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MEMORANDUM OF THE PRESIDENT

OF THE

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

AND THE INTERNATIONAL FINANCE CORPORATION

TO THE

EXECUTIVE DIRECTORS

ON A

COUNTRY ASSISTANCE STRATEGY

OF THE WORLD BANK GROUP

FOR

THE REPUBLIC OF LITHUANIA

April 19, 1999

CURRENCY EQUIVALENTS

(As of March 1, 1999)

Currency Unit	=	Litas
US$1	=	4.00 Litas

BORROWER'S FISCAL YEAR

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ABBREVIATIONS AND ACRONYMS

CAS	-	Country Assistance Strategy
CIS	-	Commonwealth of Independent States
CPI	-	Consumer Price Index
CPPR	-	Country Portfolio Performance Review
DEM	-	Deutsche Mark
EBRD	-	European Bank for Reconstruction and Development
EDI	-	Economic Development Institute
EIB	-	European Investment Bank
EU	-	European Union
FDI	-	Foreign Direct Investment
FIAS	-	Foreign Investment Advisory Services
FY	-	Fiscal year
G-24	-	Group of 24
GDP	-	Gross Domestic Product
GEF	-	Global Environmental Fund
IBRD	-	International Bank for Reconstruction and Development
IDF	-	Institutional Development Fund
IFC	-	International Finance Corporation
IFI	-	International Financial Institute
IMF	-	International Monetary Fund
MDP	-	Municipal Development Project
MIGA	-	Multilateral Investment Guarantee Agency
NGO	-	Non-Governmental Organization
NIB	-	Nordic Investment Bank
NLS	-	Non-Lending Services
SAL	-	Structural Adjustment Loan
SME	-	Small and Medium Enterprises
SOE	-	State-Owned Enterprise
UNDP	-	United Nations Development Program

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REPUBLIC OF LITHUANIA
COUNTRY ASSISTANCE STRATEGY

TABLE OF CONTENTS

Text Table

Text Boxes

Annexes

REPUBLIC OF LITHUANIA

WORLD BANK GROUP COUNTRY ASSISTANCE STRATEGY

EXECUTIVE SUMMARY

1. Since the last Country Assistance Strategy (CAS), Lithuania has made good progress in macroeconomic stabilization and the transition to a market economy. The consolidated fiscal deficit fell from 4.4% of GDP in 1996 to 1.7% in 1997, while the currency board-backed exchange rate has remained fixed at 4 litas per US dollar since April 1994. In 1997, accelerated privatization supported the growth of FDI to record levels, while most other structural reforms proceeded apace. As a result, the rate of GDP growth rose from 3.3% in 1995 to a high 7.3% in the first half of 1998, while the rate of CPI inflation fell to 2.4% in 1998, one of the lowest rates among economies in transition.

2. While most longer-term fundamentals remain sound, Lithuania's short-term trajectory has been fundamentally altered by the crisis in Russia. Growth slowed sharply to still positive levels, the twin budget and current account deficits widened, and accumulated quasi-fiscal imbalances emerged. Maintaining sustainable growth and managing the resulting increase in macroeconomic risks will require a near-term policy response combining a fiscal adjustment with systematic structural reforms to limit quasi-fiscal deficits in key sectors. These measures would also help Lithuania meet its overarching medium-term goal of membership in the European Union, as well as laying the foundations for a more rapid convergence of living standards toward EU levels and for sustained reductions in poverty.

3. To assist Lithuania in meeting these goals, the Bank Group and the Government have agreed a program covering three main areas elaborated in the CAS document. Specific interventions within each of these areas have been designed taking into account both the Bank Group's comparative advantage, as well as the potential for using partnerships to leverage or complement the support of other international donors, especially the EU, the Nordic countries, the IMF and regional development banks.

4. The following areas of support are elaborated in the CAS document:

(i) To **improve macroeconomic and financial stability**, the Bank Group will help Lithuania to analyze and monitor macro-financial vulnerabilities, strengthen the financial sector and its regulation and supervision, and develop a supportive overall structural reform program for sustainable growth and EU accession.

(ii) Bank Group **support for implementing the agenda of reforms and investments needed for EU accession** will strategically focus on four key sub-themes:

(a) **Enhancing competitiveness** through a combination of IFC financial support for private investments, possible MIGA guarantees, and IBRD and FIAS advice and analysis focused on strengthening the regulatory framework for competition and improving the foundations for private sector-led growth.

(b) **Developing the rural economy and improving agricultural productivity,** including through technical assistance for land reform, analysis of the rural poverty and of measures required for EU accession, and possible lending for elements of a market-supporting rural development strategy.

(c) **Strengthening central and local public administration** through support for capacity building and training, analysis and development of institutions for managing public finances and public investments, and possible support for fighting corruption.

(d) **Improving infrastructure and environmental management** through investment projects for upgrading ports and local infrastructure and public utilities, and through analytical support and possible future lending for the difficult restructuring of the important energy sector.

(iii) Bank projects to support **reforms, institution building and investments in health, education and social assistance**, along with continued Bank Group analysis and technical assistance for supporting the evolving **pension reform**.

5. The Government has made it clear that it wishes the overall emphasis in the Bank Group program to shift towards IBRD policy and technical advice and analysis and IFC financing of the private sector. The proposed CAS envisions a modest 'steady state' of project lending over a broad range of satisfactory policies. In the base case scenario characterized by a renewed commitment to fiscal balance, continued progress on structural reforms, and a modest improvement in the external environment, the IBRD lending program would be very selectively focused in areas (ii.d) and (iii) above, with six projects totaling around US$150 million spread over the period FY00-02. Selectivity is also evident in the limited number (two per year) of major economic studies. At the same time, the broad nature of the reform agenda for sustainable growth and EU accession means that we will maintain a modest policy dialogue in areas not covered by projects or major studies, as well as a some capacity to respond to Government requests.

6. Specific policy and performance conditions--sustained improvement in portfolio performance, strengthened fiscal discipline, and concrete progress on bank privatization, energy sector profitability, and market-supporting rural development strategy--have been identified as triggers. In the unlikely event that Lithuania fails to meet these triggers, the Bank's lending program would be scaled back and limited to human development and the social safety net, with three operations totaling US$60 million over three years. The proposed CAS also envisions enhanced self-evaluation of the impact of the Bank Group assistance program based on a range of measurable, qualitative and survey indicators.

7. In the near-term, Lithuania faces significant risks to its rapid development. Its large current account deficit leaves Lithuania dependent on continued net capital inflows, which could be curtailed by contagion, by reduced foreign confidence in domestic policies, or by the confluence of these two types of factors. *Ad hoc* efficiency-reducing policy measures aimed at mitigating the immediate problems of particular constituencies also remain possible. Yet, political stability and the strong social consensus for EU membership help to make any protracted departure from the reforms which have so far brought success highly unlikely.

8. The following items are suggested for Board discussion:

- What are the Board's views on the key themes chosen for emphasis, particularly on the focus of the lending program on human development/social sectors and supporting investments in infrastructure and environmental management which are crucial for EU accession?

- What are the Board's views on maintaining a sizeable program of technical assistance and non-lending services relative to the volume of Bank lending?

- What are the Board's views on the adequacy and appropriateness of the measures proposed to limit the macroeconomic risks resulting from, and brought out by, the crisis in Russia?

MEMORANDUM OF THE PRESIDENT OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT AND THE INTERNATIONAL FINANCE CORPORATION TO THE EXECUTIVE DIRECTORS ON A COUNTRY ASSISTANCE STRATEGY OF THE WORLD BANK GROUP FOR THE REPUBLIC OF LITHUANIA

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1. This document discusses the proposed World Bank Group Country Assistance Strategy (CAS) for Lithuania during the period FY00-02. This is a joint Bank-IFC CAS, with programs for both institutions presented in a unified strategic framework. The activities of MIGA, WBI and FIAS are also noted. The CAS has been prepared in close consultation with the Lithuanian Government. It also takes into account many of the priorities highlighted during meetings held with representatives of Parliament, the Bank of Lithuania, local government, the business community, academia, and NGOs concerned with social and environmental interests, as well as with the donor community. The document has benefited from the findings of a recent Client Survey.

I. OVERVIEW

2. In 1992-94, Lithuania experienced one of the sharpest downturns among the ex-Soviet countries, as its large enterprises languished through the loss of traditional markets. But these years also saw the beginnings of the development of small and medium enterprises and of investor interest in Lithuania, which propelled a revival starting in 1995. The growth of the small and medium sector enabled a wide distribution of ownership, avoiding a concentration of economic power. A high degree of political stability has also made an important contribution to economic revival. Lithuania, like Latvia and Estonia, now appears fortunate that its 1995 banking crisis occurred while global growth was rapid, so that it was able to begin restructuring its banks and economy in the context of strong growth and a relatively healthy fiscal situation.

Box 1 - Country Profile

The Republic of Lithuania is the southernmost and largest of the three Baltic states with a territory of 40,600 square miles (65,300 square kilometers). It lies on the eastern shore of the Baltic Sea and is bounded by Latvia to the north, Belarus to the east, and Poland and Russia's Kaliningrad region to the south. Lithuania has a 62-mile (99-kilometer) Baltic coastline, along which lies the major port of Klaipeda. More than half the country is agricultural land. Forests cover about 30% of its relatively flat territory. Lithuania has limited natural resources (mainly quartz sand, limestone, dolomite and clay), but no appreciable domestic source for its sizable fuel needs. Over 80% of Lithuania's power is generated by the Ignalina Nuclear Power Plant, the largest dependence on nuclear energy for any country. Industry accounts for 25.2% of GDP and 20% of employment; agriculture for 11.7% of GDP and 21.7% of employment. More than 80% of the population of 3.7 million people is of Lithuanian origin, about 600,000 of whom live in the capital, Vilnius.

3. During the two years until mid-1998, Lithuania's performance was characterized by moderate but rising growth, falling inflation, accelerated privatization, increasing FDI, and good progress on most structural reforms. While there were concerns about the depth of reforms in some areas, in particular about structural sources of fiscal and quasi-fiscal pressures, the probability of a serious downside scenario was generally deemed to be small. Rather, in setting its policies, Lithuania was seen as facing a choice between development paths which were of different speeds, but always relatively stable.

4. This perception was fundamentally altered by the crisis in Russia, which emerged in August 1998. Its deflationary impact put pressure on the budget and brought out hidden quasi-fiscal pressures, while slower growth of foreign demand increased the already high current account deficit. Policy adjustments aimed at cushioning the impact of the crisis further fueled the budgetary and current account deficits. In addition, a degree of complacency growing out of past successes was shown in the decision to proceed with the Savings Restitution Plan (see *Box 3* below), despite the worsened external conditions. As a result, the risks of a short-term disruption to growth have risen to a level which cannot be discounted.

5. In this much less favorable setting, Lithuania's resistance to external shocks will depend on the strength of its domestic policies and reforms. Were the external environment to improve rapidly, Lithuania could conceivably muddle through with moderate adjustments. Given recent fiscal trends, the potential for continued volatility abroad, and the high economic and social costs of a true downside scenario, pursuing such an option would be very risky. To guard against a loss of international confidence and limit risks to acceptable levels, Lithuania will need a more concerted adjustment of policies. In particular, it will need to reduce the current account deficit, not through efficiency-reducing customs tariffs, capital controls and other direct measures, but by targeting the sources of excess aggregate demand. This requires a near-term fiscal adjustment focused on extra-budgetary expenditures, backed by systematic structural reforms to limit quasi-fiscal deficits in key sectors.

6. The resulting reduction in risks will assist Lithuania to meet its other longer-term goals. Lithuania is among the countries on track for eventual membership in the European Union. This goal helps to define much of the structural, institutional and social policy agenda. The strong social consensus for its achievement works to make a protracted reversal unlikely. The speed with which EU membership is achieved, and the level of benefits which it eventually brings, are likely to depend on the depth and quality of Lithuania's future reforms. By rapidly completing these reforms, Lithuania will lay the foundations for a convergence of living standards towards EU levels and sustained reductions in poverty.

II. POLITICAL, ECONOMIC AND SOCIAL CONTEXT

A. Recent Developments

7. **Political economy.** Since the restoration of its independence, Lithuania has had three governing coalitions. Despite differences in emphasis on specific issues, the broadly market-oriented direction of reforms has remained consistent throughout, with majority coalitions allowing strong policy decisions once the need for these had been recognized. This past record and the role of prospective EU membership in promoting consensus on reforms combine to make any major changes in course following the parliamentary elections scheduled for 2000 unlikely. Nonetheless, Lithuania has at times responded to difficult problems with *ad hoc* non-market conforming policy actions which soften the adjustment path at the expense of long-run efficiency. A protectionist trade regime in agriculture and hidden and off-budget state support to key sectors, a major source of quasi-fiscal deficits (see below), are two examples of this approach. While subsequent measures to nudge the economy back on course (e.g. a December 1998 decision to cut planned government expenditures for that year by 0.7% of GDP) have so far worked to avoid major crises, their often *ad hoc* nature has further reduced efficiency and thus Lithuania's growth potential. Key issues in governance are discussed in *Box 2* below.

8. **Early reform history.** Following the collapse of the Soviet Union, disruptions to traditional foreign trade patterns, combined with tight macroeconomic policies, brought sharp drops in output and living standards. The April 1994 introduction of a currency board, which pegged the exchange rate at 4 litas to the US dollar, institutionalized tight monetary policy and raised confidence in the exchange rate. This confidence, as well as the slowly growing faith in the banking system, was severely tested by a late-1995 banking crisis. While the resulting loss of foreign reserves and credit squeeze dampened short-term

GDP growth, the combination of tight monetary policy, a concerted strengthening of banking regulation and supervision, and a deepening of structural reforms, ensured the stability of the litas and laid the foundations for a renewed acceleration of growth.

Box 2 - Key Public Sector and Governance Issues in Lithuania

Lithuania faces problems common to most economies in the region emerging from a system in which economic, political and judicial power was unified in a single state authority, and where corruption was widespread. The transformation to a market system poses four particular challenges for its public sector.

Public administration reform is a growing priority of the Government, especially as weakness in this area could hamper EU accession and management of the process towards it. Some important steps have been taken. The number of ministries has been reduced from 17 to 14 and a training strategy for EU accession has been prepared. A new Law on the Civil Service, aiming to ensure the independence of civil servants and improve their effectiveness, has been prepared but not yet approved by the parliament, where it is one of the first laws subject to discussion in open public hearings - a positive example of improved legislative transparency. A public administration institute is scheduled to open in 1999.

Formal *decentralization* of government responsibilities has been extensive. Its real impact is limited by weak capacity of local governments, especially as concerns the budget (limited allocation of funds based on government strategy and priorities, weaknesses in financial management), and by the lack of a tradition of municipal governance. A further wave of subnational reform is planned in which the number of municipal governments will be increased in stages, compounding the problem of inadequate capacity. The EU is supporting improvements in capacity to handle EU pre-accession and structural funds but these efforts need to be placed within a broader framework of effective public expenditure management. More work also needs to be done to strengthen external and internal auditing and financial control, in both ministries and local governments.

Progress in *legal and judicial reform* is particularly needed. The main immediate bottlenecks are staffing shortages, poor training and organizational problems, despite an increase in the number of judges and some improvements in their training. Many laws are obscure in spite of being overly detailed, thus permitting wide variation in interpretation. Court proceedings are lengthy, especially in commercial cases, hampering application of the new bankruptcy law. In late-1998, several laws were amended to allow more effective implementation of the bankruptcy law.

Corruption is a matter of concern to both the public and the Government. Empirical evidence is limited, but the general perception appears to be that corruption is below CIS levels and close to that in Central Europe. Relevant legal acts that took effect in 1997 include; a public procurement law (on which more work is needed for EU harmonization and to improve enforcement); a law on the compatibility of public and private interests in the public service; and a law on financing political parties. A "clean hands" commission has investigated some cases of abuse of official position. In January 1999, the Government approved a long-term program on prevention of organized crime and corruption. EU Phare is giving substantial support to efforts to map the nature and extent of corruption and devise a strategy to reduce it. The effects of these measures are still unclear, although there have been high profile cases of parliamentarians, ministers, judges and other officials charged with corruption being sentenced or dismissed. These efforts to strengthen detection and enforcement now need to be complemented with a broader strategic approach that focuses on prevention and public outreach. Simplification of complex regulations, rationalization of the regime of business inspections, and creation of more transparent tax and customs administration would reduce opportunities for corruption.

