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October 7, 1993

To: Members of the Executive Board

From: The Secretary

Subject: Republic of Lithuania - Request for Stand-By Arrangement and Purchase Under the Systemic Transformation Facility

Attached for consideration by the Executive Directors is a paper on Lithuania's request for a stand-by arrangement in an amount equivalent to SDR 25.875 million and for a request expected to be received for a purchase under the systemic transformation facility, which is tentatively scheduled for discussion on Friday, October 22, 1993. Draft decisions appear on page 18.

Mr. Knöbl (ext. 38821), Mr. Tersman (ext. 38823), or Mr. Wein (ext. 38794) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Unless the Documents Preparation 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 Commission of the European Communities (CEC), the European Investment Bank (EIB), and the Organisation for Economic Cooperation and Development (OECD), following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Request for Stand-By Arrangement and Purchases under the Systemic Transformation Facility

Prepared by the European II Department

(In Consultation with other Departments)

Approved by John Odling-Smee and Anoop Singh

October 6, 1993

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I. Introduction

Lithuania became a member of the Fund in April 1992. In October 1992, at EBM/92/127, the Executive Board approved an 11-month stand-by arrangement for Lithuania in the amount of SDR 56.925 million in support of a program for the period July 1, 1992 through June 30, 1993. 1/ The two reviews under the stand-by arrangement were completed by the Executive Board on April 7, 1993 and June 28, 1993. 2/ Lithuania met all quantitative performance criteria and purchased the total amount available under the stand-by arrangement. In its discussion on April 7, 1993, the Executive Board also completed the first Article IV Consultation with Lithuania. 3/ Lithuania continues to avail itself of the transitional arrangements of Article XIV, Section 2.

In the June 28, 1993 discussion on Lithuania, Executive Directors congratulated the authorities on the introduction of the national currency, the litas, the conditions for which had been established through continued fiscal and wages discipline, and a more recent tightening of monetary policy. The authorities were urged to continue a prudent stance of financial policies, and to renew their efforts to continue structural reforms.

Staff teams 4/ visited Vilnius in the periods July 14-29 and September 9-16, to confirm compliance with the June 30, 1993 performance criteria under the stand-by arrangement with Lithuania approved in October 1992; and to conduct discussions for a new program through end-1994, to be supported by a stand-by arrangement from the Fund in an amount equivalent to SDR 25.875 million (25 percent of quota) and two purchases

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1/ EBS/92/157, (9/30/92), and Supplement 1 (10/20/92).

2/ EBS/93/42 (3/17/93), and Supplement 1 (4/6/93) and Cor.1 (4/5/93); and EBS/93/86 (6/7/93), and Supplement 1 (6/24/93).

3/ In addition to the staff report cited above, see Recent Economic Developments (SM/93/62, 3/24/93).

4/ Both missions were headed by Mr. Knöbl, and included Messrs. Camard, Tersman, and Wein (all EUR II), Mr. Doyle (FAD), and Mr. Cornelius (PDR, July mission and EUR II, September mission). Mr. Shikado, and Ms. Norkaitis as staff assistant (both EUR II) participated in the July mission, and Mrs. Padmore as administrative assistant (EURII) participated in the September mission. Mr. Odling-Smee joined the mission from July 25-27. Mr. Solheim, Alternate Executive Director, participated in some of the meetings. The missions were assisted by Mr. Hedfors, Resident Representative, and Ms. Zambaite of his office.

under the STF, each in an amount equivalent to SDR 25.875 million. 1/ The authorities also indicated their desire to move to an EFF in due course. The missions met with President Brazauskas, Prime Minister Sleževičius, Governor Visokavičius, Minister of Finance Vilkelis, Minister of Economy Veselka, Minister of Social Security Medaiskis, as well as a number of other ministers and their senior officials, as well as with senior officials in the commercial banking sector.

On October 22, 1992, a World Bank import rehabilitation loan of US$60 million, was approved. Disbursements of US$0.5 million were made in 1992, and US$30.5 million through end-September, 1993. The remainder of this loan is expected to be disbursed by end-1993. An EBRD energy rehabilitation loan of US$44 million was approved in May 1993. As of mid-September 1993, US$0.5 million has been disbursed from this loan, and disbursals are expected to be complete by end-1994. Lithuania has also received commitments for US$220 million of G-24 loans, of which US$58 million, representing half of the EC commitment of ECU 100 million was received at the end of July 1993. The remainder is to be disbursed subject to review by the EC and completion by Lithuania of arrangements for its receipt. Each loan is subject to approval by the Lithuanian Parliament.

II. Political Developments

Following elections in February 1993, Mr. Brazauskas became the first President of Lithuania. In March, a new Government, headed by Prime Minister Sleževičius took office, and shortly thereafter Mr. Visokavičius became Governor of the Bank of Lithuania. In September, however, Governor Visokavičius was suspended pending the resolution of judicial proceedings. The Acting Governor is Mr. Juozas Sinkevičius, who as Deputy Governor has headed the legal department of the Bank.

III. Recent Economic Developments

1. Domestic economy

After a decline of more than a third in 1992, real GDP is expected to stabilize in the second half of 1993 and to decline by 15 percent for the year as a whole (Tables 1 and 2). Industrial output fell rapidly throughout 1992, but levelled off in the first half of 1993. Agricultural production

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1/ Purchases under the arrangement have been phased so as to provide for a second purchase under the Systemic Transformation Facility to be made upon completion of the first program review. Thus, in order to provide for an appropriate distribution of resources over the period of the arrangement, the phasing provisions of the stand-by arrangement do not provide for an additional amount to be made available under the arrangement upon completion of the first program review.

was hit by a drought last year but recovered this year. However, the official figures do not capture a part of private sector activity, which now may account for 10-15 percent of the total.

Monthly inflation, which averaged 24 percent during 1992, and 14 percent in the first half of 1993, has decelerated rapidly in recent months. With continued fiscal discipline and a much tighter monetary stance from April/May--reversing, inter alia, the depreciation of the exchange rate--monthly inflation declined to 6 percent in June, 3 percent in July, and less than 1 percent in August (Chart 1 and Table 3). 1/

Lithuania has maintained a tight incomes policy with the goals of, first, helping the economy adjust to the terms of trade shock from higher energy prices, 2/ and also supporting the lowering of inflation. In 1992, real wages fell sharply, especially in the second half, since when they have been nearly unchanged. Year-on-year, real wages in 1993 are estimated to be 45 percent lower than in 1992, following a decline of 17 percent in 1992. Open unemployment has remained low, but is expected to rise as underemployment through labor hoarding and short-time work becomes less widespread.

2. External developments

With energy prices at world market levels, the current account has shifted from a surplus in 1992 to an estimated deficit of about US$100 million in the first half of 1993. Imports of petroleum, net of re-exports of refined products, amounted to 2 million tons in the first half of the year, compared with 2.7 million tons in the first half of 1992. 3/ Likewise, gas imports in the first six months of 1993 were about 40 percent lower than in the same period in 1992. Partly reflecting re-exports of imports from FSU countries, Lithuania's trade balance with non-FSU countries is estimated to have shown a surplus of more than US$100 million in the first half of the year. During this period, exports to and imports from non-FSU countries amounted to about 40 percent and 30 percent of Lithuania's total foreign trade, respectively, mirroring a continuous shift in the direction of trade toward western markets.

A new trade regime was adopted on July 15, 1993. Export licensing was abolished, while export taxes were temporarily introduced for a limited

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1/ Inflation in July and August, however, was also seasonally low.

2/ This terms of trade shock is estimated at approximately 50 percent of GDP for 1992-93 combined.

3/ Lithuania and Russia have agreed that in 1993, 6 million tons of crude oil will be refined in Lithuania's refinery, with 80 percent re-exported and 20 percent retained as the refining fee. However, actual deliveries of crude oil are likely to be about 4 million tons, supplemented by private sector imports of oil.

number of items. 1/ On the import side, the vast majority of goods subject to tariffs can be imported at rates between 5 and 15 percent, although higher rates apply for some food products and about a dozen categories of manufactured goods. 2/ With the exception of tobacco and tobacco products, specific excise taxes have been replaced by ad valorem taxes, and unified for identical goods, whether imported or domestically produced. There are no quantitative import restrictions, except for health and security reasons.

Free trade agreements have been signed with Finland, Norway, Sweden, and Switzerland, providing for duty-free trade in industrial products. While these agreements allow Lithuania to temporarily levy duties on trade with these countries, the latter are excluded from the tariffs introduced in July 1993. Similar agreements were recently signed with Estonia and Latvia. Moreover, free trade agreements exist with Belarus, Kazakhstan, and Ukraine, which, however, are less specific, for example, with regard to rules of origin. Negotiations with Russia, Poland, and Iceland on free trade agreements have recently been initiated.

While Lithuania has been granted trade preference under the EC generalized system of preferences, a separate agreement has recently been reached regarding trade in textiles and negotiations on fisheries have started. Lithuania also intends to apply for associate membership status in the EC. Lithuania has been granted observer status to the GATT, and is proceeding toward full membership. Bilateral payments agreements still exist with former CMEA countries, but are not operative and there are no outstanding balances. With regard to FSU countries, as of September 15, 1993, Lithuania's correspondent accounts showed surpluses with all republics, except Russia, Tajikistan, and Kyrgyzstan; there has been little progress concerning the settlement of these balances.

3. Financial policies

In October 1992, monetary independence was achieved with Lithuania's withdrawal from the ruble area, and the replacement of rubles with provisional coupons (talonai). 3/ However, during the period until May 1993, confidence factors contributed importantly to a sharp rise in money velocity, and net domestic assets of the banking system and

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1/ Export taxes were introduced for certain categories of sugar beet, molasses, leather and fur, timber and certain types of metals. For some of these categories, export taxes are based on a cascading structure (declining rates with each stage of production), distorting the pattern of exports that would otherwise result on the basis of comparative advantage.

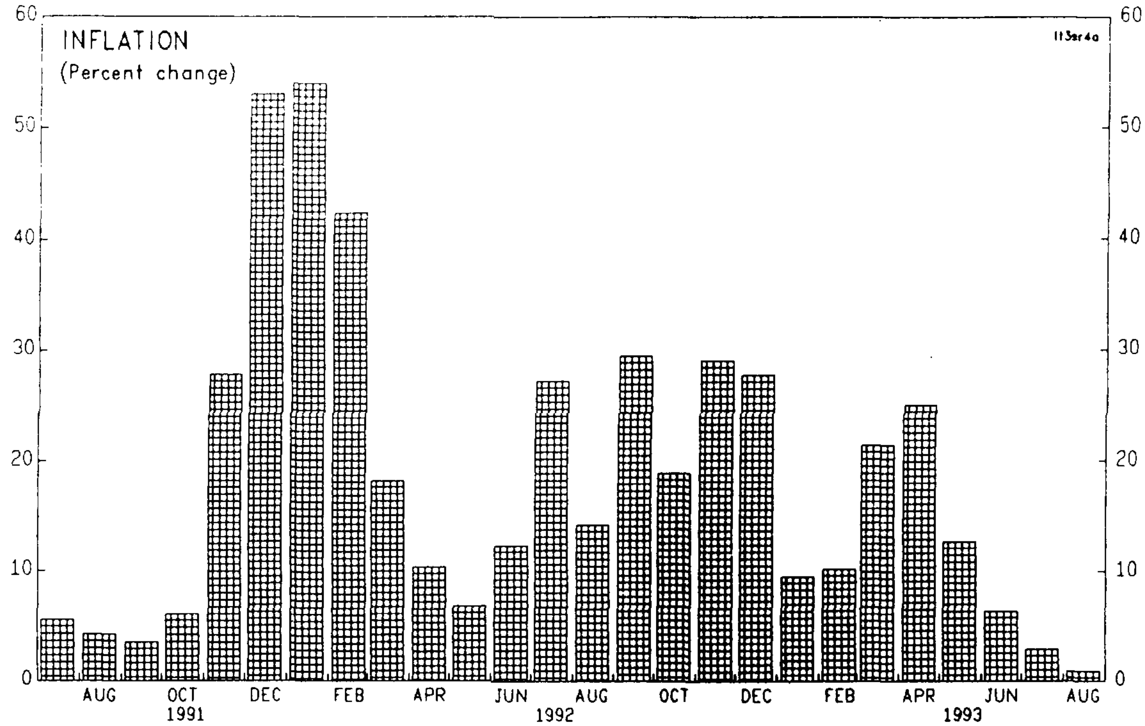
2/ Sugar, butter, eggs and oil (20-30 percent); and tape recorders and TV sets (20 percent); fuel pumps, air compressors, carpets, weapons, and furniture (25 percent).

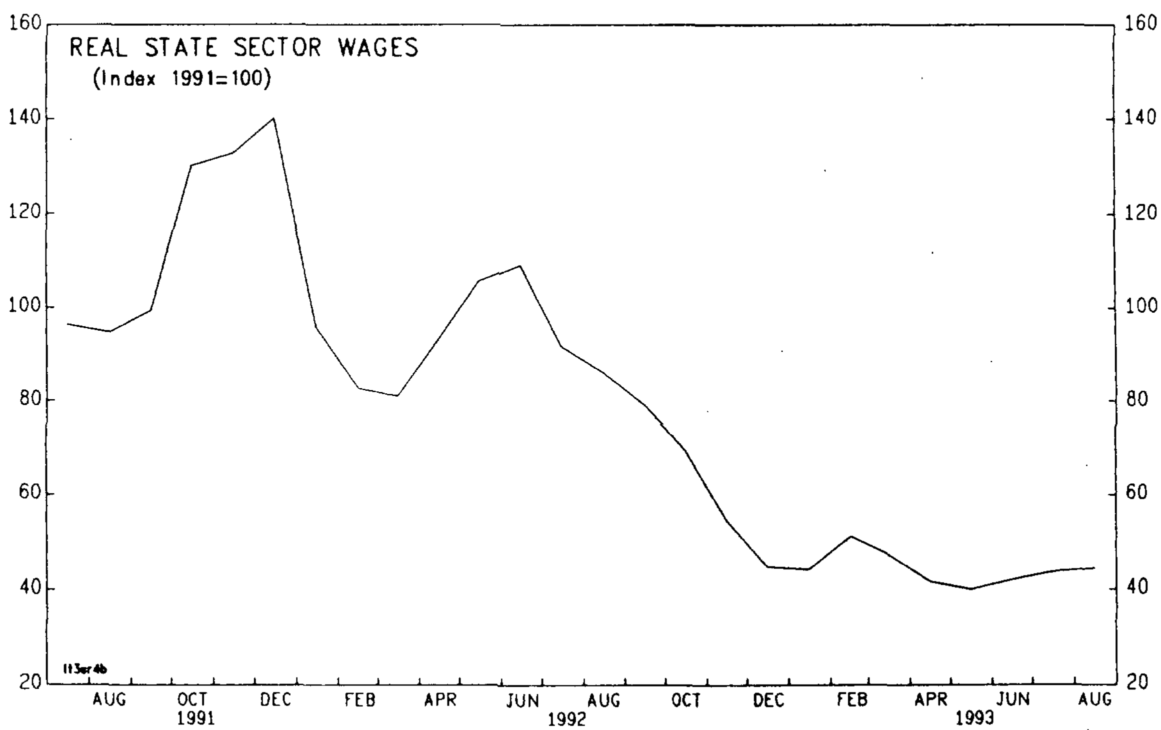
3/ With a shortage of ruble notes, talonai had been originally introduced in May 1992 to meet the need for banknotes.

CHART 1

LITHUANIA

MONTHLY INFLATION AND REAL WAGES





Source: Data provided by the Lithuanian authorities.

particularly net credit of the banking system expanded less rapidly than anticipated. 1/ Moreover, the commercial banks took large open positions in foreign exchange in the expectation of continued depreciation of the talonas against the dollar would continue.

