EBS/92/157
Supplement 2

CONFIDENTIAL

October 23, 1992

To: Members of the Executive Board

From: The Secretary

Subject: Republic of Lithuania - Stand-By Arrangement

Attached for the records of Executive Directors is the text of the stand-by arrangement for Lithuania agreed at Executive Board Meeting 92/127, (10/21/92).

Att: (1)

Other Distribution:
Department Heads

Lithuania: Stand-By Arrangement

Attached hereto is a letter and annexed Memorandum of Economic Policies (the "Memorandum") dated September 21, 1992, from the Prime Minister of Lithuania and the Governor of the Bank of Lithuania, as well as a supplementary letter dated September 26, 1992, from the Prime Minister and the Acting Governor of the Bank of Lithuania, requesting a stand-by arrangement and setting forth (i) the objectives and policies that the authorities of Lithuania intend to pursue for the period of this stand-by arrangement; and (ii) 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 of 11 months from October 21, 1992, Lithuania will have the right to make purchases from the Fund in an amount equivalent to SDR 56,925,000 subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 17,250,000 until February 28, 1993, the equivalent of SDR 30,475,000 until May 31, 1993, and the equivalent of SDR 43,700,000 until August 31, 1993.

(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 in the credit tranches beyond 25 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary resources only.

4. Lithuania will not make purchases under this arrangement that would increase the Fund's holdings of its currency in the credit tranches beyond 25 percent of quota:

(a) during any period of the stand-by arrangement while

(1) the limit on contracting or guaranteeing of external government debt of maturities of less than one year (excluding liabilities on the correspondent accounts with FSU countries) referred to in paragraph 64 of the Memorandum; or

(2) the limit on the accumulation by the Government of external payments arrears referred to in paragraph 64 of the Memorandum, is not observed; or

(b) during any period in which the data at the end of the preceding period indicate that

(1) the limit on the cumulative change in total net international reserves referred to in paragraph 63 and Annex IV of the Memorandum; or

(2) the limit on the cumulative change in net international reserves in convertible currencies referred to in paragraph 63 and Annex IV of the Memorandum; or

(3) the limit on the net disbursement of external debt with maturities between 1 and 12 years referred to in paragraph 64 and Annex V of the Memorandum; or

(4) the limit on the net disbursement of external debt with maturities between 1 and 5 years, referred to in paragraph 64 and Annex V of the Memorandum; or

(5) the limit on the cumulative change in net credit from the banking system to the general government referred to in paragraph 28 and Annex I of the Memorandum as modified by the supplementary letter of September 26, 1992; or

(6) the limit on net domestic assets of the banking system referred to in paragraph 35 and Annex II of the Memorandum as modified by the supplementary letter of September 26, 1992 and Table 1 to the Stand-By Arrangement attached hereto, has not been observed; or

(c) after February 27, 1993, until the first review referred to in paragraph 65 of the Memorandum has been completed and appropriate understandings have been reached on suitable criteria for the remainder of the stand-by arrangement; or after such performance criteria have been established, while they are not being observed; or

(d) after May 30, 1993, until the second review referred to in paragraph 65 of the Memorandum has been completed; or

(e) during any period of the stand-by arrangement, if Lithuania

(1) imposes or intensifies restrictions on payments and transfers for current international transactions; or

(2) introduces or modifies multiple currency practices; or

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

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

When Lithuania is prevented from purchasing under this arrangement because of this paragraph 4, 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.

5. Lithuania will not make purchases under this stand-by arrangement during any period of the arrangement in which it has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase or pursuant to Decision No. 9331-(89/167), as amended.

6. Lithuania's right to engage in the transactions covered by this 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 6, 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.

7. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Lithuania, the Fund agrees to provide them at the time of the purchase.

8. Lithuania shall pay a charge for this arrangement in accordance with the decisions of the Fund.

9. (a) Lithuania shall repurchase the outstanding 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 related to repurchase as Lithuania's balance of payments and reserve position improves.

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

10. 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.

11. In accordance with the authorities' letter, Lithuania will consult with 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 4 above have not been observed, or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Lithuania has outstanding repurchases 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.

Table 1. Lithuania: Net Domestic Assets of the Banking System

(In litas equivalents of millions of rubles) 1/

	Previous limits 2/	Revised limits
Estimate for June 30, 1992	30,900	30,900
Indicative limits for September 30, 1992	61,000	61,000
Limit through December 31, 1992	80,000	75,500
Limit through March 31, 1993	87,500	83,000

Source: Information provided by the Lithuanian authorities.

1/ In rubles for June 30, and September 30. From October 1, Talonai have been the sole legal tender in Lithuania. The litas is to be introduced later.

2/ From Lithuania: Request for Stand-By Arrangement (EBS/92/157, 9/30/92), Annex II.

September 21, 1992

Dear Mr. Camdessus,

The Government of the Republic of Lithuania has started to transform Lithuania into a market economy. To this end, decisive measures have been taken over the course of the past year, including the elimination of price controls for most goods, reform of the ownership of state enterprises and land, maintenance of a prudent fiscal policy, and liberalization of Lithuania's trade and payments system. Moreover, the Bank of Lithuania has taken a number of important steps to prepare itself to conduct monetary policy and exercise prudential supervision following the introduction of a national currency, the litas, which is to be convertible, at least for current international transactions. These reforms have been pursued against a background of sharply contracting output, brought about by trade dislocations with Russia and other trading partners and the move to world market prices for energy and other raw materials.

The Government and the Bank of Lithuania believe that the policies set out in the attached Memorandum of Economic Policies would be adequate to achieve internal and external stability, and to support the continued restructuring of the economy. This will make a key contribution to maintaining confidence in the litas and to creating preconditions for sustained growth over the medium term.

In support of its economic program, the Government hereby requests an eleven-month stand-by arrangement in the amount of SDR 56.9 million. The Government and the Bank of Lithuania will provide the Fund with any information that it may request for the purposes 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 policies on such consultations. Furthermore, we stand ready to take any additional measures that may become necessary to achieve the aims of the program.

We will complete with the Fund two reviews of economic developments and policies under the program, the first by February 28, 1993, and the second by May 31, 1993. The quantitative performance criteria for June 30, 1993 will be specified at the time of the first of these reviews.

Sincerely,

/s/ /s/

Aleksandras Abisala
Prime Minister

Vilius Baldisis
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.

September 15, 1992

Lithuania - Memorandum of Economic Policies

I. Introduction

1. Following the occupation of Lithuania by the Soviet Union in the early 1940s, all industrial property and real estate was nationalized, the agricultural sector was collectivized, and a command economy was introduced, leading to a heavily industrialized structure with emphasis on large-scale, highly-specialized enterprises operating under the central planning system. Half a century later, Lithuania has regained its independence. Beginning in September 1991, Lithuania started privatization of enterprises and residences and restitution of the remaining real estate, including land, to the former owners or their descendants. The economy is being transformed into a system of decentralized market-oriented decision making.

2. Yet, the heavy dependence of the Lithuanian economy on the republics of the Commonwealth of Independent States (CIS) as sources of inputs and markets for outputs, as well as continued reliance on the ruble as a medium of exchange, has created severe difficulties for the transformation effort. Political and economic instability within the ruble area, the USSR-imposed economic blockade in the summer of 1990, and the imposition of trade restrictions have resulted in a large cumulative decline in output during recent years. The loss has been compounded since late 1991 by the shift in the prices of oil and other traded goods toward world market levels. This is causing a sharp rise in the average price of our imports relative to the average price of our exports, or a sharp deterioration in our "terms of trade".

3. We have been consulting closely with the International Monetary Fund (IMF), the World Bank, the European Community, and others in designing a strategy for addressing Lithuania's macroeconomic problems and for continuing the transformation toward a market economy. This strategy has at its center a program of economic stabilization designed by the Government. We trust that our demonstrated commitment to create a market-oriented economy and our comprehensive macroeconomic stabilization and reform program will receive timely and adequate financial support from the international community. Such support will allow us to adjust our economy much less abruptly than we would be forced to do without any external financing.

II. The Lithuanian Economy in Early 1992

4. During the first half of 1992, the decline in real gross domestic product (GDP) accelerated, owing primarily to disruptions in trade with the CIS republics and the impact of the sharp deterioration in the terms of trade. It is estimated that real GDP fell more than 30 percent from the beginning of 1990 through mid-1992. Oil imports during the first half of 1992 were about 3.4 million tons (little more than half the capacity of the Mazeikiai refinery), compared with imports of 6 million tons in the first half of 1991. Imports of other energy resources during the first half of 1992 were also much less than the amounts obtained during the first half of 1991. Open unemployment reached 19 thousand workers, or more than 1 percent of the labor force, as of August 1, 1992. Consumer price inflation accelerated to monthly rates around 50 percent during January and February 1992, largely reflecting the price liberalizations and rapid monetary emission in Russia and other parts of the ruble area, and then slowed to about 30 percent in March and an average of about 10 percent from April through June. Beginning in July, inflation has been rekindled by further sharp increases in the prices of imported energy products. Despite these difficulties, the Government has persevered with its efforts to transform the economy, maintaining a prudent fiscal policy, and preparing the institutional framework required for the successful introduction of Lithuania's own currency, the litas.