9. **Recent macroeconomic developments.** The economic crisis in Russia was a watershed for Lithuania's economy. The preceding two years were characterized by broadly favorable and improving macroeconomic outcomes (see *Table A* below). GDP growth rose from 3.3% in 1995 to 4.7% in 1996 and further to 6.1% in 1997. The steady decline in CPI inflation to 8.4% in 1997 was buttressed by the currency board and by a reduction in the consolidated fiscal deficit (including net lending but excluding

privatization revenues) from 4.4% in 1996 to 1.7% in 1997. The main negative trend during this period was a high current account deficit, which remained stubbornly around 10% of GDP from 1995 to 1997.

10. The Russian crisis had a deflationary impact on Lithuania. GDP growth, which had reached 7.3% in the first half of 1998, fell back to an estimated 4.7% for the year as a whole, still a robust rate given the changed economic environment. CPI inflation was cut to 2.4%, one of the lowest rates among transition economies, while producer prices actually fell. Fiscal outcomes deteriorated, with the consolidated fiscal deficit (as defined above) rebounding to 5.9% of GDP in 1998. (The financial deficit, excluding net lending, increased to a more modest 2.5% of GDP.) This reflected a combination of slower revenue growth, a policy response aimed at easing the shock to enterprises (including increased export subsidies and government purchases of surplus food products), the emergence under less favorable conditions of quasi-fiscal deficits accumulated in earlier years, and the start of the previously announced Savings Restitution Plan (see *Box 3* below).

11. From September 1998, monthly export and import volumes declined. For 1998 as a whole, the growth rate of exports of goods and services declined but stayed positive, while the growth rate of imports increased (see *Table A*). As a result, the recorded current account deficit rose further to 13% of GDP in the first 9 months of 1998.[1] The data as reported show this increase coming primarily from falling government savings, with increases in private investments and declines in non-government savings also playing a role. The impact of investment on the current account deficit appears weak. Capital goods imports represent only 15% of total imports, and are not correlated with total investment levels.

Table A: Selected Economic Indicators, 1995-2002 [1/]

	Actual			Estimate	Projected			
Indicator	1995	1996	1997	1998	1999	2000	2001	2002
(% change from previous period, in constant prices)								
Gross domestic product	3.3	4.7	6.1	4.7	3.5	4.5	5.5	5.5
Exports (GNFS)	9.2	3.6	6.5	2.0	5.0	7.0	8.0	8.0
Imports (GNFS)	2.3	3.6	4.2	6.2	3.5	4.5	5.5	5.5
Inflation (CPI, end of period)	35.7	13.1	8.4	2.4	4.8	4.0	3.0	3.0
(As% of GDP, unless otherwise specified)								
Gross domestic investment	24.7	24.5	26.5	26.8	26.1	25.6	25.3	25.0
O/w Gross fixed investment	23.0	23.0	24.4	23.3	23.1	23.6	23.8	24.0
O/w public investment	4.2	3.0	2.9	2.5	2.3	2.3	2.5	2.5
Gross national savings	14.5	16.0	16.7	13.3	13.0	14.7	16.3	17.4
Current account balance	-10.2	-9.2	-10.2	-13.5	-13.1	-10.9	-9.0	-7.5
Fiscal surplus (+)/ deficit (-)	-4.7	-4.4	-1.7	-5.9	-3.5	-1.5	-0.0	-0.0
Financial surplus(+)/deficit (-)	-2.2	-2.5	-0.9	-2.5	-1.0	0.5	1.0	1.0
Debt service/exports (%)	5.1	5.9	9.2	6.6	7.8	10.1	9.2	14.9
Foreign direct investment (net)	1.2	1.9	3.4	9.5	5.2	4.0	2.6	2.0

Source: Lithuanian authorities (for historical data) and staff projections.

[1/] See Annex B6 for a more complete list of key economic indicators.

12. **Structural reforms.** Macroeconomic stabilization provided the platform for implementing structural reforms. Privatization together with a rapid development of new businesses has spurred growth of the private sector, whose estimated share in GDP reached 70% by 1997. The privatization program, which was lagging in 1996 after the end of the first voucher-based phase, gained new momentum in 1997.

[1] The simultaneous sharp jump in "errors and omissions" (to +5% of GDP) makes the actual increase likely to be smaller. Still, the deficit is unlikely to be below 10% of GDP.

Strategic stakes in several large firms, e.g. telecoms and liquid fuels, have recently been sold. Most other sales appear on track, and will lay the basis for future private investment in infrastructure. However, delays have been experienced in the sale of two large state-owned banks, and in restructuring the power sector. In addition, mass privatization left many medium and large-scale enterprises with a weak structure of corporate governance. The resulting highly dispersed ownership structure often passed control of these firms to management insiders without the abilities, incentives and financial resources to pursue the needed restructuring.

13. The most important element of the structural reform agenda is the need to impose strict financial discipline on key sectors such as energy and agriculture. Restructuring of the agricultural sector has been delayed by tariff protection and subsidies, both of which were further increased following the Russian crisis. Past decisions to keep energy prices below cost-recovery levels led utilities to accumulate debts which they could not repay. Implicit or explicit government guarantees allowed these firms to continue operating under a soft budget constraint, and even to borrow abroad.[2] This unhealthy source of dissaving also increased the current account deficit. In the benign pre-Russian crisis period, some of these debts could be rolled over and thus hidden. This became harder in the post-crisis period. A significant part of the recent increase in the fiscal deficit reflects the takeover by the Government of large energy sector debts which had been called by foreign creditors.

Box 3 - The Lithuanian Savings Restitution Plan

In June 1997, the Lithuanian parliament passed a Law establishing the Savings Restitution Plan (SRP), the main aim of which is to restore the real value of residents' household deposits held at state-owned banks in February 1991 up to a per capita limit of 6000 litas (US$1500). The estimated total cost of the SRP is 3.5 billion litas, or around 8% of 1998 GDP. The main funding source for the SRP is privatization revenues, of which at least two-thirds must be transferred to an SRP special account at the Lithuanian Savings Bank (LSB). Remaining privatization revenues can be used at Government discretion for more general purposes.

The Law divides deposit restitution into four phases. Phase I, covering those over 85, the most seriously disabled, and previously politically repressed persons, and costing 443 million litas (1% of GDP), began in November 1998. Phase II, applying to those over 70, the disabled and large families, and estimated to cost 867 million litas (about 2% of GDP), is set to begin in April 1999. Phase III will include those above 60, and Phase IV all others. People wishing to keep restored savings in LSB time deposits are offered above-market interest rates supported by additional government subsidies.

The SRP adds to pressure on the already high current account and fiscal deficits and will mainly fuel consumption demand. Payments under the SRP have also placed downward pressure on interest rates, reducing incentives to save and leading to lower capital inflows and a loss of foreign reserves. The latter has increased economic vulnerability. The Government would be well advised to phase these large transfers in public expenditures over a longer period of time, and to place these funds in reserve during the interim period, in order to minimize potential macroeconomic risks.

14. A strong and deep financial sector is a prerequisite for savings mobilization to underpin longer-term reduction of the current account deficit, as well as for private sector development. Progress in this area has been mixed. The strengthening of banking regulation and supervision, along with formal deposit insurance, restored some confidence in the banking system. However, that part of depositor confidence which reflects perceived implicit guarantees on some large banks has come at the cost of hidden fiscal pressures. The low level of monetization and the still small 25% ratio of banking sector assets to GDP

[2] While electical energy prices have now moved closer to cost-recovery levels and the growth of domestic energy arrears has slowed, more progress is needed.

evidence a residual uncertainty. Privatization of the remaining state-owned banks plus further strengthening of supervision are key measures to spur savings mobilization. Supervision of non-bank financial institutions is less advanced than that of banks. Mass privatization led to the stock market listing of many small firms which are not public companies by nature, and thus to low levels of stock market liquidity. As elsewhere in the region, bonds markets remain underdeveloped. The growth of investment funds has been hampered by weak supervision and unfavorable tax treatment.

15. **Evolution of social conditions and poverty.** According to the Household Budget Survey, overall poverty has changed insignificantly during the last five years. In 1997, about one-sixth of the population fell below a poverty line defined as 50% of average expenditures (US$62 per month, or US$2 per day). The most vulnerable are young families with two or more children, long-term unemployed, single pensioners, the disabled and those who lost hope of finding work. Analyses of Household Budget Survey data show that the incidence of poverty is highest among those households where the breadwinner is younger than 30 or older than 60, families with small children and/or headed by a woman, and families with unemployed members. Pensioner households are not, as is often claimed, the poorest. Poverty among farmers and those living on allowances or scholarships is much higher. Poverty in rural areas remains higher than in urban areas, but the greatest poverty is in small towns.

16. Other indicators of social conditions have evolved favorably in recent years. In the early period of transition, official unemployment increased, while life expectancy fell sharply (especially for males), as did the UNDP Human Development Index. Life expectancy at birth began rising in 1995. By 1997, it reached pre-reform levels for men (65.9 years) and exceeded these for women (76.8 years). The 1997 UNDP Human Development Report made a positive assessment of trends in living standards and poverty in Lithuania, showing the Human Development Index improving. For the first time since 1990, official employment increased while the numbers of economically inactive and unemployed people fell. Registered unemployment stood at 7.1% by 1996 and fell further to 5.9% in 1997. However, according to labor survey data there are two to three times more unemployed than those registered. Unemployment varies significantly between regions, and between urban and rural areas. The chances of finding new jobs are strongly linked to the level of education, but the unemployed tend to lack skills most in demand in the current labor market. The Russian crisis will have an adverse impact on social and economic conditions, and inevitably worsen poverty. While the transformation of the rural economy needed to improve competitiveness and EU prospects will raise rural unemployment and poverty. This impact will have to be monitored, and policies and programs adjusted accordingly.[3]

B. Economic Prospects

17. Lithuania's development is currently characterized by political stability, solid economic growth, low inflation, reasonable progress on structural reforms, and mixed progress on fiscal sustainability. Given the increased risks posed by the confluence of recent fiscal easing, a growing current account deficit and a less favorable external environment, maintaining creditworthiness will require additional efforts to limit economic vulnerability, with a focus on fiscal consolidation to raise government savings and foreign reserves. This includes a reduction by around 6 percentage points of GDP of the consolidated fiscal deficit (including net lending) from 1998 to 2001, focusing on limiting extra-budgetary expenditures rather than the social safety net. It also requires containment of structural sources of fiscal

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[3] Lithuania's key challenges in reducing poverty during the CAS period are discussed in *paras. 28(ii)* and *29*. While poverty reduction is an overarching goal of the proposed Bank Group program, the assistance most directly targeted at this goal is described in *Box 5* and *paras. 41* and *46(b)*. This includes an analysis of poverty in rural areas early in the CAS period, and a lending program strongly focused on strengthening human development and social assistance.

pressures by rapidly privatizing banks and enterprises, and by imposing a hard budget constraint on energy utilities while permitting the price increases and efficiency improvements which they need to service accumulated debts and undertake needed investments.

18. Assuming progress in these areas,[4] growth is expected to fall only marginally from 4.7% in 1998 to around 3.5% in 1999, before rising to 5.5% in 2001 and 2002 (see *Table A* above)[5]. The growth rebound would primarily reflect sustained competitiveness in western markets, partial recovery in trade with the CIS region, and productivity improvements resulting from recent FDI, privatization, and tightened financial discipline. Inflation would rise from 2.4% in 1998 to 4.8% in 1999 before falling to 3% in 2002. The share of gross fixed investment in GDP would rise slightly from 23.1% in 1999 to 24% in 2002. Gross national savings would bottom out at 13% of GDP in 1999, rising to 17.4% by 2002, primarily due to higher government savings reflecting fiscal tightening and improved tax administration.

19. Under these assumptions, controlled inflation, productivity gains, and a gradual restoration of competitiveness in CIS markets are expected to lead to a recovery in the export growth rate to 8% by 2002, with import growth reaching 5.5%. Since these growth rates approximate that of real GDP, the share of trade in GDP is projected to stay relatively constant during the CAS period. The current account deficit would peak at 13.5% of GDP in 1998, reflecting the effects of the Russian crisis and recent fiscal expansion. It would then fall gradually to 7.5% in 2002, due to increased national savings supported by fiscal tightening and financial market development. In the first half of 1999, this deficit would be partly financed by drawing down foreign reserves. FDI will decline from the record level reached in 1998 due to the privatization of the telecoms utility (see *Table A*), but will remain an important source of external financing, supported by further privatization and an improved environment for greenfield investments. The combined effect of fiscal tightening and improved global conditions would restore some external borrowing, but at levels which maintain a squeeze on imports, growth and the current account deficit.

20. ***Alternative scenarios.*** In the absence of fiscal tightening and/or substantial improvement in Lithuania's access to foreign capital markets, a less favorable scenario emerges in which Lithuania becomes vulnerable to bullet repayments of foreign debts (see *para. 24* below). Without good access to capital markets at that time, Lithuania could face a liquidity, import and investment squeeze, and thus a further growth slowdown in 2000. This would undermine the budget and/or force large firms into bankruptcy, with a possible ripple effect on banks. Lithuania's progress towards integration into the European economy would slow down. However, a strong policy response focused on fiscal and financial measures, possibly combined with additional support from the Bank and Fund, would ensure that these setbacks were temporary and that growth would be restored. In the unlikely event of a failure to initiate such a policy response, the impact would be severe. Fueled by a depreciating exchange rate, inflation would rebound, growth and investments would stall, and prospect of EU accession would be postponed.

21. A less likely but more favorable scenario would be driven by a more rapid or significant improvement in the external environment (higher demand in key trading partners, improved sentiments

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4 The Government is currently working to identify expenditure savings of up to 1.2% of GDP in the approved 1999 budget. If the Government is able to successfully implement its announced plans of substantially limiting the deficit for 1999 and achieving a balanced fiscal deficit (excluding net lending) in 2000, it would make an important contribution to limiting the level of macroeconomic risks.

5 There are differences between the economic projections of the Bank and those of the Government, with the latter generally being more optimistic. In early 1999, these differences were significant, with the Government forecasting GDP growth of 5.5% in 1999 and 6.5% in 2000. In March 1999, the Government reduced its GDP growth forecasts to 3.7-4.1% for 1999 and 5.2% for 2000, only modestly above the levels forecast by the Bank. As a result, there is now substantial convergence in the growth forecasts of the Government, Bank, other international institutions and the private sector.

towards emerging markets). Greater access to foreign capital, lower interest rates and higher foreign demand would fuel a recovery of export and GDP growth, as well as further progress towards integration into the European economy. The resulting improvement in fiscal balance, combined with the strong incentive created by the prospect of more rapid EU accession, would shift the government's focus towards the remaining major structural reforms.

C. External Environment and Financing Requirements

22. **External environment.** As outlined in *paras. 4* and *5*, Lithuania's external environment and the risks associated with it have been strongly affected by the Russian economic crisis and its repercussions. Until August 1998, a combination of exchange rate stability, gradual trade liberalization, and favorable global and regional trends allowed trade volumes to expand in line with GDP. The share of exports of goods and services in GDP rose slightly from 53% in 1995 to 54.5% in 1997. Following extensive reorientation towards western markets in the early reform period, the broad direction of trade stabilized, with turnover with the EU slightly above that with the CIS region. The latter links were significant enough to become a major transmission channel for the effects of the Russian crisis. The resulting loss of CIS markets spurred a new wave of reorientation, with the share of the CIS in exports falling from 46% in 1997 to 36% in 1998. As noted above, this also worked to increase the current account deficit to 13% of GDP for the first 9 months of 1998. Due to external turbulence, the planned shift from the currency board to a normal fixed exchange rate has been delayed to at least 2000.

23. Net foreign direct investment (FDI) into Lithuania grew from 1.2% of GDP in 1995 to 3.4% in 1997. During the same period, improvements in Lithuania's creditworthiness allowed the Government and enterprises (including SOEs) to tap foreign credit markets on increasingly competitive terms. As recent FDI has primarily gone into acquiring existing assets, rather than being directly linked to new physical investment, its major initial impact has been on central bank reserves. The successful July 1998 sale of a 60% stake in its telecoms utility to foreign investors raised foreign reserves by the equivalent of 5% of GDP. This significant boost in external liquidity provided important financing immediately after the Russian crisis, which had a negative impact on debt creating capital inflows. Despite the resulting reserve outflow, Lithuania ended the year with a net increase in foreign reserves. The Government's ability to issue DEM 70 million of Eurobonds late in 1998, albeit on unfavorable terms, signaled a modest return to the capital markets.

