited to 10 percent. Lending against own shares/securities prohibited.
Equity investment in nonfinancial institutions	The total sum of investment in a non-financial company may not exceed 10 percent of core capital. Banks are prohibited from acquiring controlling interest in nonfinancial companies. No restrictions on investments in specified financial institutions.
Liquidity ratio	30 percent of liabilities maturing within one month. Methodology strengthened (e.g., certain securities can no longer be included as liquid assets), effective July 1, 1999.
Required reserves	10 percent of deposits, including foreign liabilities, not exceeding one year, averaging during maintenance period, unremunerated.
Foreign exchange.	Overall open position: 30 percent of own funds; and in one currency: 20 percent of own funds.
Off-site supervision based on CAEL	Monthly submission of balance sheet and key prudential ratios. Quarterly submission of profit and loss statements. The information is used in an early warning system. The BOL may require more frequent submission of information.
On-site supervision based on CAMEL	At a minimum, one annual on-site inspection in addition to the external audit, which both include a review of the loan portfolio. The external auditor is obligated to collaborate with the BOL. The BOL conducts ad hoc inspections focusing on particular issues.
Y2K	Banks must comply with an action plan and report quarterly. The annual external audit of 1998 and the regular BOL on-site inspections in 1999 include a review of bank preparedness for the Y2K problem.
Deposit protection, effective January 1, 1999	Litas: 100 percent up to LTL 10,000; 90 percent from LTL 10,000 to 25,000; 70 percent from LTL 25,000 to 45,000. Foreign exchange: 90 percent up to LTL 10,000; 80 percent from LTL 10,000 to 25,000; 60 percent from LTL 25,000 to 45,000. In May 1999, it was proposed to amend the law on deposit insurance with a view to include branches of foreign banks and to further phase the increase in coverage.
Money laundering	Law on Money Laundering adopted in June 1997, methodology clarified by the BOL.
Sanctions	The BOL can impose sanctions ranging from penalties (paid by individuals); removal of managers, members of the board and council; suspend certain operations; appoint a temporary administrator, and suspend or revoke the license.

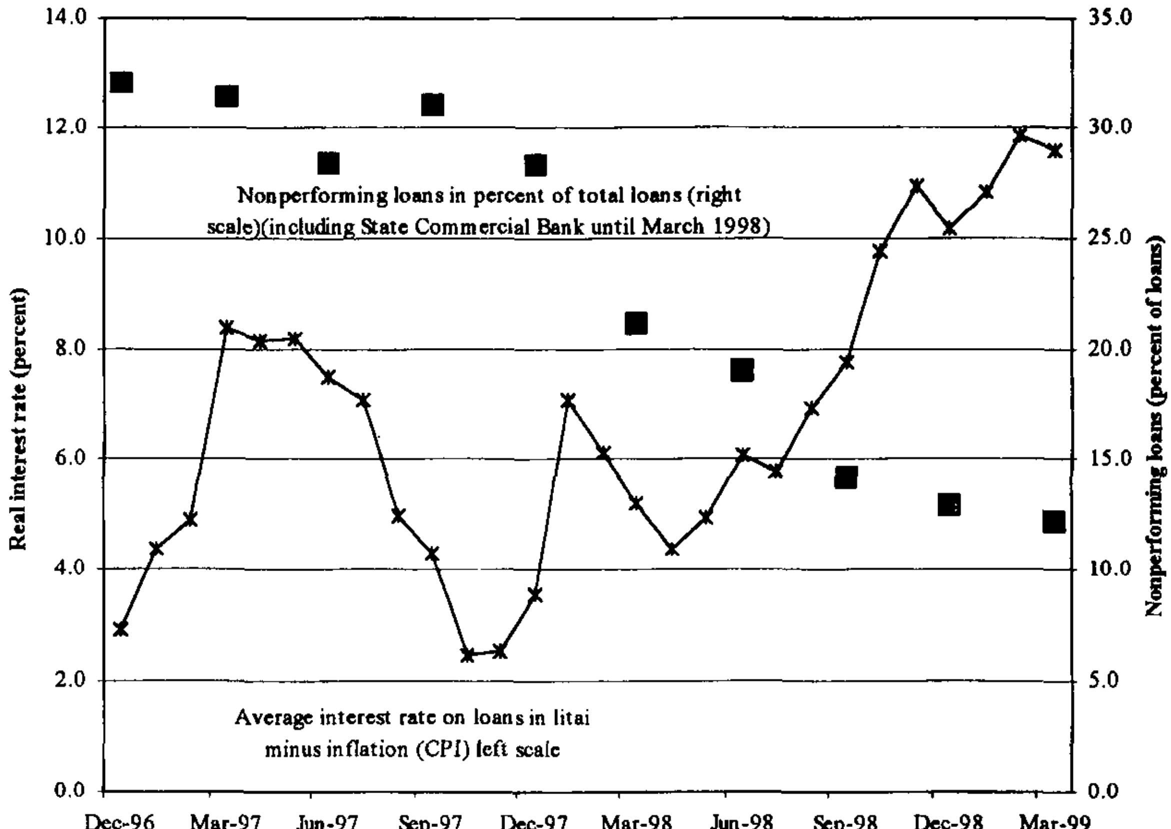
Table 9. Lithuania: Prudential Indicators of Commercial Banks, 1996-99

	1996	1997	1998	March 1999
		(End of Period)		
Capital adequacy ratio (percent)	10.5	10.8	23.8	22.7
State-owned banks (percent)	...	0.3	19.6	18.3
Privately owned banks (percent)	...	18.0	26.0	25.1
Leverage ratio 1/	6.6	5.9	14.9	14.8
Nonperforming loans (percent of total loans)	32.1	28.3	12.9	12.2
Specific Provisions (percent of loans)	...	18.5	5.7	5.6
Loans collateralized by real estate (percent of loans)	...	12.9	12.0	11.5
Loans in foreign exchange in percent of total loans	33.4	39.7	55.8	57.5
Net foreign assets (percent of total assets)2/	5.4	3.4	-4.4	-3.6
Net foreign assets (percent of international reserves)2/	11.6	7.3	-8.2	-8.0
Aggregate open position in foreign exchange 3/	...	-33.4	-3.8	3.0
Liquidity ratio (percent)	...	65.5	58.7	57.2
State-owned banks (percent)	...	56.1	48.7	50.0
Privately owned banks (percent)	...	76.1	70.0	65.6

Source: Bank of Lithuania.

1/ Defined as the ratio of total capital to total liabilities; an increase in the ratio indicates an improvement.
2/ The March 1999 figure includes total banking system and credit unions.
3/ Percent of own funds. The State Commercial Bank and the Agricultural Bank were exempted from capital requirements in 1997.

Figure 7: Real Interest Rate and Nonperforming Loans



Source: Bank of Lithuania.

88. The Russian crisis in August 1998 has been reported to have relatively limited direct impact on Lithuanian banks as their direct exposure to Russia (mainly in the form of securities) was 1½ percent of total assets. This low exposure was in part a result of the fact that the BOL requires full risk-weight for claims on CIS countries, including government securities issued by such countries. Furthermore, government support programs offered to enterprises affected by the Russian crisis have so far helped limit the indirect impact on banks. The Russian crisis nevertheless necessitated additional provisions of LTL 54 million, equivalent to about 1 percent of total loans. Although economic activity has remained subdued and real interest rates have increased in the aftermath of the Russian crisis (Figure 7), the BOL is confident that appropriate provisions have been made to cover indirect effects.

Table 10. Lithuania: Composition of Bank Loans by Economic Activities, 1995-99

	1995	1996	1997	1998	March 1999[1/]
	(End of period, percent of total loans)				
Agriculture, hunting, forestry, and fishing	7.0	8.2	6.5	4.8	5.0
Mining and quarrying	0.1	0.1	0.1	0.6	0.8
Manufacturing	23.8	30.4	28.6	23.9	27.8
Electricity, gas, and water supply	2.3	2.6	3.3	6.3	8.7
Construction	10.6	9.7	3.1	2.7	3.3
Real estate, renting, and business activity	5.7	7.2	4.3	3.0	3.0
Wholesale and retail sale	27.2	22.0	21.7	22.1	25.6
Hotels and restaurants	0.8	1.0	1.0	1.6	2.1
Transport, storage, and communication	3.4	4.0	4.2	4.3	5.7
Banks	3.4	2.0	1.5	0.3)	8.6
Other financial intermediaries	0.6	1.4	3.5	8.0)	
Other economic activities	15.1	11.4	22.2	22.4	9.4

Source: Bank of Lithuania.

1/ The quarterly reporting of loans by economic activities was changed, effective January 1, 1999, having regard to the breakdown used in the European Union. The breakdown is thus based on the economic activity the loan is financing rather than the economic entity.

89. Available data indicate that commercial banks are very liquid (Table 9). Banks generally have relatively large holdings of treasury bills, which accounted for about 11 percent of total assets in March 1999. The secondary treasury bill market, however, is not particularly deep, and the activity in the money market is also relatively modest.

90. Banks' direct foreign exchange exposure is limited, since banks typically hedge or pass on their currency risk to borrowers (Table 9). Banks are also potentially exposed to some interest rate risk, in part from their portfolio of treasury bills (although their maturities are short) and other debt securities (about 2½ percent of total assets). On average, banks' portfolio of equities is relatively modest (about 1½ percent of total assets).

D. Deposit Insurance

91. A limited uniform deposit insurance scheme for individual depositors has been in place since 1997. State-owned banks had a competitive advantage until spring 1997, when Seimas revoked the Civil Code provisions that guaranteed full deposit protection for individual deposits in these banks. In 1998, all deposits at the State Commercial Bank were transferred to the Savings Bank and thus fully covered. The coverage of the deposit insurance scheme is phased, covering up to LTL 45,000 in 1999, and rising to LTL 65,000 in year 2000. Coinsurance is also phased, thus, in 2000 the first LTL 25,000 will be fully covered, 90 percent of the next LTL 20,000 will be covered, and the next LTL 20,000 will be covered by 70 percent. Deposits denominated in foreign exchange (U.S. dollars and currencies of EU member states) are covered as well, but the coinsurance is larger (90 percent, 80 percent, and 60 percent, respectively). The insurance premium is currently 1.5 percent of household deposits, but will be reduced to 1 percent, effective January 1, 2000. The Deposit Insurance Fund has assets available to cover about 2½ percent of all household deposits. An amendment of the law is being considered with a view to change the phasing and coverage, and to allow branches of foreign banks operating in Lithuania to participate.

