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Country Assistance Evaluation

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Abbreviations and Acronyms

AAA	Analytic and Advisory Activities
AIDS	Acquired Immunodeficiency Syndrome
BEEPS	Business Environment and Enterprise Performance Survey
BoL	Bank of Lithuania
CAS	Country Assistance Strategy
CBA	Currency Board Arrangement
CEEC	Central and Eastern European Countries
CEM	Country Economic Memorandum
EA	Extended Arrangement
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
EFSAP	Enterprise and Financial Assistance Project
EIB	European Investment Bank
ESW	Economic and Sector Work
EU	European Union
FIAS	Foreign Investment Advisory Services
FSSA	Financial System Stability Assessment
GDP	Gross Domestic Product
HIV	Human Immunodeficiency Virus
HUDF	Housing and Urban Development Foundation
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
ILO	International Labor Organization
IMF	International Monetary Fund
ISPA	Structural Policy Instrument for Pre-Accession
KSSA	Klaipeda State Seaport Authority
MDP	Municipal Development Project
MIGA	Multilateral Investment Guarantee Agency
MIG	Municipal Infrastructure Grant
NGOs	Non-Governmental Organizations
NIB	Nordic Investment Bank
OECD	Organization for Economic cooperation and Development
OED	Operations Evaluation Department
PPP	Purchasing power parity
PREM	Poverty Reduction and Economic Management
QAG	Quality Assurance Group
ROSC	Reports on Observance of Standards and Codes
SAL	Structural Adjustment Loan
SAPPARD	Special Accession Program for Agriculture and Rural Development
SBA	Stand By Arrangement
SIDA	Swedish International Development Authority
SME	Small and Medium-Scale Enterprise
TB	Tuberculosis
UNDP	United Nations Development Program
USAID	U.S. Agency for International Development

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Preface

This evaluation provides an independent assessment of the role of World Bank assistance to Lithuania during 1991-2002. It covers all lending activities and economic and sector work during this period.

The building blocks of the Country Assistance Evaluation (CAE) are OED data and project assessments, interviews with Government officials, IBRD and IMF staff at headquarters and in Lithuania, and with key staff of main partners. An OED mission visited Lithuania from May 7 to 13, 2002. Comments from the Region and the Government are reflected in the report and Government's comments are attached in Annex F.

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Summary

1. Lithuania has overcome difficult structural problems and external shocks to achieve a generally successful transition to a market economy. When independence was regained in 1990, production was almost entirely state-owned and oriented to trade with the countries of the Council for Mutual Economic Assistance. Against this, its population of 3.7 million was well educated, GDP per capita at $2,710 was relatively high, Lithuania's location provided easy access to Western markets, and donors were supportive. Phased price liberalization was implemented early on. Lithuania adopted the Currency Board Arrangement in 1994 and has maintained a good record in adhering to its discipline. Trade reform was vigorously pursued to reorient markets.

2. Structural reforms were implemented slowly during the first half of the decade, but progress accelerated subsequently, in part motivated by Lithuania's efforts to overcome a banking crisis in 1995/6 and the impact of the Russia financial crisis in 1998 and 1999. Macroeconomic management and fiscal management in particular have been satisfactory, leading to strong GDP growth and even stronger export growth. Enterprise privatization is now almost complete, all banks are privately owned with substantial foreign participation, the framework for the banking sector is generally satisfactory, the energy sector operates on a largely commercial basis, and important issues in infrastructure are being addressed.

3. Unemployment is still higher than desirable, although it decreased from 17 percent in the first quarter of 2002 to 12 percent in the third quarter. However, reforms in health, education, and agriculture have lagged, human capital and labor mobility need to be enhanced; and further improvements are needed in the business regulatory environment (especially for small and medium scale enterprises). While poverty levels are only about 1 percent according to Millennium Development Goal definitions, they are about 25 percent according to the standards used by the European Union (EU). Pensions now account for 7.2 percent of GDP, almost one-fourth of public sector expenditure, and further reforms are being explored. Finally, municipal budgets account for 34 percent of public sector finances, and reforms are needed to make these more responsive to public sector needs.

4. EU accession has been an important anchor for Lithuania's reforms since the mid-1990s. Lithuania is expected to become a full member from May 1, 2004. However, further progress in agriculture is needed over time for convergence to EU income levels. In the energy sector, the Ignalina nuclear power plant needs to be closed which will be a substantial burden on the budget.

5. Since 1992, the Bank has lent a total of US$491 million to Lithuania, for 17 operations. Of this, 49 percent has been for three adjustment operations. As of December 2002, nine loans have closed, and seven have been evaluated by Operations Evaluation Department (OED). All but one have had satisfactory outcomes. The *Rehabilitation Loan* (RL) and *Structural Adjustment Loan I* (SAL I) achieved almost all of their objectives, with *SAL I* addressing issues important in helping Lithuania deal with serious financial sector problems. More recently, Lithuania met most of the conditions of *Structural Adjustment Loan II* (SAL II), which were important in overcoming the macroeconomic problems of 1999 and furthering adjustment in

the financial, energy, and other sectors. However, two key conditions were not met. One, relating to privatization of the gas company, raises the issue of whether there was adequate broad-based ownership to warrant the Bank's intervention in this difficult area, where the Bank considered that it would be in Lithuania's long-term interest to ensure that management of the company could act independently of the gas supplier. The second condition related to putting an end to government price intervention for sugar and grains, and although some sugar subsidies still exist, there has been a significant reduction in spending on agricultural support mechanisms.

6. The Bank's program of investment lending in environment, enterprise and financial sector reforms, energy efficiency, and agriculture has also met most of its objectives, and OED has rated the outcome of 95 percent of loan commitments as satisfactory. The outcome of only one project (agriculture) was rated unsatisfactory, as the Bank-funded line of credit was not competitive with domestic sources of finance, and the project failed to further key aspects of adjustment. In spite of the weaknesses outlined above, the overall outcome of the Bank assistance program is rated satisfactory.

7. Given Lithuania's forthcoming membership in the EU, it is likely that the reforms supported by the Bank will be sustained. Lithuania's institutions have been substantially improved and Bank projects have had a high impact on institutional development, particularly in areas such as banking reform, enterprise privatization, and energy.

8. Against this satisfactory track record of reforms, Lithuania still faces the continuing challenges outlined above. The key question for the Bank is its future role in post-accession Lithuania. If Lithuania requests Bank assistance, including lending, the Bank should focus on areas that complement EU assistance and where the Bank has a comparative advantage, in particular:

(i) *Direct Poverty Reduction and Unemployment.* The Bank should focus on labor market constraints and lack of labor mobility, the business environment, human capital development including the knowledge economy, unemployment services, and, in *agriculture,* development of a land market.

(ii) *Health care.* The Bank needs to build on the early experience of the Health Project to overcome vested interests in the sector and promote further progress.

(iii) *Municipal Governance*. The Bank needs to sustain and enhance its assistance to promote reforms in this sector.

(iv) *Pensions*. The Bank should continue offering technical assistance for pension reform.

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1. Country Background

Description

1.1 Lithuania is the southernmost and largest of the Baltic countries, on the eastern shore of the Baltic Sea. It shares borders with Belarus, Latvia, Poland and Russia. Its population of 3.5 million is 83.4 percent of Lithuanian origin. In 2001, the per capita income was estimated at $3,444.

Initial Conditions

1.2 In 1990, the year independence was regained, Lithuania found itself integrated into the Council for Mutual Economic Assistance, with exports highly concentrated in a few products (machine tools, dairy products). Reorienting trade to the West, restructuring productive assets, privatization, and price adjustments were all huge tasks. The energy sector posed special challenges in addition to public ownership and pricing, as the capacity of the two large Ignalina nuclear reactors exceeded Lithuania's power requirements. On the positive side, the population was highly educated and per capita incomes were among the highest in the Soviet Union, estimated at US$2,710. There was widespread support for economic reforms and, with its largely homogeneous population, Lithuania was not subjected to the kinds of demographic stresses found in other countries, although closely balanced political parties have resulted in twelve governments since 1990 due to shifts in voter preferences.

Economic and Social Progress 1990–2002

Macroeconomic Perspectives

1.3 During the first five years of the decade the focus was on stabilization and trade reform, and a start was made on privatization and restructuring. During these years, a new currency (the litas) was introduced, a reasonable exchange rate was fixed, and a Currency Board Arrangement (CBA) instituted in 1994 with support from the IMF. Many subsidies were eliminated and prices decontrolled so that over a five-year period the monetary overhang disappeared. Trade barriers came down and trade with market economies expanded. In spite of difficulties in implementing a new tax system, consolidated government deficits were limited to 5 percent of GDP and the financing constraints imposed by the CBA were respected.

1.4 Economic growth after 1994 has been, on the whole, satisfactory, although marred by two episodes. A banking crisis in 1995/96 (see para. 1.10) caused outflows which, with the constraints imposed by the CBA, generated economic contraction. While the immediate crisis was addressed and outflows reversed, some fundamental reforms stalled (including bank privatization and energy pricing) and short-term relief measures (loan guarantees, tax incentives, direct subsidies) were not phased out. Second, during the Russia crisis of 1998 exports lost competitiveness due to the depreciation of the ruble and the strength of the dollar to which the litas was fixed. GDP fell by 3.9 percent in

1999 and unemployment (International Labor Organization definition) increased steadily from 13.3 percent in 1998 to 17 percent in 2001 although in 2002 it dropped back to 13.8 percent. Exports to the Commonwealth of Independent States dropped by 59 percent, and total exports dropped by 18 percent. In addition, economic management weakened and the consolidated fiscal deficit increased from 5.8 percent of GDP in 1998 to 8.5 percent of GDP in 1999 as extra-budgetary expenditures and net lending (largely concerning the privatization of the Mazeikiai Oil Company) increased. A reform program was implemented to address these issues. The consolidated fiscal deficit was reduced to 2.8 percent of GDP in 2000 and further to 1.2 percent of GDP in 2002 as a result of revenue measures, postponement of a controversial savings restitution plan, and cuts in lending. These reforms were a sound basis for recovery, and their implementation resulted in Lithuania meeting or exceeding targets of the IMF Stand-By Agreement (SBA). As a result of these reforms, GDP growth during 2000–2002 has been strong, reaching over 6.5 percent per year for 2001 and 2002. Lithuania now has a competitive and dynamic export sector, and the ratio of exports of goods and services to GDP has increased from 27 percent in 1994 to 40 percent in 1999 and 50 percent in 2001.

1.5 Even though total external debt has increased substantially (and now exceeds 40 percent of GDP), it is well within sustainability limits given the growth of Lithuania's export earnings. Fully half of the debt is private sector debt, associated with privatizations and foreign direct investment. Public sector debt remains within prudent limits, with the IMF's SBAs playing an important role. An indicator of overall progress and external confidence in government's management of the economy was Lithuania's successful medium-term bond offering in early 2002 at rates below IBRD lending rates to Lithuania.

Table 1.1: Trends and Selected Economic Indicators 1992-2002

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
GDP growth	-21.3	-16.2	-9.8	3.3	4.7	7.3	7.3	-1.8	4.0	6.5	6.7
Inflation	1021	410	72.2	39.6	24.6	8.9	5.1	-1.8	1.0	1.3	0.3
Consolidated Fiscal Deficit/GDP	0.5	-5.1	-4.0	-3.8	-4.5	-4.5	-5.9	-8.5	-2.8	-1.9	-1.2
External Gross Debt/GDP	3.3	12.9	14	15	18	28	34.8	42.5	43.5	44.4	44.5
Unemployment rate by survey	1.0	4.0	4	6	15	14	13	14	15	17	13.8

Sources: IMF Reports, Structural Adjustment Loan documents, Lithuanian Authorities, and Country Economic Memorandum (CEM), 2002.

1.6 Progress on structural adjustment was quite significant, although uneven. Small and Medium Scale (SME) enterprise privatization proceeded quickly, and new SMEs were established, so that, despite some constraints in the business environment, SMEs accounted for 55 percent of both employment and value added by 1998. Larger enterprises were privatized more slowly, however, with indications of corruption in some cases. Structural reforms in infrastructure and, especially, agriculture, have been implemented more slowly than in industry.