5. Liberalization of the economy. Although Lithuania won international recognition of its independence only in August 1991, the drive to transform the economy began a year and a half earlier with the election of a new Supreme Council that declared Lithuania's independence in March 1990. Since that time, the Government's strategy has been to create the legal and institutional frameworks required to implement policies of privatization and restitution, establish a market price system, preserve fiscal stability, encourage the development of the financial sector, introduce a system of unemployment support, and initiate various other social and economic reforms.

6. Privatization. The privatization process began in September 1991. The privatization process has been based on a system of vouchers allotted to Lithuanian citizens in amounts based on their age. Lithuanian citizens can buy privatization items for vouchers, rubles, or convertible currency, and non-Lithuanian citizens for convertible currency only. Flats and other dwellings have been appraised and offered for sale to occupants. As of August 21, 1992, 76.1 percent of the total state-owned flats had been privatized. Small enterprises, which are primarily in the services and trade sectors, are being sold at auction. Most small enterprises have already been sold, and it is intended that the privatization of these assets will be completed by the end of 1992. Large enterprises have so far been privatized mainly through a share subscription scheme, in which initial bids are submitted and share prices are then adjusted to balance the supply and demand for shares, but new initiatives are being launched to speed up the process. It is intended to diversify the forms of privatization and to

simplify procedures and eliminate unnecessary restrictions; see paragraph 55. By mid-1992, about 600 large enterprises had been converted into enterprises owned predominately by private shareholders, and there are plans to convert a total of nearly 3500 by the end of 1993; this will leave approximately 350 large enterprises (including power plants, the oil refinery, etc.) under state ownership. In agriculture, it is anticipated that by the end of 1992, 50 percent of all usable land will be privately owned and 80 percent of the total assets from collective farms and state farms will be private property.

7. Prices and wages. Lithuania has taken a series of actions during 1991 and early 1992 to eliminate price controls from most products, and subsidies for food products have been gradually reduced. To maintain budgetary control, most of the higher costs of imported energy products have been passed on to enterprises, and local governments have been encouraged to raise rents and domestic heating charges to reduce the costs to the budget. During the period from the end of 1991 through the beginning of August 1992, the price of energy increased 100 times, and from end-1991 through end-1992 it is estimated that it will have increased 280 times. As of September 1, 1992, the main prices still subject to administrative control were rents, various public utilities charges, transportation fares, fuels, and the prices of certain goods produced or distributed with a high degree of monopoly power. From January 1991 through June 1992, the consumer price index rose about 1700 percent, and the average level of wages increased by roughly the same amount. In this sense, Lithuania maintained a relatively high standard of living in comparison with some neighboring states, although imports and some goods and services that were heavily subsidized in the past became much less affordable. From January 1991 through July 1992, the consumer price index rose about 2200 percent while average wages rose about 1800 percent.

8. Public finance. The consolidated general government budget for 1991 was in surplus by an amount equivalent to nearly 3 percent of GDP. 1/ In nominal terms, the outturns for revenues and expenditures were much higher than originally budgeted, largely reflecting the sharp rise in prices. The surplus also reflected a reduction in subsidies and the positive effects on tax revenues of the increase in profits that resulted from Lithuania liberalizing prices ahead of its major suppliers of imported inputs to production. For the first half of 1992, the authorities maintained a policy of matching spending to available budgetary revenue, and it is estimated that the fiscal outcome was in balance. However, the fiscal situation has become much more difficult with the continuing decline in output and the adverse shift in the external terms of trade.

1/ As defined in detail in Annex I, the consolidated general government budget is the consolidated budget of the state and local governments and all extrabudgetary funds.

9. Monetary policy. Lithuania has not yet been able to conduct an independent monetary policy. Although it would have been possible to introduce the litas earlier, it was decided to delay such action pending (i) the formulation of macroeconomic stabilization policies that can achieve relative stability in the price level, (ii) efforts to agree on arrangements for settling trade and payments with countries that remain in the ruble area, (iii) the accumulation of adequate external reserve assets, and (iv) the separation of the commercial banking operations from the central banking operations of the Bank of Lithuania, along with changes in the organizational structure of the central bank to enable it to perform its monetary policy and prudential supervision functions effectively.

10. The Lithuanian banking system has been substantially reorganized over the past two years. In addition to the central bank, it comprises three state-owned banks--the Savings Bank, the Agricultural Bank, and the State Commercial Bank of Lithuania (in the process of being created)--and about 20 licensed commercial banks. The Savings Bank, the Agriculture Bank, and the Bank of Lithuania have numerous branches throughout the country.

11. From the end of 1990 through the end of June 1992, the rates of growth of broad money and the net domestic assets of the banking system 1/ were about 300 percent and 165 percent, respectively, considerably lower than the rate of consumer price inflation. As a result, the stocks of money and credit have declined considerably in real terms, and the "monetary overhang" that built up when prices were controlled has been substantially reduced or eliminated. By April 1992, shortages of ruble banknotes had created a situation in which the banking system was unable to provide enterprises and the government sufficient cash to pay workers their full salaries, and on May 1 the Bank of Lithuania, in conjunction with a decision by the Government, began issuing talonas (a form of coupons denominated in rubles) to ease the currency shortage. Talonas are provided to banks by the Bank of Lithuania and enter circulation through withdrawals from the bank deposits of enterprises, government agencies, and individuals; they represent legal tender as general substitutes for ruble banknotes in all cash transactions within Lithuania. Interest rates on bank deposits and loans have been increased but remain well below the rate of inflation. Since June, the expansion of credit to the economy has accelerated.

12. External policy. Since regaining independence, Lithuania has taken steps to liberalize its foreign exchange and trade arrangements and to establish independent trade relations with foreign countries, including the

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1/ Broad money is defined as the sum of currency in circulation, including talonas, plus the total deposits of the banking system excluding government and interbank deposits. As defined in detail in Annex II, the net domestic assets of the banking system are defined as net credit to the government plus gross credit to the rest of the economy, plus other items net. Net credit to the government is gross credit to the government minus government deposits in the banking system.

CIS republics. We strongly desire to expand our trade with countries outside the current ruble area and have already signed trade agreements with Sweden and Norway and trade and cooperation agreements with the European Community and many individual countries. At the same time, we recognize that the CIS republics remain our major trading partners, and we attach great importance to improving trade relations with these countries. To this end, Lithuania, Latvia, and Estonia have agreed to form a Baltic Customs Union, and have also proposed a trade arrangement with the CIS republics on a nondiscriminatory basis.

13. In Lithuania, exchange rates for the ruble are market related for most commercial transactions, although a small group of specific enterprises (perhaps 3 percent of all state enterprises) must surrender their foreign exchange earnings to the hard currency fund administered by the Ministry of Finance at an exchange rate less favorable to them than the market level. Foreign exchange to purchase imports, other than essential items financed from the Government's hard currency fund, is provided through the foreign exchange market. Resident enterprises and individuals may hold foreign exchange accounts domestically, and enterprises are not generally prohibited from holding bank accounts abroad.

14. A uniform import and export tax of .01 percent is now assessed for purposes of collecting trade statistics. Except for purposes of national security or health, there are no quantitative restrictions or licensing requirements on imports. Excise duties are levied on exports to the CIS republics of certain raw materials and products, ranging from 20 to 61 percent on leather, timber, and energy products, and up to 92 percent for alcoholic beverages; and for some of these goods, exports to other countries are also subject to excise taxes. For most other goods, an excise duty of 10 percent temporarily applies to products sold or bought for hard currency if international agreements do not specify otherwise.

15. Following the collapse of the centralized system for distributing goods under the Soviet regime, Lithuania has sought bilateral trade agreements with the CIS republics and the other Baltic states as a means of ensuring adequate supplies of material inputs and essential consumer goods. These agreements have been frequently violated by our CIS partners, and resulting shortages of key inputs have idled many factories. For 1992, trade agreements have been signed with all of the CIS republics, but major uncertainties remain about the amounts of oil and other vital imports that we will actually be able to obtain, and about the eventual settlement of trade imbalances. Bilateral trade arrangements for 1992 are also in place with Bulgaria, China, Cuba, the Czech and Slovak Federal Republic, and Hungary.

16. Lithuania's net official international reserves amounted to US$76 million at the end of June 1992. This amount includes 5.1 tons of gold that France and the United Kingdom have returned to Lithuania, which is valued at US$58 million at world market prices. In July, Sweden compensated Lithuania for 1.2 tons of gold, the dollar equivalent of US$14.5 million.

We are conscious of the need to limit external borrowing to a level that can be supported by the economy. Since Lithuania regained its independence, the Government has not accumulated any foreign debt, but in preparation for future borrowing, steps are being taken to centralize the recording and monitoring of external debt. Because Lithuania was an occupied country for the last 50 years, and because Vneshekonombank has appropriated a large amount of Lithuania's foreign exchange reserves, Lithuania does not accept responsibility for any of the external debt of the former Soviet Union. We are prepared, however, to discuss the servicing of US$35.7 million of debts incurred by our enterprises through Vneshekonombank. At the end of 1991, Lithuania owed the Czech and Slovak Federal Republic US$3.2 million under a bilateral clearing arrangement, and agreement has been reached to settle this amount through the export of fertilizer and other products. There were no other outstanding balances at end-1991 on clearing arrangements with states outside the ruble area.