24. **Financing requirements and debt service.** Even after concerted efforts aimed at its reduction, Lithuania's current account deficit will remain at levels which require substantial foreign financing to sustain investment, economic restructuring and improvements in living standards. Lithuania's balance of payments will be additionally stretched by increases in debt service payments reflecting three factors: rising debt levels, the ending of grace periods on some loans, and two bullet repayments of large loans. The coming due of loans received from the G-24 and EU will increase debt service ratios from 7.8% in 1999 to 10.1% in 2000, while the maturing of a Government Eurobond will raise this further to 14.9% in 2002.

25. Starting in 1999, the central government has targeted a balanced state budget (excluding net lending).[6] A deepening T-bill market underlies its decision to set an upper limit of 18% of GDP on its foreign debt, compared to actual levels of 14.6% in 1996 and 16% in 1997. For these reasons, the bulk of foreign financing during the CAS period will go to the non-government sector, and to a lesser extent to local governments. Official external debt stocks and debt service are expected to remain moderate. The Government's successful March 1999 issue of a EUR 200 million (2% of GDP) Eurobond, albeit at a

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[6] We assume somewhat slower GDP growth than envisioned in the 1999 government budget, and thus a modest deficit by this definition as well.

relatively high interest rate, signaled a further return to the capital markets. Supported by progress in stabilization and an improved global environment, net capital inflows could rebound further in late 1999. Levels of FDI are difficult to predict, but will decline from the record level achieved in 1998. The lower drawing power of Russian export markets and the fact that many attractive enterprises have already been privatized, could lead to a temporary fall, but broadly sound fundamentals and opportunities for buying private firms should maintain investor interest. Private non-equity flows are expected to remain steady. Bilateral sources and multilateral institutions are also expected to continue providing Lithuania with additional credit resources. While there are peaks in official debt servicing in 2000 and 2002, in the absence of simultaneous exogenous shocks and policy missteps, the potential volatility of short-term flows should not become a threat to Lithuania's refinancing capacity and currency stability.

III. LITHUANIA'S REFORM AGENDA

26. To achieve sustained growth and steady progress towards EU accession, and to meet the high legal, institutional and physical standards and level of competitiveness required for EU integration, Lithuania will need to pursue a comprehensive agenda of strengthening macroeconomic stability and continued structural reforms. The latter includes institutional strengthening in both central and local public administration, as well as increased and better planned public investments. It also includes renewed attention to developing the country's human resource base, improving the quality and efficiency of social services, and providing a social safety net to protect the poor and maintain social cohesion. ***The key policies required to meet these challenges are described in more detail in the attached matrix.***

A. Maintaining Macro-Financial Stability

27. This is a precondition for sustained progress on structural reform and social and human development. It hinges on forcefully addressing the risks resulting from the combination of continuing high fiscal and current account deficits, the past and ongoing accumulation of government contingent liabilities and quasi-fiscal deficits, and the volatile external environment in the aftermath of the Russian crisis. The following measures, taken in close consultation with the IMF, will be crucial for mitigating these risks:

- Enhancing fiscal sustainability through rationalization of expenditures, especially extra-budgetary expenditures; controlling net lending to the non-government sector; raising revenue collection; and strengthening the budget process, its transparency and its institutional underpinnings;
- Eliminating contingent liabilities and other sources of quasi-fiscal pressures by imposing a hard budget constraint on large state-controlled enterprises and banks, including through ending the policy of explicitly or implicitly guaranteeing their financial liabilities; and
- Strengthening the financial sector through privatization of the remaining state-owned banks and the state insurance company; and upgrading regulation and supervision, especially of new private pension funds and other non-bank institutions.

B. Implementing the Policies and Programs Identified as Central to EU Accession

28. This includes formal requirements of the *acquis communautaire*, as well as policies which increase the economy's ability to compete in the post-accession period and which speed the convergence of incomes towards EU levels. The wide scope and depth of the pre-accession agenda allows the Government little room for maneuvre beyond transition periods in some areas. While it must advance on all fronts, four challenges stand out:

(i) ***Enhancing competitiveness.*** While its recent record on private sector led growth is encouraging, Lithuania must do more to make its growth dynamic and sustainable. First, the privatization agenda needs to be completed. Lithuania has largely finished small-scale privatization and partially sold most large firms, but some strategic stakes in large infrastructure enterprises, many minority holdings, and real estate remain to be divested. Second, there is large agenda of post-privatization reforms needed to improve the environment/institutions for private investors. Much of this agenda of "second-generation" challenges is common to all economies in transition. In Lithuania, particular focus needs to be given to:

- strengthening corporate governance (which has been weakened through the control of enterprises by management insiders, dispersed ownership of illiquid shares, and some cases of direct ministerial influence on management decisions), including through improved application of the bankruptcy law, and through legal changes facilitating the creation of investment funds and protecting the rights of small shareholders;
- the judicial system, where both law and legal practice need modernization and capacity bottlenecks severely hamper the processing of bankruptcy and other commercial cases;
- strengthening the legal and institutional basis for regulating energy and infrastructure industries and general anti-competitive behavior; and
- limiting overt and hidden subsidies and other state supports to enterprises.

The deepening and strengthening of the financial sector will be an important component of the drive for competitiveness in the EU context.

(ii) ***Raising rural productivity.*** Achieving long-run increases in rural incomes and meeting the large formal EU accession agenda in agriculture will require institutional strengthening and improvements in agricultural efficiency and product quality. Since agriculture accounts for around 11% of GDP but 22% of recorded employment, and the restructuring of agro-processing is still underway, a shakeout looms which will further increase already high rural unemployment, underemployment and poverty. This will also have fiscal implications. Managing the difficult short-term trade-off between efficiency improvement and unemployment, while achieving the desired increase in rural productivity, will call for improvements in the private sector environment (including completing land reform, strengthening the legal basis for the land market, and permitting greater use of the forms of collateral available in rural areas), selected investments in infrastructure and public goods, investments in human capital (education and training focused on the growing sectors of the labor market), and social protection measures. The success of such a market-supporting rural development strategy will be linked to the ability of local governments to develop strategy, prepare and manage investment projects, and supply counterpart funds.

(iii) ***Strengthening public administration capacity and institutions at the central and sub-national levels.*** Recent performance and major issues in these areas were extensively analyzed in *Box 2* above. Lithuania's main challenges at the **central government** level include: strengthening the budget process through increasing the role of strategic analysis in budget planning; improving expenditure management, audit and control systems; continuing civil service reform by upgrading implementation capacity and inter-ministerial coordination; and streamlining the public sector in the face of a hard budget constraint. Training needs are extensive, and the anti-corruption effort needs to be further deepened. Resources and assigned functions of **local governments** remain mismatched. This needs to be addressed by clarifying expenditure assignments and creating a more stable inter-government distribution of revenues. Local governments also require significant improvements in capacity, especially for policy and budget formulation; basic financial management and control; and effective service delivery.

(iv) ***Upgrading infrastructure and environmental quality and management to meet EU accession standards.*** The large investments required in these areas are constrained by limited (albeit improving) capacity to plan and develop projects; limited access to long-term financing; and inadequate

rules for blending public revenues, loans and grant funds. Even though Lithuania is a small country, much of the upgrading and maintenance of infrastructure and environmental management will be done at the local level, where the challenges of modernization, quality improvement, financial strengthening and possible privatization are most acute in district heating, water and waste water utilities. While restructuring away from heavy industry has cut overall pollution levels, these remain relatively high, especially in urban areas. Maintaining this positive trend under economic growth will require more investment, as well as increased monitoring and enforcement capacity, particularly at the local level. In addition to an enormous environmental clean-up task, Lithuania faces the challenge of upgrading environmental management to levels required for EU accession, developing its hazardous waste management system, and dealing with nuclear safety issues.

Lithuania's national infrastructure is relatively well developed compared to that of many of its neighbors. For example, the country's main cities are linked by a good system of major highways. Nonetheless, Lithuania will have to undertake large investments and upgrading to meet EU accession standards and reduce transport costs, with the greatest needs being in railways and ports. Improvements in traffic safety and management are also urgent. This will require reform of Lithuania's transport policy, legal and regulatory framework and institutions. Restructuring the important power sector, where the reform agenda remains extensive and difficult, will be a central aspect of infrastructure development and the accession negotiations, as well as of reducing persistent quasi-fiscal deficits. This will require: clarifying the long-term sectoral strategy; introducing a well-functioning regulatory framework; adjusting domestic tariffs to medium-run cost recovery levels (including adequate return on investments, meeting financial obligations and allowing for new investments); controlling the growth of export arrears; comprehensive restructuring of Lithuanian Energy (including increased accounting transparency, unbundling of generation and distribution units, partial privatization, and strengthened corporate governance); and further development of options for closure of the *Ignalina Nuclear Power Plant*.

C. Designing Cost-Effective, Financially Viable Social Safety Net and Human Development Programs

29. Lithuania faces the challenge of mitigating short-term and structural *poverty*. In spite of rising average incomes, the benefits of reform do not yet reach many sectors of society, especially in rural areas (see *paras. 15* and *16* above). Over the long term, sustained economic growth and improvements in productivity will be the main engine of poverty reduction, complemented by policies which facilitate labor market adjustment, enable access to education and health services, and provide adequate pensions or benefits. In the short term, the transition to a market economy is not finished. Profound structural change will bring a shakeout which can continue for several years. This shakeout will reflect less the impact of privatization, which is well-advanced, and more the impact of post-privatization restructuring spurred by a gradual strengthening of financial discipline. There will be fewer people who work but are not paid regularly, or who are on forced leave or truncated working hours, and more who will lose their jobs altogether.

30. Lithuania has restructured its system of *social assistance* benefits and transfers, including decentralization of provision to community level. The ability of this system to reach those regions and persons most in need is limited by the imperfect targeting of services, weak implementation arrangements, and financial constraints on local governments. As a result, many poorer families are not reached, while wealthier households receive assistance. Redesigning the system requires thorough analysis of the characteristics of the poor and the development of appropriate poverty reduction policies, followed by a strengthening of implementation capacity and monitoring of targeting.

31. In reforming its *pension, health and education* systems, Lithuania faces many of the same challenges as other economies in transition. Demographic shifts, broad entitlements, increases in

disability certifications, and tax evasion are eroding the long-term financial sustainability of its pension and health systems. Unless reformed, the pension system will fail to provide income support for the elderly, and will be a burden on the fiscal system. Completion of the steadily progressing pension reform requires increasing contribution compliance, reducing entitlements, and moving the system to a partially funded basis while introducing effective supervision of private pension funds. The reform of *health* care has been much less extensive. Aggregate health indicators are lower than in current EU member countries, while the health sector suffers from low efficiency and quality of service delivery, and from limited access. The latter works to limit the ability of the poor to move out of poverty. Key challenges for Lithuania include introduction of a population-based regional resource allocation formula for health care financing, strengthening managerial capacity and accountability, optimization of excess capacity, and implementation of a public health strategy to address the changing burden of disease. Nearly one-quarter of Lithuania's public expenditures (excluding transfer payments) go for education. Much of this is inefficiently used because of poorly designed school buildings, schools with small enrollments, and excessive staffing levels reflecting over-specialization of teachers. Key challenges in education include: raising cost-effectiveness through physical upgrading, modernization of equipment and improving incentives for efficient resource use; reforming vocational, professional and higher education to meet EU accession requirements; and improving the uniformity of quality and access to education across space and income groups to promote growth and reduce poverty.

IV. THE BANK GROUP'S COUNTRY ASSISTANCE STRATEGY

A. The Role of the Bank Group to Date

32. Lithuania joined the World Bank in July 1992. Bank lending began a few months later with a fast-disbursing Rehabilitation Loan for critical imports. During the following three years, the Bank supported investment projects designed to implement structural reforms and build capacity at the sector and local levels, as well as a line of credit through commercial banks for small and medium enterprises. Another important area of Bank involvement was support for the international effort to clean up the Baltic Sea, with two projects dealing with major sources of water pollution. The non-lending work was oriented to analyzing the steps needed to implement the structural reform agenda. A particularly important contribution was the first public expenditure review for Lithuania, which provided the context for a meeting of the international community to discuss their support programs for the country.

33. The banking crisis in 1995 led to a request for the Bank to provide balance of payments support through a Structural Adjustment Loan. This was focussed on the effort to clean up the quasi-fiscal deficits which had emerged through the growth of energy arrears, and also to improve the situation of the commercial banks and set them on the road to privatization. While the loan was successful in achieving these objectives, it did create some strains in the relationship between the Bank and the Government. The loan was negotiated and signed with the outgoing Government before an election. Although we were careful to consult with the then opposition, the new Government found the timing of some of the previously agreed conditionality awkward. Given the public focus at that time on economic policy required for EU accession, the Government felt it had little option except to reach agreement on the conditions, to avoid the perception that the Bank was dissatisfied with the policies being pursued. Subsequently, the Government has been extremely sensitive to this possible nexus between performance on Bank or IMF conditionality and its negotiations with the EU, making it reluctant to request significant policy-linked lending from the Bank or the Fund. The last Extended Fund Facility arrangement with the IMF expired in October 1997.

34. In contrast, the appreciation in Lithuania of the Bank's technical advice and support has been unambivalent, whether delivered through loans for investment projects or through non-lending services. The Bank is seen as a useful partner at the project level and as a supplier of valuable technical inputs,

particularly related to institutional issues in which there is little experience in Lithuania. Even when the Bank's formal leverage has been limited, its influence on policy-making has been substantial. In parallel with IMF work on the macroeconomic side, the Bank's analysis of structural reform priorities establishes a yardstick against which progress can be measured and evaluated. In particular, the Bank's work has brought to light the problems associated with the quasi-fiscal deficit and led to increased focus on this important potential source of economic instability. These problems were the focus of a major Bank study on the steps Lithuania needs to take to complete the structural policy agenda.[7] While there have been difficult periods in the dialogue as described above, it has always been characterized by a respect for the motives of the Bank on the part of our Lithuanian counterparts and vice-versa. This mutual respect is reflected in the largely positive outcomes of the client survey, which at the same time identified a number of areas where the Bank needs to be more sensitive and proactive. The proposed response to these is described in *Box 5* below.

Box 4 - Lessons From Past Experience with Projects

Experience thus far, as well as a (broadly positive) QAG assessment of supervision in the Siauliai Environment project, suggest several ways to improve selection, design, preparation and implementation of Bank projects in Lithuania. These lessons, a summary of which is provided below, will be incorporated in the processing of bank supported activities during the CAS period.

First, projects should be *selected* in those sectors where the Government has a well-defined strategy and sufficient implementation capacity, and where a productive policy dialogue has been established. This has been especially critical for ensuring a positive impact of pilot projects. Careful consideration of supervision and staffing requirements should also be an integral part of project selection. Partnerships with other donors have been most successful in cases when the client, donors, and Bank are equally committed to a common priority, e.g. cleanup of the Baltic Sea, and when partners have been fully engaged from identification through supervision, rather than viewed mainly as co-financiers. These lessons have been incorporated in the design of the Municipal Development project (see *Box 6* below).

Experience with *design and preparation* shows the importance of consistency with the country's priorities and its stage of development, as well as of national and local government input. The Bank's emphasis in the Power Rehabilitation project on developing alternative non-nuclear capacity was not fully consistent with country priorities, while the requirement in the Private Agriculture Development project to channel credits through commercial banks proved premature. Both projects have had a mixed performance record. In contrast, design of the successful Social Policy and Community Services project was left largely to the local grassroots level. The QAG review identified the grounding of projects in solid sector work and the full integration of procurement staff into project preparation as other contributors to success.

Project *implementation* (the experience with which is summarized in *Section C* below) has at times been hampered by insufficient institutional capacity to coordinate and manage projects. This capacity can be improved by closely integrating project implementation units with regular administrative structures, which also promotes the dissemination of technical assistance well beyond the institution which directly deals with Bank or other donors. The QAG assessment also identified a stable project team and adequately funded supervision as factors contributing to good implementation. In addition, successful modification of problematic projects would be facilitated by flexibility during preparation and implementation, a clear client/stakeholder orientation, and a strong emphasis on field-based staff supervision (see *Box 5* below).