1.7 As a result of these reforms, Government's role in the economy is now quite modest. Total government expenditure accounts for 34 percent of GDP, the smallest among the European Union (EU) accession countries[1] (where government, on average, accounts for 41 percent of GDP), and well below the average for countries of the EU which stands at 46 percent.[2] However, this enviable position is threatened by several problem areas not yet addressed: education expenditures are high and there is overcapacity in the health sector, and, over time, deficits on account of pension liabilities may increase.

1.8 Since the mid-1990's, Lithuania has been strongly committed to joining the EU as quickly as possible, and this has been a guiding force in reforms. Lithuania has achieved a range of reforms and been accepted for membership in the EU from 2004. However, further progress will be important in several sectors including agriculture and energy.

Sector Perspectives

1.9 *Private sector development*. While the privatization agenda is nearly completed (aside from some energy and transportation enterprises), private sector development could be further accelerated by reducing over-regulation. SMEs face substantial barriers in operation and expansion and complain about frequent changes and lack of clarity in regulations; large scale firms are able to overcome these constraints by hiring lawyers and other specialists to interact with the government.[3] Compared to other Central and Eastern European Countries (CEEC) accession countries, Lithuania ranks poorly in perceptions about tax regulations and administration, and labor regulations.[4]

1.10 *Financial sector reform* was a key objective from the start of the transition, with three broad components: (i) allow creation of new private banks; (ii) strengthen the central bank; and (iii) privatize publicly owned banks. The rapid expansion of private banks during the early and middle 1990s, many of which were weak, undercapitalized, and poorly managed, led to weaknesses in the sector and banks encountered liquidity problems. Problems became acute in December 1995, when the Bank of Lithuania (BoL) had to suspend all operations of the country's largest private bank (Innovation Bank) and its would-be merger partner due, primarily, to serious capital inadequacy and portfolio quality problems. Deposits were withdrawn from the commercial banks and there were also outflows, which put pressure, given the CBA, on the money supply with negative consequences throughout the economy. The number of banks fell from 28 in 1994 to 12 at end-1995. "First stage reforms" sought to shore up troubled banks, and these were

[1] The EU on December 12 and 13, 2002, accepted 10 countries for membership from 2004: Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic, and Slovenia. Other countries which the EU considers to be part of the same irreversible enlargement process are Bulgaria and Romania, and these are included among the accession countries referred to in this report.
[2] World Bank. 2002. *Expenditure Policies Towards EU Accession*. Washington, D.C.
[3] See "Lithuania: Study of Administrative Barriers to Investment." Paper presented by the Foreign Investment Advisory Service (FIAS) of the World Bank Group at the Conference held in Vilnius from September 23-24, 1999.
[4] The "Business Environment and Enterprise Performance Survey (BEEPS)," 1999, commissioned jointly by the World Bank and the European Bank for Reconstruction and Development. See Annex B for a description of the survey.

followed in 1997 with more substantial "second stage reforms" including restructuring the private banks and recapitalizing state-owned banks. The cost came to about 3.5 percent of GDP.

1.11 More fundamental banking reforms stalled, especially the privatization of state-owned banks, and the sector's remaining weakness was exposed in 1999 following the Russia crisis. Measures taken in the aftermath of these two episodes have substantially strengthened the banking system which is now functioning reasonably well. The central bank has been strengthened. The objectives of banking supervision are clearly set out in law, and the BoL has a wide range of powers to license and supervise banks and credit unions, and to manage their exit from the system when necessary. A comprehensive framework of prudential regulation and supervision has been established that conforms to the Basel Core Principles in most respects, including capital adequacy and adequate staffing for implementation.[5] Privatization of state-owned banks was completed in 2002. Foreign ownership of banks (at 92 percent) is among the highest in the CEEC. Nevertheless, a few issues remain such as improving the legal protection for BoL staff involved in bank supervision.

1.12 *Agriculture's* contribution to GDP declined from 27.6 percent in 1990 to 7 percent in 2001. Land privatization and restitution were implemented rapidly, but the result was a large number of small-scale landholders with nonviable holdings. There is an ineffective land market so that consolidation is blocked – leading to increased rural poverty. Labor adjustment has lagged the sectoral declines in output, and the agricultural sector still employs 18.7 percent of the labor force (28 percent if agro-processing is included). Both labor and land productivity are low not only by EU standards, but also in comparison to the other EU accession countries.[6] The causes of this are small farm size, pervasive uncertainty about support programs,[7] and low levels of capital investment and complementary recurrent expenditures.

1.13 The *environment* has seen substantial progress, but much remains to be done. GDP per unit of energy use (PPP$ per kg oil equivalent) has increased by 35 percent from 1990 to 1999 while CO_2 emissions have fallen by more than 25 percent during this period. Some environmental standards are now more restrictive than in the EU, including provisions on evaluating the impact of planned industrial activities on the environment, recycling of waste, and defining dangerous manufacturing objects.[8] Water supply issues at the municipal level are being addressed through investments.

1.14 Nevertheless, the agenda is still substantial. In order to meet EU emission norms, the Mazeikiai oil refinery will need to convert from the currently used heavy fuel oil with

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[5] See IMF (International Monetary Fund). 2002. *Republic of Lithuania: Financial System Stability Assessment.* Washington, D.C.

[6] Measured by value of output, land is only 15 percent as productive as in the EU, and only half as productive as in the EU candidate countries. Labor productivity is even lower, at 10 percent of EU levels. See *Lithuania Country Economic Memorandum* (CEM), Report no. 25005 dated October 7, 2002.

[7] The issue of agricultural subsidies and their implications for EU accession has not yet been settled, leading to uncertainty about future levels and their implications for farm profitability.

[8] See CEM, Report no. 25005 dated October 7, 2002, pg. 112.

2.5 percent sulfur content to a low sulfur heavy fuel oil at higher cost. Investments to meet emission norms will also be needed for power plants and some industrial producers using large combustion plants—43 such plants have been identified for which conversion costs are estimated to exceed US$200 million. About half of the country's tanker trucks and almost all of its rail tanks do not meet EU emission norms. Funding from the EU's Structural Instrument for pre-accession (ISPA) is expected to play an important role in improving performance in this sector.

1.15 *Social Sectors: Some Progress in Education but more to be done.* Education is virtually universal, with 99.7 percent of all pupils continuing beyond basic education (defined as 10 years). Expenditures, however, are inefficient. The student/teacher ratio was only 11.3 in 1997, well below the OECD average of 17.1. The school age population has been shrinking and is projected to shrink by 1.5-2.0 percent per year for some time. There is also an urban bias, as fewer rural students continue beyond primary school than students in urban areas.

1.16 In the *Health Sector*, despite improvements, Lithuania is still behind EU countries, with infant mortality substantially higher and life expectancy lower (related in part to alcohol and tobacco usage, but also to the higher incidence of TB and other diseases), as indicated in Table 1.2 below. There is overcapacity in some areas.

Table 1.2: Health Status Indicators

	Life Expectancy		Infant Mortality Rate		Standardized Death Rates Per 100,000						
	1990	1999	1990	1999	Circulatory	Cerebro-vascular	Ischemic Heart Disease	TB	Selected Alcohol-related Causes	Selected Smoking related causes	All Causes
Lithuania	71.3	72.4	10.3	8.7	509.0	119.2	307.1	10.0	166.6	503.2	980.0
Other CEEC Accession Countries	70.7	72.3	14.8	9.9	559.2	154.3	234.6	5.1	129.1	468.2	1058.8
EU Average	75.8	78.1	7.7	5.2	269.8	68.6	109.1	0.9	81.8	247.9	690.1

Source: WHO, Health for All Database, 2001
Note: All country data is for the year 1999 while the EU average is for the year 1997.

1.17 Lithuania introduced substantial pension reforms in 1994/95, well ahead of many of its neighbors and highly regarded at the time, although further reforms are warranted. Pensions now account for 7.2 percent of GDP, or about one-fourth of public sector expenditure, and the deficit on account of this Pay-As-You-Go (PAYG) system now amounts to 0.4 percent of GDP, with increases projected for the future. The tax rate on gross wages to finance pensions is 25 percent,[9] with 22.5 percent borne by the employer

[9] The 25 percent tax rate is lower than in most of the EU accession countries such as the Czech Republic, Hungary, Latvia, and Poland, although it is higher than in Estonia and Slovenia. Concerning the EU itself, the 25 percent rate is higher than in Germany (20 percent) and France (15 percent for incomes between eu9,800 and eu28,500). "Study on Social Protection Systems in the 13 Applicant Countries." GVG, November, 2002.

and 2.5 percent by the employee. Pension reform would be desirable on account of the likelihood of future increases in the deficit and the high level of taxation already in place.

Poverty and Unemployment

1.18 Despite strong GDP growth, unemployment is high, estimated at 13.8 percent of the labor force in 2002, an increase from the very low (though likely underreported) rates of about 1 percent at the beginning of the transition. Poverty reduction needs to be a continuing priority. Poverty rates were measured at 1 percent under the $1 per day criteria in 1995, but, more relevantly, at about 3.3 percent in 2000 for the more widely accepted cut-off level of US$2.15 purchasing power parity (PPP) per day in 2000 (equivalent to a minimum standard of living as calculated by the Government), and at 25.5 percent for a cut-off of US$4.30 PPP per day in 2000 (a minimum standard of living as calculated for OECD countries).[10] Households headed by women and those with education of less than secondary school level have the highest concentrations of poverty. Rural poverty rates are much higher than urban poverty rates.

Remaining Challenges

1.19 Remaining challenges include: (i) implementing a smooth transition to full EU membership in 2004, including further progress in agriculture, energy (including the framework for addressing issues raised by the Ignalina Nuclear Power facility), and financial and budgetary provisions; (ii) addressing unemployment and poverty by: upgrading human capital skills and unemployment services; reducing labor market constraints; reducing market imperfections in agriculture and other sectors; and focused programs for vulnerable groups; (iii) completing the privatization agenda in public utilities; (iv) addressing shortcomings in the regulatory environment; and (v) furthering health, education and pension sector reforms.

2. World Bank Products and Services

Strategy and Policy Advice

2.1 The Bank's overall objectives during the past ten years were to assist in the transition and to address poverty reduction by helping to restore and sustain overall growth. Given the overall decline in the economy during the first four years of the transition, estimated at as much as a 50 percent drop in GDP, these objectives were well chosen. The central components of this strategy were stated in Country Economic Memoranda (CEMs) and other Economic and Sector Work (ESW) which helped set a detailed agenda, and adjustment loans which assisted in implementation of key reforms. Investment lending has also supported important reforms, but proposed investment lending has not always materialized as priorities have shifted with changes in

[10] *Source*: Lithuania Household Budget Survey, 2000.

governments. The key question for the future is the role of the Bank in post-accession Lithuania, discussed in Chapter 5.

Country Assistance Strategies

2.2 The Bank's 1994 strategy of assistance to Lithuania was the first fully developed statement of Bank assistance strategy. Its main objectives were to: (i) maintain macro-financial stability, and strengthen the financial sector, including privatization of banks; (ii) provide incentives for further liberalization and private sector development; (iii) reorient the energy sector; (iv) provide targeted social protection; and (v) maintain and develop physical infrastructure.

2.3 To support these objectives, a lending program of about US$43 million per year for a period of five years was planned. Only investment operations were proposed, in accordance with Lithuania's preferences, as the IMF and industrialized countries were preferred sources for balance of payments support. However, the Bank's strategy included adjustment lending as a reserve instrument in case of shocks.

2.4 The 1999 Country Assistance Strategy (CAS) shifted focus somewhat. While continuing to assist to maintain macro-stability, financial sector and pension reform, the CAS introduced support for health and education and a number of specific EU accession issues, which were spelled out in some detail: (a) enhancing competitiveness, including issues in corporate governance, bankruptcy, the judicial system, the legal and institutional basis for regulating infrastructure and energy, and limiting overt and hidden subsidies to enterprises; (b) raising rural productivity; (c) strengthening public administration capacity and institutions at the central and sub-national levels; and (d) upgrading infrastructure and environment. Lending of about US$60 million a year during FY99–02 was proposed, with a high case option including adjustment lending in the event of an external shock.