E. Credit Unions

92. The BOL issues and revokes licenses and supervises credit unions according to the Law on Credit Unions. The minimum capital for a credit union is LTL 15,000, and the number of members must be at least 50. Credit unions must meet the following criteria: (i) credit union capital shall not be less than 13 percent of risk-weighted assets; (ii) a liquidity ratio of 30 percent; and (iii) limits on open positions in foreign exchange (20 percent of credit union capital in one currency and 30 percent in total exposure). Credit unions need the BOL's permission to carry out operations in foreign exchange.

93. Although the number of credit unions has more than doubled from 12 in early 1997 to 29 at present, they still account for less than 0.1 percent of the assets of commercial banks. Credit unions submit financial reports to the BOL and are subject to on-site inspections, but less frequently than banks. The financial officer of a credit union must pass an exam. Depositors are not covered by the deposit insurance fund.

F. The Insurance Sector

94. The insurance sector has grown rapidly in recent years, but its size remains modest. Total investments of insurance companies increased by 23 percent during 1998, but still accounted for less than 1 percent of GDP at the end of 1998. Approximately 64 percent of insurance companies' investments are in government securities. As of May 1999, there were four insurance companies providing life insurance and 27 companies providing non-life insurance. In addition, four life insurance companies are still liable for contracts concluded before July 31, 1997 under the former regulation, and three non-life insurance companies and two life insurance companies were under liquidation. Four insurance

companies were licensed in 1998 and one in April 1999.[66] Several banks have established or are in the process of establishing insurance subsidiaries, and many nonresidents have invested in insurance companies. The largest insurance company, Lietuvos Draudimas, which accounted for more than half of the premiums written in 1998, was privatized in May 1999, when 70 percent of the shares were sold to a foreign insurance company.

95. The Law on Insurance of 1996 delegates the authority to supervise insurance companies to the State Insurance Supervisory Authority. The law is currently under review with a view to facilitate compliance with international standards. The Supervisory Authority has about 30 staff members, who analyze the quarterly reports submitted by insurance companies and conduct regular on-site inspection every 1½–2 years, along with ad hoc inspections.

G. Capital Markets

96. The capital market in Lithuania consists of the stock market, which is divided into quoted and unquoted stocks, and the market for government securities.[67]

The stock market

97. The National Stock Exchange of Lithuania (NSEL) was created by government resolution in 1992 and started operating in September 1993. Both equities, which accounted for about 60 percent of the turnover in 1998, and treasury bills are traded at the Stock Exchange. In 1998, several legislative changes affected the Stock Exchange. The Law on Companies was amended, which made dematerialization of public limited companies compulsory. The Law on Public Trading of Securities was also amended with a view to clarifying disclosure requirements and reorganizing the Stock Exchange and the Central Securities Depository from nonprofit companies to profit-seeking public limited companies. In April 1998, continuous trading was introduced and since June 1998, equities have been divided into an Official list, a Current list, and unlisted securities. The Official list includes the most liquid securities and companies that report according to IAS (six securities were listed, in early 1999, including two banks).

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[66]Additional information on insurance companies can be found on: www.finmin.lt.

[67]For a historical overview of the development of the capital markets in Lithuania, see Chapter 11, World Bank (1998), *op. cit.*

98. During 1998, the capitalization of the quoted stocks fell from almost 18 percent of GDP to 10 percent of GDP. This to a large extent reflected the fact that the index of quoted stocks plunged about 41 percent during 1998 and since has remained subdued.[68]

Government securities

99. Government securities mainly consist of treasury bills, but special nontradable restructuring securities and newly introduced savings bonds also exist. Treasury bills are issued with 1-, 3-, 6-, and 12-month maturities and notes with a 2-year maturity.[69] They are auctioned at multiple-price auctions. The secondary market for treasury bills is rather thin, with the result that the authorities are considering introducing a primary dealer system. The yield on treasury bills was relatively stable during the first half of 1998, but immediately after the Russian crisis, banks wanted to remain liquid, and the bids fell short of the offers, resulting in higher interest rates (Figure 8).[70] In April 1999, the government issued its first savings bonds.

The Securities Commission

100. The Securities Commission is charged with regulating and supervising capital markets. With the adoption of the Law on Public Trading in Securities of 1996, it became an autonomous institution directly accountable to Seimas and funded by the government. The Law on Securities, the Company Law, the Law on Investment Companies, and the Code of Ethics of Intermediaries of Public Trading of Securities establish the framework for participants in the capital market. The Commission oversees the Lithuanian Stock Exchange, the Central Securities Depository, brokerage firms, investment companies, and it will also supervise the new private pension funds, according to the law on private pension unds adopted in June 1999 (which will become effective January 1, 2000). Several regulatory changes were adopted during 1998 with a view to complying with the relevant EU directives. For instance, new capital requirements for brokerage firms became effective,

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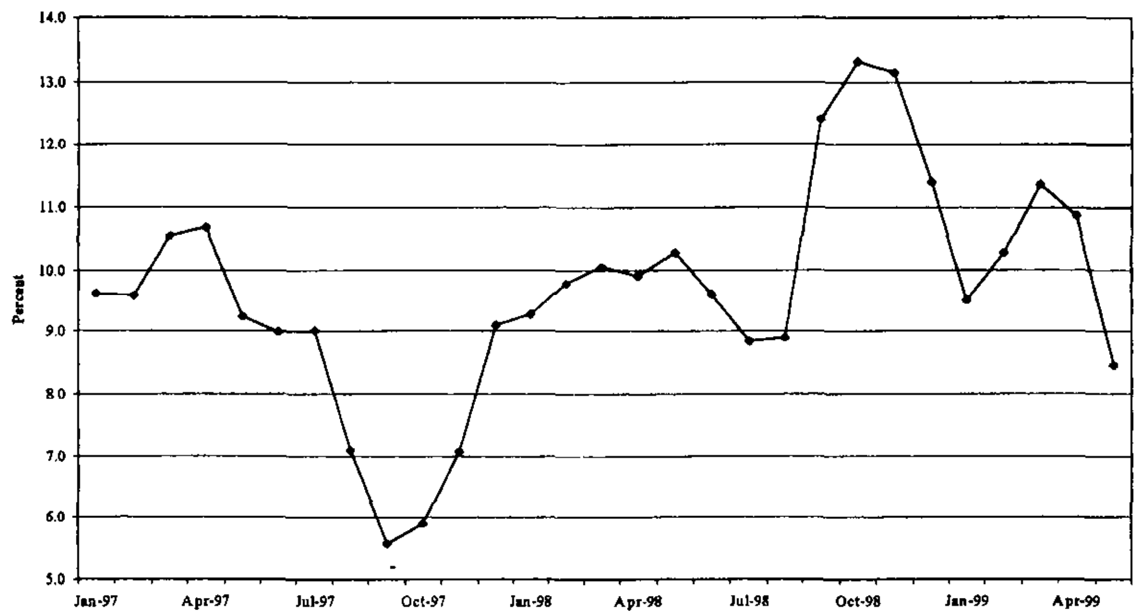
[68]Additional information on the Stock Exchange can be found on its web-site: www.nse.lt.

[69]The outstanding amount of treasury bills increased from LTL 1.5 billion at end-1997, to LTL 1.6 billion at end-1998, and to LTL 1.9 billion at the end of May 1999. At the end of 1998, the maturity distribution was 6 percent, 21 percent, 44 percent, and 28 percent on 1-, 3-, 6-, and 12-month maturities, respectively. The 12-month maturity was introduced in 1997 and the 24-month maturity was introduced in 1999. Commercial banks' share of total outstanding treasury bills declined from about 84 percent of total outstanding treasury bills at the end of 1997 to 64 percent at the end of 1998. About 20 percent are held by insurance companies, 1½ percent by nonresidents, and about 15 percent by others.

[70]Information on the market for government securities can be found on: www.finmin.lt.

Figure 8: Three Month Treasury Bill Interest Rate



Source: Ministry of Finance.

and the legal status of the Stock Exchange and the Central Securities Depository were changed. Furthermore, rules on notification of acquisition or sale of a substantial bloc of shares and disclosure of issuer's material events have been strengthened. Before the end of 2000, the Commission intends to prepare amendments to the Securities Law with a view to fully comply with relevant EU directives. The three Baltic securities commissions have agreed to unify their coordination efforts.[71]

101. The Securities Commission licenses brokers trading at the Stock Exchange.[72] At the end of 1998, 50 broker companies were licensed, of which 39 were brokerage firms and 11 were brokerage divisions of banks, compared to 102 licensed broker intermediaries in 1994. Several of the brokerage firms are owned by foreign investors. New capital requirements became effective January 1, 1998, with the result that two brokerage firms had their license revoked and four firms had their license temporarily limited until they complied with the new capital requirements. The brokerage firms thus increased their own

[71]For further information, see the Lithuanian Securities Commission's *Annual Report of 1998* and its web-site (www.lsc.lt).

[72]Licenses for financial brokerage companies are divided into three categories: (A) a general license with a right to engage in all types of activities listed in the Securities Law; (B) a license where a brokerage firm cannot trade on its own account and underwrite securities; and (C) a license for investment advisors. At the end of 1998, 228 individuals held a broker's license.

capital by 25 percent during 1998 to LTL 44.5 million. These firms, however, experienced an operating loss of LTL 3.6 million during 1998. The largest broker accounted for almost 15 percent of the turnover at the Stock Exchange, and the five largest broker intermediaries account for about 55 percent of the turnover.

H. Conclusions

102. Important strides have been made since the 1995-96 banking crisis to rationalize the banking sector and strengthen prudential oversight. However, the monetization of Lithuania's economy has remained relatively modest. Mobilization of savings is also limited, and there continues to be a strong reliance on cash, in spite of a relatively generous deposit insurance scheme. Against this background, the authorities are committed to improving the soundness of the financial system further and developing it with a view to facilitate sustainable economic growth. The authorities intend to implement a number of measures toward this end, including the privatization of the two state-owned banks, continued enhancement of banking supervision, and further development of capital market infrastructure.

103. The two remaining state-owned banks continue to dominate the banking sector and the government generally keeps its deposits with these banks, which also provide a range of banking services to the government, all of which may affect competitiveness. These two state-owned banks are expected to be privatized in 1999/2000, with a view to ensuring a level playing field. To this end, the Agricultural Bank has already transferred bad loans of a net value of LTL 28 million (gross value LTL 288 million) to the workout unit (Turto Bank) to improve its balance sheet. However, an attempt to privatize it failed. As part of the preparations of privatization, the possible transfer of further bad loans to the workout unit and the clarification of the role of these banks as service providers for the government are currently being discussed.[73]

104. The authorities are also determined to further enhancing banking supervision. The BOL has adopted a three-year strategic plan and a more detailed annual action plan. The Law on Commercial Banks and bank regulations will be amended as necessary, after discussions with the banking industry, with a view to comply with EU directives and the Basle Core Principles for Effective Banking Supervision. The authorities also plan to continue the enhancement of the supervision of capital markets in line with EU-directives, and to develop the legal framework for institutional investors, like the recently adopted law on private pension funds.