35. An increasing share of responsibility for both our operational activities and the policy dialogue has been taken on in the past two years by our office in Vilnius. Since 1993, the work of the office was overseen by a Regional Mission for the Baltics headquartered in Riga, Latvia. On July 1, 1998, the Country Unit for Poland and the Baltics was established and decentralized to Warsaw, Poland. Given the

[7] Lithuania: '*An Opportunity for Economic Success*' (World Bank Country Study, 1998).

proximity of the Country Unit, the Vilnius office was turned into a separate office, headed by a national staff member. This forms part of the Country Unit and reports to the Country Director in Warsaw, who maintains an agenda of quarterly visits to Lithuania to review programs and project implementation and discuss country strategy, and to meet members of civil society and the donor community. These are supplemented by *ad hoc* visits of the Country Director and Country Unit staff to participate in key meetings or missions, or to troubleshoot on implementation issues. The objective is to ensure maintenance in the new structure of the effective role previously played by the Regional Mission. A further important innovation supporting the planned increased role of IFC in Lithuania is the decision to operate the Vilnius office as a combined World Bank/IFC office with sharing of costs and some staff members, and with direct involvement of Warsaw-based IFC staff in appraisal of investment projects.

Box 5 - Results of the Client Survey

The Bank conducted a Client Survey in Lithuania in November 1998 to improve the understanding of clients' perceptions and priorities, identify areas in Bank performance and Bank-client relationships which need improvement, increase responsiveness to clients, and provide input into the proposed CAS. Those surveyed included senior government officials, public and private enterprise managers, legislators, think-tanks, NGO and media representatives, and other donors. A remarkably high response rate of 78% was achieved.

Main findings. The Bank scored highly in the following areas: technical competence, reliability in delivering on commitments, accessibility, provision of explanations and assistance with Bank procedures, clarity of communication, knowledge about international best practices, and accuracy in concentrating on Lithuania's key development priorities. The Client Survey also suggests that the staff is viewed as competent and has high integrity and energy. The marks are less flattering and there is room for improvement in adjusting to local circumstances and making use of local expertise. Bank rules and regulations are often seen as too rigid and inflexible. While respondents gave relatively low priority to the goal of poverty reduction, the Bank is also not rated high in effectiveness at reducing poverty, although it scores better on this count than most other donors.

Key actions in response to survey. These fall under three broad areas:

Improved communication to better explain the Bank's positions. A full time local External Affairs Officer has been hired. The notion that the Bank does poorly on poverty is partly an issue of communications, as the development objectives in its operations are not always perceived to be linked to poverty. Given the depth of the initial decline in incomes, the Bank's past work in Lithuania (with the notable exception of the highly successful Social Policy and Community Social Services project) was strongly focused on reducing poverty through raising growth potential. The increased emphasis in the proposed CAS on work more directly targeted at poverty, beginning with the survey of rural living standards, should work to reduce this perception. The Bank will also strive to achieve a more extensive discussion of its objectives, operations and procedures with a wider group of stakeholders, in order to achieve broader ownership and support for Bank projects through enhanced visibility and consultation.

Actions to make better use of local expertise. This includes expansion of the Vilnius office and increased responsibilities of local staff in execution of Bank-supported programs (supervision in particular). Lithuanian staff who have previously worked on Bank-funded contracts in Lithuania are now working elsewhere in the region. We also plan to increase the use of Lithuanian experts in carrying out economic and sector work.

Actions to adapt to changing local conditions. An important role will be played by the increased use of the staff of our resident mission for project supervision. This will allow quicker feedback and a better understanding of the constraints faced by our counterparts. The recent restructuring of the Private Agriculture project is an example of this approach where the financial specialist in Vilnius was able to link slow disbursement to the relative disadvantage faced by commercial banks through lower lending spreads for agriculture relative to what they were receiving under the Bank's Enterprise and Finance project. We were then able to approach the Government to adjust the spreads with a consequent strong improvement in project performance.

36. Lithuania joined both IFC and MIGA in 1993. IFC has approved four projects in Lithuania so far: (i) financing expansion and modernization of a textile mill, with German sponsors; (ii) a credit line to support SMEs in the Baltic States and Poland; (iii) an equity investment in a venture capital fund (with Danish sponsors) supporting medium-sized companies in the Baltic States; and (iv) a loan for modernization of a color TV picture tubes producer. IFC has also conducted technical assistance projects including: (i) advisory work on securities markets and leasing regulations; (ii) review of opportunities for IFC's involvement in SME financing; and (iii) assessment of modernization needs of industrial companies following privatization. Lithuania is a member of MIGA, which has so far not issued any guarantees, but has four preliminary applications pending. Lithuanian representatives have participated in MIGA-sponsored meetings on investment promotion, and the country is an active user of MIGA's Internet-based information dissemination facilities.

B. The Proposed Country Assistance Strategy

37. With the completion of the first generation reforms and the establishment of a market economy in Lithuania, the Bank's focus is shifting to a second generation of programs designed to deepen the current reforms with a view to EU accession, to build capacity in municipal and local institutions which will have the primary responsibility for carrying out EU financed programs during the accession period, and also very importantly to support those social areas which are not part of the immediate requirements for accession, but which will figure prominently in Lithuania's ability to take advantage of eventual EU membership and to reduce poverty.

38. **Partnerships.** Partnerships with other ***donors*** and effective aid coordination are important parts of our strategy (see *Box 6* below). This is particularly true in the environmental sector, where one commonly agreed priority is the clean-up of the Baltic Sea. Nearly all Bank-supported projects in Lithuania have been carried out with substantial support from the Nordic donors in particular, who recognize Bank project preparation and supervision as providing the needed discipline and framework for their bilateral programs. Both other donors and the markets derive some comfort from an ongoing Bank presence at a reasonable level. The Government also sees the Bank as a catalyst in generating grant funds, e.g. for environmental management purposes, capacity building and training at all levels of government. Now we are entering a new phase with partnerships with **IFIs** and the EU in the accession process. This is described below. Partnerships with **NGOs** have so far been less extensive than those with donors, partly reflecting their early stage of development. However the Bank's relationship with environmental NGOs is open and mutually supportive.

39. **Mix of Instruments.** While a modest 'steady state' of lending operations continues to be supported, the Government has been very clear that it would like the emphasis to shift towards the Bank's policy and technical advice and analysis, and towards IFC financing of the private sector. While there is an appreciation that Bank technical support is often best delivered through project lending, the Government sees only a modest role for new Bank loans. Conventional CAS presentations which show progressively higher lending levels associated with better policies are therefore not particularly relevant here. Instead there is a steady state in which the Bank maintains a modest lending presence over a range of satisfactory policies, with the major focus of these being to assist in the effort of the international community to ensure steady progress towards EU accession.

40. **Strategic Focus.** The proposed assistance strategy covers the three main areas linked to the Government's priorities – ***human development***, ***macro-financial stability***, and ***EU accession***. *The attached matrix provides more detail on the links between the priorities and the specifics of program design. Annexes B3* and *B4* highlight our major planned assistance efforts. The proposed CAS is extremely selective. The IBRD lending program is focused on only two areas, partly due to IFC's ability

now to take the lead in most lending directed to the private sector. We will undertake no more than two major economic studies per year. Our advisory and analytical work will focus on key sub-themes where our comparative advantage leaves us well placed to respond. At the same time, the broad nature of the EU accession agenda means that we will continue to maintain a general policy dialogue in some areas not covered by projects or major studies, as well as maintaining some "response capacity" to manage specific requests from the Government. Other factors influencing the composition of non-lending services include concrete Government requests, the priorities of the EU and other international agencies with larger programs than the Bank, and the overall size of our operational budget.

Box 6 - Donor Coordination in the Municipal Development Project

Lithuania's Municipal Development Program (MDP) is expected to be supported by a US$20 million World Bank line of credit. At the request of the Government, the World Bank approached Finland, Denmark and Sweden as well as the Nordic Investment Bank and European Investment Bank to coordinate support for subprojects under the MDP. An intensive effort to develop one investment window for municipalities and a well-coordinated approach to sub-project preparation, capacity building and investment support was launched. Donor inputs were solicited in project design and careful consideration was given to the longstanding Nordic country experience in related urban sectors.

The objectives of collaboration under the MDP are four-fold: (i) to provide a real opportunity for all funding partners to leverage Bank involvement, and vice-versa, and quickly expand the combined reach of their respective resources; (ii) to focus donor-related technical assistance and investment support toward subprojects prepared under an established and mutually acceptable preparation process; (iii) to assist in enhancing parallel activities in technical assistance and investment where donor, IFI, and EC efforts are similar in nature but are directed at different target audiences or sectors (i.e. local government vs. national administration); and (iv) to provide a formal intermediary that helps coordinate activities at the local level.

An important element to this effort is building local capacity to effectively coordinate donor activities. A strong effort was made to build capacity in the Housing Credit Foundation (HCF), the Project Implementation Unit for the MDP, by involving it in the donor consultations and giving it direct accountability for donor coordination. The HCF will coordinate the TA package under the MDP Loan and help municipalities match their needs with sources of available finance. The HCF would be required to convene periodic donor partner meetings, together with local stakeholders, to update them on its activities, establish an indicative funding envelope for the coming period and facilitate dialogue on urban sector issues. In addition, the Association of Local Authorities in Lithuania will participate in this process and may eventually take over subproject preparation assistance as it gains experience in the field. It is hoped that this effort would help to establish a systematic mechanism locally that helps to share information and coordinate support for urban sector work in Lithuania.

41. **Help Lithuania design and finance reforms and institution building in social security, health, education, and social assistance.** The Bank's strength in major human development reforms, combined with the more limited agenda of other donors in these areas, makes this a clear focus of our strategy. Our main aims are to increase the cost-effectiveness and financial viability of social spending, raise the quality of service delivery and reduce poverty. To ensure that Government policies and our own support are well-targeted to poverty reduction, we plan to deepen our analysis of the incidence of poverty, beginning with an assessment of rural living standards. The results are expected to provide useful inputs for the design of social or regional policies and Bank projects, and possibly to suggest further interventions to be supported by the Bank.

42. Specific support for pension reform will focus on policy assessment, developing a funded pillar, demographic and financial projections, and private pension supervision. A new health project (FY00) will support improvements in the health financing system, hospital restructuring and primary health care development programs in four pilot regions. IFC is conducting a study of opportunities for private

provision of health insurance and health care. We will also assist Lithuania on education policy, financing mechanisms, expenditure control, and curriculum development, through a project later in the CAS period (FY02). The main vehicle for our support on social assistance will be a follow-up to the successful FY97 Social Policy and Community Social Services Project (FY01).

43. **Help Lithuania design and implement integrated policies for macroeconomic and financial stability.** Our strategy focuses on three areas. *First*, our support for understanding and reducing macro-financial vulnerabilities will include regular macroeconomic monitoring and economic analyses, following on from the recent Macro-Financial Vulnerability Review. This work will involve active collaboration with the IMF and Lithuanian experts. Future support for improving fiscal sustainability could include helping to strengthen tax and customs revenue collection.

44. *Second*, while the Government has expressed a clear preference not to use IBRD (or other officially guaranteed) funding for the financial sector, this remains an area where institutional strengthening is important. Following the macro-financial review, we expect to assist development of the regulation and supervision of non-bank financial institutions as the highest priority.

45. *Third*, we will continue to assist Lithuania in developing its overall structural reform program with a focus on reforms and policies most critical for EU accession. We could also consider supporting the structural reform agenda through a second adjustment loan. This might be needed if, despite good policies, the high costs of borrowing for emerging markets makes it difficult for Lithuania to refinance the large repayment of external credits which falls due in mid-2000. Our past and ongoing analytical work on macro-financial and structural issues would position us to move quickly with financial support if significant deterioration in the external environment would create an earlier need for financial support and the authorities respond with acceptable policy adjustment.

46. **Help Lithuania implement the agenda of measures, reforms and investments needed for EU accession.** The Memorandum of Understanding between the World Bank, EUPhare, EBRD, EIB, the Nordic Investment Bank and IFC provides a basis for partnership in assisting the Government. The Bank has been asked by the Government to help carry out an economic study to provide a general framework for Lithuania's EU accession objectives and removal of major economic and institutional constraints to accession (along the lines of studies for Poland, Slovenia and Estonia), with emphasis on the areas outlined below. The presence of partners means on the one hand that we need not lend in all areas of importance, but it also means that we can have a powerful impact by helping the Government coordinate donor efforts and by providing an analytical basis for the key programs which need to be implemented. In all four areas cited below, we plan therefore to continue our analytic work and policy advice, whether or not specific lending operations are judged an important element in the strategy.

(a) Enhancing competitiveness: Partners: EBRD, **IFC, MIGA, World Bank advice and analysis only:** Our proposed strategy includes analysis and technical assistance to help Lithuania meet key challenges. Initially, this will focus on the regulatory environment for infrastructure and utilities, and on reforms and corporate governance in the energy sector (which, as discussed above, is a major source of quasi-fiscal pressures). IBRD will also provide limited technical support for infrastructure privatization. As background for guiding its investment, IFC will conduct studies of post-privatization restructuring and of the environment for small and medium-sized enterprises (SMEs). Areas of focus in later years could include housing, real estate and mortgage markets, as well as the legislative process and judicial system.

The Government seeks a greater role for IFC in financing private sector development, especially in the financial sector, larger industrial companies, SMEs, and infrastructure. Two key areas are companies needing post-privatization restructuring and commercially sound greenfield investments which are too large for the local financial sector. IFC's active project pipeline already includes industrial projects, a bank, a leasing company, and a hotel, with others to follow pending assessment. IFC support to SMEs

will focus on capital markets projects and credits to local financial intermediaries. MIGA is currently considering some requests for guarantees and expects growing demand for its services, while FIAS plans to prepare a study on administrative barriers to investment, pending the availability of co-financing.

(b) Developing the rural economy and raising agricultural productivity: Bilaterals, EUPhare, **World Bank technical assistance and analysis, with possible lending**. While the rural sector receives some support from the international community, the Government seeks a continued engagement by the Bank in issues of rural restructuring and development. We are providing assistance on land reform, registration and titling, as well as on improving agricultural statistics (IDF). We are also carrying out a study on the implications of EU accession for the rural sector. Early in the CAS period, we will conduct an assessment of poverty in rural areas. This will help accentuate our dialogue with the Government on the policies needed to manage the transition to higher productivity agriculture while supporting poverty reduction and the diversification of the rural economy. This will focus on high return investments on infrastructure and public goods (including education) while avoiding the imposition of new tariffs, subsidies and other efficiency-reducing distortions. In this context, we may develop a project for FY01 or later.

(c) Strengthening public administration, capacity and institutions at the central and sub-national levels. EIB, EUPhare, Bilaterals, NIB, **World Bank (significant analytic work only with possible lending)**: Our strategy envisions a growing emphasis on these themes, especially at the sub-national level. One vehicle for supporting Lithuania's decentralization reforms will be *the Municipal Development Project* (MDP, FY99), which will focus on local capacity building and help Lithuania coordinate significant donor support and co-financing (see *Box 6* above). Our assistance to the central Government will begin with policy dialogue and analysis of issues crucial for EU accession. We envisage that Lithuania will take part in the cross-regional evaluation of public sector capacity in pre-accession countries. Given the importance of achieving fiscal sustainability and of careful expenditure prioritization ahead of EU accession, we plan a Public Expenditure Review in FY00. Later in the CAS period, we could offer technical assistance on fiscal management, a project to strengthen tax administration, and analysis aimed at improving Lithuania's evolving system of inter-governmental fiscal relations. We are ready to support the Government in its efforts to reduce corruption. The dearth of existing analyses and data would make comprehensive anti-corruption support a costly exercise with substantial implications for our budget. Were the Government to request such extensive support, it would need to be accommodated by a shift within our NLS program. Dovetailing more focused support into our other work on public sector issues would be easier to accommodate.

(d) Upgrading infrastructure and environmental management to meet EU accession standards and objectives. Bilaterals, EBRD, EIB, EUPhare, NGOs, **IFC, World Bank (lending with selective analytic work).** As these areas will require very large investments during the CAS period, and the Bank is well positioned to assist (especially in technical assistance components and project supervision in coordination with our bilateral and IFI partners), much of our proposed lending is concentrated here. This will include: the *MDP* (see above) for supporting infrastructure investments in large towns and medium-sized cities, often with strong positive environmental externalities; the *Klaipeda Port* project (FY99) (to strengthen competitiveness of the port via physical improvement and technical asssistance on investment planning, contracting out of port services, contract lease management); the *Vilnius/Klaipeda District Heating* project (FY00) (to rehabilitate potentially economic networks, support institutional and commercial strengthening, and prepare for possible privatization); and a further municipal lending in FY01 and FY02 in the water and urban transport sectors. Our involvement in the water and wastewater sector either directly or through a follow-up MDP would allow the Bank to play a continuing role in supporting the investments needed in the environmental area for EU accession. We also plan to extend a GEF supported program for better managing agricultural run-off and waste product disposal to all three Baltic states during the CAS period.