2.5 *Evaluation of strategies.* The strategies were relevant to addressing Lithuania's constraints. The early priority on restoring macroeconomic stability and growth while assisting in the transformation of the Lithuanian economy was appropriate, as were the sectoral emphases on energy, targeting social protection, and infrastructure. The expanded scope of assistance strategies in the FY99 CAS was also appropriate, in particular, addressing selected social issues not specifically addressed by the EU accession agenda while also supporting the EU accession agenda explicitly. The "external shock" scenario included as a high case alternative was also appropriate.[11]

Implementation of Strategies: Lending

2.6 IBRD lending has played an important role in assisting Lithuania, as foreseen in the CASs, even though the number of loans and lending volumes were somewhat less than envisaged. Total Bank lending since FY94 has been $431 million, compared to a

[11] The FY99 CAS (Report no. 19135) was presented to the Board on April 19, 1999, after the onset of Russia's economic crisis.

planned amount of $574 million, including the "External Shock" scenario which came to pass.

Table 2.1: Projected and Actual Lending (US$ Millions)

	FY94	FY95	FY96	FY97	FY98	Total 1994 Strategy	FY99	FY00	FY01	FY02	Total 1999 CAS
Proposed	27	29	85	80	85	306	48	55	40-110	55	198-268
Actual	26	32	42	113	0	213	20	57	99	42	218

Source: Business Warehouse

Overview of Lending

2.7 The Bank initiated lending to Lithuania with the *Rehabilitation Loan* (RL) (US$60 million), approved in FY93, prior to any strategy document but in the framework provided by an operationally useful CEM (see para. 2.23). Bank lending during the five years covered by the 1994 strategy fell short of projections by 30 percent, despite the addition of *SAL I* to the program ($80 million) and the country's overall need for external financing. The first years of investment lending closely follow the program proposed in 1994, with the *Power Rehabilitation Project* (FY94) and *Klaipeda Environment Project* (FY95) approved on schedule and the *Enterprise/Finance sector adjustment project*, brought forward to FY95. Thereafter, actual lending fell short of planned lending in part because the frequent changes in governments made continuity and adherence to schedules difficult. Out of the seven remaining projects proposed over the FY94-98 period, only two were approved as projected (*Agriculture and Energy Efficiency/Housing*), four slipped by more than a year, and one was dropped from the program entirely. Conversely, three projects were added to the program (including *SAL I* which was appropriately added to the lending program to support reforms as Lithuania coped with the financial crisis).

2.8 Lending also fell short of projections in the FY99 CAS. The "External Shock" scenario, which obtained in light of the Russia crisis, called for lending of $268 million, whereas the outcome was $218 million, a 19 percent shortfall. Out of eight projected loans, two failed to materialize (*Social Policy and Urban Transport*), while approval of two projects (*Klaipeda Port and Vilnius District Heating*) was substantially delayed.

2.9 In general, it was more difficult to implement social sector projects in line with agreed schedules than projects in other sectors. This seems to be related to the lack of a socio-political consensus in Lithuania in moving ahead in these areas, a situation found in many other countries. In education and

Table 2.2: IBRD Commitments by Sector

Sector	Total (US$ million)	Percent
Agriculture	30	6
Economic Policy	239	49
Electric Power and Energy	49	10
Environment	13	3
Finance	25	5
Health, Nutrition, Population	21	4
Social Protection	4	1
Education	25	5
Transportation	54	11
Urban Development	30	6
Total	491	100

Source: Business Warehouse

health reforms, improving efficiency entailed addressing the legacy of past overinvestment in physical structures and overstaffing especially in areas of lower population density, and ran into opposition from doctors and other sector professionals who were understandably resistant to policies favoring disinvestment. Although the Bank supported the substantial pension reform of 1994/95 with well-targeted non-lending technical assistance, proposed lending for the next stage of pension reform did not materialize, partly because it was difficult to develop a consensus for the next round of reforms.

Adjustment Lending Operations

2.10 The *RL* was intended to provide liquidity as the country overhauled its trade system and to allow the country to import high priority goods: energy, agricultural goods, and pharmaceuticals. However, the Bank did not appreciate the start-up difficulties for lending, and the loan took three years to disburse, rather than the projected 18 months, because of turnover in the Steering Committee and Project Implementation Unit, the rapidly-changing status of state purchasing agencies (as some were privatized and others went bankrupt), structural changes in the economy making demand difficult to project, complex Bank procurement controls, and lack of local currency resources of some potential importers. As a result of these delays, some of the imports (especially pharmaceuticals) turned out to be less useful as the rapidly growing private sector provided them more quickly.

2.11 *Structural Adjustment Loan I* (SAL I), developed in response to a request from Prime Minister Slezevicius and based on analytical work for the 1999 CEM, was approved in FY97, in the wake of the banking crisis. It addressed systemic banking sector problems[12] and constraints in energy, agriculture, and social insurance. More specifically, *SAL I* sought to strengthen banks financially, improve supervision, liquidate or close insolvent banks and bring all remaining banks into full compliance with BoL regulations, initiate bank privatizations, and apply deposit insurance equally to all banks (previously, deposit insurance had been applied only to public-sector banks). *SAL I* also supported a substantial decrease in energy sector arrears, establishment and operation of an independent Energy Pricing Commission, sale or initiation of privatization for many components of the state-owned energy sector, and much wider adoption throughout the economy of international-standard accounting, procurement, and management procedures. In agriculture, *SAL I* supported reductions in agricultural subsidies, although progress was achieved only through difficult negotiations and was barely adequate to warrant release of the tranche. Finally, *SAL I* supported the privatization of some enterprises, and reforms in social insurance. *SAL I* was highly relevant and achieved most of its objectives, although some reforms in social insurance have not yet materialized, and agricultural subsidies remained an issue. The outcome of the loan was rated satisfactory by OED.

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[12] Building on work begun in the FY95 *Enterprise and Financial Sector Assistance Project* (EFSAP), see para. 2.14.

2.12 *Structural Adjustment Loan II* (SAL II) (FY01) had an equally broad but relevant agenda, with a total of seventeen conditions for first and second tranche release. In addition to supporting a macroeconomic framework, *SAL II* supported in: (i) improving budget management, including government accounting, reducing incentives to support commercial activities, governance of extra-budgetary funds, and improving the core budget process including moving to program budgeting; (ii) reforming of pensions and social assistance, including strengthening the existing pension system and developing a timetable for deeper reforms; (iii) promoting private sector development, including completing privatization of the banking sector, moving to voluntary compliance strategy in tax administration, implementing new auditing and accounting laws to improve corporate governance, a revised bankruptcy law, removing bottlenecks in land markets and sale of goods; (iv) restructuring and privatization in the energy sector, including choosing pro-competitive models for power and gas, unbundling of power company, privatization of power distribution and natural gas, new laws for electricity, gas and district heating and strengthening the independence of the regulator, and reform of pricing rules for power and gas; and (v) reforming agriculture, including policy reform to reduce the level of subsidies and converting the open-ended nature of support mechanisms to an EU-consistent policy framework, and removing barriers to functioning of land markets.

2.13 Implementation of *SAL II* was challenging, and the record suggests that broad-based government ownership and capacity to implement parts of the package were lacking. While most of the conditions were met, two key ones were not: (i) privatization of the gas company according to a pro-competitive model; and (ii) containing agricultural subsidies. The government chose to proceed with privatization of the gas company in a manner deemed not satisfactory (that is, not pro-competitive) by the Bank, as the government is planning to sell a significant share to its only supplier of gas, GAZPROM.[13] In addition, the Government did not act on the remaining agricultural price regulation (grains and sugar), presaged by the difficult negotiations required for *SAL I* implementation. The Government decided not to seek withdrawal of the remaining tranche of *SAL II*, noting that its budget position had improved so that this funding was not required,[14] and further, that Lithuania was able to borrow on the market for general budgetary purposes at rates comparable to the cost of World Bank loans. The Bank agreed and closed the operation.

Investment Lending Operations

Private Sector Development, Finance Project

2.14 The Bank successfully promoted private sector development through the *Enterprise and Financial Sector Assistance Project* (EFSAP, FY95) for US$25.0 million which financed bank lending to enterprises for restructuring, and technical assistance to support policy reforms identified in the Bank's diagnostic work. In addition, an innovative bank capitalization fund was financed as part of this project by the

[13] In so doing, Lithuania is following the same model as in Estonia and Latvia.
[14] See Annex F, "Comments from Government".

Government of Sweden. Donor coordination in support of private sector development was promoted by the *EFSAP*, including that of the Danish, Swedish and Dutch Governments, EU-Phare, and USAID. The outcome of this project was rated satisfactory by OED.

Infrastructure, Energy, and Environment Projects

2.15 Energy sector reforms have been central to progress towards EU accession. The Bank has been active in this sector, with lending based on its diagnostic work, assisting Lithuania with the removal of subsidies (a major achievement given the extremely low prices at the start of the transition), unbundling electricity generation and distribution and guiding privatization in the sector, and implementing a regulatory system through investment lending (*Power Rehabilitation Loan*, FY94, US$26.4 million) and *SAL I* and *SAL II*. The outcomes of these loans have been rated satisfactory.

2.16 Important environmental challenges remain. At the municipal level, the *Siauliai Environment Project* (FY96, US$6.2 million) sought to reduce water pollution, improve environmental management, and achieve financial viability through increased efficiency and water pricing. It was rated moderately satisfactory by OED. Major environmental issues were successfully addressed, donor coordination in the sector was enhanced, the utility was reformed into a shareholding company with modern management and tariff structures, and a model was established for water supply sales providing financing for waste water treatment. However, water supply and treatment facilities are now oversized for current water sales which plummeted after new metering and increased tariffs, and reduced income threatens the financial viability of the utility. Tariffs are approved by locally elected officials who face local pressure, and until an impartial central regulator is appointed it seems likely that financial losses will continue, with a chilling effect on attracting needed new investment to the sector. The Government is now seeking to incorporate 40 major and hundreds of minor water supply companies into about 5 companies, which should facilitate more appropriate pricing as well as better management. The *Klaipeda Geothermal Project* (FY96, US$5.9 million) seeks to develop energy from moderate heat sources deep underground using somewhat experimental technology, but technical problems have emerged. The closing date was extended four times, as solutions for these problems were sought, but the project was found by OED to have had a moderately unsatisfactory outcome.

2.17 The Bank has been active in assisting reforms in infrastructure sectors. The Bank's *Highway Project* (FY97, US$19 million) assisted with repaving the national and district road networks, bypasses, bridge repairs, and, most important, improved road safety. Shortfalls in this otherwise successful project were the road safety program, which was not implemented as foreseen, and an expanded education program for school children which was not pursued. The Klaipeda port (the only ice-free port in the Baltic Countries) is benefiting from improved works and privatization of services supported by the ongoing *Klaipeda Port Project* (FY00, US$35.4 million), to reduce port closures by lessening the risk of accidents especially during stormy weather, accommodate deeper draft vessels, and other improvements.

2.18 The *Energy Efficiency/Housing Pilot Project* (FY97, US$10 million) was rated satisfactory in achieving its objectives in developing the market for private sector housing services, and improving energy efficiency by empowering homeowners and municipalities to make decisions about consuming space heating based on individual choice and ability to pay. This pilot project served its purpose in helping determine consumer demand for energy efficiency investments; demand for subloans was initially slow but increased when a subsidy was introduced. The ongoing *Municipal Development Project* (FY99, US$20.1 million) supports reforms of local government administration and finance through institutional capacity building and development of a viable system for financing local government expenditures, with an emphasis on municipalities outside the capital to redress regional imbalances. The project will finance municipal sub-projects and includes cross-financing[15] with the Nordic Investment Bank.