A major tightening of monetary policy took place in April/May, with a trebling of reserve requirements and the inception of auctions of central bank money. These measures (as well as continued fiscal and wage discipline) led to an appreciation of the exchange rate of 25 percent in May and June (Chart 2), setting the stage for the introduction of the national currency, the litas, from June 25-July 20. The new stance of monetary policy was marked by a sharp rise in interest rates and a shift in money demand from hard currency to litai. This shift was accentuated by a requirement that, from August 1, all domestic transactions were to be denominated and performed in litai. Taken together, these factors resulted in sharp upward pressure on the litas, and a rise in reserve money of 66 percent in the third quarter as the Bank of Lithuania purchased hard currency to smooth the market (Table 5).

As to fiscal policy, for the period of the previous stand-by arrangement, Lithuania maintained a small surplus in the consolidated general government budget. This was largely achieved through expenditure control, whereby receipts in any given period form an upper bound on releases of funds to ministries in all but exceptional circumstances. Thus, fiscal balance was maintained by means of sharp reductions in the real levels of government wages and benefits, and broad-based program expenditure cuts. 2/ Revenue measures during 1993 included those in the context of trade reform (discussed below), and an increase in the General Sales Tax from 15 percent to 18 percent. 3/ Specific excises were made ad valorem, and the effective rate of excises on petroleum products was raised.

4. Structural policies

Lithuania's privatization program has made major strides: nearly all residential dwellings have been privatized, except where residents declined this option. Moreover, as of July, 1993, nonagricultural enterprises employing more than 375 thousand persons 4/ had been privatized, either through auction or through share offerings. In the agricultural sector, former socialized farms have been largely broken up into agricultural

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1/ The development of net domestic assets also reflected the stronger than anticipated budget position. The lower net credit expansion also reflected the nondisbursal of G24 funds.

2/ The authorities have recently announced that a plan to compensate savers for the effects of inflation would be financed through the budget. For 1993, the cost would be Llt. 45 million, with additional payments spread over ten years.

3/ The increase in the GST rate took place in mid-1992.

4/ At the time of privatization

enterprises. Relatively little progress, however, has been made in land privatization. As of September, only about 4 percent of agricultural land had been fully restituted, 1/ and the process of privatizing nonagricultural land had not yet begun.

The Government has accepted that for budgetary efficiency and social equity, it is necessary to focus social benefits on the poor. It has recently tightened eligibility requirements for special social benefits, in effect income supplements, with a view to halving (compared with early 1993) the share of such recipients to 20 percent of the population. Pensions are low, but are payable to a relatively large part of the population, since the pensionable age is only 55 years for women and 60 years for men. To contain costs, a relatively flat pension payment structure has been established, but, as discussed below, a bill providing for a more fundamental restructuring of the pension law is being prepared. Unemployment benefits are also under review.

Full implementation of the bankruptcy law is a step toward hardening enterprise budget constraints. However, this has been delayed by the need to establish regulations for its implementation, and to establish a Bankruptcy Court. The Government has also established an Agency on Prices and Competition with limited power to freeze prices; however, it has no power to directly break up existing large enterprises. The authorities have also recognized the need to accord a higher priority to the compilation of statistics needed for policy implementation, and for better policy coordination amongst ministries and the Bank of Lithuania.

IV. The Program and Policy Issues

1. Background to the request

The policy program for July 1, 1992 through June 30, 1993 comprised measures to adapt the economy to a massive terms-of-trade shock while altering domestic production patterns and institutions to those of a market economy. The authorities stressed that the present request for a stand-by arrangement in support of their program for the period July 1, 1993 through December 31, 1994, is seen as building on the stabilization and structural adjustment program supported by the previous arrangement. Thus, design of the present program, as set out in the authorities' Memorandum of Economic Policies (MEP) dated September 30, 1993, has provided the opportunity to assess progress under the previous one (e.g., the stance of financial policies), to alter course where appropriate (wages policy), and to extend

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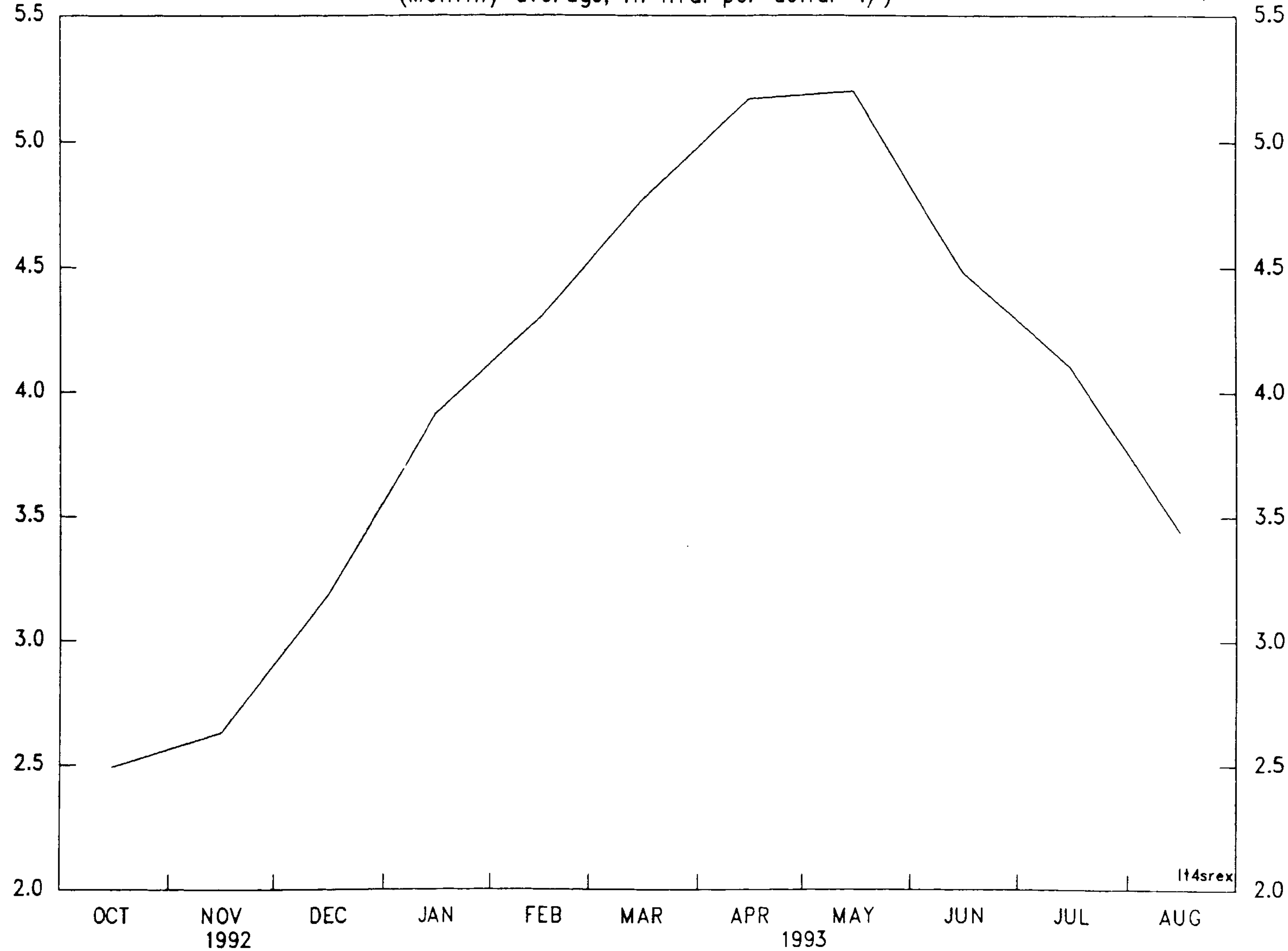
1/ Including full documentation necessary for the land to be subsequently sold.

CHART 2
LITHUANIA
MARKET EXCHANGE RATE
(Monthly average, in litai per dollar 1/)



Source: Bank of Lithuania.
1/ Litas equivalents before July 1993.

policies--particularly structural policies--where desirable. The present program also provides needed continuity by immediately following the previous one.

The main program goals are to raise real growth to the sustainable medium-term potential of the economy, while reducing inflation to single digits at an annual rate by late 1994. To achieve this, the program seeks to: 1) maintain macroeconomic balance and build confidence in economic policymaking, 2) improve the supply response of the economy through continuing structural reform, 3) direct foreign financing to the most productive uses, and, through these policies, 4) attract foreign investment. The measures to achieve these goals are discussed below.

2. Output and employment

The authorities said that, following the very sharp decline in real output in 1992-93, it was important to help sustain growth through the maintenance of credible policies and the productive use of external financing. Lower inflation would help investment to recover, and adequate supplies of energy and other inputs would remove the supply constraints and generate higher incomes and consumption. In addition, the drought that had affected agricultural output in the previous year was no longer a factor. Removal of the uncertainty that had surrounded economic policymaking would also increase confidence.

There were already signs that output was stabilizing, and that a recovery would continue, with real growth of 4 percent in 1994, especially as the expenditure of G-24 monies began to be felt, and a productivity-based rise in real wages (Table 1). Nevertheless, unemployment is expected to rise to 3 percent by the end of 1993, and to about 7 percent by the end of 1994, reflecting the rationalization of enterprise workforces as budget constraints harden, and after a prolonged period of labor hoarding through short-time and disguised unemployment.

3. Monetary policy

The authorities said that monetary policy is directed at reducing inflation to single digits at an annual rate by late 1994 and protecting the value of the litas on foreign exchange markets. The litas will be maintained at a uniform and consistent exchange rate vis-à-vis other currencies and, for the time being, would float except for intervention to maintain orderly market conditions. There was no target exchange rate.

The mission discussed with the authorities the monetary program for the first part of the program period (Tables 4, 5, and 10; and Annex III of the MEP). It was agreed to set performance targets on net domestic assets of the Bank of Lithuania rather than on net domestic assets of the banking system, as was the case under the previous stand-by arrangement. 1/ This change was desirable to allow greater flexibility in the development of the commercial banking system, and would be made possible by the instruments of monetary control and analysis now available to the Bank of Lithuania. 2/ An additional factor was the experience already gained by the Bank of Lithuania in indirect monetary control during the past program period. Reserve money indicative targets, which had been helpful to the authorities in the past in assessing the stance of monetary policy, were also retained, and every effort would be made to meet them. In particular, increases in net international reserves would be offset by restraining the growth of domestic assets of the Bank of Lithuania in order to keep reserve money within the agreed bounds. Understandings were reached on ceilings for net domestic assets of the Bank of Lithuania, and indicative targets for reserve money, for December 31, 1993 and March 31, 1994.

The main assumptions of the monetary forecasts (Chart 3) are declining monthly rates of inflation to some 1 1/2 percent by December 31, 1993 and somewhat less by March 31, 1994, despite reduced home heating subsidies, and a resumption and gradual pick-up of growth from the end of 1993; that the increased demand for litai from the requirement that transactions be in domestic currency as of August 1, 1993, has now occurred; and a small additional decline in velocity, reflecting increasing confidence and lower inflationary expectations. The permanent increase in the demand for litai is also reflected in a substantial decline in the money multiplier. The program further assumes that use of resources available under the STF will lead to some reduction in net foreign assets of the Bank of Lithuania. 3/ The rise in net domestic assets of the Bank of Lithuania basically reflects an increase in use by commercial banks of central bank credit, consistent both with rising activity and tightening monetary conditions. 4/ This should also be conducive to the maintenance of positive real interest rates, while allowing scope for the reduction of nominal rates.

Concerning interest rate policy, the authorities noted that with declining inflation, there was scope to reduce nominal interest rates, which should stimulate growth. The staff mission said that interest rate reduction should come as the result of competition within the commercial banking sector, rather than through administration of interest rates or

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1/ Direct credit controls on individual commercial banks would also be dropped. The Bank of Lithuania, however, will specify an indicative overall commercial bank credit maximums for the guidance of the latter.

2/ These included a new plan of central bank accounts, auctions of central bank money, active use of reserve requirements, and a refinancing facility.

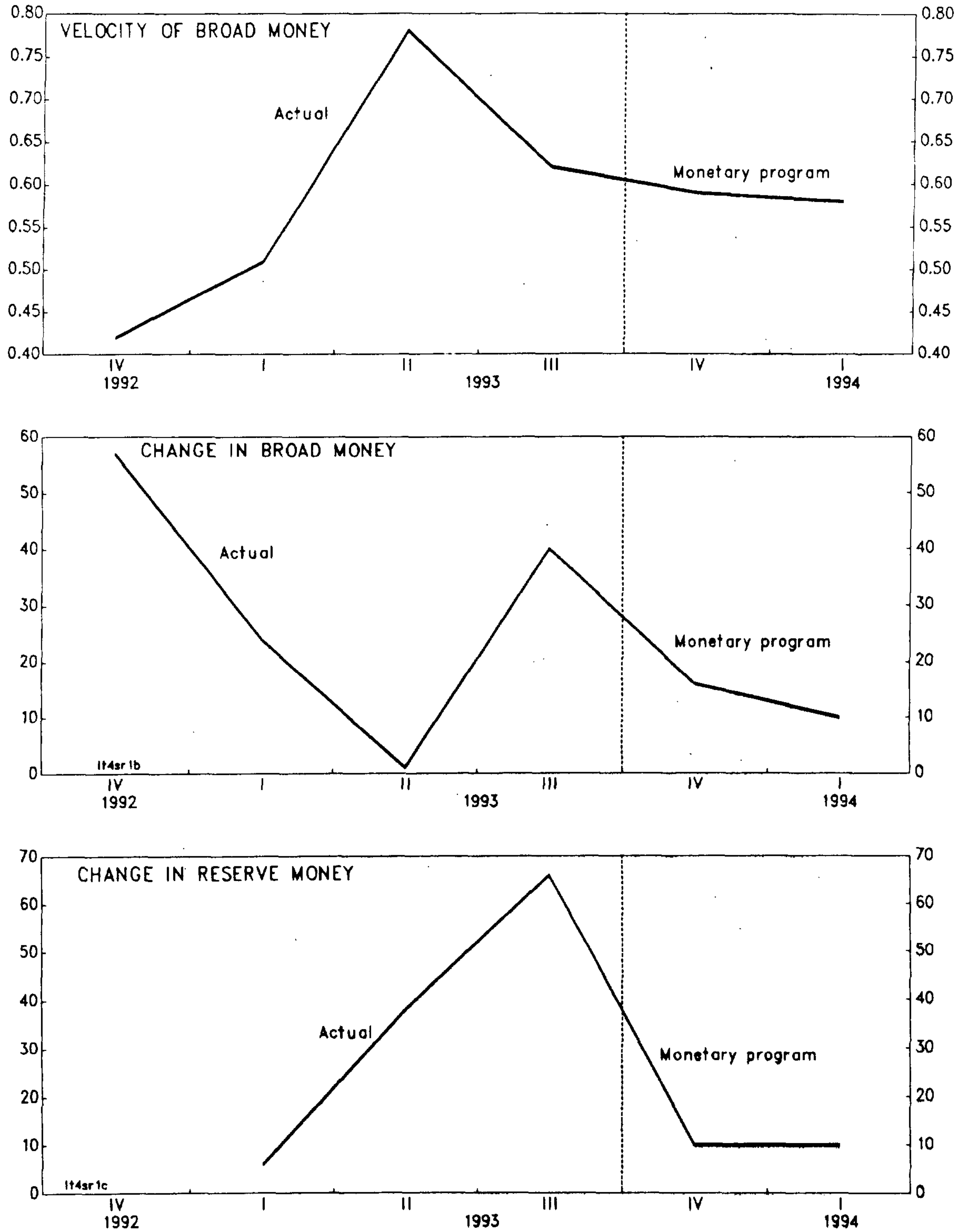
3/ However, the domestic counterpart of the STF purchases will be frozen, and cannot be used to finance government expenditure.