The power sector is an especially difficult area and will require a major input of analysis and possibly investment for replacement capacity for the *Ignalina Nuclear Power Plant.* While we do not currently have concrete plans for new lending in this sector, we would be ready to shift the program should the Government request such support. This support could involve both financing (e.g. of upgrading conventional power, managing social dislocation and environmental impacts) and analysis. Once an agreement is reached on the future of Ignalina, the Bank plans to carry out an energy review looking at both supply and pricing issues, across the three Baltic countries.

C. The Bank's Loan Portfolio

47. *Annex B8* shows Bank-supported projects under implementation since Lithuania became a member of the IBRD. This includes 10 projects with commitments totaling US$210.2 million plus DEM 4.5 million, but excludes the closed US$60 million Rehabilitation Loan. For several reasons, portfolio performance has been mixed. Of nine investment loans now on the books, four (energy efficiency, highways, enterprise finance and social assistance) can be deemed very successful. The remaining five have all experienced unsatisfactory ratings during the course of implementation. (The role of such ratings and other self-evaluation measures is discussed in *Box 7* below.) Furthermore, subtracting the adjustment loans, disbursement levels have been disappointing, with US$86.36 million, or 40%, remaining undisbursed as of March 2, 1999.

48. There are some common threads among the reasons for this mixed performance. Procurement has been a particularly difficult area. Here, the issue is less one of capacity, but rather one of lacking appreciation of the rigor and stringency of the Bank's procurement rules. The units responsible for technical implementation of the projects generally have a good grasp of what is required, but have been subject to pressures from various commercial interests. Some project authorities have tried to circumvent Bank guidelines, in spite of careful upfront explanations and assistance. This has been particularly true for projects implemented at the municipal level, where the virtue of a transparent tender procedure has at times been questioned. The two environmental projects have run into the unwillingness of local governments to raise water and sewerage rates to agreed cost recovery levels. Implementation is hampered by the excessively stringent standards imposed by the public body overseeing government construction contracts. In the past it has been difficult to get the Government to respond to these problems with the required degree of urgency, but in recent months the Ministry of Finance has taken a number of steps to restructure projects and deal with specific project problems. As a result, disbursement has accelerated and three projects which recently had unsatisfactory ratings have been upgraded. However, there remains a fundamental need to improve local capacities in project implementation, which is one of the aims of the new *Municipal Development Project.*

49. The program put forward in this CAS assumes a sustained improvement in project implementation. We have agreed with the Government that starting in FY00, we will not proceed with preparation of new lending if two or more Bank-supported projects are rated unsatisfactory. Bank staff is putting more effort into explaining the procurement rules, and to expand these briefings to a broader audience beyond the project implementation units. For upcoming projects, it is proposed that procurement workshops targeted to a broad audience be held as the project is launched. In addition, pending the outcome of the Country Portfolio Performance Review (see *Box 7* below), we will consider recruiting and training a procurement specialist for our office in Vilnius.

Box 7 - Self-Evaluation of Bank Group Performance

The proposed CAS envisions an upgraded and multi-dimensional approach to monitoring progress, evaluating the developmental impact of the Bank Group's assistance, and making corresponding on-going adjustments to the Bank Group lending and non-lending programs in Lithuania. This involves six different elements:

Project ratings. As described above, the development objectives (DO) and implementation progress (IP) ratings for IBRD's project portfolio in Lithuania have been mixed and changing over time. These ratings for individual projects and for the portfolio as a whole have helped provide important guidance on steps for improving project design and implementation. This active approach has recently brought good results, with the share of problem projects in the IBRD portfolio (by amount) falling from 20.3 percent to zero. Such an approach will be continued throughout the CAS period.

OED Performance Audit Reports. OED evaluations have so far been limited to a 1996 review of the ICR for the early Rehabilitation Loan. This identified three principal lessons in line with the Country Team's self-evaluation: a) the appointment of advisors to the Project Implementation Unit was critical to the successful management of the project and the transfer of needed procurement and distribution skills; b) clear identification of eligible imports prior to appraisal, and of the onlending and repayment arrangements for sub-borrowers, would have saved considerable time during implementation; and c) the Bank's excessive restrictions on the purchase of used equipment made it virtually impossible to find willing suppliers. During the CAS period, we expect to conclude several Performance Audit Reports, beginning with one of the environmental projects.

Country Portfolio Performance Review. Given the mixed past history of portfolio performance, we plan to carry out a CPPR early in the CAS period. This will allow us to identify generic problems in project design and implementation, and to propose steps which the Bank and Government need to take to overcome these.

Progress Benchmarks. Country performance and Bank performance will be evaluated annually as well as after the completion of the CAS relative to the observable measures outlined in the CAS Matrix (*Annex B9*).

Client Surveys. The recently concluded and broadly favorable Client Survey identified several areas with room for improvement. Box 5 above describes some of the key planned follow-up actions, several of which will be coordinated by the newly recruited External Affairs Officer in the Bank's Vilnius office. To monitor our progress on these fronts, we plan follow-up client surveys every two years, complemented by narrower beneficiary surveys for specific projects and more informal but regular stakeholder feedback.

Independent evaluation. This includes reviews by QAG and other Bank Group quality control offices.

D. Lending Scenarios, Volumes and Triggers

50. Four lending scenarios can be envisioned, each linked to different evolutions of the economy described in Section I.C. above. In three cases, satisfactory domestic policies are combined with different assumptions about the external environment. The fourth case considered is one weak policies, irrespective of the developments abroad. In all cases, a precondition (**trigger**) for preparing new project lending will be good portfolio performance defined as no more than one project being rated unsatisfactory. In each case, Bank Group exposure will remain low (see *para. 52* below).

51. The level of uncertainty concerning the external environment, especially in the CIS, means that no single scenario stands out as being far more likely than all others. Two roughly equally likely scenarios are most probable. Under the assumption that improved control of fiscal deficits and moderately improved access to external financing allows Lithuania to remain in the *base/medium scenario* described in *paras. 17* to *19*, total Bank Group financial support would continue at moderate levels. New IBRD commitments would total around US$150 million in FY00-02, with two projects

planned for each year, one in the area of human development and one for upgrading infrastructure and environmental management ahead of EU accession (for details, see *Annex B3*). Triggers would include:

- Sustained progress in reducing the consolidated fiscal deficit from 1999 to 2001 in line with the schedule described in *Table A* (with more rapid progress working to further reduce risks); and
- Satisfactory progress in the structural reform program, including; commencement of the process of privatizing the two large state-owned banks by end-1999 and the achievement of majority private ownership by end-2000; introduction by end-1999 of a combination of energy price increases and efficiency improvements which allow Lithuanian Energy to fully cover operating costs and service accumulated debts; and preparation of a market-supporting rural development strategy and associated action plan by end-2000. As discussed above, all of these measures would not only increase the economy's growth potential, but would also work to reduce quasi-fiscal deficits.

52. Under this scenario, the ratio of IBRD debt service to total public debt service is expected to fall from 8.3% in 1999 to 4.4% in 2002, with the ratio of IBRD debt service to exports remaining below 0.4%. As other sources of finance become more available, the share of IBRD and preferred creditors will decline gradually over time. Lithuania's share in the IBRD portfolio remains negligible throughout. IFC exposure to Lithuania is expected to grow rapidly but remain a small share of total exposure.

53. There is an alternative *external shock scenario* (see *para. 20*) in which a further worsening of the external environment, and/or a bunching of debt repayments in 2000 or 2002 requires Lithuania to ask for balance of payment payments support. Here, the Bank could consider adjustment lending to help Lithuania absorb the shock and strengthen macroeconomic and financial sustainability. This, however, would depend crucially on progress having been made on the policy **triggers** listed in *para. 50* above, as well as on a strong and appropriate policy response. Therefore, this scenario includes two additional triggers – that a Government macroeconomic stabilization program agreed with the IMF remain on track and that further phases of the Savings Restitution Plan be postponed. A SAL-type operation would be accommodated by displacing one of the proposed investment lending operations. Because its likely size would be about US$100 million, a SAL would raise the three-year lending total to US$220 million. The overall volume of non-lending activities would be as in the base case, but with a greater relative focus on supporting fiscal and financial stability, as opposed to the EU accession agenda, which would be delayed under this scenario.

54. Two significantly less likely scenarios are also possible. In the event of more rapid improvement in the external environment as described in *para. 21* above, Lithuania would enter a *high case scenario*. Here, no increase in IBRD lending would be planned. Indeed actual loan sizes may decline if the Government is able to access commercial loans on favorable terms. This scenario would, however, see a substantial increase in IFC lending. As it would put Lithuania on a faster track to EU accession, it could also involve a shift in the focus of our non-lending services towards areas most critical for achieving this objective. **Triggers** would remain as in the base case.

55. Finally, in the event of more serious policy slippage and/or deterioration, as defined by thefailure to meet the above **triggers**, and regardless of the severity of the external environment, Lithuania would enter a *low case scenario*. IBRD and IFC lending programs would be cut substantially. The IBRD program would be limited to human development and the social safety net, with the three operations described above for a total of US$60 million over three years. Bank Group non-lending services and analytic work would focus on measures needed for restoring a stronger, growth promoting policy framework.

E. The Main Risks to Continued Progress

56. Lithuania faces some significant risks to its rapid development and poverty alleviation during the CAS period. While in mid-1998 these seemed very unlikely to have a serious impact, they have been heightened by the crisis in Russia. Lithuania's large current account deficit leaves it dependent on continued large net capital inflows. A sharp curtailment of these flows could result from a difficulty in rolling over official or private debt, either due to contagion or to reduced investor confidence in domestic policies. This could in turn lead to a growth-reducing credit squeeze, balance of payments problems or exchange rate devaluation. In the latter event, inflation would rebound and growth and investment would be temporarily curtailed. While Lithuanian banks had minimal direct exposure to Russia, they could face higher bad loans due to the exposure of major clients. Without more conservative fiscal policies, key structural reforms, and improved access to international financial markets, risks related to external vulnerabilities cannot be discounted. A confluence of external pressures and domestic policy slippage would be particularly dangerous. We have noted to the Government the option of limiting such risks by building up a larger cushion of foreign reserves via a more extended phasing of the Savings Restitution Plan (see *Box 3* above). Such added reserves would also smooth the planned (temporarily postponed and so far well handled) exit from the currency board.

57. Second, while macro and structural policies are generally sound, Lithuania has not been immune to the *ad hoc* introduction of policy distortions or special programs which mitigate the immediate problems of narrow constituencies at the expense of long-run efficiency, fiscal balance or broader fundamentals. These have included high and arbitrary rates of protection for some agricultural products, various subsidy and guarantee schemes, and *ad hoc* support to financially weak enterprises. Such policies can harm economic efficiency, as well as increasing the current account deficit and macro vulnerability through creation of fiscal pressures. Other domestic risks include; the possible difficulty of pursuing tight fiscal policy before the next general elections; and the medium-term growth of unemployment, as businesses exposed to Russia lay off workers, and the restructuring of agriculture and large firms leads to labor shedding.

58. Yet the risk of political instability, or of significant departures from the prudent management which has brought success so far, is limited. Lithuania has a reformist majority government and popular president. Broad consensus among major political forces on the need to continue stabilization and structural reforms, and on the goal of achieving rapid EU membership, is likely to be sustained following parliamentary elections scheduled for the autumn of 2000. The awareness that major macroeconomic setbacks or reform slippage would put EU accession at risk for a number of years, will work to reduce risks substantially. This works to create an environment in which difficult short-term fiscal measures can be taken once the need for these is recognized.

James D. Wolfensohn
President

By:

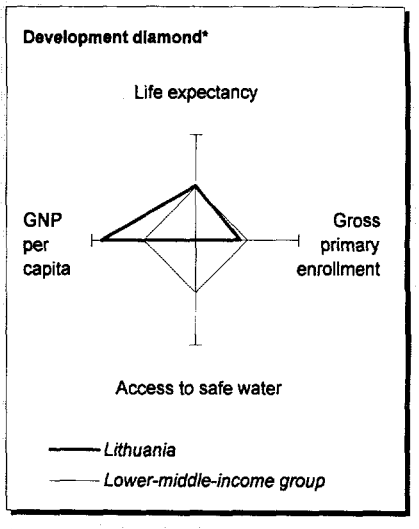
Caio Koch-Weser

Peter L. Woicke

Washington, DC
April 19, 1999

Lithuania at a glance

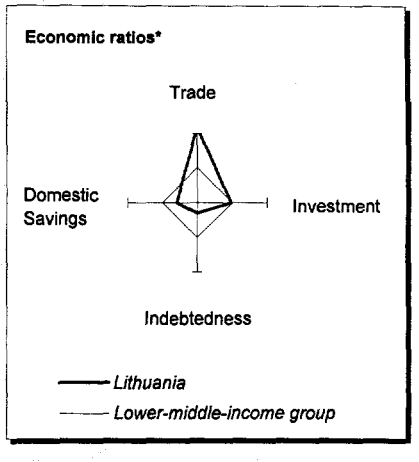
POVERTY and SOCIAL	Lithuania	Europe & Central Asia	Lower-middle-income
1997			
Population, mid-year *(millions)*	3.7	476	2,285
GNP per capita *(Atlas method, US$)*	2,230	2,320	1,230
GNP *(Atlas method, US$ billions)*	8.3	1,106	2,818
Average annual growth, 1991-97			
Population *(%)*	-0.2	0.2	1.2
Labor force *(%)*	-0.2	0.5	1.3
Most recent estimate (latest year available, 1991-97)			
Poverty *(% of population below national poverty line)*	..	..	..
Urban population *(% of total population)*	73	67	42
Life expectancy at birth *(years)*	71	69	69
Infant mortality *(per 1,000 live births)*	10	25	36
Child malnutrition *(% of children under 5)*	..	..	..
Access to safe water *(% of population)*	..	..	84
Illiteracy *(% of population age 15+)*	..	..	19
Gross primary enrollment *(% of school-age population)*	96	92	111
Male	97	..	116
Female	95	..	113



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

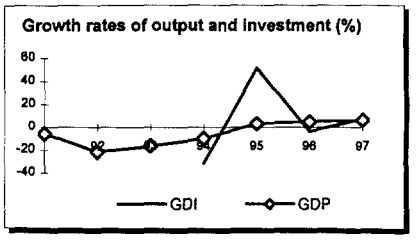
	1976	1986	1996	1997
GDP *(US$ billions)*	..	..	7.9	9.6
Gross domestic investment/GDP	..	..	24.5	26.5
Exports of goods and services/GDP	..	..	53.4	54.5
Gross domestic savings/GDP	..	..	14.7	16.3
Gross national savings/GDP	..	..	16.0	16.7
Current account balance/GDP	..	..	-9.2	-10.2
Interest payments/GDP	..	..	0.8	1.5
Total debt/GDP	..	..	18.3	27.9
Total debt service/exports	..	..	5.9	9.2
Present value of debt/GDP	..	..	14.8	19.1
Present value of debt/exports	..	..	27.3	34.5

	1976-86	1987-97	1996	1997	1998-02
(average annual growth)					
GDP	..	-4.9	4.7	6.1	4.9
GNP per capita	..	-4.2	2.7	2.9	4.9
Exports of goods and services	..	..	3.6	6.5	8.1

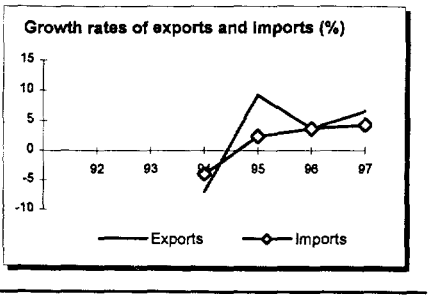


STRUCTURE of the ECONOMY

	1976	1986	1996	1997
(% of GDP)				
Agriculture	..	..	11.2	11.2
Industry	..	..	30.2	27.9
Manufacturing	..	..	20.0	18.0
Services	..	..	49.0	48.6
Private consumption	..	..	66.4	64.7
General government consumption	..	..	18.9	19.0
Imports of goods and services	..	..	63.2	65.1