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[73]The European Union's PHARE program is funding the consultants who assist the authorities with the privatization.

Lithuania: Summary of the Tax System, July 1999

Tax	Tax Base	Deductions/Exemptions	Rates
1. Taxes on Income and Profits			
1.1. Corporate Income Tax	Imposed on profits of legal persons. Profits are revenues plus miscellaneous income less costs (production costs, depreciation, interest, wages)	*Deductions:* Charitable Contributions, Nonprofit public organizations, etc. If a company does not choose to use zero rate for retained profit, deduction of value of acquired long term assets (investment) is allowed	29 percent Rate on retained earnings: 0 percent Agricultural enterprises: exempted by special law Rates for enterprises employing handicapped employees are reduced by 25–100 percent, according to number of handicapped employed. If before April 1, 1997 a foreign investor has invested foreign capital of not less than US$2 million a three-year profit tax exemption applies followed by a 50 percent profit tax reduction for a further three years.
	Enterprises with fewer than 50 employees and less than 1 million Lt annual turnover		50 percent reduced rate
1.2. Personal Income Tax	1. Wages, salaries, bonuses of residents and nonresidents (withheld at source)	Basic deduction (BD): LTL 214 *Exemptions*: Pensions, stipends for students, stipends paid from international funds (according to government resolution).	Principal Job: 33 percent Second Job: .5 BD 10 percent .5-1 BD 20 percent >1BD 35 percent
	2. Royalties	*Exemptions*: 8BD	13 percent For children and old persons: 6.5 percent. For descendants: 60 percent
	3. Individual enterprises and *partnerships*	The same as for legal persons	24 percent. Retained earnings: 0 percent. Agricultural enterprises: exempted

Lithuania: Summary of the Tax System, July 1999

Tax	Tax Base	Deductions/Exemptions	Rates
	4. Miscellaneous Income	*Exemptions*: Interest paid on bank accounts, dividends, alimony income, lottery winnings.	20 percent
	5. Personal business	*Exemptions*: 1BD	10 percent or 5 percent (depending on items sold).
	6. Gains in sale of securities	*Exemptions:* capital gains reinvested into securities + gains, not exceeding 12 BD, gains in sale of securities acquired before 1 January 1999	15 percent
	7. Dividends		29 percent
1.3 Withholding tax	Payments by residents to non-residents for: marketing, consultancy and mediation services, interest payments		15 percent
	Right to use trade works, licences and company names		10 percent
	Payments by resident companies to companies in "tax heavens"		29 or 24 percent depending on status of a resident company
2. Social Security Contributions			
2.1. Payroll tax	Wage bill		Employers: 30 percent Employees: 1 percent Self-Employed: 50 percent of minimum wage
3. Property Taxes			
3.1. Land tax	Value of private land	*Exemptions*: 1. Roads for public use 2. Land for embassies 3. State-owned land, forests etc. 4. Exemptions may be granted by local governments	1.5 percent

Lithuania: Summary of the Tax System, July 1999

Tax		Tax Base	Deductions/Exemptions	Rates
3.2.	Land Rent Tax	Rent on land	Exemptions may be granted by local *governments*	1.5 percent agricultural land *3 percent urban land* 6 percent internal water
3.3.	Real Estate Tax	Value of real estate owned by firms (nonincorporated and incorporated	*Exemptions*: 1. Diplomatic missions 2. State-owned enterprises 3. Nonprofit institutions 4. Local governments may grant exemptions	1 percent
4.	Tax on goods and services			
4.1.	Value-added tax	Value added of goods and services	*Exemptions*: medicine, medical services, education, culture, postal services, newspapers, magazines, books, financial services	18 percent *6 percent flat-rate scheme for small farmers* 0 percent for exports
4.2.	Excise Taxes			For all major excisable goods specific excises are applicable, including: Alcoholic beverages: per 1 percent alcohol per litre, wine LTL 0.12–0.16 (strong wine LTL 0.20–0.38); champagne LTL 0.42;spirits LTL 0.54, beer LTL 0.40 per liter. Tobacco excises LTL 25 per 1000 units. Gasoline LTL 1210/ton. Jet fuel, kerosene, diesel fuel, liquid fuel, gas oils LTL 560/ton. All tyoes of lubricating oils LTL 240/ton.
4.3	Road tax	Turnover tax on sales of goods and services rendered.		0.1 - 0.5 percent depending on activity company is engaged in (banks - 1 percent)
5.	Other taxes			
5.1.	Tax on pollution	Pollutants		Rates vary with quantity and type of pollutant.

Lithuania: Summary of the Tax System, July 1999

Tax		Tax Base	Deductions/Exemptions	Rates
5.2.	Tax on natural resources	Extraction of natural resources		Rates vary with nature, amount and quality of resources 20 percent for domestically produced oil and gas 29 percent if state capital is used
5.3.	Tax on assets of state-owned enterprises	Tax represents interest paid on use of state capital. Applied to total assets after bank loans, other debts and depreciation		0.5 percent
5.4.	Fees and charges stamp duty	Registration and Recording of legal document		Specific and ad-valorem rates, depending on transaction
6.	Taxes on Foreign Trade			
6.1.	Import tariffs	Import of goods and services		Three tier structure, depending on country of origin. Countries with MFN status: conventional rate. Countries with free trade arrangements: preferential rate. All other countries: autonomous rate. Rates very widely for different product groups. All tariffs are ad valorem, except for alcohol, tobacco, and sugar.

STATUS OF EU ACCESSION

105. This appendix summarizes the status of Lithuania's application for EU membership and reviews progress towards fulfilling economic membership criteria.

Accession milestones

- Since regaining independence in 1991, Lithuania has progressively strengthened its relations with the EU, including through a Trade and Cooperation Agreement (1993), a Free Trade Agreement (1995), and the membership application (1995).

- In March 1998, the EU approved Lithuania's Accession Partnership (AP). Lithuania is one of 10 "accession candidates" from Central and Eastern Europe (CEE), but is not included in the first group of CEE candidates with which membership discussions have already started.[74] The AP aims at guiding an applicant towards EU membership, setting out the priority areas for further work identified in the Commission's Opinions, and financial assistance that could be provided by the EU. The objectives are to enable an applicant to meet the Copenhagen criteria (see below) and accept the *Acquis Communautaire*.

- Also in March 1998, Lithuania presented its first National Programme for the Adoption of the *Acquis* (NPAA) to the European Commission (EC). (A modified version was prepared in June last year, and an update was presented to the EC on July 2 this year). The NPAA describes in greater detail the actions needed to reach the objectives set out in the AP.

- In May 1998, the Lithuanian government established the European Committee responsible for coordinating pre-accession work and liaising with the EU. Since early 1999, the Lithuanian government through this office has started to release quarterly progress reports (see www.euro.lt).

- During 1998, the EC initiated the bilateral screening process of progress made by Lithuania in the 29 chapters of the Acquis. By end-April 1999, the screening had been finalized for 18 chapters.

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[74]Membership talks have started with the Czech Republic, Estonia, Hungary, Poland, and Slovenia. The other CEE accession candidates are Bulgaria, Latvia, Romania, and Slovakia.

Progress in meeting the Copenhagen Economic Criteria[75]

106. EU membership requires the existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union (the so-called Copenhagen economic criteria).[76] Lithuania has been undertaking great efforts in meeting these criteria, and this has been acknowledged by the EC. In its 1997 Opinion, the EC found that Lithuania had made "considerable progress in the creation of a market economy." However, it also found that Lithuania would face "serious difficulties in coping with competitive pressure and market forces within the Union in the medium term," and that progress in fulfilling the requirements of the acquis had been "uneven."

107. In a report on economic developments in Lithuania published in the fall of 1998,[77] the EC noted that Lithuania, on the one hand, had made progress in macroeconomic stabilization and structural reforms in various areas, including large scale privatization, banking supervision and prudential requirements, bankruptcy legislation, reforms in tax policy and administration, and public expenditure management. On the other hand, the report noted that the widening of the current account deficit in 1997 and 1998 posed the biggest macroeconomic risk for Lithuania. It emphasized that Lithuania would benefit from formulating a coherent macroeconomic framework for the implementation of reforms in preparation for accession. The report also highlighted the need to deepen structural reforms by accelerating large-scale privatization (with the focus on improving efficiency rather than maximizing revenues), enforcing financial discipline for enterprises, restructuring agriculture, and following through with reforms in the energy sector on the basis of a comprehensive sector strategy. Such a strategy should include setting energy prices at cost-recovery levels, strengthening the independence of energy parastatals, restructuring and privatizing faster certain enterprises (e.g., Lithuanian Power Company), establishing a "proper regulatory and financing framework," and devising a strategy to cope with the costs of the decommissioning of the Ignalina nuclear power plant.[78] In addition, the report noted that Lithuania will need to improve its administrative capacity to be in a position to fully meet the requirements of the *Acquis Communautaire*.

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[75]The EU emphasizes the need to meet the criteria formulated at the European Council in Copenhagen in 1993, while it places less emphasis on whether or not accession candidates meet the Maastricht convergence criteria, which are primarily used as "points of reference" for the assessment of macroeconomic performance over the medium term.

[76]Additionally, political criteria form part of the Copenhagen criteria.

[77]See http://europa.eu.int/comm/dg1a/enlarge/report__11_98_eu/lithuania/ab.htm.

[78]The report stated that Lithuania is "extremely inefficient in its use of energy."

Financial support from the EU

108. The 1998 EU Phare program for Lithuania consists of a "national allocation" of euro 32 million for institution building (about 30 percent) and infrastructure projects (approximately 70 percent), especially in the environment, transport, and energy sectors. Alongside the Phare program, from the year 2000 onwards the EU will provide substantial support to CEE accession candidates in agriculture and under the Instrument of Structural Policies for Pre-Accession (ISPA) in an amount of euro1 billion per year during the period 2000-06 (for all accession candidates).[79]

109. Large additional investments will be required especially in the environment and energy sectors to comply with EU requirements. Although the EU and others can be expected to provide much of the necessary financing through ISPA and other funds, Lithuania will be faced with a considerable additional budgetary burden over the medium term. For example, to access ISPA Lithuania will have to meet additionality requirements, which calls for co-financing and real increases in domestic spending on proposed projects or programs.