III. The Economic Program through June 1993

17. Program objectives. We are convinced that the major policy changes and measures already undertaken have been in the right direction. In general, they represent a fundamental move away from the command economy system and the beginnings of transformation toward a market economy. We recognize, nevertheless, that many additional actions are necessary to stabilize the economy and ensure a successful transformation, as well as to obtain the external financing that will help ensure this success. The Government is committed, therefore, to pressing ahead speedily with a further strong program of reform and stabilization.

18. The main objectives of Lithuania's economic program for July 1992 through June 1993 are to adjust quickly to the sharp deterioration in the terms of trade, to continue to encourage an effective private market economy, to limit the effects on output arising from both the shift in the terms of trade and the process of economic transformation itself, to successfully introduce the litas and achieve a sharp reduction in inflation, and to ensure social guarantees consistent with the economic situation in Lithuania. The program sets targets for building up foreign exchange reserves to instill confidence in the new currency, and for limiting the deficit in our international balance of payments. We are seeking to obtain the external financing implied by these targets, which is considered to be an amount consistent with the economy's longer term debt-servicing capacity.

19. To achieve the objectives we have set, including the successful introduction of the litas, the program comprises: (i) further steps to reduce subsidies and make the price system more effective; (ii) improved mechanisms for directing social benefits to the most vulnerable groups of the population; (iii) various fiscal reforms aimed at strengthening budgetary control; (iv) measures to strengthen the banking system and enable the Bank of Lithuania to control the supplies of money and credit effectively; (v) a temporary incomes policy consistent with adjusting real

incomes to the deterioration in the terms of trade, and then bringing inflation down sharply; (vi) the continuation of convertibility for at least current international transactions after the litas is introduced, together with further liberalization of the exchange and trade systems; and (vii) a number of other important structural measures to develop stronger competition in the economy, to speed up the processes of privatization and land reform, to strengthen managerial incentives and begin to address the problems of large enterprises that require restructuring, and to continue reducing the scope of direct government involvement in the economy. The program also includes various steps to strengthen the statistical infrastructure and institutional framework for implementing economic policy, monitoring economic developments, and evaluating and coordinating necessary policy adjustments in a timely manner.

20. Pricing policy and inflation. Although most prices have already been decontrolled, the Government recognizes the importance of proceeding quickly to eliminate as many of the remaining price subsidies as possible. The early elimination of subsidies is important for reducing strains on the budget and for incurring the associated price rises in advance of the introduction of the litas, so as to create the best possible conditions for price stability thereafter. Furthermore, the increase in prices for energy and other products with a high import content will encourage conservation in the consumption of such products by households and enterprises, which is essential for reducing imports of these products to adjust Lithuania's balance of payments.

21. Our policy for pricing energy products distinguishes between those products that it is appropriate to produce and distribute under a concentrated industrial structure--specifically, gas, heat, and electricity--and those products for which it is appropriate to let prices eventually be determined by market forces. For the latter products, consumer prices are already being adjusted, and will continue to be adjusted as needed in the future, to cover the full costs of imports, production, and distribution, plus depreciation and a reasonable profit margin. Furthermore, to strengthen market forces, all controls on the prices charged for these products will be removed by January 1, 1993, except in any cases where regulation remains necessary because of monopolistic price setting. For gas, heat, and electricity, average prices (averaged across different groups of users and different times of day) are also being adjusted in stages, and will continue to be adjusted as necessary, to cover full costs (as defined above); this requires marking up the prices charged to enterprises to cover any subsidies on household use. The prices of gas, heat, and electricity will continue to be regulated since producers are natural monopolies. By March 1, 1993, an energy saving program will be adopted. Several stages of this program are being implemented even now. The program will involve installing utility meters to measure the consumption of energy and, during 1993, any subsidies on household use of gas, heat, and electricity will be gradually phased out. Price controls have already been removed on all goods and services other than energy products, except for a small number (primarily rents and other municipal services, utility services,

communications, public transportation, and some alcoholic beverages and tobacco products) that can be justified on the basis of monopolistic conditions or on social grounds. The Government has liberalized all procurement prices paid to farmers and will not reintroduce price controls on agricultural products. The general government budget for the second half of 1992 includes agricultural subsidies of rub 1.2 billion, partly in response to difficulties created by the recent drought. The Government intends to limit agricultural subsidies to amounts that can be accommodated within the government budget. In July of the current year it appealed to Governments in other countries to assist in cushioning the consequences of the drought.

22. The authorities intend to make the price system more effective by moving ahead quickly with anti-monopoly legislation and other measures to develop stronger competition in both production and distribution, as discussed in paragraph 54.

23. As a result of the continuing rise in prices paid for energy and other imports, which were close to full world market levels by September 1, 1992, the authorities expect that the overall consumer price index for Lithuania will rise about 100 percent in August and September combined, following the 27 percent increase in July. However, following the pass through of higher energy prices, and with the introduction of the litas and the consistent implementation of firm fiscal, monetary, and incomes policies under our economic program, the rate of inflation should decline rapidly thereafter, falling well into single digits by December 1992, and to about 2 percent per month by the end of the first quarter of 1993.

24. Fiscal and monetary policies. A successful economic transition requires a stable economic environment created by sound macroeconomic policies. To that end, we intend to hold general government spending in line with revenues, and to ensure that money and credit expansion does not endanger macroeconomic stability.

25. With regard to fiscal policy, the target for the remainder of 1992 is for balance in the general government budget. This will require a combination of changes in government spending and tax policies. To help constrain spending, subsidies will be reduced substantially by adhering to the pricing policy described in paragraphs 20-22, and efforts will be made to hold down the costs of the social safety net in accordance with the state of the Lithuanian economy, as described in paragraph 53. The wages of workers in budgetary institutions will be frozen for two months beginning on September 1, 1992, and thereafter wage increases for these institutions will be kept consistent with achieving the target rate of price inflation under the program, in line with the incomes policy described in paragraphs 41-42. The increase in consolidated general government expenditure on goods and services will be further restrained to well below the inflation rate.

26. To provide additional revenues during the second half of 1992, the value-added tax rate was increased to 18 percent beginning July 1, 1992, and

a number of other actions have been or will soon be taken. These actions include: (1) abolishing the authority of local governments to grant tax reductions, exemptions, and subsidies (except for those taxes and charges levied by local governments and for which local governments receive all the revenue); (2) raising excise taxes on alcoholic beverages to an average ad valorem rate of about 63 percent and on tobacco to more than 50 percent; and (3) converting the specific excise taxes on petroleum products to ad valorem taxes and setting the tax rates between 7 and 30 percent of the final price to the consumer, still well below the average international tax rate of 60 to 90 percent on petroleum products. If necessary, the Government is ready to take additional measures to ensure the achievement of a balanced budget for the rest of 1992. To help maintain budgetary control, no additional extrabudgetary government funds will be created. 1/ Borrowing by local authorities will not be permitted without prior approval by the central government to ensure that such borrowing is consistent with the performance criteria specified for the program. The Government will limit its own expenditure commitments to the budgetary revenues available. In addition, by January 1, 1993 the Government will review civil service staffing and remuneration policy with a view to developing a program and timetable for eliminating jobs that are no longer necessary in institutions financed from the general government budget.

27. During the remainder of 1992 and the first half of 1993, the Government will continue to aim at balance in the general government budget, and will place very high priority on actions to strengthen expenditure control, tax administration, and budgetary planning. To this end, technical assistance will be requested from the IMF, or from other sources in consultation with the IMF. By February 1, 1993 we will (1) take steps to establish within the Ministry of Finance a new system of budget and expenditure control, (2) take steps to improve the design and administration of the general excise tax to make it a full-fledged value-added tax, and (3) prepare to introduce a budget presentation of the consolidated general government based on the methods of accounts of the IMF's Government Finance Statistics. The Public Finance Working Group will be made fully operational to begin budgetary projections in linkage with other macroeconomic variables and policies, to formulate alternative fiscal policies, and to monitor the execution of the fiscal program. We also recognize the need to simplify and harmonize our tax systems. To this end, by the middle of 1993 we will act to: (1) simplify the enterprise profit tax system by setting a uniform tax rate for all enterprises; (2) simplify the personal income tax system by providing the same amount of tax credit for all tax payers, by taxing wages and salaries on a uniform basis but with a progressive tax rate schedule, and also taxing nonwage incomes on a uniform basis; and (3) equalize the enterprise profit tax rate and the top marginal rate of personal income tax.

1/ This does not prohibit charity funds to which money is contributed voluntarily.

28. Quantitative ceilings will be set for net credit to the general government from the banking system. These ceilings will confine such credit during the program period to smoothing seasonal shortfalls in budgetary revenues relative to expenditures. Taking account of seasonal factors, the net deposits of the general government in the banking system, which are estimated to have been rub 4,700 million as of June 30, 1992, shall not fall below the litas equivalent of rub 4,700 million as of December 31, 1992 nor fall below the litas equivalent of rub 4,000 million as of March 31, 1993. As detailed in Annex I, these limits do not include any disbursements of foreign loans, and they may require adjustment to allow for the use of government deposits in the financial restructuring of the Savings Bank.