	1976-86	1987-97	1996	1997
(average annual growth)				
Agriculture	..	-2.8	12.1	5.9
Industry	..	-12.6	3.7	4.7
Manufacturing	..	-15.4	2.8	6.1
Services	..	-0.7	2.3	5.8
Private consumption	..	..	8.5	-4.9
General government consumption	..	..	-3.7	-0.6
Gross domestic investment	..	..	-3.7	7.3
Imports of goods and services	..	..	3.6	4.2
Gross national product	..	-4.0	2.6	2.7

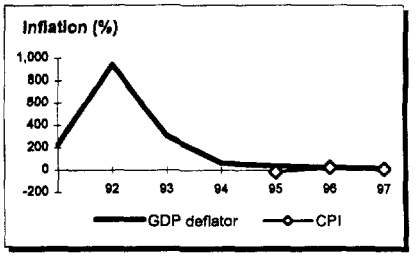


Note: 1997 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

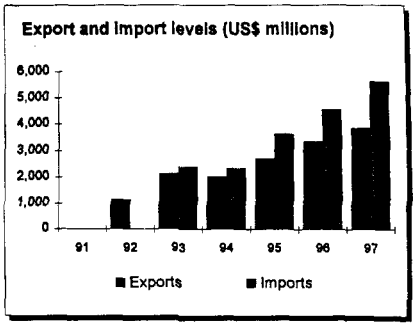
PRICES and GOVERNMENT FINANCE

	1976	1986	1996	1997
Domestic prices				
(% change)				
Consumer prices	..	..	24.6	8.4
Implicit GDP deflator	..	..	25.0	14.9
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	..	28.0	31.2
Current budget balance	..	..	0.2	1.9
Overall surplus/deficit	..	..	-4.4	-1.7



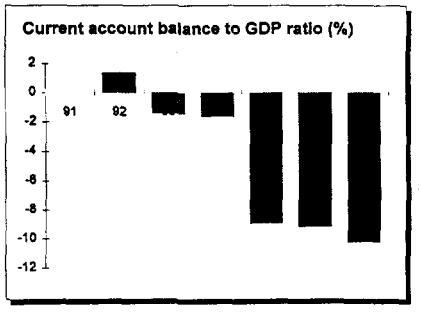
TRADE

	1976	1986	1996	1997
(US$ millions)				
Total exports (fob)	..	..	3,356	3,863
Commodity 1	..	..	521	566
Commodity 2	..	..	499	666
Manufactures	..	..	482	565
Total imports (cif)	..	..	4,559	5,644
Food	..	..	474	464
Fuel and energy	..	..	*821*	*958*
Capital goods	..	..	617	876
Export price index *(1995=100)*	..	..	127	148
Import price index *(1995=100)*	..	..	123	148
Terms of trade *(1995=100)*	..	..	103	100



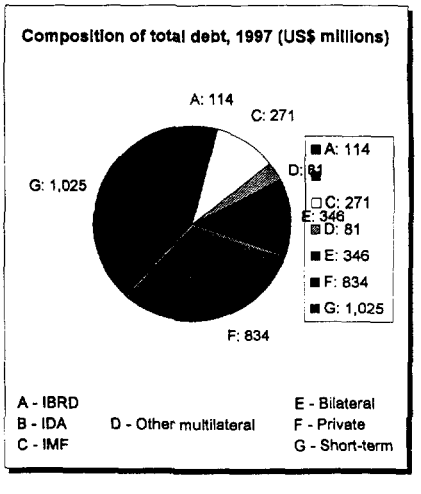
BALANCE of PAYMENTS

	1976	1986	1996	1997
(US$ millions)				
Exports of goods and services	..	..	4,211	5,224
Imports of goods and services	..	..	4,986	6,237
Resource balance	..	..	-775	-1,013
Net income	..	..	-91	-198
Net current transfers	..	..	144	231
Current account balance	..	..	-723	-981
Financing items (net)	..	..	738	1,219
Changes in net reserves	..	..	-15	-238
Memo:				
Reserves including gold *(US$ millions)*	..	..	834	1,063
Conversion rate *(DEC, local/US$)*	..	..	4.0	4.0



EXTERNAL DEBT and RESOURCE FLOWS

	1976	1986	1996	1997
(US$ millions)				
Total debt outstanding and disbursed	0	0	1447	2671
IBRD	0	0	101	114
IDA	0	0	0	0
Total debt service	0	0	253	489
IBRD	0	0	4	10
IDA	0	0	0	0
Composition of net resource flows				
Official grants	0	0	42	23
Official creditors	0	0	111	66
Private creditors	0	0	251	283
Foreign direct investment	..	..	152	328
Portfolio equity	0	0	188	173
World Bank program				
Commitments	0	0	151	4
Disbursements	*0*	*0*	*44*	*21*
Principal repayments	0	0	0	3
Net flows	0	0	44	18
Interest payments	0	0	4	7
Net transfers	0	0	40	11



Lithuania - Selected Indicators of Bank Portfolio Performance and Management

Indicator	1996	1997	1998	1999
Portfolio Assessment				
Number of Projects under implementation[a]	7	10	10	9
Average implementation period (years)[b]	1.36	1.47	2.49	3.18
Percent of problem projects[a, c]				
by number	14.29	20.00	30.00	0.00
by amount	16.45	17.35	20.26	0.00
Percent of projects at risk[a, d]				
by number	16.67	20.00	33.33	0.00
by amount	26.27	17.35	32.43	0.00
Disbursement ratio (%)[e]	2.61	12.19	15.97	13.83
Portfolio Management				
CPPR during the year (yes/no)				
Supervision resources (total US$)	412.92	1,310.47	987.42	320.95
Average Supervision (US$/project)	58.99	131.05	98.74	35.66

Memorandum item	Since FY80	Last five FYs
Projects evaluated by OED		
by number	1	1
by amount (US$ millions)	60.00	60.00
Percent rated U or HU		
by number	0.00	0.00
by amount	0.00	0.00

a. As shown in the Annual Report on Portfolio Performance (except for current FY)
b. Average age of projects in the Bank's country portfolio.
c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: investment projects only.

Lithuania - Bank Group Program Summary, FY 1999-2002

Proposed IBRD/IDA Base and High-Case Lending Program, FY 1999-2002[a]

FY	*Project*	*US$(M)*	*Strategic rewards[b] (H/M/L)*	*Implementation[b] risks (H/M/L)*
1999	MUNICIPAL DEV'T.	20.0	H	M
	KLAIPEDA PORT	28.0	L	L
	Subtotal	**48.0**		
2000	HEALTH	25.0	H	M
	VILNIUS/KLAIPEDA DISTRICT HEAT	30.0	L	L
	Subtotal	**45.0**		
2001	ENVIRONMENT	30.0	M	L
	SOCIAL POLICY	10.0	H	M
	Subtotal	**40.0**		
2002	EDUCATION	25.0	H	M
	URBAN TRANSPORT	30.0	M	M
	Subtotal	**55.0**		
	Total, FY 2000-2002	**150.0**		
	Total, FY 1999-2002	**198.0**		

[a] This table presents the proposed program for the next three fiscal years.

[b] For each project, indicate whether the strategic rewards and implementation risks are expected to be high (H), moderate (M), or low (L).

Lithuania - Bank Group Program Summary, FY 1999-2002

Proposed IBRD/IDA External Shock Case Lending Program, FY 1999-2002[a]

FY	*Project*	*US$(M)*	*Strategic rewards[b] (H/M/L)*	*Implementation[b] risks (H/M/L)*
1999	MUNICIPAL DEV'T.	20.0	H	M
	KLAIPEDA PORT	28.0	L	L
	Subtotal	**48.0**		
2000	HEALTH	25.0	H	M
	VILNIUS/KLAIPEDA DISTRICT HEAT	30.0	L	L
	Subtotal	**45.0**		
2001	STRUCTURAL ADJUSTMENT LOAN	100.0	H	M
	SOCIAL POLICY	10.0	H	M
	Subtotal	**110.0**		
2002	EDUCATION	25.0	H	M
	URBAN TRANSPORT	30.0	M	M
	Subtotal	**55.0**		
	Total, FY 2000-2002	**220.0**		
	Total, FY 1999-2002	**268.0**		

[a] This table presents the proposed program for the current and next three fiscal years, in the event of the external shock scenario described in the CAS. The table is indicative, assuming that this scenario begins in FY01, and thus involving the displacement of one project in that year. Were the scenario to begin at a different time, the project to be replaced by the SAL could be different.

[b] For each project, indicate whether the strategic rewards and implementation risks are expected to be high (H), moderate (M), or low (L).

Lithuania - Bank Group Program Summary, FY 1999-2002

Proposed IBRD/IDA Low-Case Lending Program, FY 1999-2002[a]

FY	*Project*	*US$(M)*	*Strategic rewards[b] (H/M/L)*	*Implementation[b] risks (H/M/L)*
1999	MUNICIPAL DEV'T.	20.0	H	M
	KLAIPEDA PORT	28.0	L	L
	Subtotal	**48.0**		
2000	HEALTH	25.0	H	M
	Subtotal	**25.0**		
2001	SOCIAL POLICY	10.0	H	M
	Subtotal	**10.0**		
2002	EDUCATION	25.0	H	M
	Subtotal	**25.0**		
	Total, FY 2000-2002	**60.0**		
	Total, FY 1999-2002	**108.0**		

[a] This table presents the proposed program for the current and next three fiscal years, assuming that the low-case would last the whole of the CAS period.

[b] For each project, indicate whether the strategic rewards and implementation risks are expected to be high (H), moderate (M), or low (L).

Lithuania - IFC and MIGA Program, FY96-99

Category	Past 1996	1997	1998	1999
IFC approvals (US$m) [a]	8.90	0.00	0.00	15.00
Sector (%)				
Wood processing	100.00	0.00	0.00	0.00
Manufacturing	0.00	0.00	0.00	100.00
Total	100.00	0.00	0.00	100.00
Investment instrument (%)				
Loans	67.40	0.00	0.00	85.00
Equity	10.10	0.00	0.00	0.00
Quasi-Equity b	22.50	0.00	0.00	15.00
Other	0.00	0.00	0.00	0.00
Total	100.00	0.00	0.00	100.00
MIGA guarantees (US$m)	0.00	0.00	0.00	0.00
MIGA commitments (US$m)	0.00	0.00	0.00	0.00

[a] Excludes AEF projects.

[b] Includes quasi-equity types of both loan and equity instruments.

Lithuania - Summary of Nonlending Services

Product	*Completion FY*	*Audience*[a]	*Objective*[b]
Recent completions			
CEM Policy Notes	98	Government, public dissemination	Knowledge generation
IDF – Vilnius Old Town	98	Government	Problem solving
Energy Needs Assessment	98	Government	Knowledge generation, problem solving
IDF – Statistical Office	98	Government	Problem solving
Agriculture Policy Review	99	Government	Knowledge generation
Underway			
Macro/Financial Vulnerability Review	99	Government	Knowledge generation, problem solving
CAS	99	Government, Bank, donors	Public debate, problem solving
Y2K diagnostic	00	Government	Problem solving, public debate
IDF – Agricultural statistics	01	Government	Problem solving
Financial sector regulation TA/analysis	01	Government	Problem solving
IDF – Environmental Policy Development	01	Government	Problem solving
Macroeconomic monitoring	02	Bank	Knowledge generation
Planned			
Rural living standards survey	00	Government, Bank	Knowledge generation, problem solving, public debate
Public Expenditure Review	00	Government	Knowledge generation, problem solving
CEM on EU Accession	01	Government, donor, public dissemination	Knowledge generation, problem solving, public debate
Regional Energy Review	02	Government, Bank, donor	Knowledge generation, problem solving
Anti-corruption/PSR support	02	Government	Problem solving
Social policy development	02	Government	Knowledge generation, problem solving

a. Government, donor, Bank, public dissemination.
b. Knowledge generation, public debate, problem-solving.

Lithuania Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1990-96	Europe & Central Asia	Lower-middle-income
POPULATION					
Total population, mid-year (millions)	3.3	3.5	3.7	477.9	1,125.4
Growth rate (% annual average)	1.0	0.8	-0.1	0.3	1.4
Urban population (% of population)	55.7	65.1	72.5	66.4	56.2
Total fertility rate (births per woman)	2.2	2.1	1.4	1.8	2.6
POVERTY					
(% of population)					
National headcount index	..	..	..	..	..
Urban headcount index	..	..	..	..	..
Rural headcount index	..	..	..	..	..
INCOME					
GNP per capita (US$)	..	..	2,280	2,200	1,740
Consumer price index (1987=100)	..	..	..	..	341
Food price index (1987=100)	..	..	..	..	..
INCOME/CONSUMPTION DISTRIBUTION					
(% of income or consumption)					
Lowest quintile	..	..	8.1	..	..
Highest quintile	..	..	42.1	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (% of GDP)	..	..	5.1	4.4	2.4
Education (% of GNP)	..	5.3	4.5	5.6	5.2
Social security and welfare (% of GDP)	..	..	9.5	..	..
Net primary school enrollment rate					
(% of age group)					
Total	..	..	..	96	94
Male	..	..	..	97	..
Female	..	..	..	96	..
Access to safe water					
(% of population)					
Total	..	..	..	..	75
Urban	..	..	..	..	..
Rural	..	..	..	..	..
Immunization rate					
(% under 12 months)					
Measles	..	..	94	87	86
DPT	..	..	96	81	86
Child malnutrition (% under 5 years)	..	..	..	..	..
Life expectancy at birth					
(years)					
Total	71	71	70	68	67
Male	67	67	65	64	64
Female	75	75	76	73	70
Mortality					
Infant (per thousand live births)	22	16	10	24	40
Under 5 (per thousand live births)	..	..	13	30	49
Adult (15-59)					
Male (per 1,000 population)	214	243	304	303	260
Female (per 1,000 population)	94	92	97	128	155
Maternal (per 100,000 live births)	..	27	13	..	..

World Development Indicators 1998 CD-ROM, World Bank

Lithuania - Key Economic Indicators

Indicator	Actual			Estimate		Projected			
	1994	1995	1996	1997	1998	1999	2000	2001	2002
National accounts (as % of GDP at current market prices)									
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture[a]	10.0	10.7	11.2	11.2	10.9	9.2	8.6	8.3	8.0
Industry[a]	32.4	30.4	30.2	27.9	25.3	25.3	25.8	25.8	25.8
Services[a]	48.7	48.4	49.0	48.6	42.7	43.8	43.5	43.5	43.9
Total Consumption	87.6	87.1	85.3	83.7	86.7	86.5	84.2	82.1	80.6
Gross domestic fixed investment	23.1	23.0	23.0	24.4	23.3	23.1	23.6	23.8	24.0
Government investment	3.9	4.2	3.0	2.9	2.5	2.3	2.3	2.5	2.5
Private investment (includes increase in stocks)	14.6	20.5	21.5	23.7	24.3	23.8	23.3	22.8	22.5
Exports (GNFS)[b]	55.4	53.0	53.4	54.5	50.1	48.1	48.2	47.2	46.7
Imports (GNFS)	61.4	64.8	63.2	65.1	63.6	60.7	58.0	54.6	52.3
Gross domestic savings	12.4	12.9	14.7	16.3	13.3	13.5	15.8	17.9	19.4
Gross national savings[c]	16.3	14.5	16.0	16.7	13.3	13.0	14.7	16.3	17.4
Memorandum items									
Gross domestic product (US$ million at current prices)	4247	6026	7892	9585	10552	11468	12463	13675	15004
Gross national product per capita (US$, Atlas method)	1790.0	1760.0	1940.0	2230.0	2520.0	2890.0	3190.0	3510.0	3840.0
Real annual growth rates (%, calculated from 1993 prices)									
Gross domestic product at market prices	-9.8%	3.3%	4.7%	6.1%	4.7%	3.5%	4.5%	5.5%	5.5%
Gross Domestic Income	-8.3%	-10.6%	7.9%	2.8%	3.2%	2.6%	6.4%	6.6%	6.1%
Real annual per capita growth rates (%, calculated from 1993 prices)									
Gross domestic product at market prices	-9.5%	3.5%	4.9%	5.9%	4.8%	3.5%	4.5%	5.5%	5.5%
Total consumption	-0.6%	-11.3%	7.4%	17.1%	8.8%	2.4%	2.4%	3.2%	3.1%
Private consumption	-3.6%	-17.4%	11.2%	18.3%	9.6%	3.2%	2.4%	2.4%	2.4%