4/ Unspent EC/G-24 inflows do not affect the monetary program.

CHART 3

LITHUANIA

MONETARY INDICATORS



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

interest rate subsidies by the Bank of Lithuania. 1/ The Bank of Lithuania would, through auctions and other instruments, maintain monetary conditions conducive to positive real interest rates. In addition, the efficient allocation of capital would be facilitated by the recent opening of a stock exchange in Vilnius.

The mission also expressed to the authorities concern that, especially before the tightening of monetary policy in April/May 1993, there had been serious lapses in compliance with the prudential regulations on banks' open foreign exchange positions, as well as loan concentration ratios. The authorities indicated that they had cautioned the commercial banks in this regard, and amendments to the Central Bank Act to give the Bank of Lithuania greater enforcement powers in these areas will be introduced in Parliament. Measures to restructure the financial sector were urgently needed in a number of areas, e.g., through revision of banks' plan of accounts, establishing better governance of commercial banks and nonbanks, and bringing capital adequacy ratios in line with BIS practices, and a schedule for their implementation was agreed. 2/ The process of privatizing the state banks has begun, and an interministerial committee on bank restructuring has begun to formulate a strategy for the banking system as a whole.

On the question of domestic and external arrears, available data suggest that interenterprise claims as of end-July 1993, were the equivalent of two-thirds of broad money. Enterprises continued to supply traditional customers with products on credit, even when it was clear that payment would be indefinitely delayed. Moreover, export receipts in non-convertible currencies could not easily be exchanged for litai, leading to difficulties in paying domestic suppliers. The Bank of Lithuania had organized several arrears netting operations (but without providing credit) through the interbank Payments Center, although thus far these had not been very successful, in part because of insufficient documentation of arrears.

4. Fiscal policy

In order to monitor fiscal performance under the proposed stand-by arrangement, understandings were reached on the general government financial deficit from July 1, 1993 to December 31, 1993 and March 31, 1994, respectively (Tables 6 and 10, Appendix V, and Annex I to the MEP). The performance limit on the general government deficit provides for a small deficit, equivalent to 1 percent of GDP, in the second half of 1993, implying balance for 1993 as a whole. For 1994, the general government financial deficit should not exceed 1 percent of GDP.

1/ Average interbank interest rates have declined from a peak of 12 percent per month in May to half that by mid-September. During the mission's September visit, the authorities abrogated lending rate ceilings for commercial banks imposed in August.

2/ See the Memorandum of Economic Policies.

The authorities noted that the Government now expected to play a more active role in the disbursement of EC/G-24 loans than had earlier been foreseen as the banking system was as yet not able to intermediate these funds efficiently. The Government had established a State Liabilities Commission chaired by the Prime Minister 1/ to approve and monitor the Government's lending program, and it was important that external funds be used for investment under this program, rather than for current budgetary expenditure. It was agreed that, to monitor this use of external resources, a second fiscal performance criterion, establishing ceilings on net lending by the Government would be established.

Given the large expected disbursals from the EC/G-24 (including bilateral loans), the IBRD and the EBRD, 2/ the authorities and the staff mission agreed that net lending by the Government in 1994 should not exceed 4 percent of GDP, and that a larger lending program risked straining the capacity of the authorities to identify sufficiently productive projects, and unduly limiting the access of the banking system to external financing. The authorities would remain in close touch with the staff on the development of the lending program. Net lending by the Government from external loans in the fourth quarter of 1993, chiefly from the IBRD and EBRD but also including a small amount from the first tranche of the EC monies, are expected to amount to US$53 million (5 percent of fourth-quarter GDP).

To a large extent, the initial tranche of EC loans (ECU 50 million, or the equivalent of about US$58 million) was to be used to pay gas arrears (US$10.5 million) and for advance purchases of fuel (US$38 million). Of the initial tranche, only US$7 million will be onlent directly to enterprises by government for investment projects, and only US$3 million will be onlent through the banking system. (However, the share of EC/G-24 disbursements through the banking system is expected to rise to 20 percent (US$20 million) in 1994.)

As part of the adjustment program, the Government is undertaking a wide range of measures to rationalize the budgetary process. As described in the MEP, the most important of these are, on the revenue side, introduction of a VAT with a wider base at the same or increased rate as the General Excise Tax it will replace and simplification of the income tax system; and, on the expenditure side, improved public expenditure management including expenditure prioritization and, as described below, focusing of social safety net programs. In addition, expenditures on home heating subsidies are projected to decline as prices charged households for heating rise. The authorities undertook to take additional steps as needed to meet the fiscal targets of the program.

1/ Other members are representatives of the key ministries, and of the Bank of Lithuania. The Fund's Resident Representative has an advisory role as an ex-officio member.

2/ These were expected to total 5 percent of GDP in 1994.

5. Balance of payments prospects, external debt and assistance, and restrictive system

Lithuania suffered a severe and permanent terms-of-trade shock resulting from the rise in the cost of imported energy to world market levels. 1/ The current account deficit for 1993 is now projected to be about US$250 million (more than 8 percent of GDP), compared with a much higher earlier forecast, reflecting the more pronounced and prolonged decline in activity than earlier expected (Table 7). While this revision is reflected in net imports from the interrepublican area (in practice, Russia), imports from the convertible area have also been revised downward, because of the lower activity and delays in disbursements of foreign assistance.

For 1994, the current account deficit is forecast to widen to US$400 million, reflecting mainly imports from the non-FSU area financed from external loans. With the projected increase in activity, petroleum imports may increase by 12 percent, following a cumulative decline in volume terms in 1992-93 by almost two thirds. Likewise, gas imports are expected to increase by 18 percent, after a decline by almost 50 percent in 1992-93. Nevertheless, Lithuania's energy balance is anticipated to remain virtually unchanged as export prices of electricity are expected to rise gradually to world market prices by end-1994. As a result, the terms of trade, which deteriorated sharply in 1992-93, will somewhat improve in 1994.

A positive impact on trade is expected to arise from the trade policy measures envisaged under the program. On the export side, the authorities intend to review export taxes with a view to eliminating most of them during 1994. On the import side, a uniform tariff structure of 10 percent with few exceptions will be introduced by end-1993. The authorities also remain committed to removing restrictive trade barriers with FSU countries and reducing the direct involvement of the Government in trade relations. Free trade agreements with five FSU countries have already been signed. During the period of the program, the Government will not conclude bilateral payments agreements inconsistent with Article VIII of the Fund's Articles of Agreement.

The current account deficit is expected to be financed by foreign loans from the EC/G-24, the World Bank and the EBRD, by purchases under the stand-by arrangement and STF, and by foreign direct investment. It is assumed that the second EC tranche (ECU 50 million) will be released in the first quarter of 1994 as well as most of the bilateral G-24 loans. Disbursements from the World Bank are anticipated under a financial sector reform loan and two sectoral loans concerning agriculture and energy, totaling US$30 million in 1994. The EBRD is expected to disburse US$28 million under the energy

1/ See Appendix IV.

rehabilitation loan (amounting to US$42 million), approved in May 1993. This loan will be used for extending port oil handling facilities and to build a pipeline to the refinery.

6. Medium-term outlook

The staff has revised earlier medium-term balance of payments projections. While these are highly tentative, they indicate a narrowing current account deficit and projected real GDP growth averaging 6 percent annually (Table 8). Higher growth rates are projected for imports from western countries, while nonenergy trade with FSU countries is assumed to stagnate, implying a continuous shift in the direction of trade. Likewise, export volumes, which are assumed to grow by about 7 percent a year, will be increasingly concentrated on non-FSU countries. A significant contribution to the projected export growth is expected to follow foreign investments in Lithuanian firms. As a result, the trade deficit is forecast to be eliminated by the end of the projection period.

With net receipts from service transactions increasing in the medium term--partly from declining net interest payments--the current account is expected to move into a surplus by the end of the projection period. In contrast, net capital inflows would decline gradually after 1997 as maturities on foreign loans begin to fall due. With a rise in international reserves from two months of imports in 1993 to three months by 1998, financing gaps would exist until 1996 but with a sound policy environment it is expected that these could be filled by additional multilateral and bilateral official, and private, flows.

Including use of Fund credit, Lithuania's external debt would reach 19 percent of GDP in 1997, before falling thereafter. Debt service payments in terms of exports of goods and nonfactor services would gradually increase form 1.5 percent to 6 percent. External debt vis-à-vis international financial institutions would amount to nearly 50 percent of Lithuania's total external debt. Use of Fund credit would gradually decline as a proportion of Lithuania's total external debt, from its peak of 34 percent in 1993 to 5 percent (Table 9). Debt service payments to the Fund would peak at SDR 38.4 million in 1997, representing 1.1 percent of total exports of goods and nonfactor services, and 2.5 percent of exports to non-FSU countries alone.

An alternative scenario has also been prepared, under which it is assumed that Lithuanian electricity export prices reach world market levels only by 1997. 1/ An additional financing gap in 1994-2000 of more than US$500 million then arises because of lower export receipts and higher debt service payments (due to larger external borrowing to close this gap).

1/ Both scenarios assume the need to maintain minimum electricity generation levels, and also take into account the restricted export possibilities resulting from the present electrical grid.

External debt would be about 5 percentage points of GDP higher than in the baseline scenario, while the debt service ratio would rise 9 percent by 2000. Alternatively, domestic absorption might be limited to lower import growth by an average of about 2 1/2 percentage points a year in 1994-96. This would, however, result in lower nonenergy exports. As a result of tighter financial policies needed for a more rapid external adjustment, economic growth would be lower by an average of almost 1 percentage point per annum.

The simulations indicate that the total level of projected debt obligations appears to be within the country's servicing capacity. Given the authorities' strong commitment to the implementation of the adjustment program, the staff is of the view that Lithuania will be current in meeting future obligations to the Fund.

7. Structural policies

The structural policy measures proposed by the authorities generally continue the implementation of policies previously begun:

Privatization is to be extended and reformed. Reforms include liberalization of the preferential access rules for the privatization of medium-sized and large enterprises to allow majority ownership by outside investors. Restitution of agricultural land is proceeding slowly, although privatization in the agricultural sector other than land is nearly complete. A bill to speed the process while minimizing the disruption to production, e.g., by requiring that some restituted land be rented to ongoing agricultural concerns, was passed in June, but it is now expected this process, including full documentation, will continue until 1998.

The Government has adopted the goal of halving, compared with early 1993, those receiving special social benefits (an income supplement) to 20 percent of the population by greatly tightening eligibility for such benefits. With technical assistance from the World Bank, a new subsistence minimum to which social benefits will be linked is to be implemented by early 1994, and means testing procedures improved.

The Government will propose to Parliament raising the pensionable age for women to 56 in 1994, and thereafter by one year every two calendar years until the retirement age for men (60 years) is reached. The new system aims at providing a closer relationship between contributions and pensions received.

Unemployment benefits are to be reformed by January 1, 1994, by relating benefits to the minimum wage rather than previous salary, and by restricting the maximum period for the receipt of benefits to six months. Retraining schemes will also be reassessed and strengthened within budgetary constraints.

Full implementation of regulations of the Bankruptcy Law, including the establishment of a special Bankruptcy Court, will go into effect by the end of 1993 and market-economy accounting standards are to be implemented by the end of the program period. These measures should serve to constrain the further build-up of arrears through hardening of the budget constraint and better analysis of enterprise financial conditions. 1/

The authorities will also give a higher priority to the acquisition and analysis of economic statistics needed for policymaking. From 1994, the Government is to introduce a statement of economic policy, enunciating its economic strategy and the Bank of Lithuania will issue an Annual Report. In addition, the responsibility for coordination of balance of payments statistics is to be moved to the Bank of Lithuania. The Government will also propose legislation to strengthen enforcement powers for the collection of needed statistics.

8. State Liabilities Commission (SLC)/Public investment program (PIP)

Final approval of enterprise requests for government loans is given by the SLC, with disbursement schedules and monitoring of repayments by the Ministry of Finance. Proposals for such loans from the first EC tranche are at present under consideration by the SLC, and decisions in this regard will be made with advice from EC PHARE. Other public investment projects normally executed through the budget will remain the responsibility of the sponsoring ministry. The World Bank will, through its public expenditure review and other sector work; and EC/PHARE, through resident advisors and other technical assistance, will assist in the preparation of a public investment program.

9. Technical assistance

The Fund is continuing to provide technical assistance in its areas of expertise, including monetary policy and foreign exchange operations, tax system design and administration, and compilation of balance of payments and price statistics. To an increasing extent, the Fund's technical assistance is being rendered through long-term resident advisors. 2/ Technical assistance from the World Bank is expected to play an important role in many of the structural policies to be implemented by the authorities, e.g., social safety net reform and enterprise restructuring, and technical assistance is also expected to be received on a bilateral basis. EC/PHARE will also provide advisors in the first half of 1994 in the areas of debt management, loan disbursal, and tax administration. To facilitate the

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1/ The monetary program also serves to prevent credit expansion as an approach to the problem of arrears.

2/ Resident advisors in the areas of foreign exchange operations and the implementation of monetary policy are in place, and additional advisors on tax administration and statistics (based in Riga and covering the three Baltic countries) are expected to take up their posts early next year.

timely provision of technical assistance, a Technical Assistance Coordinator position has been established in the Ministry of Foreign Affairs. The Coordinator will maintain close contacts with providers of technical assistance as well as a central register of technical assistance projects.

10. Performance criteria and program reviews

The performance criteria under the proposed arrangement, some of which have been discussed above, are specified in the authorities' Memorandum of Economic Policies, and are shown in Table 10. Understandings have been reached on the quantitative performance limits for December 31, 1993 and March 31, 1994. Quantitative performance criteria and indicative targets for June 30, 1994 and September 30, 1994 will be specified at the first program review under the arrangement, to be completed by the Fund in March, 1994, and for December 31, 1994, at the time of the second program review in September, 1994. The first review will also, besides evaluating the effect of financial policies on growth, inflation, and the exchange rate, focus, inter alia, on implementation of the VAT, the functioning of the foreign exchange market, and progress in unifying import tariffs. It will also evaluate technical assistance received and additional technical assistance needs. The second review will also evaluate, inter alia, the operation of monetary policy, progress in implementing financial sector restructuring, and the quality of economic statistics.

V. Staff Appraisal

Lithuania has already completed a first adjustment program, supported by the recently expired stand-by arrangement from the Fund. All of the quantitative performance criteria under this stand-by arrangement were met. However, there was a sharper-than-anticipated fall in output during the program period and, until recent months, when the authorities moved decisively to tighten monetary conditions (setting the stage for introduction of the litas), much higher than programmed inflation. Much of the output decline was the result of a substantial and permanent increase in import costs, due to a rise in the price of energy imports to world market prices. It also reflected disruptions to traditional trading relationships, as well as substantial shifts in relative prices. To the authorities' credit, the impact of the terms-of-trade shock on employment was cushioned by a strictly applied incomes policy.

The authorities are to be commended for the steps already taken toward establishment of a market-based economy. The present program of macroeconomic and structural adjustment, if fully implemented, will continue this process, and should establish a credible basis for renewed growth of the Lithuanian economy in a low inflation environment.

The program provides for continued fiscal prudence, with only a small general government financial deficit, but with additional measures to reform the structure of taxation and establish expenditure priorities in place of broad based expenditure cuts. In addition, taking into account the inability of the banking system to absorb the large flow of external funds expected in the program period, substantial net lending by the Government from these funds has been targeted. Though this is second best to disbursements through a developed banking system, careful scrutiny of proposed projects should serve to guard against waste. Elaboration of a public investment program should now be of the highest priority.