[79]Lithuania is also benefitting from an additional allocation of euro4 million for cross-border programs, and from funds that are being provided under the "Catch-up Facility" specifically aimed at supporting Bulgaria, Latvia, Lithuania, Romania, and Slovakia. Further support is being provided through the EIB, the EBRD, and bilateral programs of current EU members.

Table 11 . Lithuania: GDP by Expenditure, 1994-99
(In percent of GDP)

	1994	1995	1996	1997	1998
GDP	100.0	100.0	100.0	100.0	100.0
Domestic demand	106.0	111.8	109.8	110.6	111.9
Consumption	87.6	87.1	85.3	84.0	86.4
Gross investment	18.4	24.7	24.5	26.5	25.5
General government	3.9	3.8	2.7	2.7	2.7
Other	14.5	20.9	21.8	23.9	22.8
Current account	-2.2	-10.2	-9.1	-10.2	-12.1
Export of goods and n.f.s.	55.4	53.0	53.4	54.5	47.4
Imports of goods. and n.f.s.	61.4	64.8	63.2	65.1	59.4
Gross national saving	16.2	14.5	15.3	16.3	13.4
General government	1.6	2.4	0.2	2.0	-1.0
Non-government	14.6	12.1	15.2	14.4	14.4

Source: Data provided by the Lithuanian authorities.

Table 12. Lithuania: Gross Domestic Product by Sector at Current Prices, 1993-98
(In percent of total)

	1993	1994	1995	1996	1997	1998 1/
Total	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture and fishing	13.8	10.1	10.7	11.2	10.5	9.1
Electricity and gas	4.0	2.7	3.3	3.2	3.7	4.1
Industry	29.4	22.8	20.7	20.5	18.8	17.0
Construction	5.0	6.8	6.5	6.5	6.9	7.1
Trade, hotels, and restaurants	15.0	17.9	17.7	17.0	16.3	15.9
Transportation, storage and communications	9.5	9.5	8.6	8.7	8.6	8.6
Financial intermediation	7.2	4.7	3.1	2.6	2.2	2.3
Government services	2.9	4.8	5.2	5.7	5.3	6.0
Other services	10.9	15.2	15.8	16.5	17.2	19.5
Less: FISIM 2/	4.9	3.5	2.1	1.6	1.3	1.4
Gross value added	92.8	91.1	89.5	90.4	88.1	88.2
Plus: Taxes on products	9.3	10.1	11.5	10.5	12.5	12.2
Less: Subsidies on products	2.1	1.2	1.0	1.0	0.6	0.4

Source: Data provided by the Lithuanian authorities.
1/ Preliminary data.
2/ Financial intermediation services indirectly measured.

Table 13. Lithuania: Industrial Production Sold by Sectors, 1993-98

(At current prices; in percent of total)

	1993	1994	1995	1996	1997	1998 1/
Total	100.0	100.0	100.0	100.0	100.0	100.0
Foodstuff and drinks	28.9	32.1	35.3	30.7	29.1	28.0
Tobacco	0.5	0.8	1.3	1.2	...	...
Textiles	7.9	8.1	7.9	7.2	7.0	7.4
Wood	1.2	1.5	1.7	2.8	3.0	2.2
Paper	1.1	1.5	1.9	1.4	1.4	1.3
Oil refining	29.5	24.2	18.4	17.7	19.9	20.2
Chemical products	3.8	5.8	8.3	8.3	7.1	8.0
Nonmetal minerals	3.9	4.5	4.2	3.5	3.2	3.7
Metal products	0.7	0.9	1.0	1.4	1.5	0.9
Machinery and equipment	5.5	5.1	4.1	3.2	2.8	2.6
Other 2/	17.0	15.5	15.9	22.6	25.0	25.7

Source: Data provided by the Lithuanian authorities.

1/ Preliminary data.
2/ In 1997 and 1998, including tobacco.

Table 14. Lithuania: Supply and Use of Energy, 1993-98
(In millions of tons of oil equivalent)

	1993	1994	1995	1996	1997	1998 1/
Total sources and uses	9.36	8.46	9.06	9.91	9.17	9.89
Sources						
Liquid fuel	4.11	3.90	3.17	3.29	3.26	3.74
Gas	1.50	1.72	2.03	2.17	2.00	1.78
Coal and coke	0.41	0.28	0.22	0.20	0.16	0.15
Domestic fuel	0.35	0.42	0.52	0.59	0.59	0.65
Hydro energy	0.03	0.04	0.03	0.03	0.03	0.04
Nuclear energy	2.96	2.10	3.08	3.63	3.13	3.53
Uses						
Intermediate use	6.26	5.48	6.37	7.15	6.51	7.19
Electricity	3.25	2.45	3.38	4.03	3.52	4.15
Heating	2.19	2.28	2.10	2.10	1.89	1.84
Oil refinery and losses	0.49	0.38	0.36	0.40	0.45	0.55
Other uses	0.33	0.37	0.53	0.62	0.65	0.65
Final use of fuel	3.10	2.98	2.68	2.76	2.66	2.70
Industry and construction	0.61	0.50	0.37	0.35	0.35	0.35
Transportation	1.10	1.09	1.16	1.23	1.23	1.28
Agriculture	0.25	0.21	0.15	0.13	0.10	0.10
Households	0.80	0.83	0.44	0.79	0.78	0.78
Other	0.35	0.36	0.29	0.26	0.20	0.19
Memorandum item:						
Oil processing (in million tons)	5.2	3.8	3.5	4.3	5.6	...

Source: Data provided by the Lithuanian authorities.

Table 15. Lithuania: Electricity Production and Consumption, 1993-98
(In millions of KwH)

	1993	1994	1995	1996	1997	1998 1/
Gross production	14,122	10,021	13,898	16,789	14,861	17,631
Thermal	1,283	1,597	1,325	1,973	2,069	3,182
Hydro 2/	579	718	751	874	768	895
Nuclear	12,260	7,706	11,822	13,942	12,024	13,554
Used at power plants 2/	1,837	1,945	2,058	2,418	2,218	2,338
Net production	12,377	8,199	11,998	14,371	12,643	15,293
Thermal	1,042	1,122	990	1,381	1,498	2,766
Hydro	298	450	371	324	292	239
Nuclear	11,037	6,627	10,637	12,666	10,853	12,288
Imports	5,735	7,114	5,270	4,182	4,524	4,572
Exports	8,467	6,015	7,948	9,341	8,049	10,654
Losses	1,910	1,978	2,008	1,779	1,583	1,519
Domestic consumption	7,735	7,197	7,154	7,433	7,535	7,692
Energy sector	756	737	800	795	788	878
Final consumption	6,979	6,460	6,354	6,638	6,736	6,753
Industry	2,963	2,798	2,805	2,820	3,004	3,020
Transportation	150	145	96	103	101	100
Agriculture	870	695	521	438	374	350
Households	1,437	1,541	1,495	1,606	1,720	1,740
Others	1,444	1,281	1,437	1,571	1,537	1,604

Source: Data provided by the Lithuanian authorities.

1/ Preliminary data.
2/ Including hydro pump storage.

Table 16. Lithuania: Domestic Energy Arrears, 1998-99
(In millions of litai)

	1998				1999	
	Mar.	Jun.	Sep.	Dec.	Mar.	Apr.
Lithuanian Power Company (LPC) claims for electricity						
Total	44.9	41.6	39.0	47.0	57.5	58.8
Industry	15.9	15.9	17.2	24.9	31.6	30.5
Agriculture	6.5	6.2	5.9	6.3	6.2	6.2
Budgetary organizations	8.1	5.8	3.0	2.7	5.7	7.5
Central	2.9	2.4	1.8	1.5	2.4	2.7
Local	5.2	3.4	1.1	1.2	3.3	4.8
Households	2.8	2.8	3.1	3.3	3.6	3.7
Other consumers	11.4	10.9	9.8	9.6	10.4	10.9
Heat Suppliers	0.2	0.0	0.1	0.2	0.2	0.1
Lithuania Gas Company claims for natural gas						
Total	50.4	15.1	17.8	33.8	48.4	48.4
Industry	8.8	4.6	4.0	6.5	3.8	4.4
Agriculture	3.7	2.0	2.0	2.7	5.1	5.8
Services incl. Budgetary organizations	11.0	4.6	4.6	1.7	3.8	3.1
Households	8.3	1.5	1.1	0.2	1.2	0.5
Heat suppliers	18.6	2.5	6.2	22.7	34.6	34.6

Sources: Data provided by Lithuanian Power Company and Lithuanian Gas Company.

Table 17. Lithuania: Prices and Wages, 1996-99

	Consumer Prices	Average Wage		
	Percentage		Percentage change	
	Change	In Dollars	m-o-m	y-o-y
1996				
January	3.2	159.3	-2.5	52.8
February	2.4	153.5	-3.6	39.9
March	2.3	160.1	4.3	41.9
April	1.3	161.9	1.1	34.7
May	0.3	162.4	0.4	30.1
June	0.4	164.2	1.1	28.2
July	0.1	171.9	4.7	30.2
August	0.0	168.6	-1.9	26.1
September	0.3	172.5	2.3	31.6
October	0.1	176.2	2.2	24.1
November	1.1	173.1	-1.8	21.4
December	0.9	193.6	11.8	16.1
1997				
January	2.8	171.9	-7.8	7.9
February	0.6	174.1	1.3	13.4
March	0.1	188.4	8.2	17.7
April	0.3	187.7	-0.3	15.9
May	0.8	198.7	5.9	22.4
June	0.2	205.5	3.4	25.2
July	1.1	215.4	4.8	25.3
August	0.1	210.3	-2.3	24.7
September	0.3	213.3	1.4	23.7
October	0.4	218.6	2.5	24.1
November	1.1	222.7	1.9	28.7
December	0.4	246.2	10.6	27.2
1998				
January	1.0	227.7	-8.5	32.5
February	0.5	227.6	-0.1	30.7
March	0.4	236.9	4.1	25.7
April	0.5	245.9	3.8	31.0
May	0.6	248.7	1.1	25.1
June	-0.5	256.3	3.1	24.7
July	0.2	261.3	2.0	21.3
August	-0.6	256.2	-2.0	21.8
September	-0.4	260.7	1.8	22.2
October	0.4	260.3	-0.2	19.1
November	0.2	258.4	-0.7	16.0
December	0.1	288.1	11.5	17.0
1999				
January	1.0	258.3	-8.9	13.4
February	0.0	253.0	-2.1	11.2
March	-0.2	262.7	3.9	10.9
April	0.0	267.2	1.7	8.7
May	0.0	267.8	0.2	7.7
June	-0.1	...	...	...