29. Looking further ahead, the Government is committed to support structural fiscal reforms aiming at keeping the evolution of public expenditure in the medium term in line with the evolution of tax revenues plus noninflationary (non-bank) financing. One medium-term objective will be to strengthen the tax system to make it more elastic and efficient. A second objective will be to strengthen public expenditure management, including the processes of planning, formulating, and executing the budget. The Government also recognizes that local authorities must be able to plan investments and other expenditures on the basis of projected revenues and, accordingly, will act over the medium term to complete the set of rules specifying the shares of various tax revenues that are to be allocated to local authorities.

30. The Government recognizes that some of the banking system's outstanding loans to state enterprises will have to be covered. The authorities will seek to obtain technical assistance from the World Bank to plan the financial restructuring of the banking system (that is, to address the problem of bad loans), as discussed further in paragraph 39. Implementing the plan may require substantial budgetary outlays in the years ahead. Accordingly, the Government will consider setting aside revenues from privatization sales for this purpose, and, if necessary, will allocate additional funds in the budget.

31. With regard to currency reform and monetary policy, the Government and the Bank of Lithuania, in close cooperation with the IMF staff and with other organizations, intend to introduce the litas prior to, or at the start of, the requested financial assistance program, and in a manner consistent with the recommendations of the IMF technical assistance report on issues in introducing a national currency in Lithuania. The authorities accept the principle that the ruble bank notes withdrawn from circulation should be held by the Bank of Lithuania pending the results of negotiations with the authorities of Russia. Such negotiations should recognize that stocks of ruble banknotes obtained by Lithuania have been "purchased" through debits to Lithuania's correspondent accounts in Moscow. The authorities are seeking to agree with major trading partners in the ruble area on more effective arrangements for settling trade.

32. A two-tier banking system is essential for effective monetary policy and the successful introduction of the litas. Accordingly, we have taken action, in close consultation with technical assistance missions from the IMF, to separate the commercial banking operations from the Bank of Lithuania, and to ensure that the new organizational structure of the central bank will enable it to perform its monetary policy and prudential supervision functions effectively. This will result in the creation of a new state-owned bank, the State Commercial Bank of Lithuania. The preparation of a balance sheet for the central bank has been completed, and such balance sheets showing end-of-month data will be made available no later than two weeks after the end of each month.

33. Until the introduction of our own currency, the issuance and use of talonas (coupons) will be controlled in such a manner that, as long as the ruble is circulating in Lithuania, rubles will not be discriminated against relative to talonas.

34. Following the introduction of the litas, monetary policy will be formulated with a view to providing domestic credit at a rate that is consistent with expected economic activity and a target path for inflation.

35. As detailed in Annexes II and III, quantitative ceilings will be set for the net domestic assets of the banking system, along with a consistent indicative limit for the net domestic assets of the central bank. It is the intention to move in the future to performance criteria for the net domestic assets of the central bank rather than the net domestic assets of the banking system. The net domestic assets of the banking system are estimated to have reached rub 30,900 million on June 30, 1992. The net domestic assets of the banking system should not exceed the litas equivalent of rub 80,000 million as of December 31, 1992, nor exceed the litas equivalent of rub 87,500 million as of March 31, 1993.

36. The ceiling on the expansion of net domestic assets of the banking system will be supported by a system of bank-by-bank credit limits. For the six months ending December 31, 1992, the credit limits for individual banks will be distributed in proportion to the shares of individual banks in total net domestic credit as of June 30, 1992. In distributing the credit limits among individual banks, part of the overall credit limit will be used to provide scope for new banks to form. The credit limits for individual banks will be set on net domestic credit expansion excluding changes in net credit to other banks. This will allow banks to increase their deposits by more than their credit limits, and to lend the excess to other banks. Banks that violate their credit limits will be penalized by being required to increase their reserve holdings at the Bank of Lithuania, which will not earn interest, by 100 percent of the excess credit granted. Beginning with the three-month period ending June 30, 1993, the proportions in which the limits on net domestic credit expansion are allocated among individual banks will be adjusted from the proportions allocated during the previous quarter, taking into account the shares of individual banks in the growth of the total deposits of the banking system.

37. The Bank of Lithuania will continue to impose reserve requirements on banks in proportion to the amount of their deposit liabilities. The minimum reserve ratio is currently 10 percent and will be adjusted by the Bank of Lithuania when appropriate to control credit expansion. For the time being, until its income position is strengthened and the monetary system has developed further, the Bank of Lithuania will not pay interest on either required reserve holdings or reserve holdings in excess of the minimum requirements. A refinancing facility will be established to enable the Bank of Lithuania to provide credit to individual banks, subject to the indicative limit on total net credit provided by the Bank, and the interest rate charged on refinancing credit will be determined by auctioning the credit. To make this system effective, the practice of granting credit through automatic overdrafts on the correspondent accounts of banks at the Bank of Lithuania will be terminated. The central bank will also introduce a second facility through which a bank could borrow to meet its reserve requirements, but at an interest rate set at a level higher than bank lending rates--and significantly higher than the target rate of inflation under the program--to discourage banks from using this facility. 1/ It is expected that the interest rate on the central bank credit that is auctioned will also exceed the target rate of inflation.

38. Eventually, interest rates will become the main instrument for the allocation of financial resources in the economy. In the meantime, the Bank of Lithuania will refrain from providing interest rate subsidies. The interest rates of commercial and state-owned banks will be liberalized, although the central bank will guard against potential problems by remaining watchful of the difference between lending and deposit rates and exercising prudential supervision of banks to discourage excessive risk taking. To facilitate the eventual transition to indirect monetary control, the authorities plan to seek technical assistance from the IMF or other sources during the first half of 1993 to develop a market in Government securities.

39. The Bank of Lithuania recognizes its responsibilities as lender-of-last resort within Lithuania. It will seek technical assistance in establishing accounting, auditing, and payments systems that conform to international standards, in developing an effective system of bank supervision and regulation, and in modernizing the domestic payments and clearing system. Work has been started on procedures and reporting requirements for off-site banking supervision, in consultation with experts of the IMF and other organizations. By the end of 1992, a new reporting system for commercial and state-owned banks will be made operational to facilitate off-site banking supervision, and a new plan of accounts for the Bank of Lithuania will be implemented to facilitate monetary analysis. By early 1993, enabling regulations will be in place for the introduction of accounting, auditing, and payments systems conforming to international standards; this

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1/ A mission from the Monetary and Exchange Affairs Department of the IMF presented detailed recommendations for establishing these two facilities to the Bank of Lithuania during a visit to Vilnius in June 1992.

will be followed with training programs and institutional arrangements necessary to implement these systems and to start implementing on-site banking supervision procedures. Also by early 1993, a detailed plan and timetable will be developed for modernizing the domestic payments and clearing system. In addition, as mentioned in paragraph 30, the authorities will coordinate with the World Bank in seeking technical assistance to plan the financial restructuring of the banking system, which may require resources from the budget. Various approaches will be examined, including the creation of a special government agency to take over the non-performing assets of the banking system, with the intention of completing a study and formulating a coherent plan by February 1, 1993. The study will consider the implications of the different approaches for the budget, the banking system, and the privatization program. It will also identify ways of adapting the banking system to the needs of a market economy and, in particular, increasing private ownership of banks.

40. The strength and effectiveness of our monetary and banking system will have a major influence on Lithuania's economic growth and prosperity, and we intend to complete a comprehensive review of our banking laws, in consultation with the IMF staff and other organizations, with the aim of taking appropriate steps by March 1, 1993 to strengthen this system of legislation. In the meantime, we have acted to ensure that the system of banking laws empowers the Bank of Lithuania (i) to establish interest rate policy for all banks, and to be the only authority so empowered: (ii) to be the Government's primary depository; (iii) to manage Lithuania's official international reserves, including its gold; (iv) to prudentially supervise banks, including their foreign exchange operations; and (v) to be responsible for distributing and managing Government securities. To this end, we have rescinded the Government's authority to determine interest rate policy.

41. Incomes policy. The Government is committed to the liberalization of wages and has legalized collective bargaining at enterprises that are not financed directly from the budget. Nevertheless, given that the adverse shift in the external terms of trade implies an unavoidable loss of real purchasing power for the country as a whole, and that Lithuania has been experiencing a wage and price spiral that we want to bring down sharply following the introduction of the litas, the Government is also of the view that the success of its stabilization effort hinges critically on introducing a temporary incomes policy. Such a policy is intended initially to hold down the increase in wages relative to the rise in prices in order to prevent the shift in the external terms of trade from leading to an excessive fall in output and employment. Subsequent to adjusting to the shift in the terms of trade, the incomes policy is intended to establish guidelines for restraining the rise in nominal wages to a rate consistent with the target for price inflation. Such wage restraint will limit the increase in costs of production and, in combination with tight monetary and fiscal policies, will thereby make the inflation target achievable. It is intended that this policy will not reduce the real purchasing power of wages any more than is necessary to adjust to the shift in the terms of trade.

The need for such a policy after adjustment to the terms of trade shift reflects the fact that, even when credit is tightly constrained, managers of state enterprises--which continue to account for a substantial share of economic activity in Lithuania--may not face sufficiently strong financial constraints to be able to resist their employees' wage demands. This situation will change over time as a result of the many structural reforms we are undertaking, and we plan to review the need for an incomes policy at the end of the program period.

