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Statement by Mr. Fridriksson on Lithuania
Executive Board Meeting 92/127
October 21, 1992

Lithuania fought to regain its independence from the Soviet Union at the first opportunity, and had, in fact, received recognition by some western governments in early 1991. Independence was assured following the failed coup in the Soviet Union in August last year, and Lithuania applied for membership in the Fund in September 1991. Typical of its pioneering ambition, Lithuania was the first of the Baltic States and the former republics of the Soviet Union to become a member of the Fund on April 29, 1992.

As the staff paper shows, the Fund has had a number of missions in Lithuania, not only from the European II Department, but also a series of technical assistance missions in various areas. On behalf of my Lithuanian authorities, I would like to take this opportunity to thank the staff, particularly Mr. Knöbl and his team, for its dedication and professionalism.

The Lithuanian economy was mutilated over a 50 year period, and its rehabilitation will be a monumental task. When the program discussions started between the Lithuanian authorities and the Fund, the Lithuanian Government had already embarked upon the transition from a command economy to a market economy. The basic elements of a reform strategy had been defined and fundamental steps had been taken, particularly in the areas of price liberalization and privatization, where impressive progress has been made. In the program that has been developed with the assistance of the Fund, this strategy has been advanced further and given greater precision.

In the realm of macroeconomic stabilization, the Lithuanian Government had already committed itself to sound and forward looking policies, with fiscal discipline as a leading principle. This lays a good foundation for meeting the fiscal pressures that are intensifying due to the adverse conditions Lithuania is facing.

If the difficult situation that Lithuania finds itself in is to be successfully dealt with, nothing short of a very strong program will suffice. The program presented to the Board today meets that criterion. It is a very comprehensive program, which addresses the important problems and weaknesses in the Lithuanian economy and in the institutional framework. It is clearly described in the staff report, but I would nevertheless like to emphasize its crucial elements.

The most pressing objective is to adjust the economy to the external shock that has hit Lithuania through the sharp adverse change in the terms of trade. The authorities are committed to passing through the higher energy prices, and, to a great extent, this has already been done. Thus, at the end of last August, energy prices were 100 times higher than at the beginning of the year. At the same time, consumer prices increased by 500 percent.

The rapid passing on of the dramatically higher energy costs is closely linked to the commitment to keep the budget under control. In the Board's pre-membership discussion of Lithuania in March this year, several Directors were rightly concerned about the risk of a substantial deterioration of the fiscal position in connection with the anticipated terms-of-trade shock. Even if the full impact of the shock is yet to be felt, the budget was kept in balance through the first half of 1992, and that, according to the staff assessment, along with the decisions already taken to protect the budget, such as reductions of subsidies, tight control over social costs and tax increases, will keep the budget balanced throughout the year. The Lithuanian authorities are committed to taking the additional measures which may be necessary to maintain balance through 1992 and the first half of 1993. The fiscal policy will be supported by a temporary incomes policy to facilitate the adjustment.

As to monetary policy, an important part of the basic institutional framework has been put in place by the creation of a two-tier banking system. The Bank of Lithuania is being reorganized in order to be able to fulfil its monetary policy role, and a government securities market is being created. The Fund and a number of foreign central banks are giving valuable technical assistance in these fields.

Another necessary foundation for monetary policy is a national currency. As Directors will recall, the strategy of Lithuania in this respect has been relatively cautious. The introduction of a national currency, the litas, has been foreseen for some time, but the authorities have been aware of the need for thorough preparations for such a step. It was deemed imperative to ensure that the necessary institutional arrangements be put in place, including unification of the exchange rate and the introduction of prudential standards for limiting the foreign exchange exposure of banks.

Due to unforeseen complications, the Lithuanian authorities decided in September to modify their initial plans to introduce the litas and to leave the ruble zone. Thus, when Lithuania departed the ruble area on October 1, the coupons - talonas - which had been circulating along with the ruble since the spring, were made the only legal tender of Lithuania. During the week preceding that date, rubles could be exchanged for talonas at par. After that, the rate of the talonas against foreign currencies, including the ruble, has been determined in the market, and it has, in fact, appreciated against the Russian ruble.

The expectation is that the litas will be introduced sooner rather than later, but at a time yet to be determined. The Lithuanian authorities have committed themselves to closely collaborating with the Fund staff concerning the timing of the introduction of the litas.

As stated, the Lithuanian authorities are strongly committed to a full implementation of the program in close collaboration with the staff of the Fund. Directors should also be aware that the implementation will be fraught with difficulty. The statistical basis for various aspects of the program is far from perfect. Moreover, even though the population is ready and willing to make sacrifices in order to move quickly to a market economy, pressures will no doubt emerge during the winter when the tremendous increase in oil prices begins to be seriously felt by households, when average wages hardly suffice to cover the basic food basket and the cost of a minimum amount of fuel.

Last summer was an extremely dry one, with serious consequences for agricultural output, and now winter appears to have arrived early. The start of the heating season had to be delayed, largely due to a shortage of fuel. In addition to the unfriendliness of nature, there is the difficult trading environment with the Russian Federation and other republics of the former Soviet Union. An improved payments and settlement mechanism is urgently needed, and all means must be sought to facilitate trade between the various countries which used to belong to the Soviet Union and which used to have important trade relations. In this respect, the Russian Federation carries a special responsibility. An example of the difficult trading environment is that Lithuania has had to prepay Russia for deliveries of energy resources which have not actually begun. It is essential that trading partners abide by established principles and that trade be conducted in a non-discriminatory manner.

In this difficult environment, the authorities have completed all the prior actions agreed in the program, as confirmed in the supplement to the staff report. The fact that the prior actions were not all in place until last week stems, by and large, from institutional bottlenecks and weaknesses, and should not be interpreted as lack of commitment on the part of the authorities.

Lithuania has adopted an aggressive program which is worthy of the Fund's support as well as the support of the international community. The external financing is largely in place, and a full list of commitments within the G-24 framework is contained in Correction 1 to Supplement 2 to EBS/92/131.