Sources: Data provided by the Lithuanian authorities; nd Fund staff estimates.

1/ Whole economy except proprietorships.

2/ Comparative coefficients are used to compare the changing data of wages and salaries because this new enterprises are surveyed since 1997.

Table 18. Lithuania: Average Monthly Wages, 1993-98

(In litai)

	1993	1994	1995	1996	1997	1998 1/
Whole economy	166	325	479	621	785	1,009
State sector	190	371	532	683	851	1,021
Agriculture	122	278	303	319	449	490
Collective farms	81	132	231	304	429	468
Cooperative and private sector	142	285	516	566	734	880
Industry	209	376	489	668	824	935
Transport	246	451	719	780	943	1,050
Construction	195	422	595	749	931	1,131
Health care	135	268	385	489	640	790
Education	129	272	394	507	650	890
Banking and insurance	502	947	1,287	1,458	1,640	1,882
Minimum wage (end of year)	48	65	180	300	400	430

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

1/ Preliminary data.

Table 19. Lithuania: Labor Force and Employment, 1993-98

	1993	1994	1995	1996	1997	1998
			(In thousands)			
Population (end of year)	3,724	3,718	3,712	3,707	3,704	3,701
Working age 1/ 2/	2,104	2,100	2,111	2,122	2,135	2,139
Labor force 2/	1,859	1,741	1,753	1,784	1,774	1,770
Employment 2/	1,778	1,675	1,644	1,659	1,669	1,656
Working age 2/	1,697	1,325	1,488	1,498	1,505	1,517
Nonworking age 2/	141	150	156	161	164	139
Unemployed 3/	81	66	109	125	105	114
Male	45	31	49	57	49	56
Female	36	35	60	68	56	58
			(In percent)			
Labor force participation rate 4/	88.4	82.9	83.0	84.1	83.1	82.7
Unemployment rate 3/	4.4	3.8	6.1	7.1	5.9	6.4

Source: Data provided by the Lithuanian authoriies.

1/ Ages 16-55 for women and 16-60 for men.
2/ Preliminary data for 1998.
3/ Derived as the difference between labor force and employment.
4/ Labor force in percent of working age population.

Table 20. Lithuania: Employment Distribution, 1993-98

	1993	1994	1995	1996	1997	1998 1/
			(In thousands)			
Total	1,778	1,675	1,644	1,659	1,669	1,656
State sector	815	645	600	555	539	517
Self-employed	110	273	347	398	399	431
Private employment	853	757	697	676	731	708
			(In percent of total)			
State sector	45.8	38.5	36.5	33.4	32.5	31.2
Self-employed	6.2	16.3	21.1	24.0	23.9	26.0
Private employment	48.0	45.2	42.4	42.6	43.6	42.8
Memorandum item:						
Change in total employment (in percent)	-4.2	-5.8	-1.9	0.9	0.6	-0.8

Source: Data provided by the Lithuanian authorities.

1/ Preliminary data.

Table 21. Lithuania: Registered Unemployment at Labor Exchanges, 1995-99 1/
(In thousands)

	Rate (in percent)	Total	Male	Female
1996				
January	7.9	137.4	63.2	74.2
February	8.2	142.3	66.3	76.0
March	8.3	144.2	67.8	76.4
April	8.0	139.6	65.3	74.3
May	7.4	129.5	59.8	69.7
June	7.0	122.0	55.8	66.2
July	6.8	118.6	53.8	64.8
August	6.6	115.6	52.0	63.6
September	6.4	112.5	50.1	62.4
October	6.4	111.6	49.6	62.0
November	6.4	111.7	50.0	61.7
December	6.2	109.4	49.8	59.6
1997				
January	6.3	109.9	51.1	58.8
February	6.3	111.0	52.6	58.4
March	6.2	108.2	51.3	56.9
April	5.9	104.2	49.4	54.8
May	5.6	99.0	46.8	52.2
June	5.3	93.3	43.7	49.6
July	5.3	94.1	43.4	50.7
August	5.4	96.6	44.3	52.3
September	5.6	99.1	45.2	53.9
October	5.9	105.2	48.0	57.2
November	6.3	112.8	52.7	60.1
December	6.7	120.2	58.3	61.9
1998				
January	7.4	131.3	65.0	66.3
February	7.5	134.6	67.7	66.9
March	7.5	133.2	67.4	65.8
April	6.9	122.8	61.9	60.9
May	6.2	110.2	54.8	55.4
June	5.5	97.8	47.8	50.0
July	5.4	95.9	45.9	50.0
August	5.4	96.4	45.1	51.3
September	5.6	99.3	45.6	53.7
October	6.0	105.6	49.2	56.4
November	6.5	114.5	55.4	59.1
December	6.9	122.8	61.6	61.2
1999				
January	7.7	137.2	70.7	66.5
February	8.1	144.5	75.4	69.4
March	8.5	150.2	78.7	71.5
April	8.1	144.3	75.2	69.1
May	7.8	138.4	...	...
June	7.5	133.6	...	...

Source: Data provided by the Lithuanian authorities.

1/ Nonunemployed seeking work are referred to as unemployed as of January 1995.

Table 22. Lithuania: Balance of Payments, 1996-98
(US$ millions)

	1996	1997	1998		1998 1/
			Half 1	Half 2 1/	Year
Current account	-722	-981	-521	-777	-1,298
Merchandise trade	-896	-1,147	-644	-874	-1,518
Exports	3,413	4,192	2,110	1,852	3,962
Imports	4,309	5,340	2,754	2,726	5,480
Non-factor services, net	121	134	142	99	241
Credits	798	1,032	535	574	1,109
Debits	677	897	394	475	868
Factor income, net	-91	-198	-146	-110	-255
Current transfers	144	230	127	108	235
Financial and capital account	651	1,105	547	866	1,412
Foreign direct investment, net	152	328	222	699	921
Portfolio investment, net	63	188	10	-63	-53
Private, bonds	-28	157	-11	-94	-105
Public, bonds	74	0	21	31	52
Loans and trade credit, net	477	699	192	208	400
Trade credits	8	151	-48	14	-34
Public	229	138	79	55	134
Guaranteed	154	117	46	66	112
Private	86	292	115	73	188
Currency and deposits and other financial flows	-47	-113	122	24	146
Capital transfers	5	4	0	-2	-2
Errors and omissions	60	107	92	223	315
Central bank	-11	-231	-118	-311	-429
Fund financing	20	14	-18	-12	-30
Purchases	45	56	0	0	0
Repurchases	24	42	18	12	30
Reserves (-=increase)	-31	-245	-100	-299	-399
Memorandum items:					
GDP (US$ millions)	7,892	9,585	5,041	5,652	10,692
Gross official reserves (US$ millions)	850	1,063	1,163	1,462	1,462
In months of imports	2.0	2.0	2.2	2.7	2.8
In percent of short-term debt	456	494	506	600	600
In percent of debt service 2/	248	192	...	...	167
In percent of reserve money	136	129	125	137	137
External debt (US$ millions)	1,680	2,462	2,665	2,809	2,809
Debt service (US$ millions)	342	554	...	...	877
Debt service in percent of exports of GNFS	8.1	10.6	...	...	17.3
Export value (change in percent)	26.1	22.8	7.3	-16.8	-5.5
Import value (change in percent)	26.6	23.9	10.4	-4.2	2.6
			(In percent of GDP)		
Current account balance	-9.1	-10.2	-10.3	-13.8	-12.1
External debt	21.3	25.7	...	...	26.3
Public and publicly guaranteed	11.5	12.0	...	...	13.4
Short-term	2.4	2.2	...	...	2.3
Exports of goods and non-factor services	53.4	54.5	52.5	42.9	47.4
Imports of goods and non-factor services	63.2	65.1	62.5	56.6	59.4
Financial account	8.2	11.5	10.8	15.3	13.2
Medium and long term	8.3	10.5	8.6	16.1	11.9
Foreign direct investment	1.9	3.4	4.4	12.4	8.6

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

1/ Preliminary actual data.

2/ Debt service falling due, including public and private debt, regardless of original maturity.