Monetary policy and the monetary targets of the program aim at establishing single digit inflation at an annual rate by late 1994. With the development of additional monetary instruments, the program provides for monetary control through a ceiling on the domestic assets of the central bank. The elimination of the previous direct credit limits on individual banks should allow flexibility in the development of the banking system. In addition, the state-owned banks are to be privatized, and a number of other measures to enforce prudential requirements are to be taken to place the commercial banks on a more solid footing.

Other measures include continuation of the privatization process, which, except for land restitution, would be nearly complete by the end of the program period; full implementation of the bankruptcy law; and substantial progress toward reform of the social safety net. In many of these areas, additional technical assistance will be needed. In addition, the reorientation of external trade toward the non-FSU area is expected to continue, aided by the recently implemented liberal trade regime. The staff is encouraged by the determination of the Lithuanian authorities to press on with their program of structural reform, and would emphasize that these reforms are vital if discipline in macroeconomic policies is to be rewarded with a sustainable resumption of growth, and the projected medium-term improvement in the external accounts is to be realized. The staff also welcome the intention of the authorities to address structural reforms in the framework of the Extended Fund Facility in due course.

The task before the Lithuanian authorities is clear: to continue the process of structural reform, while building credibility and maintaining stability through the steady application of prudent financial policies. In this way, and with the external resources now available, a positive trend of incomes, investment, and growth can be established. The Lithuanian economy is now--with proper guidance from the authorities and help from the international community--poised for renewed growth and productivity that should carry well beyond the period of the present program. It is an opportunity to be seized.

The authorities' program continues the transformation of the economy to one based on market principles, and the adjustment to the permanent shock caused by the increase in imported energy prices to world market levels. In the view of the staff, the program set forth in the Memorandum of Economic Policies is soundly based and, if implemented with vigor, should contribute to higher growth that should, in turn, allow ample capacity for debt-service and elimination of the need for exceptional financing in the post-program period. Accordingly, the staff recommends approval of Lithuania's requests for a 17-month stand-by arrangement in the amount equivalent to SDR 25.875 million (25 percent of quota) in support of its economic stabilization and reform program, and for a first purchase under the Systemic Transformation Facility in an amount equivalent to SDR 25.875 million (25 percent of quota).

VI. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

A. Request for Stand-by Arrangement

1. The Government of Lithuania has requested a stand-by arrangement for a seventeen-month period in an amount equivalent to SDR 25.875 million.

2. The Fund approves the stand-by arrangement set forth in EBS/93/164.

B. Request for Purchase under Systemic Transformation Facility

1. The Fund has received a request by the Government of Lithuania for a purchase equivalent to SDR 25.875 million under the Decision on the Systemic Transformation Facility, (Decision No. 10348-(93/61) STF, adopted April 23, 1993).

2. The Fund approves the purchase in accordance with the request.

3. The Fund waives the limitation in Article V, Section 3 (b)(iii).

Table 1. Lithuania: Selected Economic Indicators

(Percentage changes over same period previous year unless otherwise indicated)

	1992	1993 1st half	1993 2nd half	1993 Full year	1994
Output and prices					
Real GDP	-37.7	-22.6	-8.6	-16.2	4.7
Real wages	-17.2	-52.8	-35.5	-45.4	9.9
Consumer prices	1020.5	694.0	291.6	393.9	33.0
External sector					
Export volume	-38.1	-2.2	-2.2	-2.2	4.4
Interrepublican	-61.9	-22.1	-12.0	-17.7	0.2
Other	78.5	18.5	4.9	14.0	7.5
Import volume	-56.5	-15.8	3.7	-6.9	17.9
Interrepublican	-64.1	-30.3	1.4	-17.2	7.7
Other	-13.0	12.2	6.5	17.3	34.7
Current account (in millions of U.S.dollars)	59.1	-101.7	-146.5	-248.2	-397.0
(in percent of GDP)	3.2	-9.6	-7.5	-8.4	-8.3
Government finances (in percent of GDP)					
Revenue	33.3	26.4	24.1	25.0	25.6
Expenditure	32.4	25.8	23.9	25.0	26.6
Financial balance	0.9	0.6	-0.5	-0.1	-1.0
Overall balance	0.6	-2.8	-6.4	-5.0	-4.9
Money and credit (Change from previous period)					
Domestic credit 1/	427	18	89	123	...
Broad money 1/	351	60	62	160	...
Interest rates 2/ (in percent per annum)					
Deposit	103	110	...	...	...
Credit	135	147	...	...	...

Sources: Information provided by the Lithuanian authorities; and staff estimates and projections.

1/ End of period.
2/ For 30-90 days at commercial banks, end of period.

Table 2. Lithuania: Real Economy Indicators

(Annual percentage changes)

	1992	1993	1994
Real GDP 1/	-37.7	-16.2	4.7
Real domestic demand 1/	-40.5	-20.1	13.7
Industrial output 2/	-51.6	-42.7	...
Employment (thousands)	1,886	1,874	1,802
Of which: state sector	1,188	...	...
Unemployment (in percent of labor force)	1.1	1.7	5.5
Real wages 2/	-17.2	-46.1	10.0
Consumer prices 3/	1,020.5	390.2	31.9
Merchandise terms of trade	-45.1	-21.7	8.3

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

1/ At 1992 prices. National accounts estimates are very tentative, in particular reflecting the inadequate coverage of the emerging private service sector.
2/ State enterprise sector only.
3/ For 1991, based on a retail price index. For May 1992 onward, based on new consumer price index.

Table 3. Lithuania: Wages and Prices

	Consumer Prices 1/		Average Wages		Real Wages
	Index	Percent Change	Index	Percent Change	Index
1991					
January	100	...	100 2/	...	90 3/
February	108	8.4	100 2/	...	90 3/
March	127	17.1	100 2/	...	90 3/
April	161	27.1	142	42.1	88
May	177	9.6	163	14.5	92
June	189	6.6	184	13.0	98
July	199	5.5	208	12.9	104
August	207	4.2	213	2.4	103
September	215	3.5	231	8.5	108
October	227	6.0	321	39.1	141
November	291	27.8	418	30.4	144
December	445	53.0	675	61.3	152
1992					
January	685	54.0	710	5.3	104
February	975	42.4	872	22.8	90
March	1,152	18.2	1,010	15.8	88
April	1,271	10.3	1,284	27.1	101
May	1,357	6.8	1,552	20.9	114
June	1,524	12.3	1,799	15.9	118
July	1,939	27.2	1,927	7.1	99
August	2,214	14.2	2,065	7.2	93
September	2,865	29.4	2,456	18.9	86
October	3,407	18.9	2,566	4.5	75
November	4,395	29.0	2,587	0.8	59
December	5,612	27.7	2,716	5.0	48
1993					
January	6,145	9.5	2,939	8.2	48
February	6,772	10.2	3,741	27.3	55
March	8,221	21.4	4,209	12.5	51
April	10,276	25.0	4,663	10.8	45
May	11,581	12.7	5,004	7.3	43
June	12,311	6.3	5,599	11.9	46
July	12,668	2.9	5,974	6.7	47
August	12,782	0.9	6,124	2.5	48

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

1/ Until May 1992, based on a retail price index for goods and services. Subsequent data are based on the new consumer price index.

2/ Average for the first quarter of 1991.

3/ Average wages divided by the quarterly average price level.

Table 4. Lithuania: Monetary Survey

(in millions of litai)

	1993			1994
	June	Sep.	Dec.	Mar.
Net Foreign Assets 1/	837	959	919	862
Net Domestic Assets	597	1,044	1,407	1,704
Domestic credit	1,027	1,474	1,837	2,134
Net credit to government 1/	-155	-155	-155	-155
Other	1,182	1,629	1,992	2,289
Other items, net	-430	-430	-430	-430
Broad Money	1,434	2,003	2,325	2,566
Currency	283	620	643	728
Nonconvertible deposits	58	50	50	50
Memorandum items				
Broad money growth (percentage change from previous period)	1	40	16	10
Velocity of circulation	9.4	7.4	7.1	7.0

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

1/ Excludes unused EC/G-24 funds.

Table 5. Lithuania: Central Bank Balance Sheet 1/

(In millions of litai; end of period)

	1993			1994
	June	Sep.	Dec.	Mar.
Net International Reserves	426	639	599	542
Gold	248	248	248	248
Foreign exchange	344	702	835	924
Use of Fund credit	-166	-311	-484	-629
Net Domestic Assets	114	257	387	542
Domestic credit	189	188	386	379
Net credit to government 2/	-128	-127	-111	-251
Credit to banks	317	314	497	630
Foreign currency	50	74	74	74
Domestic currency	267	240	423	556
Other items, net 3/	-75	69	1	163
Reserve Money	540	896	986	1,084
Memorandum items				
Projected NIR (in millions of U.S. dollars)	106	160	150	136
Reserve money growth (percentage change from previous period)	38	66	10	10
Money multiplier	2.7	2.2	2.4	2.4
Program exchange rate (litai/US$)	4.0	4.0	4.0	4.0

Sources: Bank of Lithuania; and staff estimates.

1/ Entries in the Bank of Lithuania balance sheet reflect the definitions contained in the annexes of the Memorandum of Economic Policies of September 30, 1993.

2/ Including unused EC/G-24 funds.

3/ Includes counterpart items to government deposits of G-24 funds, foreign currency required reserves.

Table 6. Lithuania: Summary of Consolidated General Government Operations 1/

	1992	1993 First Half	1993 Second Half 2/	1993 2/	1994 2/
			(In millions of litai)		
Total revenue	1,090	1,306	1,859	3,166	5,024
Tax revenue	1,032	1,220	1,806	3,026	4,891
Income and profits	375	510	695	1,205	1,692
Payroll tax	260	272	439	710	1,068
GET and excises	371	406	629	1,035	2,020
Other	26	33	43	76	110
Nontax revenue	57	86	54	140	134
Expenditure	1,059	1,278	1,894	3,173	5,214
Current expenditure	962	1,164	1,711	2,875	4,399
Social outlays	626	756	1,125	1,881	2,866
Subsidies	68	134	252	386	621
Other	268	274	333	607	911
Investment	84	110	178	288	802
Financial balance	31	28	-35	-7	-190
Net Lending	10	167	457	625	799
Fiscal balance	21	-139	-492	-631	-989
Borrowing requirement	-21	139	492	631	989
Foreign financing	24	215	573	788	1,030
Change in net bank claims on Government	-71	-153	-100	-252	-81
Privatization receipts	26	77	19	95	40
			(Percent of GDP)		
Total revenue	33.3	26.4	24.1	25.0	25.6
Tax revenue	31.6	24.6	23.4	23.9	24.9
Income and profits	11.5	10.3	9.0	9.5	8.6
Payroll tax	8.0	5.5	5.7	5.6	5.4
GET and excies	11.4	8.2	8.1	8.2	10.3
Other	0.8	0.7	0.6	0.6	0.6
Nontax revenue	1.8	1.7	0.7	1.1	0.7
Expenditure	32.4	25.8	23.9	25.0	26.6
Current expenditure	29.4	23.5	22.2	22.7	22.4
Social outlays	19.1	15.3	14.6	14.8	14.6
Subsidies	2.1	2.7	3.3	3.0	3.2
Other	8.2	5.5	4.3	4.8	4.6
Investment	2.6	2.2	2.3	2.3	4.1
Financial balance	0.9	0.6	-0.5	-0.1	-1.0
Net Lending	0.3	3.4	5.9	4.9	4.1
Of which: IBRD+EBRD		3.3	3.3	3.4	2.7
Direct lending		--	2.6	1.7	1.4
Fiscal balance	0.6	-2.8	-6.4	-5.0	-5.0
Borrowing requirment	-0.6	2.8	6.4	5.0	5.0
Foreign financing	0.7	4.3	7.4	6.2	5.2
Change in net bank claims on Government	-1.4	-3.1	-1.3	-2.0	-0.4
Privatization receipts	0.8	1.5	0.2	0.8	0.2

Sources: Ministry of Finance; and staff estimates.

1/ Including national budget, Social Insurance Fund, privatization funds.

2/ Projections.

Table 7. Lithuania: Balance of Payments 1993-94

(in millions of U.S. dollars)

	1993	1993 Q1	1993 Q2	1993 Q3	1993 Q4	1994	1994 Q1	1994 Q2	1994 Q3	1994 Q4
Trade balance	-269	-52	-60	-70	-88	-437	-95	-101	-122	-119
Exports	1,694	365	410	456	465	2,047	477	511	516	543
FSU	1,039	206	247	290	296	1,313	305	334	331	343
Non-FSU	655	159	162	166	168	734	172	177	185	200
Imports	1,964	417	469	525	553	2,484	573	612	638	661
FSU	1,550	317	371	423	439	1,903	448	464	482	509
Non-FSU	414	100	98	102	113	634	125	148	156	152
Services (net)	9	1	4	3	2	26	5	11	12	-1
Interest (net)	4	1	1	1	2	-19	-4	-4	-5	-5
Private transfers	12	4	2	3	3	14	3	3	4	4
Current account balance 1/	-248	-48	-55	-64	-83	-397	-87	-87	-107	-116
Capital account	266	27	61	113	65	344	163	74	63	45
Foreign direct investment	40	7	16	9	8	60	13	15	16	16
Official transfers	108	27	29	28	24	50	15	14	12	10
Medium- and long-term loans (net)	172	8	27	89	48	234	134	45	35	
Short-term capital (net)	-45	-	-	-30	-15	-	-	-	-	-
Other capital	18	-	-	18	-	-	-	-	-	-
Error and omissions	-27	-15	-11	-	-	-	-	-	-	-
Overall balance	18	-21	7	49	-18	-53	75	-13	-44	-71
Financing	-18	21	-7	-49	18	52	-75	13	44	71
Net foreign assets	-18	21	-7	-49	18	52	-75	13	44	71
Central Bank	-63	-3	-30	-47	18	52	-75	13	44	71
IMF purchases	98	-	19	36	42	56	35	7	7	7
Reserves (- = increase)	-160	-3	-49	-84	-24	-4	-110	6	37	64
Deposit currency banks	45	24	23	-2	-	-	-	-	-	-

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

1/ Defined to exclude official transfers.