Agriculture, Health, Education and other Social Sector Projects

2.19 The *Private Agriculture Development Project* (FY95) comprised a line of credit, of which only one-third disbursed because of noncompetitive interest rates, an inadequate distribution network (based mainly on the Agriculture Bank of Lithuania), too few bankable sub-projects (as land could not be used as collateral), and high perceived administrative costs.[16] Technical assistance promoted land restitution and reforms (titling, registration, etc.) although Lithuania was still left without a satisfactory land market, identified as a major constraint by the Bank's Agriculture and Food Sector Review (1995). The project outcome was rated as unsatisfactory. Major constraints continue to be incomplete formal transfer of direct and indirect tenurial rights to farm operators (as of January 2002, state controlled lands still comprised 47 percent of all land used for agricultural purposes and about 43 percent as of January 2003) and restrictions on farmland ownership including prohibitions against ownership by domestic legal entities and foreigners.[17]

2.20 The Bank's ongoing *Social Policy Project* (FY97, US$3.7 million) is improving resource use in the Ministry of Social Security and Labor, strengthening monitoring and policy evaluation, and supporting development of community social service pilot projects (such as training center for handicapped young adults, day center for the elderly and handicapped, and a shelter for battered mothers and their children). The project is highly appreciated in Lithuania. The ongoing *Health Project* (FY00, US$21.2 million) was based on proposals from district health units. It seeks to improve delivery of health services by rationalizing excess capacity (including oversized hospitals) and refocusing resources on higher priority needs including prevention. However, the health project is moving slowly as it has become difficult to persuade the medical establishment of the need for consolidation and retrenchment and the Ministry of Health has not played a strong leadership role. The ongoing *Education Project* (FY02, US$25.4 million) focuses

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[15] Cross-financing is an innovative project arrangement under which the Nordic Investment Bank can be called on to finance a sub-project appraised by the IBRD, and vice versa, as determined by the Government in consultation with the two parties.
[16] See Annex F "Comments from Government" which makes the point that preparation was slow and insufficiently flexible to respond to changing conditions.
[17] CEM 2002, pg 75.

on improving teaching quality, better management at the municipal level, and energy efficiency (school heating).

Box 2.1: IFC and MIGA

IFC has committed US$80.6 million for seven projects in Lithuania, and another US$63.52 million for multi-country projects which include Lithuania (see Annex C). Recent projects include IFC assistance to a major bank and lending with a focus on SMEs, privatization and upgrading facilities in a major textile enterprise (jointly with EBRD), modernization of Lithuania's only color television picture tube manufacturer, and assisting construction of an asphalt production plant. While many projects have been successful, one project (Litekas wool mill) was rated unsuccessful, another (Mediena) was cancelled, a line of credit to a major bank (Vilniaus Bankas) was replaced with a subordinated loan and one project (Drobe Wool) is now experiencing significant difficulties due to lack of a strategic sponsor with industry expertise. Given Lithuania's acceptance for EU membership in 2004 and the growing availability of financing from private sources, IFC's strategy is to focus on areas where participation could yield significant value-added, such as export-oriented projects and the development of financial institutions such as insurance and pension fund management. IFC has provided a number of advisory services, partly through FIAS.

MIGA has explored several opportunities for insurance. With EU accession so close, and Lithuania able to access international markets for financing, the kind of political risk that could be addressed by MIGA is rapidly diminishing.

Source: IFC

OED Ratings

2.21 Ten projects have been evaluated by OED, including three project performance assessments. Project performance has been better than for the ECA Region and Bank-wide, for 1992–03. Satisfactory project outcome for Lithuania stands at 97 percent by commitment.

Table 2.3: Ratings on Closed Projects (percent, by commitment amount)

	Satisfactory Outcome	Likely Sustainability	Substantial Institutional Development
Lithuania	97	97	80
ECA	74	82	47
Bank-wide	82	75	50

Source: Business Warehouse.
Note: This table has been updated as of December 19, 2003; Annex E Table 5a reflects information that was current at the time the report was sent to the Committee of Development Effectiveness (CODE), April 2003.

QAG Ratings

2.22 Lithuania also has fewer projects at risk, compared to the Bank and the ECA average (see Table 2.4).

Table 2.4: Active Projects at risk, percent by number

Lithuania	0.0
ECA	16.0
Bank-wide	17.0

Source: Business Warehouse

Implementation of Strategy: Analytical and Advisory Services[18]

2.23 The Bank's focus on key adjustment issues in the lending program also guided its analytical and advisory work, with CEMs playing a central role in defining issues and proposing reforms. The 1993 CEM was a well documented and effectively presented analysis which played an important role in setting Lithuania's transition agenda including price reform, introducing a new currency, stabilization measures, adoption of an outward orientation in trade, and comprehensive approach to restructuring of enterprises and banks building on a successful start of enterprise privatization program. Social safety net reforms were also proposed.[19] Dissemination, including translations of chapters, was well handled.

2.24 The CEM and Poverty Assessment proposed for FY96 were not completed as envisaged, but, in the wake of the 1995/96 financial crisis, the CEM was appropriately re-focused on the adjustment issues and helped set the agenda addressed by *SAL I* (FY97). Unfortunately, the Poverty Assessment was not subsequently picked up, with the most recent slippage occurring when expected bilateral financial support failed to materialize.

2.25 The FY99 CAS proposed a full CEM planned for FY01 on EU Accession. Although delayed, the FY03 CEM offers a careful analysis of the causes of poverty in agriculture and other sectors drawing on UNDP work done on poverty, and suggests a program to address a range of poverty-related issues, thereby compensating, to some extent, for the lack of a Poverty Assessment. The CEM also provides a sound analysis of the most important remaining EU accession issues, with specific recommendations to complete the transition to EU membership. The CEM also discussed pensions, but its treatment of this issue is not fully satisfactory (see para. 2.29).

2.26 Sector reports as well as activities supported by Institutional Development Funds[20] opportunistically addressed important issues and provided a relevant complementary guidance to the CEMs. They were generally of high quality and had a substantial impact on policies and institutions. The Public Expenditure Review (FY94) provided a detailed analysis and specific recommendations for reforming the framework for public expenditures which helped guide government policy. Ongoing sector work to develop the knowledge economy is welcomed by the Government as providing useful insights to develop Lithuania's human capital.

2.27 From the outset of the Bank's assistance program, it was recognized that the energy sector would require huge adjustments and therefore was an early focus of analytical work. The Energy Pricing Note (FY95) built on the Energy Sector Review

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[18] A complete list is provided in Annex E, Table 4.

[19] Even at this early stage, detailed suggestions for social safety net reforms were presented to the Government for its consideration. Ten years later, decisions are yet to be made on basic reforms. In this first CEM, the detailed reforms comprised: (i) proactive labor market policies and provision for increasing expenditures on unemployment benefits, (ii) improved targeting of social benefits including means testing, and (iii) revision of the pension system.

[20] Including those for Vilnius Old Town, Statistical Office, Agricultural Statistics, and Environmental Policy Development.

(FY94) and the study of Power Demand and Supply Options (FY93), all of which provided clear guidance on reforms, including converting the state from owner to regulator with stepwise reforms such as unbundling generation and distribution and improving the quality of supervisory boards.

2.28 Because of concern that the agricultural sector could be left behind in the transition, the Agriculture and Food Sector Review (FY95) emphasized the need for continued price liberalization, subsidy reduction, measures to restore trade, expediting land reform and formulation of a land market, and privatization, marketing, and credit reform. This analytic work had some impact on price policy, privatization, and trade policy, but had very little impact on the formulation of a land market and on subsidies. The Bank complemented these policy recommendations with the *Private Agricultural Development Project*, whose design, however, was ill-suited to address constraints identified in the sector work and whose outcome was rated unsatisfactory.

2.29 Pension reform has been a focus of Bank analytic work and policy dialogue since the Bank's early involvement in Lithuania. The Bank's technical assistance played an important role in formulating Lithuania's substantial pension reform in 1994/95. It became more difficult thereafter to achieve a consensus on subsequent reforms, despite intensive policy advice which enhanced Lithuania's capacity to analyze and manage pension systems. In addition, partly because the Bank's institutional perspectives on optimal pension systems evolved during this time, its approach and recommendations were not always consistent. The most recent published work dealing with this, the FY03 CEM, did not provide a clear analysis of pension issues. Finally, some suggested reforms could have been costly. As a result of all of these factors, the Bank's advice on pension reform has not always been well-received since the 1994/95 reforms. More recently, the Bank has offered useful analytical tools and international comparisons to re-establish the basis for a dialogue.

2.30 The FIAS study on Administrative Barriers (October, 1999) clarified problems faced by enterprises, and was a useful input to *SAL II*. However, the 2002 update of the FIAS study found that administrative barriers still impose a substantial burden on SMEs and on start-ups, although (as noted above) much less of a burden on established larger enterprises.[21]

2.31 Given the new role of the private sector in banking and finance, it was important to take stock of the existing framework, which was done by the Bank and Fund's Financial System Stability Assessment (FSSA),[22] completed in December 2001. The FSSA found that there appear to be no immediate threats to the stability of the bank-dominated financial system and that there were vigorous structural and legal reforms in preparation for accession. The FSSA also found that anti-money laundering policies were generally sound.

[21] Government has commented that it would like a further update of this study, due to the importance of the investment climate. See Comments, Annex F.

[22] Comprising Reports on Observance of Standards and Codes (ROSC) for Monetary and Financial policy Transparency, Banking Supervision, Insurance Regulation, and Payment Systems.

2.32 The report "Issues in Municipal Finance" (May 2002) determined that municipal finance issues were important and had not yet been adequately addressed. It noted that municipal governments now account for 34 percent of total government spending (excluding social security) and are primary providers of education, public utilities (excluding electricity), and a variety of welfare programs and urban services. It therefore addresses a number of key EU accession issues, and has been well-received in Lithuania, including by EU authorities.

Resource Mobilization and Aid Coordination

2.33 During the last decade, the World Bank has provided about 14 percent of aid (including other official flows).[23] Aid coordination has been facilitated by the resident mission, which has frequent contact with bilateral and multilateral donors. This has led to successful cooperation at the project level. The Bank's program in Lithuania is now an example of well-structured and even innovative coordination, as described in Box 2.2 below. Many project-specific programs have benefited from TA coordination (although this has required substantial staff inputs). For example, the *Energy Efficiency/Housing Pilot Project* was supported by grant financing from the Governments of Denmark, Sweden, and the Netherlands, the *Highway project* benefited from cofinancing from Japan and EBRD, and the *Siauliai Environment Project* benefited from financing from Sweden, Finland, and Norway. In addition, ESW, such as the Public Expenditure Review, has been an important basis for donor meetings and enhanced donor coordination.

2.34 While coordination between the Bank and the EBRD has not always been smooth and occasionally entailed competition for the same project (for example, *Vilnius District Heating*), it has improved through efforts at the institutional level with agreed memoranda of understandings and project-specific coordination between task managers.

Box 2.2: Good Practice: Donor Coordination

The *Municipal Development Project* (MDP) incorporated a collegial approach with aid partners. The project comprises technical assistance and institution-building, a line of credit to finance investment subloans, and Municipal Infrastructure Grants (MIGs) for projects in smaller municipalities that have broader economic benefits and costs, such as in the environment sector. Funding, in addition to that supplied by the World Bank's MDP, comprises: (1) for the MIGs, SIDA, the Ministry of Environment in Finland and the Ministries of Energy and Environmental Protection in Denmark, and (2) for the line of credit, a flexible mechanism for cross-financing of subprojects with the Nordic Investment Bank (NIB) 1998, and the European Investment Bank (EIB). Under the cross-financing agreement, the World Bank and NIB exchange experience and subproject pipeline information. In accord with government priorities, financing for a subloan is then arranged drawing on the WB line of credit and NIB and EIB financing. Donor coordination has also been improved with the strengthened Housing and Urban Development Foundation (HUDF), wholly owned by the Ministry of Finance.

[23] See Annex E, Table 3.

3. Assessment of the Development Impact of Bank Assistance

Macroeconomic Stabilization and Sustainable Growth

3.1 As discussed in Chapter 1, the last few years have seen sustained GDP growth, low inflation, a manageable BOP current account deficit, and sizeable foreign direct investment. The budget deficit has been kept low, and issues related to the excessive consolidated fiscal deficit and government lending in 1999 have been addressed. Exports have been growing more rapidly than GDP. An interesting overall indicator of confidence in the economy is the average yield on government bonds which has declined from 12-14 percent in 1999 to 4 percent (for 3 year bonds) to 6 percent (for 10 year bonds) in 2002. Finally, Standard and Poor's raised the country's long-term foreign currency rating from BBB- to BBB in April 2002,[24] Moody's from Ba1 to Baa1 in November 2002 and Fitch from BBB- to BBB in December 2002. The country's reputation on international markets is strong.

3.2 Other indicators which point to strengthening macroeconomic performance include increases in gross national savings, general government savings, and reductions in nonperforming loans to total gross loans in the banking sector (Table 3.1). Through the *SALs*, policy dialogue, and other vehicles, Bank assistance has played an important role in all of these areas.