Table 23. Lithuania: Merchandise Trade by Country and Country Group, 1994-98

	Exports					Imports				
	1994	1995	1996	1997	1998	1994	1995	1996	1997	1998
Total (in millions of U.S. dollars)	2,029	2,706	3,356	3,863	3,711	2,353	3,649	4,559	5,643	5,794
			(In percent)					(In percent)		
EU	25.8	36.4	32.9	32.5	38.0	26.4	37.1	42.4	46.5	50.2
EFTA	5.3	3.2	1.6	1.3	2.2	7.8	2.4	2.8	2.5	2.6
CIS	46.7	42.3	45.4	46.4	35.7	50.3	42.0	32.9	29.3	24.7
Baltics	11.0	9.3	11.7	11.1	13.7	4.3	5.0	5.5	5.8	6.7
Others	11.2	8.8	8.4	8.7	10.4	11.2	13.5	16.4	15.9	15.8
Africa	1.1	0.1	0.1	0.2	0.1	0.1	0.2	0.0	0.0	0.0
America	1.2	1.2	1.3	2.4	3.7	2.3	3.4	3.5	2.9	2.9
Canada	0.2	0.1	0.2	0.2	0.1	0.2	0.4	0.6	0.2	0.1
United States	0.6	0.7	0.8	1.6	2.8	2.0	1.9	2.3	2.4	2.6
Australia, Oceania and other	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Asia	5.3	3.8	4.3	3.7	3.5	2.7	4.3	3.8	2.8	2.0
Kazakhstan	2.1	1.3	0.9	1.1	1.1	0.7	1.8	0.5	0.3	0.2
Republic of Korea	0.1	0.5	0.6	0.7	0.6	0.1	0.2	1.1	1.0	0.4
Uzbekistan	0.9	1.0	1.4	0.7	0.6	0.7	0.7	0.4	0.2	0.1
Europe	92.4	94.9	94.2	93.6	92.5	94.8	92.0	92.2	93.7	94.4
Austria	0.3	0.5	0.5	0.5	0.7	0.6	1.0	1.0	1.0	1.1
Belarus	6.5	10.8	10.2	10.3	8.8	3.8	3.6	2.4	2.4	2.3
Belgium	0.8	1.0	1.0	1.3	1.3	0.7	1.4	1.7	1.9	2.1
Bulgaria	0.4	0.4	0.2	0.2	0.2	0.4	0.3	0.3	0.2	0.2
Czech Republic	0.6	0.4	0.4	0.4	0.5	1.5	1.7	1.8	1.8	1.6
Denmark	1.7	2.7	2.6	3.4	4.1	2.6	3.5	3.8	4.3	4.6
Estonia	2.5	2.2	2.5	2.5	2.6	1.6	1.8	2.2	2.4	2.7
Finland	1.0	1.1	1.0	0.7	0.9	2.9	3.3	3.7	3.4	4.2
France	1.2	1.7	1.6	2.2	3.5	1.8	1.6	2.1	2.5	2.9
Germany	11.5	14.4	12.8	11.4	13.1	13.8	14.3	15.8	18.7	20.0
Hungary	0.9	0.5	0.4	0.3	0.3	0.8	1.1	1.4	1.2	1.0
Ireland	0.1	1.1	1.2	0.8	0.6	0.1	0.2	0.7	0.5	0.5
Italy	1.9	1.9	2.7	3.1	4.1	2.7	2.4	3.1	3.1	3.4
Latvia	8.4	7.1	9.2	8.6	11.1	2.7	3.2	3.3	3.4	3.9
Netherlands	5.3	4.9	3.3	2.8	2.5	2.7	2.6	2.8	3.3	3.4
Norway	0.6	0.6	0.5	0.4	0.5	0.7	0.8	0.9	0.7	0.9
Poland	5.0	3.9	3.2	2.3	3.0	4.0	4.2	5.1	5.8	6.6
Russia	28.2	20.4	24.0	24.5	16.5	39.3	31.2	25.9	24.3	20.2
Spain	0.9	0.8	1.0	0.9	1.1	0.3	0.4	0.5	0.7	0.8
Sweden	3.1	2.5	1.7	1.9	2.6	2.4	2.8	3.1	3.2	3.7
Switzerland	0.2	2.2	0.9	0.7	0.8	1.2	1.5	1.6	1.6	1.6
Turkey	0.2	0.9	0.8	0.8	0.9	0.2	0.3	0.3	0.3	0.3
Ukraine	6.1	7.5	7.7	8.8	7.8	5.0	3.7	3.3	1.9	1.8
United Kingdom	2.3	3.1	2.8	3.2	3.5	1.4	3.1	3.9	3.3	3.2
Others	0.0	0.0	0.1	0.1	0.2	0.0	0.0	0.4	0.5	0.6

Source: Lithuanian Department of Statistics.

Table 24. Lithuania: Merchandise Trade by Commodity Group, 1994-98

	1994	1995	1996	1997	1998
Exports					
Total (in millions of U.S. dollars)	2,029	2,706	3,356	3,863	3,711
		(In percent of total)			
Animal and vegetable products	12.3	12.8	10.7	10.4	9.6
Food, beverages and tobacco	11.9	5.6	6.5	5.6	4.4
Mineral products	16.7	11.9	15.5	17.8	19.2
Chemical products	10.6	12.2	11.0	9.2	9.6
Plastic and rubber products	1.6	3.1	2.8	2.8	2.4
Rawhide, skins and leather products	1.4	1.6	1.5	1.4	1.4
Wood and wood products	4.1	6.6	5.9	5.1	4.8
Pulp and paper	1.2	1.6	1.6	1.9	1.7
Textiles and footwear	13.4	15.5	16.4	16.9	19.1
Cement, glass and similar materials	1.1	1.3	1.3	1.1	1.3
Base metals and products of base metals	6.2	8.7	4.4	4.1	3.8
Machinery, mechanical appliances and electrical equipment	12.0	10.8	11.8	12.2	10.8
Vehicles and transport equipment	3.7	5.1	7.3	8.0	8.1
Optical, photographic, and measuring instruments	1.4	1.0	1.1	1.2	1.0
Other 1/	2.6	2.2	2.2	2.4	2.8
Imports					
Total (in millions of U.S. dollars)	2,353	3,649	4,559	5,643	5,794
		(In percent of total)			
Animal and vegetable products	5.7	7.9	7.3	5.8	6.1
Food, beverages and tobacco	4.3	5.5	5.9	5.3	4.8
Mineral products	32.8	20.6	19.3	18.2	15.6
Chemical products	8.8	9.4	9.4	9.4	9.2
Plastic and rubber products	3.1	5.3	5.0	5.3	5.1
Rawhide, skins and leather products	0.5	1.0	1.0	0.8	0.7
Wood and wood products	0.6	0.7	0.7	0.9	1.1
Pulp and paper	2.2	3.1	3.0	3.1	3.4
Textiles and footwear	7.9	9.1	8.3	8.3	9.5
Cement, glass and similar materials	1.2	1.4	1.4	1.6	1.7
Base metals and products of base metals	6.5	8.8	6.7	6.2	6.2
Machinery, mechanical appliances and electrical equipment	16.5	15.2	17.1	18.4	18.4
Vehicles and transport equipment	6.0	8.1	9.9	11.4	12.3
Optical, photographic, and measuring instruments	2.2	2.2	2.2	2.3	2.3
Other 1/	1.7	1.6	2.8	3.1	3.6

Source: Lithuanian Department of Statistics.

1/ Includes precious stones and metals, arm and ammunitions, works of art, and miscellaneous manufactured articles.

Table 25. Summary of Lithuania's Import Tariff Regime, May 1999

	Most-favored-nation rates	Preferential Tariffs 1/						
		Czech Republic & Slovak Republic	Slovenia	Estonia/ Latvia	EU	EFTA 2/	Poland	Ukraine
Simple average	5.33	2.81	3.46	0	2.81	4.2	2.95	2.43
Agriculture	14.35	11.71	14.35	0	8.13	12.26	10.87	10.15
Nonagriculture	2.49	0.01	0.03	0	0.31	1.66	0.46	0
Share of tariff lines with rates:								
Zero rated	70.8	88.6	84.9	100	87.2	77.8	81.8	92.9
Under 20 percent	21.1	5.9	8.1	0	8.3	16.3	12.3	1.5
Over 20 percent	5.4	3	43.3	0	4.2	3.2	4.7	3.1
Over 40 percent	2.7	2.5	2.7	0	0.3	2.7	1.2	2.5

Source: Ministry of Economy.
Note: Excludes non-ad valorem rates.

1/ Some preferential partners are not included in the table.
2/ Tariff data for imports from Switzerland and Liechtenstein; rates for imports from Iceland and Norway are similar.

Table 26. Lithuania: Summary of Consolidated General Government Operations, 1995-98 1/
(In millions of Litai)

	1995	1996	1997	1998
Total revenue	7,789	9,346	12,501	14,604
Tax revenue	7,625	9,092	12,250	14,307
Taxes on income and profits 2/	2,244	2,673	2,579	3,000
Taxes on companies	554	587	621	579
Taxes on individuals	1,690	2,087	1,958	2,422
Payroll tax (social security tax) 2/	2,035	2,608	4,391	5,524
Taxes on goods and services	2,786	3,115	4,513	4,952
Excises	614	836	1,165	1,340
Value-added tax	1,975	2,280	3,348	3,612
Property taxes	157	177	217	235
Foreign trade	187	214	271	245
Other taxes	216	303	279	350
Nontax Revenue	164	254	251	297
Expenditure and net lending	8,868	10,791	13,165	16,820
Expenditure	8,412	10,156	12,771	16,192
Current expenditure	7,202	9,294	11,752	14,590
Wages and Salaries 3/	2,229	3,018	3,333	4,239
Goods and Services 3/	2,210	2,434	3,730	5,069
Transfers to households	2,389	3,151	4,017	4,499
Subsidies	274	396	349	290
Interest Payments	100	293	322	494
Savings restitution	...	...	0	443
Capital Expenditures	923	862	1,019	1,159
Capital Transfers	715	687	706	858
Purchases of Fixed Assets	208	176	313	301
Discrepancy	286	-22	32	270
Financial balance	-623	-789	-302	-1,858
Net lending	456	635	395	628
Lending	596	669	626	925
Repayments (-)	-140	-34	-231	-297
Fiscal balance (deficit (-))	-1,079	-1,424	-697	-2,487
Borrowing requirement	1,079	1,424	697	2,487
Domestic financing	174	354	-17	-315
Bank financing	-105	178	294	-695
Non-bank financing	279	176	-311	380
Gross Privatization receipts	38	32	104	2,267
Foreign financing	867	1,038	610	535
Borrowing	878	1,228	1,688	1,005
Amortization	-11	-189	-1078	-470

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

1/ Including the state budget, municipal budgets, Social Insurance Fund and from 1997, the Health Insurance Fund (HIF).

2/ From 1997, contributions to the HIF are reclassified from income tax to payroll tax.

3/ From 1997, expenditures of the HIF are reclassified from wages and salaries to goods and services.

Table 27. Lithuania: Summary of Consolidated General Government Operations, 1995-98 1/

	1995	1996	1997	1998
	(In percent of GDP)			
Total revenue	32.3	29.6	32.6	34.1
Tax revenue	31.6	28.8	31.9	33.5
Taxes on income and profits 2/	9.3	8.5	6.7	7.0
Taxes on companies	2.3	1.9	1.6	1.4
Taxes on individuals	7.0	6.6	5.1	5.7
Payroll tax (social security tax) 2/	8.4	8.3	11.5	12.9
Taxes on goods and services	11.6	9.9	11.8	11.6
Excises	2.5	2.6	3.0	3.1
Value-added tax	8.2	7.2	8.7	8.4
Property taxes	0.7	0.6	0.6	0.5
Foreign trade	0.8	0.7	0.7	0.6
Other taxes	0.9	1.0	0.7	0.8
Nontax revenue	0.7	0.8	0.7	0.7
Expenditure and net lending	36.8	34.2	34.3	39.3
Expenditure	34.9	32.2	33.3	37.9
Current expenditure	29.9	29.4	30.7	34.1
Wages and Salaries 3/	9.2	9.6	8.7	9.9
Goods and Services 3/	9.2	7.7	9.7	11.9
Transfers to households	9.9	10.0	10.5	10.5
Subsidies	1.1	1.3	0.9	0.7
Interest Payments	0.4	0.9	0.8	1.2
Savings restitution	...	...	...	1.0
Capital Expenditures	3.8	2.7	2.7	2.7
Financial balance	-2.6	-2.5	-0.8	-4.3
Net lending	1.9	2.0	1.0	1.5
Fiscal balance (deficit (-))	-4.5	-4.5	-1.8	-5.8
Borrowing requirement	4.5	4.5	1.8	5.8
Domestic financing	0.7	1.1	0.0	-0.7
Bank financing	-0.4	0.6	0.8	-1.6
Gross Privatization receipts	-0.1	0.0	-0.1	1.5
Treasury Bills (nonbank)	1.2	0.6	-0.8	0.9
Foreign financing	3.6	3.3	1.6	1.3
Borrowing	3.6	3.9	4.4	2.4
Amortization(-)	0.0	-0.6	-2.8	-1.1
Memorandum Items:				
Nominal GDP (in millions of litai)	24,103	31,569	38,340	42,768

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

1/ Including the state budget, municipal budgets, Social Insurance Fund and from 1997, the Health Insurance Fund (HIF).