Table 8. Lithuania: Medium-Term Outlook, 1993-2000

(In millions of U.S. dollars)

	1993	1994	1995	1996	1997	1998	1999	2000
Trade balance	-269	-437	-300	-203	-149	-125	-113	-101
Exports	1,694	2,047	2,388	2,633	2,878	3,124	3,379	3,656
FSU	1,039	1,313	1,517	1,624	1,737	1,858	1,987	2,126
Non-FSU	655	734	871	1,010	1,141	1,266	1,392	1,530
Imports	1,964	2,484	2,688	2,836	3,027	3,249	3,492	3,757
FSU	1,550	1,903	2,059	2,145	2,260	2,382	2,513	2,650
Non-FSU	414	581	629	691	767	867	979	1,107
Services (net)	9	26	38	62	83	100	117	137
Interest (net)	4	-19	-45	-57	-56	-49	-39	-25
Private transfers	12	14	15	17	18	20	22	24
Current account balance 1/	-248	-397	-247	-124	-47	-5	27	60
Capital account	266	344	224	234	243	236	241	182
Foreign direct investment	40	60	70	80	90	100	110	120
Official transfers	108	50	30	10	--	--	--	--
Medium-and long-term loans	172	234	124	144	144	117	100	29
Disbursements	172	234	130	150	160	170	180	190
Amortization	--	--	6	6	7	34	49	128
Short-term credit (net)	-45	--	--	--	--	--	--	--
Other capital	18	--	--	--	--	--	--	--
Errors and omissions	-27	--	--	--	--	--	--	--
Overall Balance	18	-53	-23	109	196	232	268	242
Financing	-18	53	-60	-132	-196	-232	-268	-242
Net foreign assets	-18	53	-60	-132	-196	-232	-268	-242
Central bank	-63	53	-60	-132	-196	-232	-268	-242
IMF purchases	98	56	--	-17	-196	-29	-20	-11
Reserves (- = increase)	-160	-3	-60	-115	-167	-202	-247	-230
Deposit money banks	45	--	--	--	--	--	--	--
Financing gap	--	--	83	23	42	--	--	--
Memorandum items:								
Export volume								
(percentage change)	-2.2	4.4	9.7	9.0	7.3	6.1	5.5	5.6
FSU	-17.7	2.2	2.5	2.5	2.5	2.5	2.5	2.6
Non-FSU	14.0	7.5	16.0	13.0	10.0	8.0	7.0	7.0
Import volume								
(percentage change)	-6.9	17.9	3.0	3.8	4.9	5.9	6.2	6.3
FSU	-17.2	7.7	0.8	1.2	2.2	2.3	2.5	2.5
Non-FSU	17.3	34.7	6.0	7.0	8.0	10.0	10.0	10.0
Terms of Trade								
(percentage charge)	-17.1	7.8	1.3	-0.5	--	0.9	1.2	1.2
Current account balance 2/	-8.4	-8.3	-4.3	-1.4	-0.2	-0.3	-0.5	0.7
Gross official reserves 3/	1.7	1.4	1.6	2.0	2.6	3.1	3.7	4.2
Debt service 4/	0.8	1.5	2.2	3.0	2.9	3.7	3.9	3.4

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

1/ Defined to exclude official transfers.
2/ In percent of GDP.
3/ In months of imports.
4/ In percent of imports of goods and nonfactor services.

Table 9. Lithuania: Indicators of Capacity to Repay the Fund, 1993-2000

	1993	1994	1995	1996	1997	1998	1999	2000
				(in millions of SDRs)				
Outstanding Use of Fund credit	88.0	134.6	139.8	122.9	89.9	59.6	42.6	33.3
IMF Obligations	0.7	5.7	7.0	23.5	38.4	34.1	19.5	11.0
Repurchases	-	-	-	16.9	33.0	30.3	17.0	9.3
Charges	0.7	5.7	7.0	6.6	5.4	3.8	2.5	1.7
				(in percent)				
Outstanding Use of Fund Credit								
as a ratio of GDP	4.1	3.8	3.4	2.9	2.2	1.5	1.1	0.9
Exports of goods and nonsector services								
Total exports	6.5	8.1	7.2	5.9	4.4	3.2	2.5	2.0
Exports to non-FSU countries	14.7	19.5	17.0	13.4	9.9	7.1	5.3	4.2
External debt	34.6	28.6	19.2	15.1	11.3	8.2	6.2	5.3
Net official international reserves 1/	74.3	167.7	111.4	56.6	28.2	15.2	9.1	6.4
Quota	85.0	130.0	135.0	118.7	86.9	57.8	41.1	32.2
Debt service obligations to IMF								
as a ratio of GDP	0.1	0.1	0.2	0.4	0.5	0.5	0.3	0.2
Exports of goods and nonfactor services								
Total exports	0.1	0.3	0.3	0.9	1.1	1.0	0.6	0.3
Exports to non-FSU countries	0.2	0.7	0.8	1.9	2.5	2.2	1.4	0.7
Total debt service	13.0	20.3	13.5	30.4	38.2	26.7	15.4	5.9
Net official international reserves 1/	0.9	6.0	5.0	8.2	7.2	4.7	2.4	1.1

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

1/ Convertible currencies.

Table 10. Lithuania: Quantitative Performance Criteria 1/

	Variable and Periods	Amounts		
		(In millions of litai)		
I.	Limits on net domestic assets of the Bank of Lithuania:			
	June 30, 1993: Position	114		
	September 30, 1993: Indicative limit	270		
	December 31, 1993: Performance criterion	400		
	March 31, 1994: Performance criterion	550		
II.	Limits on the general government financial balance:			
	July 1, 1993 - September 30, 1993 (Indicative limit)	-20		
	July 1, 1993 - December 31, 1993 (Performance criterion)	-50		
	July 1, 1993 - March 31, 1994 (Performance criterion)	-100		
III.	Limits on net lending by the general government:			
	July 1, 1993 - September 30, 1993 (Indicative limit)	285		
	July 1, 1993 - December 31, 1993 (Performance criterion)	520		
	July 1, 1993 - March 31, 1994 (Performance criterion)	740		
IV.	Indicative limits on reserve money:			
	June 30, 1993: Position	540		
	September 30, 1993: Indicative limit	900		
	December 31, 1993: Indicative limit	1,000		
	March 31, 1994: Indicative limit	1,100		
		(In millions of U.S.dollars)		
V.	Minimum net international reserves of the Bank of Lithuania	Minimum limits		
	June 30, 1993: Position	106.4		
	September 30, 1993: Indicative limit	150.0		
	December 31, 1993: Performance criterion	110.0		
	March 31, 1994: Performance criterion	110.0		
VI.	Limit on accumulation of external payments arrears by the Government:	Maximum limits		
	September 30, 1993: Indicative limit	--		
	December 31, 1993: Performance criterion	--		
	March 31, 1993: Performance criterion	--		
VII.	Cumulative limits on contracting and guaranteeing public and publicly guaranteed debt	Maximum limits		
		1-12 year maturity	1-5 year maturity	0-1 year maturity
	From June 30, 1993 until:			
	September 30, 1993: Indicative limit	105	18	--
	December 31, 1993: Performance criterion	205	43	--
	March 31, 1994: Performance criterion	305	68	--

Source: Memorandum of Economic Policies.

1/ Definitions of the performance criteria are included in the Annexes to the Memorandum of Economic Policies of September 30, 1993.

Table 11. Lithuania: Schedule of Purchases
Under Proposed Stand-By Arrangement and Under the STF

Amount of Purchase	Expected availability date	Conditions fulfilled or necessary for purchase
SDR 31.050 million	On or after October 22, 1993	Board approval of stand-by arrangement and first purchase under the STF
SDR 25.875 million 1/	On or around March 15, 1994	Compliance with quantitative performance criteria for December 31, 1993, and completion of program review
SDR 5.175 million	On or after May 15, 1994	Compliance with quantitative performance criteria for March 31, 1994
SDR 5.175 million	On or around August 15, 1994	Compliance with quantitative performance criteria for June 30, 1994, and completion of program review
SDR 5.175 million	On or after November 15, 1994	Compliance with quantitative performance criteria for September 30, 1994
SDR 5.175 million	On or after February 15, 1995	Compliance with quantitative performance criteria for December 31, 1994

Sources: Draft stand-by arrangement and Memorandum of Economic Policies of the authorities.

1/ The expected amount and timing of the second purchase under the STF.

Table 12. Lithuania: Projection of IMF Position During Period of Proposed Stand-By Arrangement and Financing Under the Systemic Transformation Facility

	1993	1994				1995
	Oct.-Dec.	Jan.-Mar.	Apr.-June	July-Sep.	Oct.-Dec.	Jan.-Mar.
	(In thousands of SDRs)					
Purchases	31,050	25,875	5,175	5,1755	5,175	5,175
Ordinary resources						
Tranche policies	5,175	--	5,175	5,175	5,175	5,175
Special facilities	25,875	25,875	--	--	--	--
Repurchases	--	--	--	--	--	--
Total Fund credit outstanding (end of period)	87,975	113,850	119,025	124,200	129,375	134,550
Tranche policies	62,100	62,100	67,275	72,450	77,625	82,800
Special facilities	25,875	51,750	51,750	51,750	51,750	51,750
	(In percent of quota)					
Total Fund credit outstanding (end of period)	85.0	110.0	115.0	120.0	125.0	130.0
Tranche policies	60.0	60.0	65.0	70.0	75.0	80.0
Special facilities	25.0	50.0	50.0	50.0	50.0	50.0

Sources: Staff projections.

Table 13. Lithuania: Projected Payments to the Fund as at August 31, 1993

(in millions of SDRs)

	Overdue	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Beyond	Total
. Obligations from existing drawings													
1. Principal													
a. Repurchases	-	-	-	-	15.2	21.9	6.6	-	-	-	-	-	43.7
b. ESAF/SAF repayments	-	-	-	-	-	-	-	-	-	-	-	-	-
c. Trust Fund obligations	-	-	-	-	-	-	-	-	-	-	-	-	-
2. Charges and interest 1/	-	.6	2.3	2.3	2.0	1.1	.2	-	-	-	-	-	8.5
Total Obligations 2/	-	.6	2.3	2.3	17.3	22.9	6.8	-	-	-	-	-	52.2
(percent of quota)	-	.5	2.2	2.2	16.6	22.1	6.5	-	-	-	-	-	50.3
. Obligations from prospective drawings													
1. Principal													
a. Repurchases	-	-	-	-	1.7	11.1	23.7	17.0	9.3	8.6	8.6	10.8	90.9
b. ESAF/SAF repayments	-	-	-	-	-	-	-	-	-	-	-	-	-
c. Trust Fund obligations	-	-	-	-	-	-	-	-	-	-	-	-	-
2. Charges and interest 1/	-	.2	3.4	4.7	4.6	4.4	3.6	2.5	1.7	1.3	.8	.4	27.6
Total obligations	-	.2	3.4	4.7	6.3	15.5	27.3	19.5	11.0	9.9	9.5	11.2	118.5
(percent of quota)	-	.1	3.2	4.5	6.0	14.9	26.3	18.8	10.6	9.5	9.1	10.8	114.4
. Cumulative (existing and prospective)													
1. Principal													
a. Repurchases	-	-	-	-	16.9	33.0	30.3	17.0	9.3	8.6	8.6	10.8	134.6
b. ESAF/SAF repayments	-	-	-	-	-	-	-	-	-	-	-	-	-
c. Trust Fund obligations	-	-	-	-	-	-	-	-	-	-	-	-	-
2. Charges and interest 1/	-	.7	5.7	7.0	6.6	5.4	3.8	2.5	1.7	1.3	.8	.4	36.1
Total obligations 2/	-	.7	5.7	7.0	23.5	38.4	34.1	19.5	11.0	9.9	9.5	11.2	170.6
(percent of quota)	-	.7	5.5	6.7	22.7	37.1	32.9	18.8	10.6	9.5	9.1	10.8	164.8

1/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA, and on current interest rates for SAF, ESAF and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.
2/ Overdue obligations (if applicable) will be settled in full at close of business September 1, 1993 .

Prepared by Treasurer's Department

Lithuania: Fund Relations
(As of September 30, 1993)

I. Membership Status: Joined 4/29/92

II. General Resources Account:	SDR Million	Percent of Quota
Quota	103.50	100.0
Fund holdings of currency	160.43	155.0
Reserve position in Fund	.01	--

III. SDR Department:	SDR Million	Percent of Allocation
Holdings	39.71	N/A

IV. Outstanding Purchases and Loans:	SDR Million	Percent of Quota
Stand-by arrangements	43.70	42.2

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	10/21/92	9/20/93	56.93	56.93

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

	Overdue	Forthcoming				
	9/30/93	1993	1994	1995	1996	1997
Principal	...	...	...	...	15.2	21.9
Charges/interest	...	0.6	2.3	2.3	2.0	1.0
Total		0.6	2.3	2.3	17.2	22.9

VII. Exchange Arrangements

The currency of Lithuania is the litas, which replaced the talonas on June 25, 1993. The litas is floating.

VIII. Resident Representative

The first Resident Representative of the Fund in Lithuania, Mr. Per Hedfors, took up his post in May 1992. Mr. Peter Cornelius succeeded Mr. Hedfors from October 1, 1993.

IX. Consultation Cycle

Lithuania is on the 12-month consultation cycle.

Lithuania: World Bank Relations

Lithuania joined the World Bank in July 1992, following an acquaintance mission in January 1992. Since then, World Bank missions have visited Lithuania on a number of occasions, looking at issues in the areas of agriculture, energy, environment, financial sector and enterprise reform, municipal services and housing, social safety net, telecommunications, tourism and transportation. The World Bank is taking a lead role in advising and helping the Lithuanian Government to implement reforms in most of these areas. In this context, the Bank is planning to finalize several loan agreements next year with respect to the agricultural, energy, and enterprise and finacial sectors. Over the medium term, the World Bank is expecting to disburse an average of $80-90 million per year.

In view of the need for higher imports, the World Bank sent missions to Vilnius in March/April and June/July 1992, to begin arrangements for an import rehabilitation loan. These negotiations proceeded in close consultation with the negotiations toward a stand-by arrangement supported by the Fund, resulting in a mutually consistent set of macroeconomic and structural policies. The import rehabilitation loan, approved by the Executive Board on October 22, 1992, is in the amount of US$60 million, repayable over 17 years with a four-year grace period at the Bank's standard variable interest rate. As of September 29, 1993, US$30 million had been disbursed.

Lithuania: Technical Assistance From the Fund, 1991-93

Department	Subject/Identified Need	Action	Time	Counterpart 1/
MAE	General assessment of the legislative/institutional framework and needs for technical assistance	Mission	Dec. 91	BOL
MAE	Issues relating to separation of commercial and central banking functions of BOL, central bank powers and independence, and organization of the central bank	Mission	March 92	BOL
FAD	Issues relating to tax policy and administration, budgetary procedures for expenditure control and monitoring, and the social safety net	Mission	March 92	MOF
STA	Analysis of current price statistics and initiation of an improved Lithuanian household expenditure survey as steps toward an improved consumer price index	Consultant's visit	March 92	DOS
STA	Provision of training in the methodologies for financial statistics; establishment of procedures for collection and compilation of balance of payments, government finance, and money and banking statistics	Mission	March/ April 92	BOL MOF MOE DOS
STA	Balance of payments statistics	Mission	May 92	MOE DOS
MAE	Issues and procedures involved in introducing the litas; separation of BOL; improvements in accounting procedures and controls; preparation of a reporting system for banks; introduction of monetary policy instruments; improvement of prudential banking supervision	Mission	June 92	BOL
MAE	Unification of exchange rates; currency convertibility issues and elimination of exchange controls; development of institutions in the foreign exchange market; operation of the foreign exchange market following the introduction of the litas	Mission	June 92	BOL MOE MOF
STA	Consolidation of general government financial statistics and reconciliation of MOF statistics on government finance with the monetary sector accounts	Mission	June/ July 92	MOF BOL
STA	Follow-up to March 92 mission on price statistics	Consultant's visit	July 92	DOS
MAE	Payments system improvement	Consultant's visits	Aug-Dec. 92	BOL

Lithuania: Technical Assistance From the Fund, 1991-93 (cont'd)

Department	Issue	Action	Date	Counterpart 1/
STA	Balance of payments statistics	Mission	Sept. 92	MOE DOS
TRE	Quota payment	Mission	Oct. 92	MOF BOL
MAE, LEG	Review financial legislation	Mission	Nov. 92	BOL MOE MOF
MAE	Monetary instruments, forex operations	Mission	Dec. 92	BOL
EXR	Seminars on Fund, press interviews	Mission	Nov. 92	
STA	Balance of payments statistics	Mission	Dec. 92	MOE DOS
STA	Assessment of technical assistance needs	Mission	March 93	DOS
MAE	Monetary operations, bank supervision payments system improvement, central bank accounting, foreign exchange operations	Consultant's visits	Mar-Sept. 93	BOL
STA	Money and banking statistics	Mission	April 93	BOL
STA	Balance of payments statistics	Consultant's visit	April/May 93	MOE/DOS
MAE	Monetary operations, bank supervision payments system improvement, central bank accounting, foreign exchange operations	Mission	May/June 93	BOL

1/ Bank of Lithuania (BOL), Department of Statistics (DOS), Ministry of Economics (MOE) and Ministry of Finance (MOF).