Table 3.1: Selected Macroeconomic Indicators (in percent)

	1998	1999	2000	2001	2002
Average Monthly Wage (US dollars)	232	247	243	246	n.a.
Gross National Savings/GDP (percent)	12.3	11.9	14.2	16.2	17.4
General Government Savings/GDP (percent)	-1.1	-3.9	-0.2	-0.1	1.7
General Government Fiscal Balance/GDP(percent)	-5.5	-8.3	-2.7	-1.6	-1.2
Nonperforming loans to total gross loans	12.9	12.5	11.3	9.9	n.a.
Debt Service/Exports	22.6	20.0	20.9	35.1[1/]	48.6[1/]
BOP Current Account Deficit/GDP	-12.1	-11.2	-6.0	-4.8	-4.4

Source: IMF (September 2003), Lithuanian Authorities, and FSSA Report.
[1/] The rise in Debt service/Exports in 2001 and 2002 reflects large-scale amortization of dollar-denominated debt which has now been fully repaid.

Government's Role in the Economy and Governance

3.3 Government (excluding net lending)[25] accounted for 33.6 percent of GDP in 2000, well below the average for accession countries (40.6 percent) and for the EU (45.8 percent). The fiscal balance (including net lending) at -2.7 percent in 2000 and -1.2 percent in 2002 is not as healthy as EU average (a surplus of 1.2 percent), but is similar to other EU Pre-Accession states such as Latvia and Estonia. Lithuania's fiscal management is prudent, and it has closely adhered to *SAL* agreements and IMF programs.

[24] Other countries which received BBB ratings for long-term foreign currency debt were China, Oman, and Tunisia.
[25] Government net lending in 2000 in Lithuania was equivalent to 0.7 percent of GDP.

Both Bank sector work and Bank-financed projects have supported reforms that have led to these positive outcomes, through progressive tariff and price increases, resulting in reductions in subsidies, and other policies that have reduced government expenditures in these sectors.

3.4 Governance issues were identified in the 1999 CAS. At the national level, the Bank's assistance has played an important role in improving the institutional basis for regulating infrastructure and energy, limiting overt and hidden subsidies to enterprises, improving banking supervision and management of the financial sector, and improving budget management by enhancing the transparency of financial statements for government accounts. At the municipal level, the Bank has begun a promising dialogue on improving governance.

3.5 Lithuania has made substantial progress in aligning its legal system, including the Civil Code, to the EU system, with support from the EU, the EBRD, and other parties, in the context of EU accession. In its anti-corruption legislation, Lithuania has been guided by the Council of Europe, and it has ratified the Council of Europe Convention on Money Laundering, Search, Seizure and Confiscation of Proceeds from Crime. Because of this European support, the Bank has not been active in these reforms.

Private Sector Development and Finance

3.6 With about 70 percent of GDP originating in the private sector, Lithuania has clearly made the transition to a market economy, fully in line with the transitions of other EU accession states. The Bank's *EFSAP* provided finance and pro-PSD policy reforms were supported by the *SALs* and the *EFSAP*. However, obstacles remain, as indicated by the following perceptions by entrepreneurs: perceived high levels of taxation (cited by 40 percent of firms), problems with legal framework (25 percent of firms), and lack of skilled workforce (13 percent).[26] Overregulation, and the unpredictability of regulations, including enforcement, were also frequently cited impediments.

Table 3.2: Indicators of Financial Sector Performance

	1997	2001
Spread between reference lending rate and deposit rate: foreign currency	6.5	4.8
Difference between highest and lowest interbank rate in local currency	8.8	3.5
Difference between highest and lowest interbank rate in foreign currency	4.5	3.7
Ratio of personnel expenses to non-interest expenses	41	34
Banking sector assets as a percentage of GDP	24	28

Source: FSSA

3.7 The banking sector has made substantial progress, in which *SAL I* and *SAL II* have played important roles. All previously state-owned banks have been privatized. Foreign ownership is above 90 percent, second highest among accession economies. Banking sector reforms and financial regulations are rated about average for accession countries

[26] Lithuanian Firm Survey, 2001, cited in the 2002 CEM.

(EBRD index), on a par with Latvia. Efficiency has improved, as indicated by the reduced spread between reference lending rates and deposit rates for foreign exchange loans from 1997 to 2001, and the reduction in personnel expenses to non-interest expenses for the sector (see Table 3.2), as overstaffing associated with the state ownership in the past was addressed with privatization. Competition has led to a lowering and convergence of costs, indicated by the decrease in the spread between the highest and lowest interbank rate in both local currency and foreign exchange. Banks are now playing a larger role in the economy, and assets of the banking sector have grown (see Table 3.2). The financial sector as a whole has also expanded, partly as a result of financial sector technical assistance from the Bank, from 118 institutions with assets equal to 26 percent of GDP at the end of 1997 to 212 institutions with assets equal to 32 percent of GDP in June 2001.

Energy, Environment, and Infrastructure

3.8 Energy reform has come a long way in Lithuania, as noted above (para. 1.13) and shown in Annex E, Table 8. Price reforms, establishment of an independent regulatory agency, transfer of district heating from energy companies to municipal authorities, unbundling generation and distribution to prepare for privatization, and improved financing have all occurred in the last few years with substantial input from the Bank. However, the Bank has not been involved in improving the operations of the oil refinery,[27] nor in road or rail containers, where further progress is needed to address environmental concerns relevant to EU accession. As noted (para. 2.13), one aspect of the energy sector in which Bank-supported objectives were not met was in the privatization of the gas company. Since the government is negotiating to allow GAZPROM, the supplier, to own a substantial portion of the newly privatized gas company, the company is unlikely to seek alternative sources of supply.

3.9 Key reforms in the energy sector for the future will involve the progressive restructuring and privatization of the energy companies created out of the Lithuanian Energy Company, improving security of supplies (an important EU accession issue), and a range of issues concerning the closure of the two Ignalina Nuclear Power reactors which the EU deems non-upgradeable to international safety standards at a reasonable cost[28] but which produce 70–80 percent of the energy consumed in Lithuania. While the EBRD will play the main role in decommissioning, the Bank will have a continuing role in reducing the environmental impact of increased reliance on thermal and other power plants for electricity production.

3.10 The *Siauliai Environment Project* helped reduce leaks and infiltration in the water and waste water networks. Although the water supply company is still facing substantial

[27] Aside from a *SAL I* second tranche condition on measures to be taken toward the privatization of the refinery. The actual privatization occurred some time after second tranche release.
[28] See, for example, the Regular Report for 2000 from the Commission on Lithuania's Progress Towards Accession, Chapter 14, November 8, 2000.

financing problems as price increases have not compensated for decreases in water usage. OED assessed overall sustainability of benefits likely.[29]

3.11 *Highways*. Lithuania now has a better level, quality and efficiency of periodic maintenance for roads and bridges, and an improved system of planning and management for maintenance based on technical and economic criteria, as well as stronger institutional capacity. While the road safety component of the Bank's Highway Project was not fully implemented, road safety in Lithuania has improved, and the number of fatalities dropped by 12 percent (from 7.5 to 6.6 per 10,000 vehicles) between 1996 and 1999, largely due to improvements in road signs and markings on the national road network. The Bank's Highway project supported these achievements. Future savings and greater efficiency will result from contracting out of civil works and the introduction of the competitive bidding processes, also supported by the Bank's Highway Project.

3.12 *Ports*. Reforms in the sector include the establishment of the Klaipeda State Seaport Authority (KSSA) and the transfer of state-owned assets to the KSSA, which were supported by the Bank through non-lending activities. The *Klaipeda Port project* (FY00) builds on these reforms, although it is still early to evaluate its impact.

Poverty Alleviation and Social Development

3.13 The Bank has addressed poverty by promoting growth. While extreme poverty is not substantial, poverty in Lithuania exceeds that in EU comparator countries (although levels are similar to those in other accession countries), and pockets of poverty, especially in rural areas, need to be addressed by improving markets and factor mobility. Expenditure on social security and welfare as a percent of GDP was only 10.5 percent, well below the accession country average of 13.5 percent.

3.14 The Bank's lending is too recent to have had any impact in the Health sector where further progress is clearly needed (see Table 1.2, page 5). There is an urgent need to consider strategies, in conjunction with the EU and bilateral donors, to improve implementation of the reforms supported by Bank's Health project.

Outcome of the Country Assistance Program

Relevance

3.15 The objective of the country assistance strategy was highly relevant, initially addressing critical constraints to transitioning to a market economy where the Bank had a subsequent role. The CEMs offered generally sound analysis and practical recommendations on reform, which were used as a basis for the design of adjustment lending that addressed macroeconomic stability, the consolidated fiscal deficit, and related issues. Similarly, sector work highlighted critical reforms, some of which were

[29] The Government noted that EBRD interventions in the water supply sector have made substantial progress in improving municipal water supply company finances. This progress may be attributable to the fact that the solvency of EBRD's direct borrowers is a matter of some importance to EBRD and that EBRD interventions do not rely on government guarantees.

pursued such as in energy, agriculture, social sectors, and infrastructure, many of which were important for EU accession.

3.16 Most lending operations were substantially relevant, particularly the adjustment operations, energy, and municipal development, and social sector projects. However, there were several areas where assistance was less relevant.

- *Privatization*. Although the Bank offered useful policy advice and operational support through projects including the *EFSAL* and the *SALs* for privatization of small and medium enterprises, the Bank Group (including IFC and MIGA) was absent in some critical areas, especially large-scale privatization (with the notable exception of the gas company). Following a scandal over privatization of the petroleum refinery, the Bank should have tried to become more pro-active and involved in improving the rules of the game for large scale privatization, without necessarily becoming involved in specific cases such as the gas company. IFC has a relatively small presence in Lithuania, although it has had an active program of technical assistance. MIGA has no operations to date.

- *Agriculture*. Although the Bank's sector work in agriculture clearly identified constraints, the agriculture project failed to adequately address some critical areas, especially the need to develop a land market, and a follow-up operation was not defined in the FY99 CAS. Although expenditures for subsides have come down recently, they still need to be harmonized with EU policies.

Box 3.1: EU Accession and World Bank Assistance to Lithuania

The EU views continued Bank assistance to Lithuania as relevant and important as Lithuania joins the EU, based on the Bank's past and ongoing programs, particularly in poverty reduction, education, and health. The EU also acknowledges that the Bank has done a great deal of useful work in the energy sector. The EU thinks that the Bank has a role to play in pension reform, which it sees as a priority. Other areas with a strong continuing potential for complementarity include the Special Accession Program for Agriculture and Rural Development (SAPPARD) program (which can accommodate 50 percent cofinancing) and Structural Policy Instrument of Pre-Accession (ISPA) (which can accommodate 20 percent cofinancing). The Bank could play an important complementary role with specialized expertise and local knowledge.

Nothing in World Bank policy precludes an operational relationship with Lithuania following EU accession, although administrative budget resources for work in Lithuania and other post-accession countries are likely to be highly constrained. Hence, World Bank activities will need to be highly selective, focusing on areas where: (1) significant policy issues remain; (2) the World Bank has a comparative advantage; and (3) the World Bank is not duplicating the efforts of other partners. Development areas not covered in the EU acquis communautaire are a priori candidates for such assistance, and include education, health, poverty alleviation, social development and protection, some aspects of good governance and public administration, labor market and knowledge economy issues.

Efficacy

3.17 Generally, the efficacy of the Bank's assistance to Lithuania has been high. At the macro-level, the CEMs had a substantial impact in helping to guide the transformation to a market economy, while *SAL I* and *SAL II* had a strong impact on macro-economic stability by addressing the consolidated fiscal deficit and improving performance in the financial sector. Sector ESW, investment loans, and aspects of the *SALs* were also generally effective in promoting reforms in the energy sector, highways, and ports. It is too early to tell in education and health. Areas where the efficacy of Bank assistance fell short were the privatization of the gas company and removal of agricultural price controls for wheat and sugar, although there has been recent progress in reducing these controls. Following through on health and education reforms remains a challenge for the future.