2/ From 1997, contributions to the HIF are reclassified from income tax to payroll tax.

3/ From 1997, expenditures of the HIF are reclassified from wages and salaries to goods and services.

Table 28. Monetary Authorities, 1997-99

	1997	1998				1999		
	Dec.	Mar.	June	Sept.	Dec.	Mar.	Apr.	May
	(In millions of litai, end of period)							
Net foreign assets	3,170.7	3,552.9	3,661	5,094	4,836	4,591	4,787	4,487
Gold	211.0	211.0	211	211	203	203	203	203
Convertible currencies	2,952.1	3,334.2	3,442	4,876	4,625	4,380	4,576	4,276
Of which : use of IMF credit	1,086.6	1,050.1	997	1,013	1,011	976	942	931
Nonconvertible currencies	-0.1	-0.1	0	0	0	0	0	0
Other foreign assets	7.8	7.8	8	8	8	8	8	8
Net domestic assets	138.0	-167.9	59	-1,454	-575	-788	-531	-477
Net credit to government 1/	-307.4	-589.5	-310	-1,824	-947	-1,129	-908	-861
Credit to banks	70.3	68.0	51	88	52	67	68	67
Credit to private sector	7.6	7.4	7	7	7	7	7	7
Capital accounts	247.3	219.8	180	117	112	145	108	104
Other items net	100.8	107.3	111	138	193	117	188	200
Reserve money	3,308.7	3,385.0	3,719.2	3,639.7	4,260.5	3,802.4	4,256.1	4,009.5
Currency outside BoL	2,726.2	2,654.9	2,904.2	2,721.9	3,036.2	2,870.9	3,090.1	3,121.3
Deposit money banks' deposits	551.3	698.8	801.1	905.6	1,211.8	912.3	1,146.1	877.5
Reserves in litai	389.9	508.8	488.9	546.4	867.7	564.9	812.3	539.2
Reserves in foreign currency	161.3	189.8	310.8	346.8	344.0	331.9	333.8	338.3
Special deposits	0.1	0.2	1.4	0.1	0.1	0.0	0.1	0.1
Private deposits and deposits of nonmonetary financial institutions	31.3	31.3	14.0	12.2	12.5	19.2	20.0	10.6
	(Percentage change relative to previous year)							
Reserve money	32.4	36.9	30.7	18.0	28.8	12.3	25.7	15.9
Currency outside BoL	36.4	29.4	27.9	13.6	11.4	8.1	15.4	14.6
Net foreign assets	41.0	57.9	39.8	70.5	52.5	29.2	33.8	23.0
Net domestic assets	-45.0	-175.3	-74.2	-1,593.0	-516.9	369.5	177.2	154.4
Net credit to government	184.7	308.0	40.9	407.3	208.0	91.6	54.2	50.8
Credit to banks	-50.5	-57.1	-65.5	-28.5	-25.6	-2.1	0.1	32.2

Source: Bank of Lithuania

1/ Includes counterpart funds.

Table 29. Monetary Survey, 1997-99

	1997	1998				1999		
	Dec	Mar.	June	Sept.	Dec.	Mar.	Apr.	May
	(In millions of litai, end of period)							
Net foreign assets	3,483.4	3,296.4	3,283.4	4,452.1	4,292.0	4,144.0	3,986.1	3,834.5
Net domestic assets	3,788.5	3,844.9	4,295.0	3,243.2	4,035.2	3,999.2	4,800.7	4,957.1
Domestic credit	4,239.1	4,226.6	5,150.5	4,126.0	5,189.7	5,668.7	6,155.8	6,356.7
Net claims on government 1/	-79.8	-400.8	38.5	-1,341.5	-505.5	-427.1	-264.5	-98.5
Credit to nonprofit public institutions and nonfinancial public enterprises	149.4	152.1	83.7	230.2	351.9	400.1	498.5	480.7
Claims on private sector	4,169.5	4,475.3	4,716.6	4,794.3	4,873.5	5,237.9	5,448.0	5,504.7
Other items, net	-620.2	-598.0	-855.5	-882.8	-1,154.5	-1,669.4	-1,355.1	-1,399.6
Capital accounts	-1,774.0	-1,845.3	-2,110.1	-2,360.9	-2,578.7	-2,718.0	-2,761.4	-2,758.0
Other	1,153.8	1,247.4	1,254.6	1,478.2	1,424.1	1,048.6	1,406.3	1,358.4
Broad money	7,271.9	7,141.2	7,578.3	7,695.2	8,327.1	8,143.1	8,786.6	8,791.5
Currency outside banks	2,535.5	2,490.1	2,726.2	2,553.8	2,800.4	2,662.8	2,807.9	2,915.4
Deposits	4,736.4	4,651.1	4,852.2	5,141.4	5,526.7	5,480.3	5,978.8	5,876.1
	(Percentage change relative to previous year)							
Broad Money	7.5	-1.8	6.1	1.5	8.2	3.1	-1.3	-2.2
Currency outside banks	12.5	-1.8	9.5	-6.3	9.7	3.6	1.1	-4.9
Net foreign assets	-7.4	-5.4	-0.4	35.6	-3.6	-10.6	-10.2	-3.4
Net domestic assets	26.3	1.5	11.7	-24.5	24.4	20.1	7.9	-0.9
Net claims on government	-89.7	402.2	-109.6	-3580.7	-62.3	-70.1	-63.7	-15.5
Claims on private sector	11.4	7.3	5.4	1.6	1.7	0.4	-0.1	7.5
Memorandum items:								
Currency/Deposits	0.5	0.5	0.6	0.5	0.5	0.5	0.5	0.5
Money multiplier	2.2	2.1	2.0	2.1	2.0	2.1	2.1	2.1
Reserve ratio (percentage, end-of-month)	11.6	15.0	16.5	17.6	21.9	17.7	16.9	16.6
Velocity	6.1	5.2	5.9	6.0	5.4	4.5	4.4	4.4

Source: Bank of Lithuania

1/ Includes counterpart funds.

Table 30. Lithuania: Interest Rates at Commercial Banks, 1997-99 1/
(In percent per annum)

	1997				1998				1999		
	Mar	June	Sep.	Dec.	Mar.	June	Sep.	Dec.	Mar	April	May
	(Transactions in domestic currency)										
On loans											
From 1 to 3 months	14.8	12.7	13.4	12.2	10.3	11.7	14.3	16.7	14.8	15.9	13.3
From 3 to 6 months	18.8	15.2	13.5	12.8	12.1	11.2	14.0	14.5	10.9	15.0	13.8
From 1 to 5 years	16.8	14.4	14.4	11.1	13.6	13.2	13.1	10.1	13.2	13.6	14.0
On deposits											
From 1 to 3 months	9.0	8.8	6.9	6.2	6.1	6.3	6.3	7.1	6.9	7.3	7.4
From 3 to 6 months	9.7	9.4	8.0	6.4	6.7	6.8	6.2	7.4	7.4	7.7	7.3
Over 2 years	11.4	10.0	9.6	7.6	7.5	7.7	7.2	7.2	8.3	8.1	8.0
	(Transactions in foreign currencies)										
On loans											
From 1 to 3 months	16.1	15.3	12.5	10.6	11.0	10.4	10.5	9.4	11.7	12.6	12.2
From 3 to 6 months	17.6	14.6	14.2	10.5	11.6	10.0	10.8	11.3	8.6	12.9	11.3
From 1 to 5 years	11.3	11.3	10.8	10.2	9.5	9.6	9.9	10.7	11.4	11.1	11.1
On deposits											
From 1 to 3 months	5.9	5.2	4.4	4.7	4.2	4.0	3.9	4.3	4.1	4.1	4.2
From 3 to 6 months	6.6	6.4	5.3	4.8	4.7	4.7	4.3	4.7	4.7	4.8	4.9
Over 2 years	7.0	7.7	6.0	5.0	5.1	5.4	5.1	5.1	9.0	5.9	6.4

Source: Bank of Lithuania.

1/ Average annual interest rates on received deposits and on loans granted in a given month.

Table 31. Lithuania: Indicators of Financial Sector Vulnerability, 1997-99
(In percent, unless otherwise indicated)

	1997	1998			1999	Date of latest estimate
		June	Oct.	Dec.		
Indicators of Financial Sector Vulnerability						
Domestic credit (annual growth)	39.2	46.8	30.7	23.2	31.7	May 99
Commercial bank reserves (in percent of total deposits, end-period)	15.7	19.7	22.7	26.2	18.5	May 99
Cash	4.0	3.7	3.6	4.3	3.5	May 99
Reserves held at the BoL	11.7	16.0	19.2	22.0	15.0	May 99
Of which: Required reserves	8.2	13.6	13.8	13.1	12.7	May 99
Official risk indicators 1/						
Share of non-performing loans in total loans 2/	28.3	19.1	14.1	12.9	12.2	Mar. 99
Risk-based capital asset ratio (capital over risk-weighted assets) 3/	10.8	14.1	18.2	23.8	22.4	Apr. 99
Leverage ratio 4/	5.9	8.6	11.7	14.9	14.8	Mar. 99
Financial sector risk factors 5/						
Share of foreign currency loans in total lending	39.7	48.6	51.2	55.8	58.2	May 99
Share of foreign deposits in total deposits	32.5	39.4	36.0	36.4	37.4	May 99
Share of foreign currency denominated liabilities in total liabilities	32.6	36.3	38.8	36.8	35.1	Mar. 99
Short-term loans in percent of total loans	61.1	55.6	48.9	45.9	47.0	May 99
Demand deposits in percent of total deposits	66.8	64.6	63.4	62.3	57.2	May 99
Share of private credit collateralized by real estate 6/	12.9	13.7	13.3	12.0	11.5	Mar. 99
Share of real estate sector in private credit 6/	4.3	3.5	4.2	3.0	3.0	Mar. 99
Market assessment						
Share prices of financial institutions 7/	210	91	44	55	56	July 99
Spread between lowest and highest interbank and or deposit rates 8/ 9/	500	200	200	268	188	June 99

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

1/ Prudential standards are broadly at international levels, and there is a full program of on-site and off-site supervision.