Eligibility and Access Under the STF

Eligibility to use the STF requires that a country experiences balance of payments difficulties resulting from "(i) a sharp fall of total export receipts due to a shift from significant reliance on trading at nonmarket prices to multilateral, market-based trade; (ii) a substantial and permanent increase in net import costs, due to a shift from significant reliance on trading at nonmarket prices toward world market prices, particularly for energy products; or (iii) a combination of both." 1/ While in the case of Lithuania the sharp fall in exports that has occurred since its independence would also be sufficient for meeting the criteria set out in the STF decision, Lithuania's eligibility and access are demonstrated based on an increase in net energy import costs in 1993 as shown in Table 14.

As a substantial net energy importer, Lithuania has been adversely affected by the movement toward world market levels of energy prices charged by its FSU trading partners, in particular Russia. Energy imports largely comprise crude oil, natural gas, and nuclear fuel. Lithuania has a large oil refinery at Mazeikiai which used to refine 12 million tons of crude oil before the breakup of the FSU. While operating at a much smaller capacity, Mazeikiai is partly used for refining oil imported by private firms, with the refined products, mainly diesel and oil fuel, being exported. In addition, Lithuania possesses large capacities to generate electricity, including the nuclear power plant at Ignalina. These power plants are also running at very low capacities.

As discussed in previous staff reports, energy import and export prices had reached world market levels already in the fourth quarter of 1992--with the exception of electricity. 2/ Nevertheless, for the year as a whole, Lithuania's net energy payments in 1993 are estimated to be substantially higher than in 1992--despite a substantial decline in net energy import volumes, particularly for crude oil and natural gas. This increase is estimated to amount to almost SDR 330 million (210 percent of quota). While Lithuania's adjustment to world market conditions is likely to be completed earlier than in most other FSU countries--mainly reflecting the fact that price adjustments started earlier than elsewhere--the staff is of the view that the effects of these disruptions continue to give rise to balance of payments difficulties in an amount in excess of 50 percent of quota.

1/ Decision No. 10348-(93/61) STF, adopted April 23, 1993.
2/ See EBS/93/42 (4/6/93) and EBS/93/86 (6/24/93).

Table 14. Lithuania: Calculation of Increase in Net Energy Imports, 1992-93

(In millions of U.S. dollars)

	1992	1993 Estimated
Imports	349.8	952.6
Crude oil		
Volume (in millions of tons)	4.1	3.9
Value	157.1	469.4
Price (in US$ per ton)	38.3	119.7
Natural gas		
Volume (in millions of M3)	3,407.0	3,000.0
Value	108.3	255.0
Price (in US$ per 1,000 M3)	31.8	85.0
Coal		
Volume (in thousand of tons)	870.0	550.0
Value	5.2	20.2
Price (in US$ per ton)	6.0	36.6
Oil fuel 1/		
Volume (in millions of tons)	0.1	0.6
Value	7.9	48.5
Price (in US$ per ton)	59.0	77.8
Diesel		
Volume (in millions of tons)	0.1	0.1
Value	7.8	11.7
Price (in US$ per ton)	93.0	187.8
Nuclear fuel		
Volume (in rods)	1,630.0	1,600.0
Value	63.5	147.8
Price (in US$ per rod)	38,957.0	92,375.0

Table 14. Lithuania: Calculation of Increase in Net Energy Imports, 1992-93 (Cont'd.)

(In millions of U.S. dollars)

	1992	1993 Estimated
Exports	91.5	401.3
Diesel		
Volume (in millions of tons)	0.2	1.0
Value	18.6	187.8
Price (in US$ per ton)	93.0	187.8
Oil fuel 1/		
Volume (in millions of tons)	0.1	0.3
Value	5.9	25.7
Price (in US$ per ton)	59.0	77.8
Petrol		
Volume (in millions of tons)	0.2	0.4
Value	29.5	96.6
Price (in US$ per ton)	128.3	241.7
Electricity		
Volume (in millions of tons)	5,287.0	4,200.0
Value	37.6	91.2
Price (in US$ per 1,000 kwh)	7.1	21.7
Total net energy imports (in millions of SDRs)	183.5	400.3
Increase in net energy imports for 1992		
In millions of SDRs	...	216.8
In percent of quota	...	209.5

Sources: Lithuanian authorities; and staff estimates.

1/ Mazut.

Lithuania: Fiscal Performance Criteria

This annex discusses the fiscal performance criteria for Lithuania. These have been designed to be comprehensive, both in their definition of Government, and in their coverage of all creditors to government. But the new criteria nevertheless maintain the now well-established tradition in Lithuania that the Government makes little or no use of domestic bank financing for its activities.

Lending to government by foreign creditors will be substantially greater during the program period than it has been in the past. This has required the change from the performance criterion in the most recent program, which was defined on net credit to government by the domestic banking system, to performance criteria encompassing all creditors.

The new criteria also reflect the fact that, at least initially, the domestic intermediation of much of the external funds will be through government. This is necessary while the banks are insufficiently prepared to absorb the substantial increase in their activities that their intermediation of these funds would imply.

The performance criteria are constructed in the following manner:

(i) the expenditures of privatization funds appear above the line because they cover activities properly described as current public expenditure, and all their receipts appear below the line in the accounts of consolidated general government--this approach treats privatization receipts as financing items;

(ii) all other extra-budgetary funds, notably the Social Insurance Fund, are included in the definition of consolidated general government on which the performance criteria are defined;

(iii) the definition of net lending of consolidated general government includes lending by the IBRD, the EBRD and other external creditors directly extending credit to Lithuanian importers;

(iv) the first performance criterion on consolidated general government concerns the accumulated financial deficit, i.e., the fiscal deficit excluding net lending;

(v) the second performance criterion concerns accumulated net lending from July 1, 1993.

Both performance criteria have been set for end-December 1993 and for end-March 1993. Criteria will be set for the remainder of 1994 during the performance reviews.

The treatment of privatization is intended to discourage undesirable use of unanticipated privatization windfalls, by capturing them in the performance criterion on the financial balance. The inclusion of IBRD and EBRD activities in the performance criterion on net lending reflects the fact that these create liabilities on the Lithuanian Government, albeit liabilities that are matched by corresponding assets held by the Government against the beneficiaries of these loans.

The motive for specifying two criteria, on net lending and on the financial balance, is based on the dual roles of government under the program; first, as the provider of the normal services of government, and second, as intermediator, not as the primary final beneficiary of the foreign funds. The specification of two performance criteria reflects and ensures the separation of these two roles. Specifically, it prevents a stronger-than-anticipated performance on net lending from accommodating a poorer-than-anticipated performance on the other activities of government.

Measurement issues

The performance criterion on the financial balance will be measured from below the line because these data are usually available more rapidly than data from above the line. Thus, it will be measured as the sum of net credit from all domestic and foreign creditors, and privatization receipts, less net lending.

The measurement of accumulated borrowing in foreign currency after July 1, 1993 will exclude valuation changes, since these would distort the measurement of the financial deficit. Thus, each tranche of foreign borrowing will be valued in local currency at the exchange rate applicable to it on the day it was disbursed.

Data on net credit to government from the domestic banking system will be obtained from the monetary survey, while data on all other creditors and on privatization receipts will be obtained from the Ministry of Finance.

Lithuania: Stand-By Arrangement

Attached hereto is a letter, with annexed memorandum, dated September 30, 1993 from the Prime Minister of Lithuania and the Acting Governor of the Bank of Lithuania requesting a stand-by arrangement and setting forth:

a. The objectives and policies that the authorities of Lithuania intend to pursue for the period of this stand-by arrangement; and

b. Understandings of Lithuania with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Lithuania will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from October __, 1993 to March __, 1995, Lithuania will have the right to make purchases from the Fund in an amount equivalent to SDR 25.875 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. a. Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 5.175 million until May 15, 1994, the equivalent of SDR 10.35 million until August 15, 1994, the equivalent of SDR 15.525 million until November 15, 1994, and the equivalent of SDR 20.70 million until February 15, 1995.

b. None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Lithuania's currency subject to repurchase beyond 25 percent of quota.

3. Lithuania will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Lithuania's currency subject to repurchase beyond 25 percent of quota:

a. During any period in which the data at the end of the preceding period indicate that

(i) the limit on the General Government Financial Deficit described in paragraph 9 and in Annex I of the memorandum, or

(ii) the limit on Net Lending by the General Government described in paragraph 9 and in Annex I of the memorandum, or

(iii) the limit on the Net Domestic Assets of the Bank of Lithuania described in paragraph 16 and in Annex II of the memorandum, or

(iv) the floor on the Net International Reserves of the Bank of Lithuania described in paragraph 24 and in Annex IV of the memorandum, or

(v) the limit on the contracting or guaranteeing by the Government, the Bank of Lithuania, or other agencies on behalf of the Government, of external debt of maturities between 1 and 12 years described in paragraph 25 and in Annex V of the memorandum, or

(vi) the limit on the contracting or guaranteeing by the Government, the Bank of Lithuania, or other agencies on behalf of the Government, of external debt of maturities between 1 and 5 years described in paragraph 25 and in Annex V of the memorandum,

is not observed; or

b. if at any time during the period of the stand-by arrangement

(i) the limit on the accumulation by the Government of external payments arrears, or

(ii) the limit on the contracting or guaranteeing by the Government of external debt of maturities of less than one year,

described in paragraph 25 and in Annex V of the memorandum is not observed; or

c. after March 14, 1994 and September 14, 1994, until the respective reviews contemplated in paragraph 39 of the memorandum are completed, or

d. if at any time during the period of the stand-by arrangement Lithuania

(i) imposes or intensifies restrictions on the making of payments and transfers for current international transactions; or

(ii) introduces or modifies multiple currency practices; or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII; or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Lithuania is prevented from purchasing under this stand-by arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Lithuania and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Lithuania will not make purchases under this stand-by arrangement during any period in which Lithuania has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation (a) in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action, or (b) in respect of a purchase in support of debt and debt service reduction operations pursuant to Decision No. 9331-(89/167), as amended, or (c) pursuant to subparagraph 16(a) or 33(a) of Decision No. 8955-(88/126), as amended, on the Compensatory and Contingency Financing Facility.

5. Lithuania's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Lithuania. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Lithuania and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless, at the request of Lithuania, the Fund agrees to provide SDRs at the time of the purchase.

7. Lithuania shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

8. a. Lithuania shall repurchase the amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Lithuania's balance of payments and reserve position improves.

b. Any reductions in Lithuania's currency held by the Fund shall reduce the amounts subject to repurchase under a. above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

9. During the period of the stand-by arrangement Lithuania shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Lithuania or of representatives of Lithuania to the Fund. Lithuania shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Lithuania in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

10. In accordance with paragraph 4 of the attached letter, Lithuania will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not been observed or because the Managing Director considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Lithuania has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Lithuania's balance of payments policies.

September 30, 1993

Dear Mr. Camdessus:

Lithuania has made considerable strides under difficult circumstances in transforming its economy to one based on market principles. In the period of the stand-by arrangement granted by the Fund that ended on September 20, we balanced the budget and greatly strengthened monetary discipline, resulting in lower inflation and a strengthened exchange rate; in addition, we have made progress in structural reform, in areas such as privatization, anti-monopoly policy, enterprise reform, and reform of the social safety net. We also introduced our national currency, the litas.

While these steps are a promising beginning, there remains much more to be done. To this end, the Government of Lithuania believes that the policies set out in the attached Memorandum of Economic Policies will build policy credibility, establish higher growth in a stable macroeconomic setting, and deepen and extend structural reforms.

In support of these policies, the Government hereby requests a seventeen-month stand-by arrangement in an amount equivalent to SDR 25.875 million (25 percent of quota) from the International Monetary Fund. In addition, we intend to request two purchases in the aggregate amount of SDR 51.75 million (50 percent of quota) under the Systemic Transformation Facility. It is intended that the first purchase under the STF would be in an amount equivalent to SDR 25.875 million and would be made on the date on which the Fund approves the stand-by arrangement. The second purchase, also for SDR 25.875 million, would be made upon the completion of the first review by the Fund under the arrangement.

The Government and the Bank of Lithuania will provide the Fund with such information as the Fund may request for the purpose of monitoring progress under the program supported by the stand-by arrangement, and will remain in close consultation with the Fund, in accordance with the Fund's polices on such consultations. Furthermore, we stand ready to take any additional measures that may become necessary to achieve the aims of the program. Moreover, we will complete with the Fund two reviews of economic developments and policies under the program, the first by March 15, 1994, and the second by September 15, 1994. Quantitative performance criteria will be specified for June 30 and September 30, 1994 at the time of the first review, and for December 31, 1994, at the time of the second review.

Yours sincerely,

/s/	/s/
Adolfas Šleževičius	Juozas Sinkevičius
Prime Minister	Acting Governor, Bank of Lithuania

Attachment: Memorandum of Economic Policies

Michel Camdessus
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431
U.S.A.

Memorandum of Economic Policies

I. Introduction

1. The period since independence has been a turbulent one for the Lithuanian people. We have undertaken fundamental change at both the political and economic levels. Politically, we have established the institutions of a parliamentary democracy, and these have already withstood the test of a smooth change of political leadership. Economically, we have begun the process of throwing off the distortions of central planning, and transforming the economy into a system of decentralized market-oriented decision making. We have also had to withstand the shock of the transition to world market prices for our inputs, particularly energy.

2. Even before our membership in the Fund in April 1992, the Lithuanian authorities had begun to work closely with the Fund staff to develop policies to achieve macroeconomic balance and structural reform. This relationship was formalized in October 1992, with the approval by the Fund of a stand-by arrangement in support of Lithuania's stabilization and structural reform program for the period July 1, 1992 through June 30, 1993. We have met all of the quantitative performance criteria specified under the stand-by arrangement, and have recently made the last purchase under it.

3. Nevertheless, the progress we have made has not been achieved without sacrifice. In 1992, GDP is officially estimated to have fallen by over 35 percent which, however, may overestimate the fall, as the national accounts do not fully capture activities in the growing private sector. Economic activity is expected to improve during the course of 1993. Meanwhile, there has been a sharp drop in real wages. In June, real wages in the state sector are estimated to have been 62 percent lower than one year earlier. Inflation has been unacceptably high, averaging 24 percent per month in 1992, and 14 percent during the first six months of 1993, though since May it has decelerated rapidly to less than 1 percent in August.

4. Despite these hardships, we consider that remarkable progress was made in the program period:

--In terms of macroeconomic policies, we have maintained fiscal balance and established confidence in the domestic currency with a credible monetary policy buttressed with a responsible incomes policy. This led to a sharp reduction in inflation and a firming of the exchange rate, which allowed us to replace our provisional currency, the talonas, with our national currency, the litas.

--In terms of structural policies, we have established a two-tier banking system; introduced auctions of central bank money and a special refinancing facility as instruments of monetary control; adopted amendments to laws to speed land restitution and privatization, and drafted a National Agricultural Development Program; set in train a reform of the social safety net; passed a bankruptcy law; liberalized our trade regime; established a competition agency; passed a law to modernize accounting standards; and begun to improve our statistical system and policy coordination procedures.