Efficiency

3.18 Efficiency is rated as substantial, in view of the diseconomies of scale to be expected for a small country. The average cost per project for 15 ongoing and completed projects is similar to that in Latvia, 12 percent less than in Estonia and 12 percent more than in Slovenia (see Annex E, Table 6). Average costs per US$1,000 of gross commitment for satisfactory and nonrisky projects is US$29.4, compared to US$42 for Latvia and US$53 for Estonia, but 75 percent higher than the ECA and Bank-wide averages. This is not too surprising since the average project size in Lithuania is $30 million, about one-third the average for ECA and the Bank. Lithuania is not an outlier given its size relative to other countries and seems to be among the more efficient programs for small countries.

Summary Rating of the Outcome of Country Assistance Development Impact [30]

3.19 The overall rating for the outcome of Bank assistance to Lithuania is satisfactory. Despite some concerns, the Bank's record over the past 10 years in assisting Lithuania in its successful transition to a market economy and in achieving growth objectives, as well as important sector reforms in fiscal, financial, energy, and transportation sectors, points to a satisfactory development impact.

Institutional Development Impact

3.20 Bank assistance had a high impact on the budget (which in turn was critical for achieving stability and growth), privatization, banking reform, municipal/housing development, power/energy (despite gas privatization), ports (Klaipeda), and social policy. By contrast, Bank assistance has had only a modest impact thus far on health and a negligible impact in agriculture. Given the substantial impact achieved in major areas, the overall rating of substantial is warranted.

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[30] See Annex G.

Sustainability

3.21 Sustainability is judged to be likely in virtually all areas. Some risks to sustainability over time are presented by the lack of progress in addressing the high unemployment rate (which is now about 14 percent with indications of a downward trend). However, the high degree of government ownership in most areas, anchored by EU accession, is a major factor in this evaluation. Reforms such as the privatization of the banking sector and energy measures are most unlikely to be reversed or undermined. The budget reforms and deficit reduction measures are subject, as in any country, to some risk of reversal in view of popular pressures, but the public sentiment in support of accession is strong enough to give only a low probability to this kind of reversibility. Finally, high GDP growth rates based on successful reforms have given the government the opportunity to address issues such as pensions and unemployment, an opportunity which should be pursued as soon as possible to avoid further risk.

Counterfactual

3.22 The Bank had seen investment lending as the basis for its assistance, with adjustment lending as a possible response to adverse developments. If the Bank had not responded to Lithuania's adjustment needs with *SAL I* and *SAL II*, Lithuania's response to financial sector issues and the ballooning consolidated fiscal deficit would probably have been more limited. Progress might have been slower in key reforms such as privatization of the banking sector and moving the energy sector to a more competitive framework. This would have adversely affected both the efforts for macroeconomic stabilization and economic growth as well as accession discussions with the EU.

3.23 As a more extreme counterfactual, the Bank might not have initiated any assistance program, on the basis of Lithuania's good relations with several donor countries, its small size, and its relatively high per capita income. This, however, would have substantially set back Lithuania's transition and left the country to face a difficult adjustment with fewer intellectual and financial resources than comparator countries. In the absence of Bank assistance, it is much less likely that Lithuania would have by now achieved acceptance for EU membership.

4. Contributions to Outcomes

World Bank Performance

4.1 The Bank addressed most of the right issues and included provisions in its strategies for adverse contingencies (in the form of adjustment lending). This showed a good assessment of the risks faced by Lithuania and were an appropriate response. In addition, the quality of the diagnostic work was good and there were generally strong links between the analysis and the design of the Bank's lending program. Finally, the Bank has made a concerted effort at forging partnerships. The client survey supports this assessment.

Box 4.1: The Client Survey

The Client Survey conducted in 1998 sought to improve the Bank's understanding of clients' perceptions and priorities and to identify areas which need improvements. The survey included senior government officials, public and private enterprise managers, legislators, think-tanks, representatives of the non-governmental organizations (NGOs), media representatives and other donors.

In general, the Bank was highly regarded for technical competence, accessibility, delivering on commitments, knowledge about best international practices, and appropriate focus on Lithuania's development priorities. There was, however, a feeling that the Bank's rules and regulations were too rigid and inflexible. On the other hand, the Bank was rated highly, for providing explanations and assistance in dealing with its rules and regulations.

There was a general perception that there was room for improvement in adjusting to local circumstances and making use of local expertise. This is a frequent perception in client countries.

To respond to the survey, the Bank has sought to improve communications (including the hiring of a local External Affairs Officer) to better explain the Bank's positions, make better use of local expertise in the Vilnius office, and to take actions to adapt to changing local conditions.

Client Country Performance

4.2 Lithuania has been guided by its desire to reform and restructure its economy, with the focus for the past few years on joining the EU anchoring this desire in a concrete set of objectives. Changes in government, however, have made policy continuity difficult and slowed reforms concerning issues such as health, where stronger country initiatives could have achieved significant progress. Although Lithuania was not strongly pro-active in addressing some issues such as banking reforms, it did react with speed when faced with a crisis.

Aid Partner Performance

4.3 Lithuania's aid partners have been generous and generally focused on high priority areas. The Nordic countries have played a most important and generous role in moving rapidly to provide technical assistance and financing. This has been complemented by the United States and the Netherlands. The EU is increasingly the major aid partner; and accession provides a wide-ranging framework to guide progress. The EU now has a firm presence and a very active program.

4.4 The IMF has played an important role through its 1993 SBA, the Extended Arrangement (EA) in 1994, and the SBA in 2000, through which the Fund has supported the successful implementation of the CBA, maintenance of macroeconomic balances, and reforms in areas such as the fiscal and financial sectors.

4.5 The EBRD program, close in size to that of the World Bank, has generally addressed high priority issues, including adjustment away from nuclear energy and energy sector reforms. Nearly half of its lending has been in infrastructure (energy efficiency and power, municipal and environment infrastructure, and transport), one fourth in industry, and the balance in finance. The EBRD has played a very useful role and is highly respected in Lithuania.

4.6 The UNDP has done high priority work with the preparation of a poverty "benchmark" analysis in 1997. In addition, the UNDP agreed with the Government on a poverty reduction strategy for 2002–2004, which is built on the poverty analysis and includes strategies to attack poverty including enhancing employability, improving vocational training, developing small business and farming in rural areas, supporting NGOs, and assisting in education, health, and other sectors.

Impact of Exogenous Factors

4.7 The single most important exogenous factor in the last decade has been the Russian banking crisis of 1999. Lithuania took advantage of this threat to its economy to push forward with reforms and to expeditiously address many adjustment issues.

5. Lessons and Recommendations

5.1 The main question for the future concerns the role that the Bank could play in post-accession Lithuania. Demand for Bank adjustment lending is likely to be small, and, in any event, such lending would be difficult to justify given Lithuania's emerging access to bond markets and its capacity to finance its overall budget. However, there are still important issues to be addressed for which the Bank has some relevant expertise and where the Bank could make a difference in the pace and strength of policy reforms. These areas include health, education, pensions, municipal governance/finance, agriculture, the environment, and energy. Therefore, a well-targeted program fully coordinated with EU programs could have a high pay-off. Lithuania's per capita income is well below the cut-off for IBRD lending, so that in terms of Bank guidelines continued lending beyond EU accession would be appropriate.

5.2 Other important recommendations emerging from this evaluation are:

(a) As an essential component of the strategy to reduce poverty, the Bank should find a way to support agricultural sector adjustment and land reform, including the creation of a land market. Further work would be useful to ensure that sector issues are fully understood and such understandings should be shared with the Government. Direct assistance would be useful, including facilitating public acceptance of limited land sales to foreigners. In addition, to address unemployment, the Bank should support initiatives to reduce labor market constraints, improve the business environment and unemployment services, and upgrade human capital.

(b) To ensure an appropriate payoff from good sector work, more attention needs to be paid to sequencing and prioritizing. Such was the case in a number of sectors such as energy and private sector development, but less so in agriculture.

(c) The Bank should focus early on developing a public consensus for contentious issues, including a strong component of public outreach in areas where there may be resistance, such as health and pension reform in which progress continues to be difficult.

Individuals Interviewed

Present and former Lithuania Government officials

Ms. Adudrone Morkuniene,
Vice Minister of Social Affairs and Labor

Ms. Ruta Skyriene
Deputy Director-General
Nordea Bank

Mr. Arturas Dainius
Vice Minister of Economy

Mr. Gediminas Rainys
Vice Minister of Economy

Ms. Asta Ungulaitiene
Vice Minister of Finance

Ms. Natalija Kazlauskiene
Advisor to Minister of Finance

Mr. Rimantas Vaicenavicius
Head of Fiscal Policy Dept.
Ministry of Finance

Ms. Rima Vaitkiene
Head of Secretariat of National Health Council
Former Vice Minister of Health

Mr. Andrius Kubilius
Former Prime Minister
Member of Budget and Finance Committee
Seimas (Parliament of Lithuania)

Mr. Emilis Guistainis
Vice Minister of Environment
Ministerial Secretary

Mr. Vygantas Katkevicius
Director of Economics and Finance Dept.
Ministry of Agriculture

Ms. Laima Mogeniene
Chairperson, Association of SME of Kaunas Region

Mr. Ramunas Vilpisauskas
Free Market Institute

Mr. Reinoldijus Sarkinas
Chairman of the Board
Bank of Lithuania

Ms. Ramune Zabuliene
Former Head of WB Lithuania Office
Deputy Chairwoman
Bank of Lithuania

Mr. Mindaugas Jonikas
Former Vice Minister of Finance
UAB Hermis Finansai

Mr. Aloyzas Vittkauskas
Managing Director
Housing and Urban Development Fund (HUDF)

Ms. Daiva Kamarauskiene
Head of State Debt Management Dept.

Ms. Diana Vaitiekuniene,
State Guarantees and Loan Division

Mr. Valentinas Milaknis
Former Minister of Economy
Director General
Lithuanian Radio and Television

World Bank Staff

Mantas Nocius, Manager, World Bank Office, Vilnius

Ms. Giedre Tarbuniene
Research Analyst, PREM

Mr. Lars Jeurling
Former World Bank Resident Representative for Lithuania, Latvia, and Estonia
Consultant, ECSPF

Ms. Vilija Kostelnickiene
Sr. Operations Officer, ECSHD

Mr. Inesis Kiskis
Sr. Environmental Specialist, ECSSD

Michael Carter, past Country Director

Basil Kavalsky, past Country Director

Dominique Lallement, Infrastructure

Gary Stuggens, Lead Energy Economist

Jeffrey Balkind,, Municipal Development

Rodrigo Chaves, Agriculture

Christopher Hall, Country Manager

Marcello Giugalie, Past Country Economist

Ardo Hansson, Lead Economist

Bernard Funck, Lead Economist

Celestin Monga, Senior Economist

Others

Mr. Michael Graham
Ambassador
Head of European Commission Delegation

Mr. Mark Horton
IMF Resident Representative

Mr. Vaidotas Ilgius
Head of NGO Information and Support Center

Ms. Cihan Sultanoglu
UNDP Res. Rep, Program Coordinator

Surveys Referred to in the CAE

This annex provides background information for the surveys referred to in the CAE.

Household Budget Survey. Since 1995, Lithuania has carried out Household Budget Surveys which comply with the main requirements of Eurostat. Households are selected for the survey using a random sampling method from the population register. The selected households are provided questionnaires in which they keep track of monthly income and expenditures on non-food commodities and services, while expenditure on food products is recorded twice a month. For the year 2000, 9246 households were selected of which 7111 (77 percent) fully participated in the survey. The five major cities showed the highest percentage of non-response (34 percent), while the rate of non-response in other cities and towns was 19 percent, and in rural areas, 12 percent.

Client Survey. The Client Survey was commissioned by the Bank and carried out as part of the CAS process in October-November 1998 by the Lithuanian Firm “SIC Rinkos Tyrimai”. 110 clients were selected, defined as all those with an informed opinion about the World Bank’s work in Lithuania. 86 questionnaires were filled out, a very high response rate. The largest three sectors covered by the survey were finance, banking, or insurance (31 percent), infrastructure (19 percent), and social organizations (15 percent). By kind of organization, senior officials in government comprised 18 percent of the sample, public enterprise managers, 17 percent, private enterprise mangers 14 percent, and NGO representatives, 13 percent, with 38 percent scattered in other categories.