2/ Includes loans overdue for 31 days. The classification of loans may be adjusted according to the borrower's standing and 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).

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

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

5/ Deposit money banks.

6/ Percent of total loans.

7/ Vilniaus and Hermis Banks; simple average of share prices.

8/ Interbank loan rate; basis points; end of period.

9/ As of January 1, 1999, the difference between the average of the highest and lowest Vilnius Interbank Offered rate (VILIBOR) and Vilnius Interbank Bid rate (VILIBID).

Table 32. Lithuania: Indicators of External Sector Vulnerability, 1997-99
(In percent of GDP, unless otherwise indicated)

	1997	1998 June	1998 Oct.	1998 Dec.	1999	Date of latest Estimate
Indicators of External Vulnerability						
Financial indicators						
Public sector debt 1/	21.2	20.0	21.1	22.5	24.0	Mar. 99
Broad money (percent change, 12-month basis)	34.1	23.5	15.1	14.5	20.1	May 99
Broad money to reserves	1.7	1.6	1.3	1.4	1.6	May 99
Private sector credit (percent change, 12 month basis)	18.9	28.5	25.7	16.9	19.0	May 99
31 day T-bill yield	6.6	7.3	10.3	8.7	7.3	June 99
31 day T-bill yield (real) 2/	-1.8	1.3	6.7	6.2	6.7	June 99
External Indicators						
Exports, goods&svcs.(GS) (percent change, 12-month basis in US$)	24.0	8.0	2.6	-2.9		Dec. 98
Imports GS (percent change, 12-month basis in US$)	25.0	13.0	10.6	1.8		Dec. 98
Current account balance	-10.2	-10.8	-13.1	-14.4	-9.6	Mar. 99
Capital and financial account balance	11.5	8.0	22.1	8.3		Dec. 98
Other investment (loans, trade credits etc.)	7.5	1.2	4.9	3.3		Dec. 98
Gross official reserves (in mil US$)	1,063	1,163	1,491	1,462	1,355	May 99
Central Bank foreign currency exposure (in mil US$) 4/	1,045	1,126	1,183	1,290	1,053	May 99
Net foreign assets of financial sector (in mil US$) 5/	78	-94	-159	-120	-143	May 99
Short term foreign liabilities of the financial sector (in US$) 5/		144	238	245		Nov. 98
Foreign currency exposure of the financial sector (in mil US$) 4/ 5/	-1	-91	-186	-128	-81	May 99
In percent of total liabilities	0.0	-3.8	-7.3	-4.8	-2.9	May 99
Official reserves in months of imports of goods and services (GS)	2.1	2.0	2.6	2.8	3.5	Mar.99
Total short term external debt to reserves (in percent) 3/	20.2	19.8	16.8	18.1		Dec. 98
Total short term external debt (million US $)	215	230	256	265		Dec. 98
Government 1/	54	50	45	136	148	Mar. 99
Enterprises	148	160	140	93.4		Dec. 98
Banks 6/	13	44	71	35.3		Dec. 98
Total external debt 7/	25.7	25.1	25.0	26.3		Dec. 98
o/w: Public sector debt	12.0	13.4	14.5	13.4		Dec. 98
Total external debt to exports GS	48.6	55.1	52.4	57.3	.	Dec. 98
External interest payments to exports GS	2.7	3.1	2.6	4.6		Dec. 98
External amortization payments to exports GS	7.6	15.7	15.1	13.7		Dec. 98
Total external debt 8/	34.1	...	...	35.0		Dec. 98
Exchange rate (per US$, period average)	4.0	4.0	4.0	4.0	4.0	July 99
REER appreciation (+) (12 month basis) 9/	13.9	6.3	15.6	17.0	23.5	Apr. 99
Financial Market Indicators						
Stock market index, end period 10/	1,863	1,582	1,082	1,089	1,001	July 99
Market capitalization (shares, percent of GDP)	17.9	16.5	13.4	13.8	14.2	May 99
Foreign currency debt rating 11/	BBB-	BBB-	13.4	BBB-		Dec. 98
Spread of benchmark bonds (basis points, end of period) 12/	105	220	795	499	346	Jun. 99
Memo item: Nominal GDP in mil US $	9,550	10,605	10,605	10,692	10,916	July 99

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

1/ Public and publicly guaranteed debt.
2/ CPI-based inflation.
3/ Liabilities 1 year and under, remaining rather than original maturity.
4/ Net open position. For commercial banks, includes off-balance sheet foreign currency liabilites, such as short forward position as of July 1998.
5/ Deposit money banks.
6/ From the International Investment Position.
7/ Includes IMF. Excludes trade credits, currency and deposits, and other liabilities.
8/ Includes IMF and trade credits, and currency and deposits, and other liabilities.
9/ CPI-based REER
10/ LITIN-G price index, calculated for all issues that have been quoted in the current trading list in the past three months, exlcuding treasury bills and shares of investment companies.
11/ S&P investment grade rating.
12/ Spread of 5-year Eurobond ($200 million) issued in July 1997 above the rate on U.S. treasury bill maturing July 31, 2002.

Table 33. Lithuania: Stock of Foreign Direct Investment, by Source Country, 1995-98 1/

	1995	1996	1997	1998
Total (in millions of U.S. dollars)	352	700	1,041	1,625
		(In percent)		
United States	17.2	28.5	25.9	18.7
Sweden	8.5	12.0	12.2	16.9
Finland	3.9	4.7	4.3	10.7
Germany	19.4	13.0	11.2	8.2
United Kingdom	11.5	8.9	7.9	6.8
Denmark	4.5	5.6	6.2	6.6
Luxembourg	1.3	4.3	3.9	4.7
Estonia	1.0	0.9	4.3	4.3
Norway	1.7	2.5	3.1	4.2
Ireland	5.1	4.3	4.9	2.8
Poland	1.5	1.0	0.9	1.8
Russia	6.5	1.8	1.5	1.7
Switzerland	2.5	1.6	1.6	1.7
Austria	2.6	2.1	2.3	1.3
France	1.8	1.3	1.5	1.3
Italy	0.4	0.4	1.4	1.0
Memorandum Item:				
European Union	61.7	58.2	57.0	61.2

Source: Bank of Lithuania; Lithuanian Department of Statistics.

1/ End of period.

Table 34. Lithuania: Stock of Foreign Direct Investment, by Sector, 1995-98 1/

	1995	1996	1997	1998
Total (in millions of U.S. dollars)	352	700	1,041	1,625
		(In percent)		
Manufacturing	44.1	41.2	36.6	32.4
of which:				
Food, beverages and tobacco	39.60	39.20	36.50	36.30
Light industry	14.70	17.10	11.30	14.80
Electrical and optical equipment	9.20	8.20	8.20	6.30
Wood and paper products	7.20	9.90	7.00	7.10
Rubber and plastic products	5.70	3.60	3.70	4.30
Manufacture of n.e.c.	23.60	22.00	33.30	31.20
Wholesale and retail trade, repair	29.40	32.50	29.90	25.10
Post and communications	4.10	10.30	8.45	17.40
Financial intermediation	6.70	5.50	6.40	9.80
Mining and quarrying	1.90	2.50	2.02	1.04
Hotels and restaurants	1.90	2.40	3.90	3.30
Construction	1.20	0.40	0.40	0.50
Transport and storage	1.30	0.90	3.30	3.40
Real estate	1.80	1.70	4.40	3.80
Education, recreation, health and culture	1.80	1.00	2.30	0.80
Agriculture, forestry and logging	2.06	0.66	1.18	0.86
Other activities	3.74	0.94	1.15	1.60

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

1/ End of period.

Table 35. Lithuania: Foreign Direct Investment Inflows, 1993-98
(In millions of U.S. dollars)

	1993	1994	1995	1996	1997	1998
FDI in Lithuania	30.2	31.3	72.6	152.4	354.5	925.5
Equity capital 1/	30.2	31.3	65.4	127.8	217.6	772.1
Reinvested earnings 1/ 2/	n.a.	n.a.	7.2	24.6	43.4	99.8
Other FDI 3/	n.a.	n.a.	n.a.	n.a.	93.5	53.6
Outward FDI 2/	n.a.	n.a.	1.0	0.1	27.0	4.2

Source: Data provided by the Bank of Lithuania (Balance of Payments statistics)

1/ Equity capital and reinvested earnings are aggregated for presentation in the IIP as of end 1997.
2/ Not recorded prior to 1995.
3/ Recorded as portfolio investment prior to 1997.

Table 36. Lithuania: Bankruptcy Cases, 1993-99

	1993	1994	1995	1996	1997	1998	First Half 1999	Total
Bankcruptcy cases initiated	6	28	36	76	110	99	63	418
of which:								
Bankruptcy petitions to courts	2	16	27	69	105	97	63	379
Out-of court proceedings	4	12	9	7	5	2	0	39
Bankruptcy cases finalized								90
of which:								
Finalized by January 1993-June 1998:	..	..	..	..	..	..	..	36
In court	..	..	..	..	..	..	..	26
Out of court	..	..	..	..	..	..	..	10
Finalized by July 1998-June 1999:	..	..	..	..	..	..	..	54
In court	..	..	..	..	..	..	..	49
Out of court	..	..	..	..	..	..	..	5

Source: Ministry of Economy.

Table 37. Lithuania: Major Privatization Transactions, 1998-99

Name of company		Authorized capital, (million LTL)	Part of sold shares in the authorized capital, (%)	Purchase price, million LTL)	Investment planned, (million LTL)	Number of jobs
Lietuvos Telekomas	(telecommunications)	814.9	60	2040	884	9,888
Klaipedos Smelte		38	89.51	45	75	731
Vakaru Laivu Remontas	(shipyard)	167.8	92.51	83	80	1,656
Aliejus		8.9	70.24	8	8.1	141
Viesbutis Lietuva	(hotel)	26.9	70.04	36	...	297
Vilniaus Pienas		14.1	70.44	16	10.9	455
Panevezio Stiklas	(glass)	39.9	99.13	1	24	1,100
Alytaus Tekstile	(textiles)	100.2	63.18	12.9	240	3,500
Marijampoles Cukrus	(sugar)	40.2	24.89	12.5	26.5	...
Klaipedos Juru Kroviniu		128.98	90	200	...	2,432

Source: State Property Fund.