42. Under the incomes policy each enterprise and organization will be asked to keep the percentage increase in its average wage below a certain uniform wage guideline during each specified period. For this purpose, wages will be measured to include all remuneration to workers and managers, including any bonuses or premiums paid out of profits and any expenditures on nonwage benefits for the employed (other than health benefits and professional training). Each enterprise or organization will remain free to reward individual workers on the basis of relative productivity, merit, and market value; the guidelines will apply only to the percentage increase in the average wage of the enterprise or organization. The Government will secure the legal authority from the Supreme Council to control wages directly in state enterprises. This authority would be used, if necessary, to ensure compliance with the wage guidelines. The incomes policy will be reviewed with the IMF during the reviews of the program in February 1993 and May 1993. Although a system of direct wage controls would not apply to the private sector, it can be expected that enforcement of the wage guidelines for the state sector would have a major influence on wages in the private sector as well. Details of the incomes policy measures, which will also cover the minimum wage rate, are described in Annex VI.

43. <u>External sector policies</u>. The Government recognizes that, in the transition to a market economy, the removal of exchange and trade restrictions is a central part of the strategy for introducing a rational structure of relative prices, for exposing domestic monopolies to competition, and for alleviating supply bottlenecks. These measures work together with price liberalization and privatization to create a competitive environment and establish appropriate market signals to guide production and investment choices by decentralized decision makers.

44. From the time of the introduction of the new currency, Lithuania will adopt a unified exchange rate applying to both current and capital transactions. All official buying and selling rates for enterprises will be replaced by market rates established at the banks that are licensed to buy and sell foreign exchange. In this connection, the Government's extrabudgetary foreign currency funds will be abolished with or before the introduction of the litas, and the Government will purchase and sell foreign exchange at the prevailing market exchange rate. The unification of exchange rates will also require that various taxes related to foreign exchange transactions, or paid in foreign currencies, be eliminated or replaced by appropriate domestic taxes. To this end, the 5 percent tax on foreign exchange transactions has already been abolished, and taxes paid in

hard currency--including a portion of the profit tax and various excise taxes--have been or will be replaced by taxes payable in domestic currency that do not discriminate between domestic and foreign sales after introduction of the litas. The special exchange rates for sales of property and equity shares to Lithuanian expatriates will be replaced by equivalent taxes on sales of assets to expatriates. Any negative effects on fiscal revenues resulting from the above measures could be offset by introducing low and relatively uniform tariff rates on imports.

45. Concurrent with the introduction of the litas, the Bank of Lithuania will establish a new foreign exchange regime consistent with a high degree of convertibility of the litas at market-determined exchange rates. Our goal is to make the litas convertible for all international transactions. To this end, we will ensure that residents continue to be allowed to purchase foreign exchange in the market for purposes of making payments for all bona fide current international transactions. Recognizing the importance of attracting inflows of foreign capital and establishing a secure environment for investment, we will also ensure that nonresidents continue to be allowed to purchase foreign exchange in the market for purposes of repatriating their earnings (after paying domestic taxes) and their capital. Any restrictions on other capital account transactions will be kept to a minimum and lifted as our external reserve position strengthens.

46. With the introduction of the litas, a floating exchange rate regime will be established and the value of the litas will be determined in the market established by the banks that are licensed to deal in foreign exchange. With technical assistance from the IMF and other sources, the Bank of Lithuania is taking steps to deepen and broaden the institutional arrangements required for the smooth and efficient functioning of foreign exchange markets. The Bank and Government are also committed to the pursuit of sound monetary and fiscal policies to ensure the stability of the litas and enable us to consider the adoption of a fixed exchange rate system once the litas has demonstrated its stability and Lithuania has built up adequate foreign exchange reserves.

47. Households and enterprises will be allowed to continue to hold their savings in foreign currency deposits with the domestic banking system. If it is decided in the future to impose a requirement that export earnings be sold to the Lithuanian authorities, such a surrender requirement would only be at a market-determined exchange rate. For prudential purposes, the foreign currency exposure of domestic banks will be limited. In particular, banks will be expected to maintain approximate balance between their foreign currency liabilities and their foreign currency assets, thereby holding down their exposure to large valuation losses that could result from changes in exchange rates. To this end, by October 1, 1992 the Bank of Lithuania will establish prudential monitoring and standards for foreign currency exposure of domestic banks. These standards will apply to exposure in each foreign currency.

48. Lithuania does not currently impose quotas or licensing requirements for imports, and will not introduce quantitative restrictions on imports except for purposes of national security or health. We intend to remove all quotas and licensing requirements for exports by November 1, 1992, with the exception of those applying to certain energy products and timber of local origin, and to remove all remaining quantitative restrictions by January 1, 1993, except those restrictions on exports of products subject to quantitative import restrictions in the country of destination or to administered prices, or restrictions deemed by the Government to be necessary for reasons of security or health. For the limited number of products that require export restrictions in association with controls on prices, export taxes will be imposed instead of quotas whenever possible. Other trade-related taxes will be reviewed and simplified by the end of 1992, including excise tax rates that depend on whether products are sold domestically or exported. In any event, in compliance with its international responsibilities as a member of the IMF, the Lithuanian authorities do not intend to introduce or intensify restrictions on payments and transfers for current international transactions, to introduce or intensify import restrictions for balance of payments purposes, 1/ or to introduce or modify multiple currency practices. Moreover, the Lithuanian authorities do not intend to accumulate external payments arrears.

49. The Government is committed to removing remaining interstate trade barriers, promoting direct trading between enterprises, and reducing the direct involvement of the Government in trade relations. During the period of the program, the Government will not conclude new bilateral payments agreements inconsistent with Article VIII of the IMF's Articles of Agreement. The Government intends to conduct Lithuania's international economic relations on a nondiscriminatory basis in line with multilateral trading principles prevailing in the world economy. In this context, the Government recognizes the need for continued close economic relations with the CIS republics, as well as the need to integrate its economy into the world trading system. It is committed to fostering cooperative relationships in all areas of interstate and foreign economic and financial relations, and to avoid actions that would disrupt trade. To that end, the trade initiatives mentioned in paragraph 12 are being seriously pursued, and we plan to prepare an action plan for implementing the Baltic free trade agreement, in cooperation with Estonia and Latvia, and in the context of Lithuania's general future trade relations and tariff regime. Over the medium term, Lithuania intends to develop a rational tariff structure with low and relatively uniform tariff rates that are in accordance with internationally accepted principles.

50. It is clear, however, that interstate cooperation cannot be achieved by Lithuania acting alone. It also requires equivalent actions by others. We note that part of the IMF's mandate is to assist countries so that they do

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1/ This does not preclude the introduction of relatively uniform import tariffs to raise fiscal revenues.

not resort to measures destructive of international prosperity. We understand that the IMF will seek to work closely with Lithuania and all other member countries of the IMF to facilitate the development of cooperative agreements and relationships.

51. Structural policies. Extensive structural changes are necessary to generate an efficient supply response to macroeconomic management, to strengthen incentives for microeconomic units to invest in the economy and engage in productive activities, and to provide a system of social benefits that protects the population against economic hardship. Many types of structural reforms are needed to accomplish our objectives, and the faster these can be undertaken, the sooner the economic system will be strengthened and growth resumed. The Government has been involved in extensive discussions with the World Bank and IMF staff on structural adjustment measures relating to the social safety net, anti-monopoly policy, privatization, the legal and institutional framework for commercial activity, enterprise reforms, financial restructuring of the banking system, economic management, and regional economic policy.

52. Social safety net. We are committed to the protection of the most vulnerable groups of the population by providing social benefits to eligible individuals and families. This will require various types of programs, both to address the emerging problem of unemployment and to target the provision of social benefits to the groups that most need them.

53. The current system of social benefits is broadly based and requires reform. We intend to count on technical assistance from the World Bank or other international institutions in restructuring the social safety net, and will remain in close consultation with IMF staff on matters relating to the financing of the social benefit system and the degree to which benefit levels are indexed to wage or price levels. To keep expenditures consistent with budgetary resources, the following transitory and extraordinary measures will be prepared by November 1, 1992 for quick introduction in case of necessity: (i) a simplified (possibly flat rate) structure of unemployment benefits, along with appropriately modified eligibility criteria; and (ii) a simplified flat-rate structure of pension benefits. The Government also intends: (iii) to review and, as unemployment projections require, strengthen the staffing and equipment of local employment offices; (iv) by January 1, 1993 to define a minimum poverty line (linked to an index of prices for a basic subsistence-level consumption basket) which will form the basis for developing recommendations for a viable social assistance program and identifying and initiating necessary legislative changes; (v) by January 1, 1993 to determine the general priorities and develop a plan for the medium-term design and financing of the social safety net system (pensions, unemployment benefits, family benefits, sick pay benefits, social assistance benefits) including, in particular, a comprehensive pension reform plan based on a full costing of alternative options and an evaluation of options for establishing private pension schemes within an appropriate legal framework; (vi) by January 1, 1993 to design and start implementing a system of retraining and other

active labor market policies, with a specified level of financing; (vii) by January 1, 1993 to take the steps necessary to strengthen the staffing and equipment of the network of local social assistance offices; and (viii) by early 1993 to design and start implementing an effective means-testing system for channeling social benefits to the most vulnerable groups of the population, with the objective that the system be fully operational in the second half of 1993.