Enterprise Surveys. The Enterprise Survey is carried out annually by the Enterprise Statistics Division of the Statistics Department according to regulation No. 58-97 dated 12/20/1996 of the European Council on Business Structure Statistics. It is based on data from the Statistical Survey and from the State Tax Authority. Enterprises are grouped by type of enterprise (state, municipal, joint stock companies, closed stock companies, cooperatives, sole proprietorships, and individuals working on patents), and by size, determined by number of employees. In the year 2000, data was collected on 58,804 enterprises (of which 36066 were sole proprietorships or individuals working on patents). In 2001, there were 62,236 enterprises, of which 40,496 were sole proprietorships or individuals working on patents. Tax data was the only source of information used for sole prioprieterships or individuals working on patents, while for the large enterprises, 15,677 submitted their financial data to the Statistics Department for the survey, while tax data was used for 6,063 enterprises (28 percent).

Business Environment and Enterprise Survey (BEEPS). Commissioned jointly by the World Bank and the EBRD, the 1999 BEEPS was a firm-level survey of more than 3,000 enterprise owners and senior managers in 22 transition countries.

IFC in Lithuania
(member of IFC since 1993)

Investment

1. IFC has committed a total of $80.6 million in seven projects in Lithuania. Investments are in food processing, textiles, and electronics industries, as well as an investment in Vilniaus Bankas, the country's leading bank. (For details, please see attached table). In addition, IFC has committed $63.52 million in multi-country projects, which have included activities in Lithuania. Regional investments include funds for SMEs, housing finance, and in private outpatient clinics. A new regional investment will provide partial guarantees to private banks providing loans to enterprises for investments in energy efficiency improvements.

Advisory

2. IFC has provided a range of technical and advisory assistance in Lithuania. Since 1993, the Foreign Investment Advisory Service (FIAS), a joint facility of IFC and the World Bank, has supported the Government's efforts to improve the investment climate and remove administrative barriers to foreign direct investment. FIAS also advised the Government on the foreign investment law.

3. Other work was conducted with support of IFC's Technical Assistance Trust Funds. A full list of advisory assignments can be found in the attached table, but some highlights include:

- In 1999, at the request of the Ministry of Finance, IFC reviewed the legal environment for leasing and assessed the market potential for leasing in Lithuania.
- IFC's strategy for SME development focuses on intermediaries, which can provide medium-term funding to viable SMEs. IFC conducted a survey of the SME sector in the Baltics in order to better support this key sector.
- In the financial sector, IFC provided technical assistance to the Lithuanian Securities Commission in drafting securities laws and identifying regulatory gaps in the system.
- IFC carried out an independent review of the largest state-owned insurance company in preparation for privatization.
- At the request of the Government, IFC conducted a survey of several local companies, fully or partially owned by the Government and in varying degrees of financial and operational distress. The survey classified the companies and developed specific action plans for each.
- IFC reviewed draft legislation of the voluntary and mandatory pension legislation and contributed to the dialogue between the Government and World Bank on pension development.

Issues

4. Mediana was cancelled due to sponsor issues. The first commitment to Vilniaus Bank (VB), a 20 million dollar credit line committed in 1999, was cancelled at the request of VB and replaced with the subordinated loan of US$18.3 million in 2000. The other six committed projects have gone forward.

5. The Litekas project was evaluated and rated unsuccessful, mostly due to the bankruptcy of the sponsor.

6. The only other project currently experiencing significant difficulties is Drobe Wool. The critical weakness in the project has been the lack of a strategic sponsor with industry expertise, as the largest shareholder is an investment fund, and other shareholders include EBRD, IFC, company management, and small shareholders. Macroeconomic and country issues cannot be blamed for most of the company's adversities, although the local government has put a lot of pressure on the plant, for example, to continue operation of a non-core asset that provides district heating (and was later purchased by the government) and because the plant is a large employer.

7. Remaining obstacles to increased private sector activity and foreign direct investment in Lithuania include the need for privatization in key sectors.

Strategy

8. In the real sector, IFC will continue to focus on export-oriented projects in which Lithuania has a comparative advantage, such as pulp and paper and food processing, and projects in sectors with large growth potential, such as retail trade and services. IFC will also promote the development of financial institutions, such as insurance and pension fund management.

IFC Investment Projects and Advisory Assignments

Committed Investments

Board Approval Date	Project	Project Cost*	IFC Commitment	Project Description
May-02	Hotel Lietuva	30.4	9.8	Refurbishment and repositioning of Hotel Lietuva in Vilnius from a Soviet-style to an international standard mid-market hotel.
Nov-00	Vilniaus Bankas		18.3 20.0	Provision of long-term funding to Vilniaus Bankas AB. By improving the bank's capital position, the project is expected to allow Vilniaus Bankas to prudently expand its operations and better serve Lithuania's developing corporate sector, primarily SMEs. This project would be a key component of IFC's strategy to target SMEs in the Baltics. Credit line (cancelled)
Dec-99	Drobe Wool	21.3	6.6	Privatization and phased upgrading of fabric forming and finishing operations at Drobe, the country's largest producer of wool worsted fabrics. Established in 1920, Drobe is one of the largest textile producers in Central and Eastern Europe, employing over 2,000 employees and headquartered in Lithuania's second-largest city, Kaunas. Drobe has established itself in Western markets as a quality, low-cost source of fabrics. The company currently sells about three-quarters of its output to Western markets. This project is a joint investment with the EBRD.
Jan-99	AB Ekranas	39.5	12.4	Modernization of Ekranas, Lithuania's only television color picture tube (CPT) manufacturer and one of the largest private sector employers. It is located in Panevezys in the northern part of the country. As a result of the project, Ekranas will i) modernize CPT production including refurbishment of the glass furnace; ii) raise the quality of final products due to better glass and improvements in the CPT assembly process; and iii) address various environmental deficiencies.
Jan-00	Mediena		2.8	CANCELLED
Jan-99	Vilniaus Margarino Gamykla	2.3	0.5	Construction of a margarine production plant in Vilnius. The project was financed through the Investment Fund for Central and Eastern Europe.
Apr-95	Liteksas Ir Kalw	27.2	10.7	Modernization and expansion of a privatized, export-oriented wool mill to increase the production capacity and improve fabric and blanket finishing. This project is IFC's first investment in Lithuania.

Advisory Assignments for Lithuania
(including regional assignments benefiting Lithuania)

Country	Project Name	Appvl Amt (USD Equiv.):	Financial Year:	Approval Date:	TF id:	Dept:	sector name:	Status
Baltic Republics	Estonia, Latvia, Lithuania: Baltic Small and Medium Enterprise (SME) Fund TA Facility	100,000	2001	5/14/2001	AUS1	CEU	Private Equity Funds	Active
Baltic Republics	Baltic Small and Medium Enterprise (SME) Fund Technical Assistance Facility (Estonia/Latvia/Lithuania)	140,000	2001	5/15/2001	FIN2	CEU	Private Equity Funds	Active
Baltic Republics	TA to Support SME Activities	350,000	1998	6/ 9/1998	FIN2	CSE	Other	Active
Baltic Republics	Fishing Fleet Modernization	100,000	1993	8/18/1992	USA1	CAG	Fishing	Closed
Baltic Republics	Construction Materials Sector/ Project Identification Study	100,000	1994	11/ 9/1993	FIN2	CEM	Construction and Real Estate	Closed
Baltic Republics	Forestry Sector-Development Study	150,000	1996	11/14/1995	SWE2	CSE	Silviculture	Closed
Baltic Republics	Forestry Sector-Development Study	250,000	1996	12/12/1995	FIN2	CEM	Silviculture	Closed
Baltic Republics	Health Care Sector Study	100,000	1998	12/18/1997	FIN2	CEM	Health Care	Closed
Europe Region	Regional: Pension Reform Technical Assistance	350,000	2000	5/15/2000	NET2	CSE	Finance & Insurance	Active
Europe Region	TA to conduct Occupational Health Reform Related Activities and a Fire safety Audit-Medicover (Central & Eastern Europe)	200,000	1999	3/16/1999	NET2	CSE	Health Care	Active
Europe Region	Feasibility Study for ORESA Ventures Health Care Fund (Eastern and Central Europe)	35,000	2000	4/ 4/2000	IFC4	CHE	Health Care	Closed
Europe Region	Poland & Baltics: TA for SMEs concerning the Management of Working Capital	66,000	1999	4/23/1999	DEN2	CSE	Finance & Insurance	Closed
Europe Region	Market Assessment for Housing Finance Projects	216,300	2001	12/ 4/2000	NET2	CFM	Finance & Insurance	Active
Lithuania	Dairy Sector	25,000	1999	1/20/1999	IFC3	CAG	Food & Beverages	Closed
Lithuania	Leasing Study	20,000	1999	2/ 3/1999	IFC3	CSE	Rental & Leasing Services	Closed
Lithuania	KLAIPEDOS MEDIENA Wood Products Plant:Technical Assistance on Business Plan & Expansion Options	50,000	1994	2/17/1994	FIN2	CEM	Industrial & Consumer Products	Closed

Country	Project Name	Appvl Amt (USD Equiv.):	Financial Year:	Approval Date:	TF id:	Dept:	sector name:	Status
Lithuania	Developing the Environment for Leasing	20,000	2000	2/18/2000	NOR2	CSE	Rental & Leasing Services	Active
Lithuania	Advisory Assistance to Government on Restructuring of Selected Key Enterprises	60,000	2000	2/21/2000	SWE4	CSE	Other	Closed
Lithuania	Post privatization Project	50,000	1998	3/16/1998	IFC2	CSE	Other	Closed
Lithuania	LITEKSAS (Management and Training)	200,000	1995	5/10/1994	SWI2	CEM	Textiles, Apparel & Leather	Closed
Lithuania	Post privatization Project-Phase II	75,000	1998	5/22/1998	IFC2	CSE	Other	Closed
Lithuania	Developing the Environment for Leasing	100,000	1998	6/10/1998	NOR2	CSE	Rental & Leasing Services	Active
Lithuania	TA on Establishing of Register of Economic Entities	115,000	1999	6/14/1999	NOR2	CSE	Other (For Non-Investment Projects)	Active
Lithuania	Environmental Audit of "EKRANAS" (a TV tube producer)	50,000	1997	6/27/1997	DEN2	CEM	Electrical Equipment, Appliances and Components	Closed
Lithuania	Liteksas Integrated Wool: Products Study	115,000	1994	7/12/1993	SWI2	CEM	Textiles, Apparel & Leather	Closed
Lithuania	LITEKSAS (Management & Training)	97,650	1995	7/15/1994	UKG1	CEM	Integrated Textile Operation (Spinning, Weaving/Kn	Closed
Lithuania	TV Tube Producer (EKRANAS)-Technical & Market Study	25,000	1998	7/18/1997	IFC2	CEM	Electrical Equipment, Appliances and Components	Closed
Lithuania	Drobe Wool: Assist in Sale of Drobe Textiles' Plant Property and Equipment in Vieciunai, Lithuania	25,000	2001	8/ 3/2000	IFC5	CSE	Textiles, Apparel & Leather	Closed
Lithuania	Lietuvos Draudimas - Review Assignment	30,000	1999	11/12/1998	NET2	CSE	Finance & Insurance	Active
Lithuania	Post Privatization Assistance to Potentially Viable SMEs	48,500	1999	12/15/1998	IFC3	CSE	Other	Closed

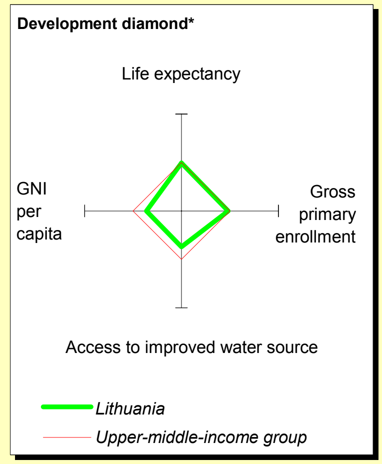
Statistical Tables

Note: Tables 2 to 8 reflect information that was current at the time report was sent to the Committee of Development Effectiveness (CODE), April 2003.