5. We believe that the credibility of our policies, supported by the Fund, has been demonstrated. Moreover, we have formulated, in consultation with the Fund staff, a program of macroeconomic and structural reform covering the period July 1, 1993 through December 31, 1994. We view this program, the main elements of which are described below, as the beginning of a sustained effort to raise real growth to a rate in line with the medium-term potential of the economy, while bringing inflation down to single digits at an annual rate (a monthly rate of less than 1 percent) by late 1994 through: (1) maintaining macroeconomic balance in the economy, using inter alia improved instruments of macroeconomic policy; (2) continuing to improve economic efficiency and the supply response of the economy through continued structural reform; (3) disbursing external loans and grants in the most productive manner; and (4) attracting foreign investment. As part of the medium-term focus of our policies, we are consulting with Fund staff with a view to requesting an Extended Arrangement from the Fund, and expect to request such an arrangement before the end of the stand-by arrangement we are currently requesting.

II. The Economic Program

6. Prices policy. Price liberalization has been nearly completed, with the exception of limited price controls on energy supplies to households, rents, electricity, gas for heating, and telecommunications and transportation services. All energy subsidies except for residential heating have been eliminated. We intend to reduce subsidization of heating to residential consumers by substantially raising heating prices in steps to them. This process will be complete by October 1, 1994. The poorest income groups will receive a partially offsetting payment for the higher energy prices as part of the social safety net.

7. Wages and incomes policy. Incomes policy has been successful in the past in buttressing financial policies. Our intention is to firmly establish single digit inflation at an annual rate by late 1994 and to lower inflationary expectations accordingly. We will continue to implement incomes policy until the end of 1993, through wages for civil servants set according to budget possibilities, monitoring of pay scales outside budgetary organizations, and setting wage guidelines for the state enterprise sector consistent with the inflation objective of the program.

We are, however, aware that incomes policy also creates its own distortions by artificially constraining wage differentials, and may in time exert a negative influence on productivity. We will, however, continue to maintain restraint in setting public sector wages, and will closely monitor wage developments elsewhere in the economy. We will continue to review wage developments, and will set voluntary wage guidelines with a view to discouraging excessive wage rises. Should wage rises exceed the guidelines and appear to endanger our program, we will reintroduce a mandatory incomes policy.

8. Fiscal policy. We have discussed with the Fund staff the appropriate stance of fiscal policy for the period ahead. Although in the previous program period, the policy of fiscal balance served us well from the perspective of macroeconomic stabilization, we feel that a small deficit relative to GDP by the general government, as well as prudent lending operations by the Government, are appropriate in the period ahead. In this regard, because of the need for the Government to play a greater role than earlier envisaged in the utilization of EC/G-24 funds that are now being disbursed, we have established a State Liabilities Commission to approve and monitor disbursal of these Funds. This Commission is chaired by the Prime Minister and includes the Fund's resident representative as an ex-officio member.

9. Taking this into account, we propose to aim at a modest general government financial deficit of not more than 1 percent of GDP and government net lending of not more than 6 percent of GDP in the latter half of 1993. For 1994, the objective is a government financial deficit of 1 percent of GDP, and government net lending operations of not more than 4 percent of GDP, which would provide stimulus to growth without endangering our inflation target. We will take such additional measures as may be necessary not to exceed these targets should they appear from monthly budgetary returns to be in danger. The deficit and net lending would be predominantly financed from foreign loans. We may also issue domestic government bonds to help finance the deficit. Consistent with this, the projected growth path for the economy, and the projected balance of payments, quantitative ceilings on the financial deficit are given in Annex I. For the period July 1, 1993 to December 31, 1993, the general government financial deficit shall not be more than Llt 50 million, and for July 1, 1993 to March 31, 1994, shall not be more than Llt 100 million. We are also establishing a ceiling on net lending by the Government, with a view to prudent use of borrowed external funds, as well as to allow such funds to be onlent through the banking system to the extent possible. For the period July 1,1993 to December 31, 1993, the net lending by the general government shall not exceed Llt 520 million, and for July 1, 1993 to March 31, 1994, Llt 740 million.

10. We also will continue to simplify and revise our tax systems, and will:

a. Bring before Parliament a proposal for a Value Added Tax at a rate of not less than 18 percent (the present General Excise Tax rate) to be effective January 1, 1994. In so doing we shall seek (i) few exemptions; and (ii) inclusion of all individual excises in the base.

In addition, by June 30, 1994, we shall:

b. Unify the present multiple rate structure of the profits tax.

c. Simplify the income tax system by: (i) unifying the present multiple tax thresholds, (ii) taxing each income source at the same rate as soon as administratively possible, and (iii) simplifying the tax rate structure.

d. Establish a system of personal income declarations.

e. Equalize the enterprise tax rate and the top marginal rate of personal income tax.

We will seek technical assistance from the Fund and others to meet these goals.

11. On the expenditure side:

a. The Government recognize that, although across the board expenditure restraints have been effective in maintaining budgetary balance, they do not result in the most effective or efficient use of government funds. Accordingly, we propose to strengthen public expenditure management including the processes of planning, formulating, and executing the budget, so as to prioritize expenditures and make any necessary expenditure cuts based on these priorities. We expect to receive technical assistance from the Fund staff, World Bank, and others in this area.

b. We will review civil service staffing, wage levels and structures, with a view to achieving greater efficiency in budgetary organizations. We will examine the possibility of rationalization and consolidation of administrative structures in order to achieve this goal.

c. As discussed below, we will focus and streamline special social benefits.

12. We will improve the system of tax administration through (i) improved computerization, (ii) strengthened audit procedures targeted on larger taxpayers, (iii) tightened taxpayer identification procedures to identify tax arrears and defaulting at an early stage, and (iv) strengthened enforcement procedures to collect taxes due and penalize delinquent taxpayers.

13. The Government recognizes that banking sector reform will entail the use of public funds. In consultation with the Bank of Lithuania, Fund and World Bank staff, and others, the Government will assess the commitment of such funds that may be prudently used for restructuring the balance sheets of the state commercial banking sector. By June 30, 1994, we will develop a restructuring plan.

As a further step in banking system reform, we intend by December 31, 1993 to begin to privatize the state sector banks, i.e., the State Commercial Bank, the Agriculture Bank, and the Savings Bank. We intend to request technical assistance from the World Bank and others to complete this process by December 31, 1994.

14. We have benefitted from fiscal technical assistance in the past, but would request further assistance from the Fund, World Bank, EC PHARE and others to help us meet our most urgent needs. These are: (i) to implement and administer VAT and other taxes, (ii) to prioritize public investment projects, and (iii) to analyze and monitor the fiscal impact of social safety net program revisions.

15. Monetary policy during the program period will be directed toward lowering inflation to an annual rate in single digits by late 1994 and protecting the value of the litas on the foreign exchange markets. In so doing, our intention is to reduce inflationary expectations and build both domestic and external credibility for monetary policy. We recognize that such credibility is an important part of our growth strategy.

16. With the experience we have already gained in our previous program, and with the use of instruments of monetary analysis and control that are now established, such as the new plan of central bank accounts, auctions of central bank credit, and the special financing facility, direct credit controls on individual commercial banks are no longer essential or desirable for the effective functioning of credit policy. The Bank of Lithuania will, however, as a transitional measure, set indicative credit guidelines for the banking system that are consistent with the monetary program.

Accordingly, and consistent with the intention expressed in our earlier program, quantitative ceilings will be set on the net domestic assets of the Bank of Lithuania, as specified in Annex II. These ceilings will be consistent with the inflation and real growth paths projected for the economy. The net domestic assets of the Bank of Lithuania shall not exceed Llt 400 million as of December 31, 1993, nor exceed Llt 550 million as of March 31, 1994.

17. We have also found the reserve money aggregate helpful in the past as an indicator of monetary conditions that takes into account developments in net foreign assets, and will continue to use it as an indicative target. Accordingly, as specified in Annex III, and consistent with the net domestic assets of the Bank of Lithuania specified above and the projected net

foreign assets of the Bank of Lithuania, reserve money shall not exceed Llt 1,000 million as of December 31, 1993, nor exceed Llt 1,100 million as of March 31, 1994.

18. We intend to establish interest rates as the main instrument for the allocation of financial resources, and have already made progress in moving to a positive real interest rate structure. Consistent with this goal, the Government will not interfere in the setting of interest rates nor will the Bank of Lithuania provide interest rate subsidies on new lending. Moreover, the Government will refrain from directing bank lending, or stipulating sectors to be accorded priority by commercial banks in the making of payments to commercial creditors.

19. Financial sector restructuring. Restructuring of the financial sector is urgently needed in order for these institutions to play an effective role in the efficient allocation and intermediation of funds, including funds from the EC/G-24. We have established an inter-agency Committee on Bank Restructuring to develop our strategy in this area. With technical assistance from the Fund, the World Bank and others, we intend to take the following steps:

a. By November 1, 1993, we intend to submit amendments to the Central Bank law to Parliament based on a draft prepared with technical assistance from the Fund. In this context, a revised plan of accounts of the Bank of Lithuania, oriented toward the banking needs of a market economy and prepared with technical assistance from Fund staff, will be fully operational by December 31, 1993.

b. We will also take the following steps to restructure the rest of the financial sector:

(i) By December 31, 1993, with technical assistance from the Fund, we will review the bank licensing system, with a view to requiring banks to amend their statutes so as to allow adequate bank governance, and to regulating nonbank deposit takers.

(ii) By March 31, 1994, diagnostic audits of the Agricultural Bank and the Savings Bank will be conducted with technical assistance from the World Bank and others.

(iii) By December 31, 1993, the Bank of Lithuania will review in cooperation with the staff of the Fund and the World Bank, minimum capital requirements and the definition of capital, with a view to gradually bringing the capital adequacy standards in line with BIS practices. The Bank of Lithuania will review, in cooperation with the staff of the Fund and World Bank, the existing prudential rules for large exposures, as well as those dealing with insider lending, and will also develop a program to strengthen its on-site inspection capability.

(iv) Steps to introduce a new plan of accounts for the commercial bank sector (including the state banks) will be taken by April 1, 1994. We intend to request technical assistance from the World Bank for this purpose. By November 1, 1993, we also intend to submit amendments to the commercial banking law to Parliament.

(v) The requirement that banks' reserves at the Bank of Lithuania against deposits in foreign currency be held in domestic currency has recently been changed to require that 70 percent of such reserves be held in foreign currency. By December 31, 1993, we intend to require that all such reserves be held in foreign currency.

20. We are aware of serious lapses in monitoring and enforcing the prudential requirements, including those on foreign exchange exposure of the commercial banking system, and are concerned that this may endanger the banks involved and their depositors, as well as the credibility of monetary policy. We have cautioned the commercial banks in this regard, and are taking steps to heavily penalize future infractions. As part of the amended Central Bank Act, and with technical assistance from the staff of the Fund and World Bank, we intend to give the Bank of Lithuania greater enforcement powers in this area.

21. External sector policies. We have already made considerable progress in modernizing and liberalizing our external policies, with the abolition of the Government's foreign exchange funds and foreign exchange taxes, as well as the introduction of a liberalized trade regime (see below). We have also abolished the surrender requirement on foreign exchange earnings of state enterprises from June 16, 1993. Nonresidents continue to be allowed to purchase foreign exchange in the market for purposes of repatriating their earnings (after paying domestic taxes on such earnings). We do not intend to introduce any restrictions on capital transactions.

22. We have recently introduced our national currency, the litas, replacing the provisional money (the talonas) in use from the time of our withdrawal from the ruble area on October 1, 1992, until July 20, 1993. The litas, like the talonas, is being maintained at a uniform and consistent exchange rate vis-à-vis other currencies. We intend for the time being to maintain a floating exchange rate regime for the litas, and do not have a target exchange rate, although we may from time to time intervene to maintain orderly conditions in the exchange market. However, the Bank of Lithuania shall refrain from undertaking other special foreign exchange operations with individual banks. We will consult with the Fund staff before adopting any change in this regime.

23. Lithuania will continue to require substantial inflows of foreign financing for imports, especially of investment goods, needed to support the resumption of growth of GDP. For 1993, the current account deficit is projected to be about US$250 million, and for 1994, US$450 million. This deficit is projected to be financed by official balance of payments support from the EC/G-24, the World Bank, the European Bank for Reconstruction and

Development, and bilateral creditors, as well as from private capital flows. Purchases from the Fund will be used to nearly close the financing gap during the program period, with the balance used to build reserves.

24. We have established floors for international reserves, as defined in Annex IV. Net official international reserves amounted to US$150 million on August 31, 1993. Net official international reserves shall not be less than US$110 million by December 31, 1993, and US$110 million by March 31, 1994.

25. External borrowing with maturities of less than 12 years contracted or guaranteed by the Government or other agencies on behalf of the Government (excluding proceeds from the Fund), which amounted to US$195 million on June 30, 1993, will be held below US$300 million through September 30, 1993, below US$400 million through December 31, 1993 and below US$500 million through March 31, 1994. Consistent with this target, the authorities will not contract or guarantee external debts with maturities of less than one year, with the exception of normal import-related credits, and external debts with maturities between one and five years will be held below US$50 million through September 30, 1993, below US$75 million through December 31, 1993, and US$100 million through March 31, 1994 as set out in Annex V. As a performance criterion the Government will not accumulate external payments arrears.

26. Free trade agreements have been signed with Belarus, Estonia, Kazakhstan, Latvia and Ukraine, in addition to those with Finland, Norway, Sweden, and Switzerland. Negotiations with Russia, Poland and Iceland on free trade agreements have recently been initiated. Moreover, it is the Government's intention to apply for associate membership status in the EC. We have been granted observer status to the GATT in September 1992, and plan to apply for full GATT membership in due course.

27. Bilateral payments agreements still exist with former CMEA countries, but are not operative and there are no outstanding balances. With regard to FSU countries, as of June 30, 1993, Lithuania's correspondent accounts showed surpluses with all republics except Russia, and Kyrgyzstan. The Government remains committed to removing remaining trade barriers and reducing the direct involvement of the Government in trade relations. During the period of the stand-by arrangement, the Government will not conclude bilateral payments agreements inconsistent with Article VIII of the IMF's Articles of Agreement. Moreover, the Government will not introduce any restrictions on payments and transfer for current international transactions, introduce multiple currency practices, or introduce or intensify import restrictions for balance of payments reasons.

28. Effective July 15, 1993, we have adopted a new trade regime. Export licensing has been abolished. At the same time, export taxes have been introduced for certain categories of sugar beet, molasses, leather and furs, timber and certain types of metals. On the import side, the vast majority of goods subject to tariffs may be imported at a rate between 5 percent and 15 percent. Higher rates, however, apply for some basic food products,

alcohol and tobacco, and about a dozen categories of manufactured goods. There are no quantitative import restrictions, except for health or security reasons. Specific excise taxes on imports have been abolished on almost all goods. These trade reforms apply to all trading partners. We plan to reduce the dispersion of tariff rates to achieve a uniform rate of 10 percent by December 31, 1993, with few exceptions, and will review export taxes with a view to eliminating most of them during 1994.

29. We also intend to establish export processing zones as part of our strategy to attract foreign capital, facilitate the transfer of technical know-how, and promote manufactured exports, based on the results of a detailed feasibility study. In addition, the Government will evaluate the possibility of introducing duty-exemption and drawback systems. With technical assistance from the EC, we are continuing to modernize our customs services to speed up customs clearance and customs documentation. We also plan to establish information and promotional services centers.

30. We are committed to use the external loans we have and will receive in the most productive manner and consistent with prudent management of external debt. The sums now being disbursed from the EC/G-24 loan commitments to Lithuania are larger than the commercial banking system can quickly and efficiently absorb, and the Government has accordingly decided to play an active role in the placement of these funds, the use of the EC portion of which is also subject to approval by the EC Commission. We will make provision for possible losses from loans made with these funds with a government guarantee by setting aside 100 percent of the proceeds arising from the spread between borrowing and lending rates on these loans. The lending rates for these loans will be set with due regard to market rates.