54. Anti-monopoly policy. The Government intends to give special attention to developing stronger competition in the economy, both in production and distribution. This will involve a combination of measures. Actions have been taken to remove legal barriers to starting new businesses, to eliminate restrictive licensing requirements for production and distribution, to permit trading by distributors without geographical restrictions, and to begin the splitting up of multi-plant enterprises. Rational actions to break up large enterprises are to continue, both on a case-by-case basis under the aegis of the relevant branch ministries and in conjunction with the privatization program. A law defining unfair competition and monopoly practices, and identifying penalties for such behavior, has been submitted to Parliament; and technical assistance has been requested for the further development of accompanying regulations and the evaluation of alternative institutional arrangements to implement and enforce the law. In this regard, our intention is to have appropriate regulations and institutional arrangements in place by the beginning of 1993. As additional actions to promote new private investment and commercial activity, a decree has recently been issued requiring the contracting out of public services, and we intend to intensify our ongoing efforts to disseminate information systematically about relevant legislation, regulations, and sources of external and domestic assistance.

55. Privatization. As already noted, it is our intention to proceed with the privatization of state enterprises as quickly as possible, as well as with the restitution of property. We intend to take measures to remain on schedule in privatizing almost all eligible housing and small enterprises by the end of 1992. In this regard, for those enterprises that were not sold the first time they were put up for auction, we have reduced restrictions on the amounts of vouchers and cash that citizens can use as means of payment in subsequent auctions. Moreover, we intend to remove cash-quota restrictions for auctions of all enterprises as soon as the litas is introduced. Other new initiatives are also being launched to speed up the privatization of large enterprises and we have submitted to Parliament amendments to the law on privatization that would enable liberalization and simplification of the privatization process. Most restrictions on privatization to foreign investors were eased in June 1992, except for a small list of reserved activities, and a diagnostic study is being undertaken to assist in designing more ways to promote foreign private investment. Based on this study, we intend to prepare further amendments to remedy deficiencies in the foreign investment law, and accordingly to modify procedures for foreign investment by April 1, 1993. Additional initiatives to encourage privatization of large enterprises include: the systematic

break-up, where feasible, of such enterprises into small units that are easier to sell, according to guidelines issued earlier this year; and the introduction of a wider variety of privatization techniques. In connection with the latter initiative, by November 1, 1992 we intend to prepare, with World Bank assistance, a specific plan of action for undertaking demonstration privatizations using a number of additional techniques.

56. The framework for commercial activity. To further strengthen the legal and institutional framework for commercial activity, a bankruptcy law--drafted with input from OECD experts--has been submitted to Parliament. Efforts are being made to develop accompanying regulations and strengthen the juridical infrastructure necessary to enforce the law, with the objective of making bankruptcy proceedings operational as soon as possible. To eliminate obstacles to commercial activities, restrictions on leasing land and renting business premises are being removed, and we will seek to remove the remaining restrictions on land sales by mid-1993. We also intend by mid-1993 to undertake a comprehensive review of all major laws governing transactions (such as laws governing transfers of property and sales, credit, and collateral) with the intention of elaborating and modifying this legislation as appropriate.

57. Enterprise reforms. The Government has been undertaking initiatives, in addition to the privatization program, to create independent commercially-oriented entities from previous state-owned conglomerates and large enterprises. Such enterprises were made independent of their founding ministries by early 1992, with complete financial autonomy, and all direct subsidies for current expenditures from the state budget to enterprises have been discontinued. As further action, we intend to complete a study by the end of 1992, with World Bank assistance, to re-examine the present organizational arrangements for state-enterprise management and make plans for modifications which would facilitate improved performance. Initiatives are also being undertaken to strengthen financial accounting. The Parliament has passed a law on new accounting procedures meeting internationally accepted standards; regulations and accompanying institutional arrangements to implement these accounting procedures are to be prepared by the end of 1992; and training is to be provided with the aim of making the new procedures fully operational during 1993. In addition, we intend to design and make operational by the beginning of 1993 an effective system for reporting the financial flows of enterprises.

58. While we recognize that the production structure built up under the Soviet regime will have to be substantially changed over time, we attach great importance to insuring that adjustments on the supply side of the economy proceed in an orderly way. Because many state enterprises currently employ large numbers of workers and labor mobility is low, the financial constraints on state enterprises cannot be tightened abruptly without risking unacceptably high output losses and social costs. At the same time, we recognize that failure to tighten the financial constraints on enterprises could undermine the stabilization effort and the process of transforming the economy if it led to fiscal spending in excess of revenues

or to excessive domestic credit expansion. Accordingly, to help address the difficulties that will arise, we intend by early 1993, and with assistance from the World Bank, to begin to undertake thorough studies of selected sectors and large enterprises in order to identify their medium-term restructuring needs, with emphasis on Lithuania's potential to expand production of exportable goods and services.

59. Economic management. The Government recognizes that there are weaknesses in the present statistical infrastructure and institutional framework for monitoring economic developments and evaluating and coordinating policy. High priority must be given to implementing mechanisms for data collection and compilation--and to providing adequate staffing and training in our ministries and central bank--so that national accounts, price, monetary, fiscal, and balance of payments statistics become available on a timely basis. To this end a Statistics Law to clarify responsibilities for data compilation and provide the necessary legal authority for data collection will be prepared and passed as soon as possible. We have completed the work necessary to reconcile the recording of general government financial statistics by the Ministry of Finance with the statistics reported by the banking system. In addition, by November 1, 1992 we will establish a system for monitoring, recording, processing, and managing external debt flows, consistent with the reporting requirements of the World Bank, with all inflows of foreign grants and government borrowing centralized through the accounts of the Ministry of Finance. In taking measures to improve our statistics, we are drawing on the technical assistance we have already received from the IMF, and, where necessary, we will continue to seek appropriate technical assistance in this area. Serious efforts will also be made to strengthen the institutional framework for policy development and the mechanisms for coordination among the various economic ministries and the Bank of Lithuania. To this end, a committee consisting of representatives of the Ministry of Economy, the Ministry of Finance, the Ministry of International Economic Relations, the Ministry of Foreign Affairs, the Bank of Lithuania, and the Resident Representative of the IMF, will closely monitor progress under this program and report directly to the Prime Minister.

60. By early 1993, in anticipation of a resumed public investment program, we will establish a mechanism to set priorities, establish project evaluation criteria, and appraise projects proposed for public investment. By mid-1993, we will prepare the first version of a rolling three-year public investment program.

61. Regional economic policy. The Government will endeavor to develop the basis for prompt implementation of regional economic development programs and promotion of traditional and locally-based entrepreneurship activities. To this end municipal property will be founded, stable municipal budget income sources will be defined in terms of objective principles, and the rights of local municipalities will be established and their functions segregated. In addition, to create more favorable conditions for entrepreneurship in Lithuania and to improve the efficiency of government

management, vocational training programs will be implemented for governmental and municipal staff, and their rights and responsibilities will be defined. Measures will also be taken to eliminate both the possibility for persons to abuse powers pertaining to their positions and any delays in decision making procedures.

62. Balance of payments prospects and financing. Over the medium term, we expect exports to strengthen substantially in response to the structural changes in production and the strong competitive position that the Government intends to maintain. In the short run, however, the balance of external payments will deteriorate owing to the initial adverse impact of structural adjustment and the worsening in the terms of trade, and to the very severe drought that has been experienced during 1992. The current account deficit is targeted at close to US$500 million for the program year. Part of this deficit will be offset by private capital flows (mainly through direct investment). The remaining gap is expected to be financed by official balance of payments support, including support from the IMF, World Bank, EBRD, and bilateral creditors. A substantial portion of such assistance, including virtually all support from the IMF, is intended to permit a buildup of gross official international reserves, to US$120 million by the end of June 1993.

63. We have established targets for changes in net international reserves, as defined in Annex IV. Net official international reserves in convertible currencies amounted to US$76 million on June 30, 1992. Including the deficit in the correspondent accounts with the CIS republics, total official reserves stood at US$25 million. The fall in net official international reserves in convertible currencies that takes into account the repatriation of the equivalent of gold of US$14 million shall not exceed US$10 million during the six months ending December 31, 1992. With a targeted reduction in the deficit in the correspondent accounts of US$10 million, there shall be no fall in total net international reserves during this period. During the nine months ending March 31, 1993 there shall be a cumulative reduction in the deficit in the correspondent accounts of US$25 million, while the fall in net international reserves in convertible currencies shall be limited to US$10 million. As a result, total net international reserves shall increase by not less than US$15 million during this period. The targeted reduction in the deficit in the correspondent accounts assumes that at least some of the net arrears owed to Lithuanian enterprises by enterprises in the CIS republics will be offset against imbalances in the correspondent accounts. The cumulative change in total net international reserves for the period ending March 31, 1993 shall be adjusted at the time of the first review of the program depending on the outcome of the negotiations between the Lithuanian Government and the CIS republics.