(Continued)

Lithuania - Key Economic Indicators (Continued)

Indicator	Actual 1994	1995	1996	1997	Estimate 1998	1999	Projected 2000	2001	2002
Balance of Payments (US$m)									
Exports (GNFS)[b]	2351.1	3191.3	4210.6	5224.3	5284.1	5517.6	6011.1	6454.5	7013.6
Merchandise FOB	2029.2	2706.1	3413.1	4192.4	3877.3	4020.9	4368.6	4700.6	5147.7
Imports (GNFS)[b]	2610.5	3902.2	4986.0	6237.3	6713.7	6961.6	7227.2	7470.8	7853.2
Merchandise FOB	2234.1	3404.0	4309.3	5339.9	5763.5	5963.4	6170.5	6344.4	6690.9
Resource balance	-259.4	-710.9	-775.4	-1013.0	-1429.6	-1444.0	-1216.1	-1016.3	-839.6
Net current transfers (including official current transfers)	156.8	109.3	143.8	230.1	327.5	331.9	340.4	349.2	358.2
Current account balance (after official capital grants)	-94.0	-614.4	-722.6	-977.2	-1423.2	-1502.2	-1352.7	-1230.8	-1132.7
Net private foreign direct investment	31.3	71.6	152.3	327.5	1000.0	600.0	500.0	350.0	300.0
Long-term loans (net)	207.4	370.9	201.6	349.0	400.1	492.1	564.2	552.8	489.3
Official	67.0	91.9	111.4	66.2	80.0	20.0	-58.0	-23.0	-64.0
Private	140.4	279.0	90.2	282.8	320.1	472.1	622.2	575.8	553.3
Other capital (net, including errors and omissions)	39.1	403.7	384.0	538.5	484.2	335.1	445.2	495.8	480.8
Change in reserves[d]	-183.8	-231.8	-15.3	-237.8	-461.2	75.0	-156.6	-167.8	-137.4
Memorandum items									
Resource balance (% of GDP at current market prices)	-6.1%	-11.8%	-9.8%	-10.6%	-13.5%	-12.6%	-9.8%	-7.4%	-5.6%
Real annual growth rates (1992 prices)									
GNFS exports	7.0%	9.2%	3.6%	6.5%	2.0%	5.0%	7.0%	8.0%	8.0%
Primary	..	..	..	..	..	..	..	..	..
Manufactures	..	..	..	..	..	..	..	..	..
GNFS imports	-4.0%	2.3%	3.6%	4.2%	6.2%	3.5%	4.5%	5.5%	5.5%
Public finance (as % of GDP at current market prices)[e]									
Current revenues	29.9	29.9	28.0	31.2	30.6	30.8	31.4	31.7	31.6
Current expenditures	28.6	28.3	27.8	29.2	30.7	29.6	28.6	28.2	28.1

(Continued)

Lithuania - Key Economic Indicators (Continued)

Indicator	Actual			Estimate		Projected			
	1994	1995	1996	1997	1998	1999	2000	2001	2002
Current account surplus (+) or deficit (-)	1.3	1.6	0.2	2.0	0.0	1.3	2.8	3.4	3.5
Capital expenditure	7.8	6.7	4.8	3.5	5.9	4.8	4.3	3.5	3.5
Foreign financing	2.9	3.6	3.3	1.6	1.3	2.0	0.9	0.5	0.5
Monetary indicators									
M2/GDP (at current market prices)	25.8	23.3	17.2	19.0	17.7	16.5	16.4	16.4	16.4
Growth of M2 (%)	63.0	28.9	-3.5	34.1	2.7	1.5	7.8	9.7	9.7
Private sector credit growth / total credit growth (%)	107.4	186.4	-491.2	56.3	56.5	70.2	92.8	94.9	78.1
Price indices(1993 =100)									
Merchandise export price index	105.2	131.4	167.3	194.9	187.0	187.5	189.7	193.5	194.5
Merchandise import price index	103.2	151.7	187.1	224.6	219.0	221.9	227.6	233.4	239.4
Merchandise terms of trade index	101.9	86.6	89.4	86.8	85.4	84.5	83.4	82.9	81.2
Real exchange rate (US$/LCU)[f]	35.1	43.8	51.7	59.1	63.0	65.1	66.1	66.3	66.5
Real interest rates									
Consumer price index (% growth rate)	45.1%	35.7%	13.1%	8.4%	2.4%	4.8%	4.0%	3.0%	3.0%
GDP deflator (% growth rate)	61.6%	38.0%	25.0%	14.9%	5.1%	5.0%	4.0%	4.0%	4.0%

a. If GDP components are estimated at factor cost, a footnoote indicating this fact should be added.

b. "GNFS" denotes "goods and nonfactor services."

c. Includes net unrequited transfers excluding official capital grants.

d. Includes use of IMF resources.

e. Should indicate the level of the government to which the data refer.

f. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

Lithuania - Key Exposure Indicators

Indicator	Actual			Estimate		Projected			
	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total debt outstanding and disbursed (TDO) (US$m)a	588	995	1447	2671	2845	3204	3687	4148	4477
Net disbursements (US$m)[b]	207	391	630	818	478	541	581	561	428
Total debt service (TDS) (US$m)[b]	39	167	253	489	358	440	620	609	1069
Debt and debt service indicators (%)									
TDO/XGS[c]	24.8	30.7	33.9	50.3	52.7	56.7	60.0	62.9	62.5
TDO/GDP	13.8	16.5	18.3	27.9	27.0	27.9	29.6	30.3	29.8
TDS/XGS	1.6	5.1	5.9	9.2	6.6	7.8	10.1	9.2	14.9
Concessional/TDO	..	..	..	..	..	..	..	..	..
IBRD exposure indicators (%)									
IBRD DS/public DS	4.8	8.8	3.9	3.2	8.1	8.3	5.7	7.9	4.4
Preferred creditor DS/public DS (%)[d]	23.3	51.0	47.6	25.9	38.1	30.9	31.1	27.0	18.0
IBRD DS/XGS	0.1	0.1	0.1	0.2	0.3	0.3	0.4	0.4	0.4
IBRD TDO (US$m)[e]	49	62	101	114	163	173	178	178	173
Of which present value of guarantees (US$m)	0	0	0	0	0	0	0	0	0
Share of IBRD portfolio (%)	0.04	0.05	0.09	0.10	0.15	0.14	0.13	0.13	0.13
IDA TDO (US$m)[e]	0	0	0	0	0	0	0	0	0
IFC (US$m)									
Loans		10.6	10.6	10.6	10.6				
Equity and quasi-equity [f]		1.0	1.0	1.0	1.0				
MIGA									
MIGA guarantees (US$m)	0	0	0	0	0	0	0	0	0

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital. Actual data is from the Ministry of Finance, estimate and projected year - from RMSM-X.

b. Includes debt securities, trade credits and foreign loans to Lithuania. Actual data based upon Balance of Payments, the Bank of Lithuania. Estimate and projected year - from RMSM-X.

c. "XGS" denotes exports of goods and services, including workers' remittances.

d. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

e. Includes present value of guarantees.

f. Includes equity and quasi-equity types of both loan and equity instruments.

Status of Bank Group Operations in Lithuania
Operations Portfolio

Project ID	Fiscal Year	Borrower	Purpose	Original Amount in US$ Millions				Difference Between expected and actual disbursements a/		Last PSR Supervision Rating b/	
				IBRD	IDA	Cancel.	Undisb.	Orig	Frm Rev'd	Dev Obj	Imp Prog
Number of Closed Projects: 2											
Active Projects											
LT-PE-8537	1994	GOVERNMENT OF LITHUANIA	POWER REHABILITATION	26.40	0.00	0.00	22.93	22.00	12.37	S	S
LT-PE-8553	1995	GOVT OF LITHUANIA	KLAIPEDA ENVIRONMENT	7.00	0.00	0.00	4.89	4.70	0.00	S	S
LT-PE-8536	1995	GOVT. OF LITHUANIA	ENTERP & FIN. SECT.	25.00	0.00	0.00	4.31	-1.38	0.00	S	HS
LT-PE-36011	1996	REPUBLIC OF LITHUANIA	KLAIPEDA GEOTHERMAL	5.90	0.00	0.00	5.87	5.86	0.00	S	S
LT-PE-8538	1996	GOVT OF LITHUANIA	PRIVATE AGRIC. DEVT.	30.00	0.00	0.00	28.61	16.78	.25	S	S
LT-PE-35783	1996	REPUBLIC OF LITHUANIA	SIAULIAI ENVIRONMENT	6.20	0.00	0.00	4.88	3.64	0.00	S	S
LT-PE-35163	1997	REPUBLIC OF LITHUANIA	ENERGY EFFIC/HOUSING	10.00	0.00	0.00	8.27	3.93	0.00	NA	S
LT-PE-8551	1997	REPUBLIC OF LITHUANIA	HIGHWAY	19.00	0.00	0.00	4.48	-3.03	0.00	S	S
LT-PE-8539	1997	REPUBLIC OF LITHUANIA	SOC. POL. COMM SERV	3.70	0.00	0.00	2.12	1.18	0.00	HS	HS
Total				133.20	0.00	0.00	86.36	53.68	12.62		

	Active Projects	Closed Projects	Total
Total Disbursed (IBRD and IDA):	46.60	138.78	185.38
of which has been repaid:	.58	5.77	6.35
Total now held by IBRD and IDA:	132.62	133.01	265.63
Amount sold :	0.00	0.00	0.00
Of which repaid :	0.00	0.00	0.00
Total Undisbursed :	86.36	0.00	86.36

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.
b. Following the FY94 Annual Review of Portfolio performance (ARPP), a letter based system was introduced (HS = highly Satisfactory, S = satisfactory, U = unsatisfactory, HU = highly unsatisfactory): see proposed Improvements in Project and Portfolio Performance Rating Methodology (SecM94-901), August 23, 1994.

Note:
Disbursement data is updated at the end of the first week of the month.

Lithuania
STATEMENT OF IFC's
Held and Disbursed Portfolio
As of 31-Jan-99
(in US$ millions)

		Held				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1996	Liteksas	8.45	1.00	0.00	0.00	7.27	1.00	0.00	0.00
1999	EKRANAS	12.80	0.00	2.20	0.00	0.00	0.00	0.00	0.00
Total Portfolio		21.25	1.00	2.20	0.00	7.27	1.00	0.00	0.00

Approvals Pending Commitment

	Loan	Equity	Quasi	Partic
Total Pending Commitment	0.00	0.00	0.00	0.00

LITHUANIA CAS
COUNTRY PROGRAM MATRIX (FY99 - 02)

Key Development Objectives	Country Strategy & Key Actions	Bank Group Performance Benchmarks	Country Performance Benchmarks	Bank support instruments	IFC/MIGA support instruments	Other IFI/Donor Actions
1. Maintaining macro-financial stability. The confluence of a large current account deficit, accumulated and new quasi-fiscal imbalances, heightened global and regional volatility, high trade exposure to the CIS, and an financial sector which does not yet command complete confidence, raise the economy's vulnerability.						
Reduced economic vulnerability Strengthened medium-term fiscal sustainability	Contain current account deficit through near-term fiscal adjustment; reduce quasi-fiscal deficits through hardening budget constraint on enterprises; adopt policy framework conducive to increasing savings rate Develop Government and Bank of Lithuania capacities to monitor, analyze and counter macro-financial vulnerabilities Improve medium-term fiscal sustainability through expenditure rationalization, strengthening budget process and institutions/tax administration, and limiting accumulation of state contingent liabilities	Authorities regularly monitoring and analyzing macro-financial vulnerabilities Creation of new quasi-fiscal imbalances being controlled, including through ending policy of explicit or implicit government guarantees on financial liabilities of key enterprises and banks	Current account deficit declining from 99, inflation below 5%, GDP growth of around 3.5% in 99, 4.5% in 00 and 5.5% in 01-02, national savings rate increasing Consolidated fiscal deficit being reduced in line with schedule specified in Table A of CAS Authorities taking policy measures needed to reduce vulnerability Tax administration, budget process and financial management being strengthened	Macro-Financial Vulnerability Review (99) Macroeconomic monitoring (99-02) Public Expenditure Review (00) Y2K diagnostic (99)		IMF regular consultations, possible programs USAID/ US Treasury advice on tax and monetary policy, budget reform EU PHARE/Danish support for Treasury automation
Strong legal, regulatory, supervisory framework for capital markets and non-bank financial institutions, harmonized with EU requirements Completed restructuring of banking and insurance sectors Financial markets deepened; greater availability of long-term credits and mortgages	Improve rules and framework, strengthen and increase cooperation between institutions for financial regulation and supervision, esp. of capital markets and non-banks Privatization of Savings and Agricultural banks and State Insurance Company; limitation of state influence on commercial decisions of banks Implement legal and institutional changes to deepen financial markets, incl. formation of active housing finance market	Commencement of privatizing Agricultural and Savings banks by end-1999, achievement of majority private ownership by end-2000	Banking supervision strengthened further Privatization of majority stake in State Insurance Company Regulatory authorities for capital markets, private pension funds and other non-banks functioning increasing effectively Increased availability of long-term loan and equity finance, mortgages; increased non-bank financial activity	EFSAL supervision TA on financial sector regulation framework, with focus on capital markets & non-banks, including pension funds Possible support for development of mortgage market	Potential IFC investment in financial sector, incl. banks, housing finance, venture capital fund, insurance, and leasing IFC TA and analysis on legal/ regulatory framework for leasing (99)	EBRD, other investment in financial institutions Danish TA for developing mortgage financing system Norwegian support for IFC leasing study Canadian support for credit union strengthening
Enhancing growth potential and competitiveness, improving prospects for EU accession, and reducing vulnerability to shocks	Pursue remaining structural reform agenda, including measures outlined in recent World Bank Country Study	Key structural reform measures needed for EU accession, control of quasi-fiscal deficits being taken	Deep structural reform agenda being implemented	EU Accession Study (99/00) Possible SAL II		IMF regular consultations, possible programs

Key Development Objectives	Country Strategy & Key Actions	Bank Group Performance Benchmarks	Country Performance Benchmarks	Bank support instruments	IFC/MIGA support instruments	Other IFI/Donor Actions
2. Implementing the policies and programs identified as being central for EU accession. Lithuania faced an extensive reform agenda in meeting the formal requirements of the *acquis communautaire*, as well as in increasing the economy's ability to compete in the post-accession period and speeding the convergence of incomes towards EU levels. Key challenges are in the four areas described below.						
2A. Enhancing Competitiveness						
Strong private sector-led economic growth Strong legal and judicial framework and general environment for private business Strengthened financial discipline Effective system for regulation of energy, infrastructure and general competition Tax/fiscal system and tax administration promoting economic growth, efficiency and business development Largely privatized housing sector; well maintained housing and common spaces; accessibility to housing of the needy; well functioning real estate market	Rapid completion of recently accelerated privatization program, including plans for divesting strategic stakes in utilities, infrastructure companies, and continued sale of minority stakes Take steps to improve judicial system (adequate staffing, training, improved organization), and reduce administrative barriers Strengthen corporate governance, bankruptcy system, limit government support to enterprise sector Strengthen legal and institutional basis for regulating energy and infrastructure industries and general anti-competitive behavior Reduce distortions tax system by limiting exemptions, broadening base and reducing rates; reduce arbitrariness of tax administration; limit remaining large subsidies, tariffs and other supports to key sectors Complete housing restitution; encourage formation of homeowners' associations; privatize maintenance companies; improve targeting of housing subsidies; promote housing/real estate market development	Improved legislative process; more independent and better functioning judiciary (more cases brought to court, faster pass through on bankruptcy) Strengthened financial discipline, including well-functioning bankruptcy and corporate takeover mechanisms Regulatory agency(ies) for energy and infrastructure being strengthened, working effectively and independently	Continued progress on large-scale privatization (including of oil, gas and shipping sectors) during 1999, substantial progress by end-2000 Accounting standards and practices in line with international standards and EU directives Competition regulatory agencies strengthened Tax system reformed to reduce existing distortions; remaining subsidies, tariffs, administrative barriers, other distortions reduced Increased number of homeowners' associations; housing maintenance largely privatized; higher rate of real estate transactions	EFSAL, Housing Pilot & Energy Efficiency project supervision TA on privatization of Lithuanian Gas (99) Country Financial Accountability Assessment (99) TA for reform of legislative process and judicial system TA for regulation of infrastructure (99) (IDF) Possible support for housing and real estate policies	Active IFC pipeline of loan/equity investment projects, both greenfield and for post-privatization modernization of medium/ large companies Support for SMEs through IFC financial sector projects Post-Privatization Study (99) SME study for Baltics and Poland (99) Possible Bank/MIGA investment guarantees FIAS study on administrative barriers to foreign investment	EU PHARE support for privatization of insurance sector, credits to SMEs Nordic-financed feasibility studies, project preparation UNDP support for women's business development USAID support for improving legislative process, institutional strengthening of Judges' Association Danish/Dutch support for TA/training on energy efficiency and housing privatization Norwegian TA for privatization of housing maintenance
2B. Raising rural productivity						
Meeting formal EU accession agenda in agriculture Achieving needed productivity and quality improvements in agriculture Alleviating rural unemployment and poverty, which is already a problem and may increase further when productivity improvements lead to further release of labor	Develop phased strategy for meeting EU accession agenda in agriculture, including institutional strengthening Promote growth of agricultural efficiency by completing restitution and land reform, registration and titling; extending land ownership to at least domestic legal entities; privatizing agro-processing industries, incl. liquidation of unviable firms Develop comprehensive strategy for rural development, including private	Land reform, registration and titling being rapidly completed Market-supporting rural development strategy and associated action plan prepared by end-2000	Strategy for EU accession in agriculture, including institutional strengthening, being implemented Privatization agenda for agro-processing industry being completed Implementation of rural development strategy on track , growing rural non-farm activity Improved rural infrastructure	Private agriculture development project supervision TA on land reform, registering, titling (99) Rural Living Standards Survey (00) IDF on agricultural statistics (99-00)		EU PHARE support for agricultural restructuring, veterinary and phytosanitary control, land reform, regional policy, use of EU structural funds