31. Structural policies. We intend to maintain the emphasis on structural reform which characterized our previous program, recognizing that these reforms are crucial to generate an efficient response to macroeconomic management and higher growth, to strengthen incentives for microeconomic units to invest in the economy, and to strengthen the social safety net. We intend to build on the progress that has been made under our previous program, and to continue to collaborate closely with the Fund and World Bank staff, as well as the EBRD and others, on structural adjustment measures.

32. Privatization. We have made good progress in implementing our privatization program, which is now complete for residential dwellings. As of July 1993, 2,165 small enterprises with 15,745 employees, and 1,712 medium and large enterprises with 360,530 employees, have been privatized. New rules restricting the issuance of shares of medium and large companies came into force at the beginning of February 1993, and were intended to keep criminal elements from obtaining large blocks of shares in companies being privatized. To avoid undue concentration of shareholdings, however, we have decided to liberalize these rules to provide for more diverse ownership, with the object of allowing immediate majority ownership by outside investors. Accordingly, we shall submit legislation to reverse the provision to increase preferential employee access to shares from

30 percent to 50 percent. We shall complete privatization by vouchers by August 31, 1994, and shall not accord any preferential treatment as between holders of vouchers. In addition, special restrictions on the ownership of shares in agro-processing enterprises will be lifted from April 1, 1994. We have also made very good progress in the privatization of agricultural enterprises, which is now nearly complete.

We have experienced delays in the restitution of land, only 4 percent of which had been privatized (including full documentation) by September 1, 1993. We now hope to complete this process by mid-1995, although documentation of restituted land will continue until 1998.

33. Social safety net.

a. Social benefits. The need for the protection of the poor by the social safety net has been particularly evident during the inevitable disruptions to production and employment which have accompanied the transition to a market economy. While accepting its responsibilities in this area, the Government is aware of the need to better target benefits on the neediest groups, and has adopted the goal of reducing the extension of special social benefits from 40 percent to approximately 20 percent of the population. Moreover, from the beginning of June, eligibility for social assistance programs has been considerably narrowed, with benefits now focused mostly on children. We intend to continue to refine the eligibility for special social benefits in steps, with a view to reaching our goal for the share of the population receiving such benefits by December 1994. To facilitate this, we intend by January 1, 1994, with further technical assistance from the World Bank and others, to implement a new subsistence minimum to which social benefits will be linked. We also intend to take new measures to identify fraudulent claims for social benefits (and unpaid taxes) by those with undeclared income. To this end, we shall increase the staff of local social assistance offices and, with technical assistance from the World Bank, will improve means testing procedures for establishing eligibility for social benefits.

b. Pension payments comprise about two thirds of social safety net payments. With technical assistance from the World Bank, work toward pension reform is proceeding, though more slowly than hoped, with a new law taking international experience on pensions into account now to be introduced in 1994. Above a flat rate minimum, pensions will be based on years of service and past earnings. In addition, the pensionable age for women, which is now 55 years, is to be gradually raised and equalized at 60 years for both sexes. As a first step, we shall propose to Parliament that in 1994 the pensionable age be raised to 56 years for women, and thereafter be raised by one year every two calendar years until the retirement age for men is reached. The new system aims in the medium-term at providing a closer relationship between contributions and pensions received.

c. Unemployment benefits comprise a relatively small share of social safety net outlays at present, but are expected to account for a larger share as unemployment rises. By January 1, 1994, the Government plans to introduce reforms to the unemployment benefit provisions that would relate them to the minimum wage instead of previous salary, and restrict the maximum period for receipt of benefits to six months. By January 1, 1994, we will also assess our retraining programs, and will strengthen them as necessary, taking into account the expenditures involved.

34. Framework for commercial activity and enterprise reforms.

a. Bankruptcy Law. An important development will be the full implementation of regulations of the Bankruptcy Law passed by Parliament in September 1992, including the establishment of the special Bankruptcy Court, which will go into effect as of December 31, 1993. We expect that the implementation of this law will contribute to a reduction in interenterprise arrears. We are continuing efforts to improve our bankruptcy legislation with technical assistance from the World Bank.

To analyze their financial viability, we have introduced a system whereby founding ministries monitor important financial indicators of enterprise results under their purview on a quarterly basis. This system went into effect on a trial basis from March 31, 1993, and is operational for all state enterprises.

b. Anti-monopoly policy. Although privatization, price liberalization, import liberalization and the operation of the Bankruptcy Law are powerful incentives for structural change amongst enterprises, there remain sectors of the economy dominated by a small number of producers. In some areas the nature of the activity undertaken, e.g., public utilities, or considerations of public security or health, make it undesirable to change the current structure. In others, however, the public interest would be served by permitting additional competitors.

In order to speed the process of enterprise restructuring, we have decided to strengthen the Agency on Prices and Competition by giving it authority to recommend to the Government that enterprises with a dominant share in a sector be broken up. To this end, we have asked the Agency to conduct a study on the international experience in this area with the help of foreign experts, and to make recommendations to the Government by December 31, 1993.

c. Accounting standards. After some delay, new accounting standards based on market-economy accounting principles are now expected to be fully operational by December 31, 1994. A preliminary version will be applied on a trial basis from January 1, 1994, with assistance from foreign experts. Both state and private enterprises will be required to conform to the new system, although, as discussed below, there is a critical need for qualified auditors to implement the new standards.

35. Public investment program. We have relied on the State Liabilities Commission, charged with approval of loans taken with a state guarantee, to allocate the initial tranche of EC/G-24 loans including the portion directed through the banking system. As a framework for the operations of this Commission, we intend as a matter of urgency, to establish a rolling three-year public investment program. In establishing and implementing our Public Investment Program, we intend to apply commercial principles to project selection, and to minimize the administrative allocation of funds. While we are already able to identify the highest priority investments, we will seek technical assistance from the World Bank, EC/PHARE, and the EBRD in cost-benefit analysis and other project evaluation and implementation techniques and practices, and the institutional reforms required to develop and apply them. In addition, we will use the sectoral studies currently being undertaken by the World Bank and others to help identify our investment priorities.

36. Establishment of stock market. We have established a stock market to promote capital market development with the help of outside experts, and began trading on this market in September 1993. We have already established a Securities Commission to exercise oversight of this market, and have drafted and passed a securities law with the help of outside experts. In the light of our initial experience after the opening of the stock market, we intend to review the capitalization requirements for listed companies and our regulatory provisions. We shall also seek additional technical advice as needed to refine the regulatory provisions of the securities law, and to provide professional training to strengthen the legal and accounting staff of the Securities Commission.

37. Economic management. As the structural reform process progresses, we are placing an increasingly high priority on the acquisition of statistics and analysis needed to implement sound economic policies, and on the consistent and coordinated application of policy by all ministries and the Bank of Lithuania.

a. Economic statistics. Provision of higher quality economic statistics, particularly for the balance of payments, national accounts, and financial transactions is necessary for policy formulation. To this end, we shall submit amendments to proposed legislation to secure adequate enforcement powers for the collection of needed statistics. Additional technical assistance will also be necessary and in this context, we would welcome the secondment of a member of the Fund staff as resident Statistical Advisor for the Baltic states.

b. Policy analysis, forecasting, and coordination. We recognize the need to give higher priority to analysis, forecasting, and the coordination of policy across the Government and the Bank of Lithuania. To this end, we have stressed the need for ministries to fully share with each other information necessary for the formulation of policy. In addition, we also intend to introduce from 1994 a statement of economic policy to be introduced as background to the Budget, which will enunciate the

Government's broad economic strategy. From 1994, the Bank of Lithuania will also publish an Annual Report. We will also strengthen the analytical capacities of the policy-making units for budget preparation, as well as those units responsible for external public debt and the public investment program.

38. Coordination of technical assistance. We have greatly benefitted from the technical assistance already received. Nevertheless, we have identified above a number of areas in which we feel additional technical assistance is needed. Additional needs, not identified above, may also arise from time to time. In order to coordinate our needs and communicate them to the Fund, the World Bank, and other potential suppliers of technical assistance, we are designating a Technical Assistance Coordinator in the Ministry of Foreign Affairs with the administrative function of coordinating requests. The Coordinator will maintain close contact with international institutions and others and will maintain a central register of technical assistance projects, project timetables, and funds committed and disbursed.

39. Review of program. We believe the policies set out herein will be adequate to achieve the aims of the program and we stand ready to take any further measures that may be necessary for this purpose. We will provide the Fund with any information it may request for the purposes of monitoring progress under the program and will remain in close consultation with the Fund in accordance with the Fund's policies on such consultations. We will complete with the Fund by March 15, 1994, a review of economic developments and policies under the program. In addition to assessing whether quantitative performance criteria have been met and evaluating the effect of financial policies on growth, inflation, and the exchange rate, this review will focus, inter alia, on the implementation of the VAT, the functioning of the foreign exchange market, and progress in unifying import tariffs. This review will also evaluate technical assistance received and additional technical assistance needs. Quantitative performance criteria for June 30, 1994 and September 30, 1994 will also be specified at the time of this review. A second review will be completed by September 15, 1994. This review will evaluate, inter alia, the operation of monetary policy, progress in implementing financial sector restructuring, and the quality of economic statistics. Quantitative performance criteria for December 31, 1994 will be specified at the time of this review.

Performance Criteria on General Government Financial Balance and Net Lending

Limits on the Financial Balance

	(in millions of litai)
July 1, 1993 - September 30, 1993 (Indicative limit)	-20
July 1, 1993 - December 31, 1993	-50
July 1, 1993 - March 31, 1994	-100

Limits on Net Lending

	(in millions of litai)
July 1, 1993 - September 30, 1993 (Indicative limit)	285
July 1, 1993 - December 31, 1993	520
July 1, 1993 - March 31, 1994	740

The general government financial deficit is defined as the increase in net claims on the general government of domestic and foreign banking systems plus the increase in all other claims on general government of domestic and foreign financial and nonfinancial institutions or households, plus the gross receipts of the privatization funds, less net lending operations undertaken by the general government and by the privatization funds. The financial deficit will be measured excluding valuation gains and losses on all foreign currency denominated assets and liabilities arising from exchange rate fluctuations.

The general government encompasses the national government (comprising the state and municipal governments) and the extra-budgetary funds. The extra-budgetary funds include, but are not limited to the Social Insurance Fund, the privatization fund for firms, the agricultural support fund, and the privatization funds of the municipalities.

Net claims of the domestic and foreign banking systems on the general government are defined as all claims of these banking systems on the general government less all deposits of the general government with these banking systems.

The claims of these banking systems on the general government include (a) bank loans to general government, (b) securities or bills issued by the general government held by banks with the exception of those issued in relation with bank rescue operations, and (c) overdrafts on the current accounts of the general government with banks. They exclude the acquisition of equity in banks.

Deposits of the general government with the banks include but are not limited to: (a) money deposits with banks; (b) securities issued by banks held by the general government.

Net lending by the general government consists of lending operations by the general government to the nongovernment sector, less repayments. Lending operations include loans given, purchases of debt or equity, and payments of interest or amortization on debts of others which generate equivalent claims against the original debtors. It does not include deposits of general government with the banking system. All net lending operations, except for a quarterly amount of Llt 10 million, cumulative from July 1, 1993, shall be financed only from net foreign loans disbursed to general government as defined below.

Net foreign loans disbursed to the general government comprise total disbursements of all government and general guaranteed nonbank loans, less repayments of those loans. Nonbanks include the multilateral banks, the Japanese EXIM Bank, and the Commodity Credit Corporation of the United States.

The Ministry of Finance and the Bank of Lithuania shall report monthly data on general government deposits held abroad, disbursements of foreign loans to the general government, gross receipts of the privatization funds and net lending operations of general government and the privatization funds and any other data regarding the financial balance. Data on net claims of the domestic banking system on the Government, in the agreed format, will be reported to the Fund within 30 days of the end of each month by the Bank of Lithuania. The Ministry of Finance shall confirm these data.

Performance Criteria on Net Domestic Assets of the Central Bank of Lithuania

	(in millions of litai) 1/
Position on June 30, 1993	114
Indicative limit on September 30, 1993	270
Limit on:	
December 31, 1993	400
March 31, 1994	550

Net domestic assets of the Bank of Lithuania are defined as the difference between reserve money and net international reserves of the Bank of Lithuania. Reserve money is defined in Annex III. Net international reserves of the Bank of Lithuania are as defined in Annex IV. Thus net domestic assets of the Bank of Lithuania consist of the following assets and liabilities: net credit to the general government; credit to and deposits in domestic banks (commercial banks, the State Commercial Bank, the Agriculture Bank, and the Savings Bank), in both domestic and foreign currency; balances on correspondent accounts with FSU central banks; foreign exchange held on account for the Government, including foreign exchange purchased from the Government; foreign exchange held against required reserves of domestic banks; and other net domestic assets. Other net domestic assets include capital subscriptions to foreign financial institutions, the capital and reserve account, the foreign exchange revaluation account, the interbank float and other assets and liabilities.

For purposes of the monetary program, the foreign currency denominated components of the balance sheet of the Bank of Lithuania will be converted into litai at the accounting rates of the Bank of Lithuania in effect as of August 31, 1993. All monetary gold will be valued at US$333 per ounce.

The quarterly indicative limits will be monitored monthly from the balance sheet of the Bank of Lithuania. Data on net domestic assets of the Bank of Lithuania, in the agreed format, will be reported to the IMF within 15 days of the end of each month by the Bank of Lithuania.

1/ The limits will be adjusted by the amount of any change in required reserve holdings stemming from a change in reserve requirements.

The exchange rates of the SDR, and nondollar currencies vis-à-vis the U.S. dollar, will be kept at their August 31, 1993 levels, and all monetary gold will be valued at US$333 per ounce. The Fund staff will be informed of details of any gold sales, purchases, or swap operations during the program period, so that adjustments can be made to exclude changes in the value of gross reserves that arise merely due to a different valuation of gold.

The limits will be cumulative and will be monitored from information provided by the Bank of Lithuania. Data on net international reserves, in the agreed format, will be reported monthly to the IMF within 15 days of the end of each month by the Bank of Lithuania.

Performance Criteria on Contracting and
Guaranteeing of Medium- and Long-Term External Debt

Cumulative limit on external debt contracted or guaranteed by the Government 1/ from	Maximum Limits (In millions of U.S. dollars) 1-12 year Maturity 2/	1-5 year Maturity 3/
June 30, 1993, until:		
September 30, 1993 (Indicative limit)	105	18
December 31, 1993	205	43
March 31, 1994	305	68

External debt limits apply to medium- and long-term external debt of original maturities of more than one year up to and including 12 years that are contracted or guaranteed by the Government, the Bank of Lithuania or other agencies on behalf of the Government, with sub-limits on such debt of maturities of more than one year up to and including five years. The Government is defined as comprising the state and local authorities, and all extrabudgetary funds. Excluded from the limits are use of IMF resources; but other balance of payments support of between one and twelve years' maturity is covered by these limits, including loans from official creditors and foreign banks. The Government will not accumulate external payments arrears, and will not contract or guarantee external debts with a maturity of less than one year, with the exception of normal import-related credits, which are defined to include liabilities on the correspondent accounts with central banks of other FSU countries. Transactions subject to these ceilings shall be valued in the contracted currency and converted into U.S. dollars at the time the loan agreement is entered into at the average exchange rate for the month.

1/ As of the date when contracts and guarantees are legally binding.
2/ Maturities of greater than one year through twelve years.
3/ Maturities of greater than one year through five years.

Compliance with the limits shall be verified at quarterly intervals for the dates shown above. Information on contracting and guaranteeing of external debt, in the agreed format, will be reported monthly to the IMF within 30 days of the end of each month by the Ministry of Finance.