64. External borrowing contracted or guaranteed by the Government or the Bank of Lithuania or other agencies on behalf of the Government (excluding proceeds of purchases from the IMF) will be held below a ceiling of US$150 million, through December 31, 1992 and below a ceiling of US$350 million through March 31, 1993. 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 net disbursements of external debts with maturities between 1 and 5 years, will be held below ceilings of US$50 million through December 31, 1992 and US$125 million through March 31, 1993. Details are set out in Annex V. In addition, compliance with the obligation not to accumulate external payments arrears will be a performance criterion.

65. Review of program. We will complete with the IMF two reviews of economic developments and policies under the program, the first by February 28, 1993 and the second by May 31, 1993. In addition to assessing whether quantitative performance criteria have been met and evaluating the overall economic situations, both of these reviews will focus on the implementation of incomes policy and of various structural measures.

66. The structural measures that will be assessed during the first review will be: (1) the steps taken to strengthen public expenditure control, tax administration (especially for the value-added tax), and budgetary planning; (2) the effectiveness of monetary control procedures using the new policy instruments introduced under the program; (3) the progress made in implementing the plan for the financial restructuring of the banking system; and (4) the progress made in strengthening mechanisms for the collection, compilation, and timely dissemination of statistics, including the strengthening of staffing and training. The quantitative performance criteria for June 30, 1993 will be specified at the time of the first review.

67. The structural measures that will be assessed during the second review will be: (1) the development of the foreign exchange market and experience with floating exchange rates; (2) progress in simplifying the various tax systems; (3) progress toward developing a market in Government securities; and (4) progress toward completing the privatization process.

September 15, 1992

Net Credit to General Government

	(In litas equivalents of millions of rubles) 1/
Estimate for June 30, 1992	-4,700
Indicative limit for September 30, 1992	-4,700
Limits on:	
December 31, 1992	-4,700
March 31, 1993	-4,000

The financial transactions of the General Government with the banking system are those of the national budget (comprising the central government's state budget and local government budgets) and all government transactions through all extrabudgetary Funds. The extrabudgetary Funds include but are not limited to the Social Insurance Fund, the privatization funds, the Foreign Currency Fund, and the Reserve Fund.

Net credit of the banking system to the General Government is defined as all claims of the banking system on the General Government less all deposits of the General Government with the banking system. In this definition, the deposits of the General Government with the banking system include but are not limited to: the revenue accounts at the Bank of Lithuania and the other banks of the central and local governments; and all extrabudgetary funds, except as noted below. Excluded from deposits of the General Government in this definition are the Privatization Funds, the Agricultural Reform Fund, and deposits of counterpart funds of loans to the General Government for balance of payments support (including but not

1/ The amounts shown below are expressed in rubles. The credit ceilings will be adjusted depending on the exchange rate used to convert rubles into litas at the time the litas is introduced. These ceilings will be adjusted after the Government assumes the responsibility for the liabilities of the Savings Bank.

limited to World bank loans, and loans from the EC/G-24) as well as counterpart funds of grants not fully under control of the Government, which are blocked in the Bank of Lithuania.

The claims of the banking system on the General Government include but are not limited to the expenditure accounts at the Bank of Lithuania and the other banks of the central and local governments, and securities or bills issued by the central and local governments that are held by the Central Bank of Lithuania and the other banks.

For the purposes of the monetary program, the General Government's deposits that are denominated in convertible currency will be converted into rubles at the exchange rate of rubles 135.9 = US$1. The ruble amount will be converted into litas, whereby the credit limits will be adjusted according to the actual conversion factor and the amount of rubles which is converted into litas. Convertible currencies are defined as those that are widely traded in the international foreign exchange markets.

The quarterly limits will be monitored monthly from the accounts of the Bank of Lithuania and the other banks; the Ministry of Finance and the Central Bank of Lithuania will confirm the data for counterpart deposits to loans and grants, which are not fully under control of the government, for balance of payments support. Data on net credit to government, in the agreed format, will be reported to the IMF within thirty days of the end of each month by the Central Bank of Lithuania.

Net Domestic Assets of the Banking System

	(In litas equivalents of millions of rubles) 1/
Estimate for June 30, 1992	30,900
Indicative limit for September 30, 1992	61,000
Limit through December 31, 1992	80,000
Limit through March 31, 1993	87,500

The net domestic assets of the banking system are defined as the difference between the liabilities of the banking system to the nonbank public (broad money) and the net foreign assets of the banking system, both expressed in local currency. Broad money is defined as currency in circulation, including talonas, and the deposits held by residents in domestic and foreign currency, excluding those deposits held by the General Government. For the purposes of the monetary program, net foreign assets consist of two components. The first component is the banking system's gross foreign assets in the form of gold, holdings of SDRs, any reserve position in the IMF, and convertible currencies net. Convertible currencies net consist of gross holdings of convertible currencies (including any deposits with nonresidential financial institutions) net of the following foreign liabilities: short-term liabilities of the banking system vis-à-vis nonresidents, use of Fund resources, and the Bank of Lithuania's other medium- and long-term external debt. The second component of net foreign assets consists of the banking system's net ruble balances in Lithuania's correspondent accounts and bilateral correspondent accounts with countries in the ruble area.

Net domestic assets comprise the balance of the following assets and liabilities: net credit to the General Government as defined in Annex I; gross credit to the nongovernment sector; medium- and long-term convertible foreign assets of the banking system not included in net nonconvertible foreign assets; other net nonconvertible foreign assets (consisting of

1/ The amounts shown below are expressed in rubles. The limits will be adjusted depending on the actual conversion factor at the time the litas is introduced and the amount of rubles converted into litas.

holdings of nonconvertible currencies, net claims on nonresident institutions denominated in nonconvertible currencies, and capital subscriptions to foreign financial institutions); the capital and reserve accounts, the foreign exchange revaluation accounts, the interbank float, and other assets and liabilities.

For the purposes of the monetary program, net foreign assets and those components of net domestic credit and broad money that are denominated in foreign currency will be converted into rubles at the exchange rate of rubles 135.9 = US$1. Following the introduction of the litas, they will be converted from rubles into litas, whereby the limits will be adjusted according to the actual conversion rate and the amount of rubles that are converted.

The quarterly limits will be monitored monthly from the accounts of the banking system. Data on net domestic assets of the banking system, in the agreed format, will be reported to the IMF within thirty days of the end of each month by the Central Bank of Lithuania.

Net Domestic Assets of the Central Bank of Lithuania

	(In litas equivalents of millions of rubles) 1/
Estimate for June 30, 1992	10,450
Indicative limit for September 30, 1992	19,100
Indicative limit through December 31, 1992	24,800
Indicative limit through March 31, 1993	25,400

Net domestic assets of the Central Bank of Lithuania are defined as the difference between reserve money and net foreign assets of the Central Bank of Lithuania. Reserve money consists of the currency outside the Central Bank plus deposits of banks (including commercial branches of the Bank of Lithuania) with the Central Bank of Lithuania. Bank deposits with the Central Bank of Lithuania consist of required reserves and the net position of correspondent accounts with commercial banks. Net foreign assets of the Central Bank of Lithuania consist of net international reserves in convertible currencies plus net assets of Bank of Lithuania correspondent accounts with central banks of the states of the CIS, Georgia, Estonia and Latvia.

Thus, net domestic assets of the Bank of Lithuania consist of the following assets and liabilities: net credit to the Central Government; credit to domestic banks (branches of the Bank of Lithuania, commercial banks, the Agriculture Bank, and the Savings Bank); credit to enterprises; and other net domestic assets (including holdings of nonconvertible currencies, 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 Central Bank of Lithuania will be converted into rubles at the exchange rate of rubles 135.9 = US$1. The ruble amount will be converted into litas, whereby the indicative limits

1/ The amounts shown below are expressed in rubles. The indicative limits will be adjusted depending on the actual conversion factor and the amount of rubles and talonas converted into litas.

will be adjusted according to the actual conversion factor and the amount of rubles which is converted into litas. The cross exchange rates prevailing on June 30, 1992 will be used to convert items denominated in convertible currencies other than the U.S. dollar. All monetary gold will be valued at US$340 per ounce.

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

Targets for the Minimum Cumulative Change in Total Net International Reserves and Net International Reserves in Convertible Currencies of the Bank of Lithuania

	Total	Minimum Convertible Currencies
	(In millions of U.S. dollars)	
Position on June 30, 1992	25	76
Cumulative change from June 30, 1992		
December 31, 1992	--	-10
March 31, 1993	15	-10

Total net international reserves consist of the net asset position of the Bank of Lithuania on its correspondent accounts with central banks of the former Soviet Union plus net international reserves in convertible currencies. Net international reserves in convertible currencies consist of gross foreign assets minus foreign liabilities, both expressed in U.S. dollars.

For purposes of the program, gross foreign assets in convertible currencies will include all foreign assets of the Central Bank of Lithuania, including monetary gold, holdings of SDRs, any reserve position in the IMF, holdings of foreign exchange in convertible currencies, and any deposits with nonresident financial institutions denominated in convertible currencies. Excluded from gross foreign assets will be the participation in international financial institutions except the IMF, as well as holdings of nonconvertible currencies and claims on nonresident financial institutions denominated in nonconvertible currencies.