Key Development Objectives	Country Strategy & Key Actions	Bank Group Performance Benchmarks	Country Performance Benchmarks	Bank support instruments	IFC/MIGA support instruments	Other IFI/Donor Actions
	sector development, selected infrastructure investments, education, training and social protection measures			Study of implications of EU Accession for agriculture Possible rural development project (01)		
2C. Strengthening public administration, capacity and institutions at the central and sub-national levels						
Strong public administration and state capacity, including to speed EU accession and ensure that it produces maximal benefits Budget planning based on strategic policy; strong policy formulation and implementation capacity, financial management and control Streamlined, cost-effective public sector functions, high quality public services in face of hard budget constraint Reduced corruption	Develop and implement action plan for strengthening of public administration in line with EU accession needs Reform civil service pay and incentives, train public officials Increase role of multi-year strategic planning and analysis in budget planning and resource allocation Strengthen efficiency, accountability, performance measurement and financial management in public administration and control agencies Strengthen link with public service recipients, capacity to improve cost-effectiveness and quality of service delivery at central and local levels Develop anti-corruption program based on broad strategic approach, including deregulation, greater transparency and strengthened audit capacity	Budget planning more strategic and longer-term Central and local government officials increasingly better trained	Action plan to reform public administration, including to meet EU accession requirements, being implemented Civil service being reshaped to meet EU accession needs, reformed public sector pay scale established Greater use of performance measures in budget monitoring, internal audit and new accounting framework in ministries Reduced duplication of functions in government organizations; Quality of public services improved as evidenced by survey results Actions to create greater transparency and simplicity,; reduction in perceived extent of official corruption	General policy dialogue, TA on public sector reform EU Accession Study (99-01) WBI evaluation of public sector capacity in pre-accession countries (99-00), training programs Public Expenditure Review (00) Possible anti-corruption support		EU PHARE and bilateral donors on civil service reform laws, use of EU pre-accession and structural funds, anti-corruption program Canadian support on public sector reform USAID/ US Treasury advice on budget reform Swedish Govt financed advisor on Debt Management Support for institutional development from PHARE, Nordics and other bilateral donors
Balance between resources and assigned functions of local governments Strong sub-national capacity for effective service delivery and basic financial management	Further reform of inter-governmental fiscal relations, including clarification of expenditure assignments, higher levels of (tax, transfer and grant) revenue certainty between central and local governments Take steps to increase own resources of local governments to reduce dependence on equalization Strengthen financial management at local level Formulate policies and legal framework for sub-national development, including reform and training to strengthen local governments and governance Revise regulations on municipal borrowing to ensure greater flexibility without eroding financial discipline, develop greater long-term financing	Local governments more efficient, effective, with better capacity to formulate and execute budgets More effective and prudent means of channeling loan and grant funds (including EU structural funds) to sub-national governments being introduced Local governments gaining better access to longer-term financing	Local governments have predictable and adequate sources of own revenues and transfers Grants well integrated in the overall resources envelope of sub-national governments	General policy dialogue, TA on sub-national government reform Municipal Development Project (99)		Nordic support to strengthen Association of Local Governments

Key Development Objectives	Country Strategy & Key Actions	Bank Group Performance Benchmarks	Country Performance Benchmarks	Bank support instruments	IFC/MIGA support instruments	Other IFI/Donor Actions
2D. Upgrading infrastructure and environment quality and management to meet EU accession standards						
Strong capacity, institutions and programs for planning, implementation, management of national and local infrastructure, and environmental investment projects Appropriate public investment financing mechanisms, including rules for blending tax, loan and grants, including EU structural funds Modern, efficient, high service quality municipal utilities	Strengthen local and national capacity for planning, preparing and managing investment projects Improve functioning of mechanisms, funds and programs for financing public and private investments in sub-national infrastructure and environment, including mechanisms for blending tax, loan and grant financing Reform, strengthen financial and commercial management of municipal utilities; implement maintenance investment and restructuring/ upgrading programs; speed privatization where appropriate, create needed regulatory framework	Capacity of local governments to plan, prepare and manage investment projects strengthened Improved financing mechanisms for local government investments being established Municipal infrastructure firms supported by MDP and other Bank projects meeting benchmarks of increased sectoral efficiency and effective cost reduction; improved service standards	Significant share of municipal infrastructure firms at least partially privatized, better managed and regulated Positive experience from MDP being implemented in a wider range of local governments	Municipal Development Project (99) Vilnius/Klaipeda District Heating project (00)		IFI & bilateral (esp. Nordic) support for local gov't projects, including coordinated financing of MDP with NIB/EIB
Environmental management capacity and standards raised to levels required for EU accession Satisfactory levels of water, land and air pollution; reduced pollution of the Baltic Sea Strong environmental information management, reporting and enforcement	Strengthen national and local environmental management capacity through training, management and action plans Coordinate with EU to raise environmental management capacity, improve regulations on environmental protection, and develop financing plan to meet EU accession standards for environment Take measures to improve environmental information management, reporting and enforcement	Improved environmental quality indicators, including reduced air, water and land pollution Measurable success of Bank projects in reducing pollution of Baltic Sea Strengthened capacity for environmental policy formulation	Increased national and local capacity for environmental management, reporting and enforcement Increasing compliance with EU accession standards for environment	Klaipeda/Siauliai environment, Klaipeda geothermal project supervision Environmental Policy Development (IDF) Study of environment and EU accession Environment project (01) GEF support for biodiversity, Klaipeda Geothermal, agricultural run-off	IFC TA in environmental review of potential investment projects	EU, NIB, EBRD, EIB, NEFCO & bilateral support for environment projects, incl. PHARE support for Klaipeda Environment EU PHARE assistance for institutional development of Ministry of Env. Protection UNDP support for environment information OECD assistance on environmental expenditure review, environment finance strategy
High quality, well maintained national and local infrastructure, to meet EU accession standards, reduce transport costs and improve traffic safety Adequately regulated transport sector meeting EU accession requirements	Upgrade national transport infrastructure, especially railways and ports Improve urban road infrastructure, develop and introduce modern traffic management tools and traffic safety plan to cope with rapid growth of traffic Develop strategy and action plan for trade supporting infrastructure and services, including environmental initiatives in the transport sector; improve regulation of sector	Improvements in port and urban road infrastructure; reduced pressure for increased travel time through major cities Modern traffic management tools being introduced; Traffic safety improvement plan being developed	Improved railway infrastructure Reduced traffic accidents, border crossing time Increased efficiency of transport sub-sectors	Highway maintenance project supervision Klaipeda Port project (99) Urban Transport project (02)	IFC support for post-privatization investments in infrastructure	EBRD/EU/ EIB/NIB loan and grant support for national and cross-Baltic infrastructure EU PHARE support for road improvement, harmonization of transport legislation Danish support for strategy for trade and transport sector

Key Development Objectives	Country Strategy & Key Actions	Bank Group Performance Benchmarks	Country Performance Benchmarks	Bank support instruments	IFC/MIGA support instruments	Other IFI/Donor Actions
Clear long-term policy objectives in the power sector Power prices reflecting appropriate marginal cost, encouraging conservation and not distorting energy market Lithuanian Power Company financially sound and operating efficiently	Clarify long-term energy strategy, including plans for separating generation, transmission and distribution; and more precise cost estimates for future of Ignalina NPP, including waste storage, decommissioning costs, economic/ social implications Develop optimal long-run energy pricing linked to plans on Ignalina NPP; ensure independence of Energy Pricing Commission Adjust power tariffs to reflect current and future costs; strengthen corporate governance and financial management; control export arrears; undertake physical upgrading of LPC	Corporate governance and financial management in Lithuanian Energy strengthened Energy pricing policies and comprehensive restructuring of Lithuanian Energy ensuring cost control and full cost recovery in power sector by end-1999	Privatization plan for power sector (based on introduction of competitive principles) announced and being carried out on planned schedule Energy Pricing Commission operating effectively and independently Plans for future of Ignalina NPP clearly established based on financial and environmental analysis of various scenarios	Power Rehabilitation Project supervision Baltic Regional Energy Review (02)		EU PHARE support for nuclear energy issues, updating energy strategy, management of energy utilities, regulatory framework, technical audit of power transmission, least cost generation expansion EU PHARE, G7 (via EBRD) assistance on nuclear safety EBRD support for least cost energy sector development program USAID support for energy pricing
3. Designing cost-effective, financially viable social safety net and human development programs. Lithuania faces the challenge of mitigating short-term and structural poverty, developing well-targeted and dependable social assistance mechanisms, completing pension reform, and undertaking more comprehensive reforms and efficiency improvement in health and education.						
Reduced poverty, especially in rural areas. Benefits of reform reaching all sectors of society	Analyze incidence of poverty and characteristics of the poor to develop improved programs and adapt policies for poverty alleviation Review likely impact of EU accession, including policy adjustments, on living standards and recommend necessary institutional changes	Measures being developed to counter pressure for increase in rural poverty	Reduction of share of population living below subsistence minimum, progress on elimination of deep pockets of poverty	Rural Living Standards Survey (00) Poverty-reduction effects of projects/ESW		UNDP Human Development Reports, support for social statistics
Efficient, well-managed and well-targeted social assistance system across all regions	Analyze reasons for regional disparities in receipt of social protection services/transfers, and make needed policy/institutional adjustments Improve delivery of social services by assessing lessons learned from community pilots and replicating the best practice in other communities	Better targeted, more cost-efficient community based social assistance programs replicated in new communities	Reduced regional variation in the delivery of social assistance Extension of successful pilots from Social Policy and Community Social Services project to other areas	Social policy & community social services project supervision Social Policy and Community Social Services Project II (01)		Council of Europe Social Dev't Fund support for social services reform Government of Sweden support for community pilots Dutch Gov't support for social policy analysis, UNDP-administered
Pension system which is financially viable and stable in the short and long-run, and promotes economic growth and labor market participation while reaching intended target groups in effective and least-cost way	Take steps to complete pension reform by raising retirement age to counter demographic trends, reducing entitlements and increasing contribution compliance; moving to a partially funded system; developing effective supervision of private pension funds, and strengthening policy development and analysis	Plan for transition to fiscally sustainable well-regulated three-pillar pension system agreed Supervision of private pension funds being upgraded Pension policy development and analysis strengthened	Legal retirement age increased from current levels Funded pension tier approved Increased contribution compliance	Social policy development support TA, capacity building on private pension supervision (00)	Potential IFC investment in private pension fund management company	EU PHARE support for pension reforms Bilateral support for pension regulation

Key Development Objectives	Country Strategy & Key Actions	Bank Group Performance Benchmarks	Country Performance Benchmarks	Bank support instruments	IFC/MIGA support instruments	Other IFI/Donor Actions
Aggregate health indicators (outcomes) converging towards those in EU countries Health system characterized by high efficiency, quality of service delivery, good access and high consumer satisfaction Public health system adequately addressing changing burden of disease	Evaluate health financing reforms, introduce population-based regional resource allocation formula, improve contracts for hospital and primary health care providers, introduce transparent capital financing rules Implement national primary health care reform strategy Develop and implement national and regional health services restructuring plans to optimize hospital capacity Develop and implement modern public health strategy to address the changing root causes of the main health problems	Measurable progress towards population-based regional health resources allocation Common resource utilization indicators show steady improvement (average length of stay declining, number of hospital beds and facilities declining, share of patient hospital admissions referred by general practitioners increasing) Public health strategy and priorities developed and published Adequate and sustainable health status and risk surveillance system in place	Selected behavioral proxies for health status improving Public health strategy being implemented as scheduled	Health Project (99)	IFC study on private health insurance and health care in Poland and the Baltics	EU PHARE, SIDA support for health reforms
Formal education and training system meeting needs of flexible and open market economy More even quality of learning and access to education across space and income groups Cost-effective education system	Formulate clear overall education policy objectives, reform strategy; reorient education system towards skills needed in market economy. Develop teacher training, curricula and national assessment systems Exploit major opportunities for better cost-effectiveness; create incentives for efficient resource use by reforming budgeting methods, financing system, quality monitoring measures; enhancing accountability. Optimize network of schools	Clear education policy objectives and reform strategy adopted Education financing system improved; efficiency improved as evidenced by lower share of expenditures on facilities, cost-effective levels of school staffing	Education policy objectives and reform strategy being implemented Education system being reoriented to meet market economy needs Improvements in teacher training, curriculum Quality of education, move even across space, as evidenced by improved performance on national exams	Education project (02)		USAID support for education reform

Lithuania - CAS Summary of Development Priorities

Network area	*Country performance*[a]	*Major issue*[b]	*Country priority*[c]	*Bank priority*[c]	*Reconciliation of country and Bank priorities*[d]
Poverty Reduction & Economic Management					
• Poverty reduction	Fair	Speed and distribution of growth, esp. in rural areas	Moderate	High	Country main focus so far on growth, rural poverty study to raise awareness
• Economic policy	Good	Large current account/fiscal deficits	Moderate	High	Macrofinancial vulnerability review to define issues, show risks
• Public sector	Fair to good	Weak administrative capacity	High	High	
• Gender	Fair to good	Poor social assistance for one-parent households	Low	Moderate	Analytical work under social assistance projects to raise awareness
Human Development Department					
• Education	Fair	Low cost-effectiveness	Moderate	High	Government focus so far on other human dev't reforms
• Health, nutrition & population	Fair to good	Low cost-effectiveness	High	High	
• Social protection	Good	Poorly targeted social assistance	High	High	
Environmentally & Socially Sustainable Development					
• Rural development	Fair	Low labor productivity leads to future shakeout	High	High	
• Environment	Fair to good	Management capacity below EU standards	Moderate	Moderate	
• Social development	Good	Social exclusion of weak groups	Moderate	Moderate	

Network area	*Country performance* [a]	*Major issue* [b]	*Country priority* [c]	*Bank priority* [c]	*Reconciliation of country and Bank priorities* [d]
Finance, Private Sector & Infrastructure					
• Financial sector	Fair to good	Incomplete privatization of banks, weak non-bank supervision	Moderate	Moderate	
• Private sector	Good	Incomplete reform and implementation of legal and regulatory framework	High	Moderate	Growing role of private financing, shift within Bank Group from IBRD to IFC
• Energy & mining	Fair	Poor sectoral financial and managerial performance, weak corporate governance	Moderate	Moderate	
• Infrastructure	Good	Meeting EU accession requirements	High	Moderate	Other donors have growing programs

a. Use "excellent," "good," "fair," or "poor."
b. Indicate principal country-specific problems (e.g., for poverty reduction, "rural poverty;" for education, "female secondary completion;" for environment, "urban air pollution").
c. To indicate priority, use "low," "moderate," or "high."
d. Give explanation, if priorities do not agree; for example, another MDB may have the lead on the issue, or there may be ongoing dialogue.