For the purposes of the program, foreign liabilities in convertible currencies will be defined as use of IMF credit plus convertible currency liabilities of the Bank of Lithuania with original maturity of up to and including one year. Excluded from reserve liabilities are any liabilities of the Bank of Lithuania arising from balance of payments support of maturity longer than one year, including such loans from the EC/G-24, other international financial institutions, foreign governments, or foreign banks.

For the entire period of the program, the exchange rates of the SDR, and nondollar currencies vis-à-vis the U.S. dollar, will be kept at their June 30, 1992 levels, and all monetary gold will be valued at US$340 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. For the purpose of the program, ruble balances in the correspondent accounts will be valued at an accounting rate of rub 135.9 per U.S. dollar.

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

Medium- and Long-Term External Debt

Cumulative Net Disbursements of External Debt	Maximum Limits (In millions of U.S. dollars)	
	1-12 year Maturity 1/	1-5 year Maturity 2/
During the period from June 30, 1992 to:		
December 31, 1992	150	50
March 31, 1993	350	125

1/ Maturities of greater than one year through 12 years.
2/ Maturities of greater than one year through 5 years.

External debt limits apply to net disbursements (disbursements less repayments) of medium- and long-term external debt of original maturities of more than 1 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 1 year up to and including 5 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 maturity longer than one year 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. Disbursements and repayments shall be valued in the currencies of transactions and converted into U.S. dollars each month at the average exchange rate for the month.

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

September 15, 1992

Incomes Policy Measures

The incomes policy measures stipulated in paragraphs 41 and 42 of the Memorandum of Economic Policies are defined as follows:

1. The guideline for the increase in the average wage rate for each enterprise, organization, and activity, as well as for the increase in the minimum wage, will be based on the new consumer price index, which is available for the period starting in June 1992. An assessment of wage and price developments since the first half of 1991 is also necessary, however, to specify an incomes policy under which the adjustment in wages will be constrained adequately to avoid macroeconomic instability as Lithuania absorbs the shift in the external terms of trade, which began during 1991. Our most reliable measures of these developments are shown in the table.

2. The index of real wages (that is, the index of ruble wages divided by the index of prices) during July 1992 was 9 percentage points below its average level during the first six months of 1991. Nevertheless, a substantial further decline in real wages seems necessary to cushion both the direct effects on production costs, and the direct and indirect effects on the general government budget, of the sharp rise in the costs of energy and other essential imports. The need to prevent average wages from rising as fast as prices has been made even more pressing by the fact that output per worker has fallen as production has declined. For the economy as a whole, a large loss of real income associated with the shift in the external terms of trade is unavoidable. Part of the rationale for large reductions in real wages in the near term is to spread the real income loss widely throughout the economy and thereby to enable more enterprises to survive and fewer workers to become unemployed.

3. To meet this objective, wages will be frozen during September and October. After the consumer price index for October becomes known during November, a guideline will be announced for an increase in wages, retroactive to November 1. Each enterprise, organization, and activity will be asked at that time to keep the increase of its average wage rate not exceeding the amount of inflation targeted under the program for November-December combined, which is 8 percent, plus any amount by which actual inflation during September and October combined exceeds 30 percent.

Price and Wage Developments

	Consumer Prices 1/		Average Wages			Real Wages 2/
	Index	Percent Change	Rubles	Index	Percent Change	Index
January 1991	100	...	321 3/	100 3/	...	90 4/
February	108	8.4	321 3/	100 3/	...	90 4/
March	127	17.1	321 3/	100 3/	...	90 4/
April	161	27.1	456	142	42.1	88
May	177	9.6	522	163	14.5	92
June	188	6.6	590	184	13.0	98
July	199	5.5	666	207	12.9	104
August	207	4.2	682	212	2.4	103
September	214	3.5	740	231	8.5	107
October	227	6.0	1,029	321	39.1	141
November	291	27.8	1,342	418	30.4	144
December	445	53.0	2,185	681	62.8	153
January 1992	696	56.5	2,279	710	4.3	102
February	1,023	47.1	2,798	872	22.8	85
March	1,306	27.6	3,240	1,009	15.8	77
April	1,490	14.1	4,118	1,283	27.1	86
May	1,617	8.5	4,978	1,551	20.9	96
June	1,815	12.3	5,768	1,797	15.9	99
July	2,309	27.2	6,172	1,923	7.0	83

1/ Based during 1991 on the retail price index for goods and services in its linked inter-monthly version, from January through May 1992 on estimates of what the new consumer price index would have shown, and in June and July 1992 on the fully developed consumer price index.

2/ Average ruble wages divided by the level of consumer prices.

3/ Average for the first quarter of 1991.

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

4. Unless the actual inflation experienced during November-December is substantially higher than the inflation target for those months, the guidelines for maximum average wages established during November will not be raised again until March 1, 1993, when they will be adjusted after consultation between the Government and the IMF staff during the program review in February. The percentage adjustment in the wage guidelines for March will compensate for the amount of inflation targeted under the program for January-March combined, which is 8 percent, and will also take into account any difference between actual inflation and target inflation during the period from November through January. The new guidelines for maximum average wages that become effective on March 1 will be calculated by applying the percentage adjustment to the maximum average wage guidelines set in November. If actual inflation for November-December should exceed the inflation target for the corresponding period by more than 10 percentage points, adjustment of the maximum average wage guidelines will be made before March 1993 after consulting closely with the IMF staff.

5. Unless actual inflation experienced during February-April is substantially higher than the inflation target for that period, the average wage guidelines specified during March will continue to apply until the consultations between the Government and the IMF staff during the second program review in May. The wage guidelines will then be adjusted, effective June 1, 1993, to compensate for target inflation during the second quarter, taking into account any difference between actual and target inflation during the first quarter.

6. After the wage freeze is lifted in November, enterprises, organizations, and activities will be asked to keep the increase in their average wages within the wage guidelines but will be free to raise the wages of different workers by different percentage amounts.

7. The guidelines for average wages will be applied in all budgetary organizations. The minimum wage rate will also be frozen during September and October. Subsequently, the minimum wage will continue to be increased by the same percentage amounts, and on the same dates, as the guidelines for average wages.

September 26, 1992

Dear Mr. Camdessus:

In recent days, Lithuania has been prompted by a strong inflow of rubles to take urgent action to stabilize its economy by withdrawing from the ruble area. While such a step was anticipated in our letter to you of September 21, and the attached Memorandum of Economic Policy in support of our request for a stand-by arrangement with the Fund, the need to act quickly has led us to implement our currency reform in two stages.

Rather than proceed directly to the litas, we have decided as a first step, and with effect from October 1, 1992, to make the coupons (talonas), now circulating with the ruble, the sole legal tender in Lithuania. Pursuant to our decision, which was announced to the public on September 23, 1992, rubles may be exchanged at par for talonas through September 30. After that date, talonas notes will be used exclusively and bank accounts, contracts, and other domestic obligations expressed in rubles will be redenominated at par in talonas. The rate of the talonas against foreign currencies, including the ruble, will be determined by the market. Ruble bank accounts may be maintained after September 30, and the exchange rate of the ruble will be determined based on buying and selling by commercial banks, in the same way as for other foreign currencies.

The step we have taken is a transitional one prior to the introduction of the litas. We will remain in close consultation with Fund staff concerning the timing of the exchange of talonas into litas. The litas will be introduced using a common conversion factor against the talonas. We intend to meet all of the commitments of the Memorandum of Economic Policy which we have transmitted to you in support of our request for a stand-by arrangement with the Fund, and we ask that our request continue to be considered in a timely way.

Specifically, by the completion of our withdrawal from the ruble area as of October 1, we intend to:

(1) Comply with the principle that ruble bank notes withdrawn from circulation should be held by the Bank of Lithuania pending the results of negotiations with the Russian authorities;

(2) Unify exchange rates, which will require the elimination or replacement of various taxes related to foreign exchange transactions or paid in foreign currencies, and abolish the surrender requirements still applied to some specialized state enterprises;

(3) Introduce bank-by-bank credit limits and establish refinancing facilities at the Bank of Lithuania;

(4) Introduce prudential standards for limiting the foreign currency exposure of banks;

(5) Continue to implement for the talonas, and for the litas when it is introduced, full current account and limited capital account convertibility as specified in the Memorandum of Economic Policies.

In addition, before our request for a stand-by arrangement with the Fund is considered by the Fund's Executive Board, we intend to:

(6) Comply with the incomes policy measures, including the establishment of legal authority to impose direct contols on wages paid by state enterprises.

We would also like to inform you that we have already abolished the Government's extrabudgetary foreign currency funds and legislated the repeal of the Government's authority to determine interest rate policy.

We will also comply with the quantitative performance criteria under the Fund arrangement. To reflect the introduction of the talonas as exclusive legal tender the references in the Annexes to our Memorandum of Economic Policies to rubles should be read as talonas, converted from rubles at par or, in future, in litas as converted from talonas.

We wish to re-emphasize our continued full commitment to the program of economic measures contained in the Memorandum of Economic Policies, and our intention to keep the Fund staff fully informed of further developments and economic policies.

Sincerely,

/s/

Aleksandras Abisala
Prime Minister

/s/

Kazimieras Ratkevicius
Acting Governor
Bank of Lithuania

Michel Camdessus
Managing Director
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