Table 1: Lithuania at a glance

8/20/03

POVERTY and SOCIAL	Lithuania	Europe & Central Asia	Upper-middle-income
2002			
Population, mid-year *(millions)*	3.5	476	331
GNI per capita *(Atlas method, US$)*	3,660	2,160	5,040
GNI *(Atlas method, US$ billions)*	12.7	1,030	1,668
Average annual growth, 1996-02			
Population *(%)*	-0.6	0.1	1.2
Labor force *(%)*	-0.4	0.4	1.8
Most recent estimate (latest year available, 1996-02)			
Poverty *(% of population below national poverty line)*	..	..	..
Urban population *(% of total population)*	69	63	75
Life expectancy at birth *(years)*	73	69	73
Infant mortality *(per 1,000 live births)*	9	25	19
Child malnutrition *(% of children under 5)*	..	..	..
Access to an improved water source *(% of population)*	67	91	90
Illiteracy *(% of population age 15+)*	0	3	7
Gross primary enrollment *(% of school-age population)*	101	102	105
Male	102	103	106
Female	101	101	105

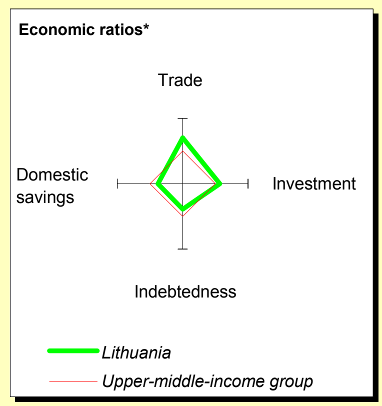


Development diamond*

KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1982	1992	2001	2002
GDP *(US$ billions)*	..	11.4	11.9	13.8
Gross domestic investment/GDP	..	15.7	21.8	22.5
Exports of goods and services/GDP	..	23.4	50.9	45.0
Gross domestic savings/GDP	..	19.2	16.3	16.5
Gross national savings/GDP	..	..	16.9	17.0
Current account balance/GDP	..	..	-4.8	..
Interest payments/GDP	..	0.0	1.8	1.7
Total debt/GDP	..	0.5	44.2	44.9
Total debt service/exports	..	0.3	30.6	31.8
Present value of debt/GDP	..	..	43.7	..
Present value of debt/exports	..	..	81.9	..

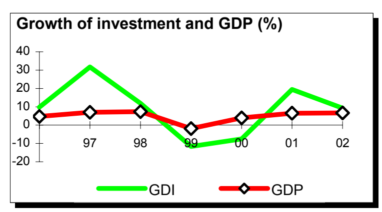
	1982-92	1992-02	2001	2002	2002-06
(average annual growth)					
GDP	..	2.5	6.5	6.7	5.4
GDP per capita	..	3.2	7.3	6.9	5.5
Exports of goods and services	..	6.0	20.8	3.5	7.3



Economic ratios*

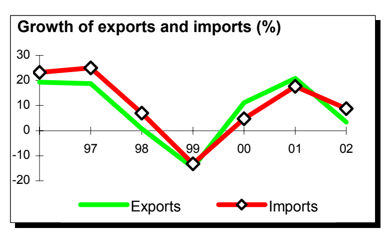
STRUCTURE of the ECONOMY

	1982	1992	2001	2002
(% of GDP)				
Agriculture	..	14.3	7.1	7.2
Industry	..	42.9	34.9	34.7
Manufacturing	..	34.4	23.2	23.1
Services	..	42.8	58.0	58.0
Private consumption	..	67.8	67.7	67.2
General government consumption	..	13.1	16.0	16.3
Imports of goods and services	..	19.9	56.4	51.0



Growth of investment and GDP (%)

	1982-92	1992-02	2001	2002
(average annual growth)				
Agriculture	..	-0.6	-6.9	3.0
Industry	..	3.4	16.4	4.0
Manufacturing	..	5.0	18.0	4.0
Services	..	3.4	2.6	5.9
Private consumption	..	6.2	3.0	21.6
General government consumption	..	1.0	0.4	10.1
Gross domestic investment	..	6.4	19.5	9.3
Imports of goods and services	..	7.5	17.7	8.7



Growth of exports and imports (%)

Note: 2002 data are preliminary estimates.

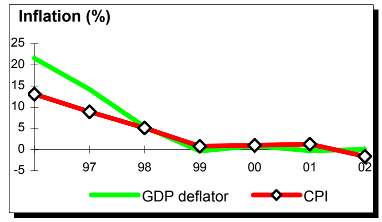
This table was produced from the Development Economics central database.

* 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.

Lithuania

PRICES and GOVERNMENT FINANCE

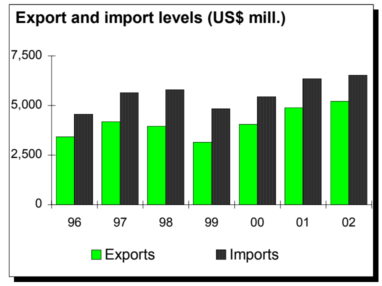
	1982	1992	2001	2002
Domestic prices				
(% change)				
Consumer prices	..	..	1.3	-1.6
Implicit GDP deflator	..	942.3	-0.2	0.0
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	30.5	29.8	29.2
Current budget balance	..	-42.9	-0.2	0.3
Overall surplus/deficit	..	-45.7	-2.0	-1.5



Inflation (%)

TRADE

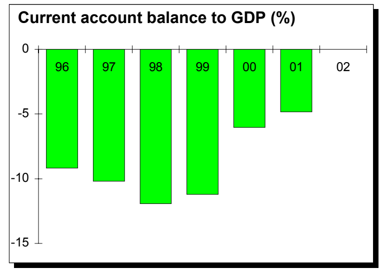
	1982	1992	2001	2002
(US$ millions)				
Total exports (fob)	..	1,142	4,889	5,212
Mineral products	..	..	1,082	992
Agriculture and food	..	..	567	658
Manufactures	..	..	1,947	1,989
Total imports (cif)	..	..	6,353	6,521
Food	..	..	397	414
Fuel and energy	..	..	509	1,709
Capital goods	..	..	897	1,027
Export price index *(1995=100)*	..	..	107	110
Import price index *(1995=100)*	..	..	95	95
Terms of trade *(1995=100)*	..	..	113	117



Export and import levels (US$ mill.)

BALANCE of PAYMENTS

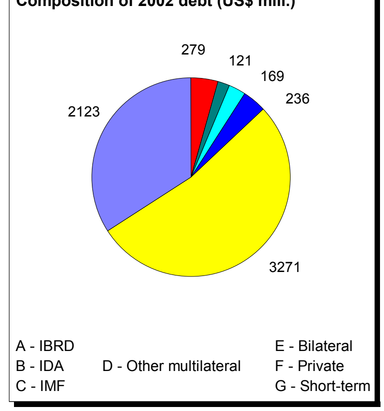
	1982	1992	2001	2002
(US$ millions)				
Exports of goods and services	..	1,272	6,046	6,409
Imports of goods and services	..	1,232	6,697	7,261
Resource balance	..	40	-651	-852
Net income	..	16	-180	-280
Net current transfers	..	..	258	249
Current account balance	..	..	-574	..
Financing items (net)	..	..	899	..
Changes in net reserves	..	-125	-325	-272
Memo:				
Reserves including gold *(US$ millions)*	..	106	1,669	..
Conversion rate *(DEC, local/US$)*	..	0.3	4.0	3.7



Current account balance to GDP (%)

EXTERNAL DEBT and RESOURCE FLOWS

	1982	1992	2001	2002
(US$ millions)				
Total debt outstanding and disbursed	..	56	5,253	6,199
IBRD	..	0	273	279
IDA	..	0	0	0
Total debt service	..	4	1,937	2,091
IBRD	..	0	29	40
IDA	..	0	0	0
Composition of net resource flows				
Official grants	..	68	94	..
Official creditors	..	10	10	-18
Private creditors	..	-3	91	42
Foreign direct investment	..	0	446	..
Portfolio equity	..	0	-16	..
World Bank program				
Commitments	..	60	0	0
Disbursements	..	0	40	16
Principal repayments	..	0	13	26
Net flows	..	0	27	-10
Interest payments	..	0	15	14
Net transfers	..	0	12	-24



Composition of 2002 debt (US$ mill.)

Note: This table was produced from the Development Economics central database. 8/20/03

Annex Table 2: Lithuania - Key Economic and Social Indicators, 1990-2001.

Series Name	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP growth (annual %)	9.47	-5.68	-21.26	-16.23	-9.77	3.29	4.71	7.28	5.11	-3.90	3.88	5.90
GNI per capita, Atlas method (current US$)*	..	..	3060	2250	1780	1690	1910	2220	2540	2640	2930	3270
GNI per capita, PPP (current international $)*	8350	8060	6590	5640	5220	5610	5980	6430	6760	6680	7150	7610
GDP per capita growth (annual %)	9.27	-5.84	-21.18	-15.83	-9.16	4.05	5.48	8.04	5.84	-3.24	4.60	4.34
Agriculture, value added (% of GDP)	27.08	16.72	14.32	14.95	11.08	12.00	12.51	11.88	10.44	8.52	7.62	7.77
Manufacturing, value added (% of GDP)	20.88	45.28	34.42	31.70	25.05	22.69	22.16	20.85	19.06	17.92	21.44	20.02
Services, etc., value added (% of GDP)	42.06	32.54	42.82	43.66	53.38	53.98	54.05	54.76	56.63	60.12	59.44	61.25
Exports of goods and services (% of GDP)	52.09	29.64	23.35	82.54	55.38	52.96	53.35	54.50	47.18	39.74	45.16	46.13
Imports of goods and services (% of GDP)	60.67	21.04	19.93	90.36	61.40	64.76	63.18	65.07	59.07	50.05	51.56	52.31
Current account balance (% of GDP)	..	..	..	-1.40	-1.61	-9.53	-9.16	-10.24	-12.08	-11.20	-5.97	-4.85
Total debt service (% of exports of goods and services)	..	..	..	0.33	2.85	1.34	2.91	7.06	9.28	15.19	17.10	..
External debt (% of GNI)	..	..	0.49	5.44	8.61	11.97	16.13	34.75	35.66	43.52	43.66	..
Gross international reserves in months of imports	..	..	..	2.08	2.73	2.51	1.97	1.96	2.61	2.63	2.63	2.83
Current revenue, excluding grants (% of GDP)	..	31.89	..	22.42	23.61	23.40	22.53	26.38	26.65	25.88	24.51	..
Expenditure, total (% of GDP)	..	28.92	..	21.36	25.39	25.22	25.01	27.43	30.33	31.09	27.51	..
Overall budget deficit, excluding capital grants (% of GDP)	..	1.37	..	-5.99	-4.71	-4.78	-3.63	-1.92	-0.43	-7.05	-1.29	..
Gross domestic savings (% of GDP)	24.03	32.89	19.16	11.35	12.40	12.93	14.67	15.97	12.52	12.35	14.32	15.74
Inflation, consumer prices (annual %)	..	..	..	410.24	72.15	39.66	24.62	8.88	5.07	0.75	1.01	1.24
Illiteracy rate, adult total (% of people ages 15 and above)	0.68	0.66	0.63	0.60	0.58	0.55	0.53	0.50	0.48	0.46	0.44	0.42
Immunization, DPT (% of children under 12 months)	78.00	..	86.00	87.00	87.00	97.00	92.00	92.00	94.00	93.00	94.00	..
Improved water source (% of population with access)	..	..	..	..	..	..	..	..	..	67.00	..	..
Life expectancy at birth, total (years)	71.28	70.57	70.31	69.01	68.70	69.26	70.41	71.22	71.57	72.11	72.62	..
Mortality rate, infant (per 1,000 live births)	10.30	14.30	16.50	15.60	13.90	12.40	10.10	10.30	9.20	8.60	8.60	..
Sanitation (% of population with access)	..	..	..	..	..	..	..	..	..	67.00	..	..
School enrollment, primary (% gross)	90.68	89.75	91.84	92.55	94.70	95.85	97.97	98.65	98.77	100.85	..	..
School enrollment, secondary (% gross)	91.85	88.21	83.12	80.94	81.60	84.20	86.32	87.58	91.62	93.43	..	..
Population, total	3.70	3.70	3.70	3.68	3.66	3.63	3.60	3.58	3.55	3.53	3.51	3.48
Population growth (annual %)	0.84	0.54	0.00	-0.32	-0.24	-0.16	-0.16	-0.09	-0.07	-0.11	-0.11	-0.14
Urban population (% of total)	67.80	67.87	67.95	68.02	68.09	68.16	68.23	68.30	68.37	68.44	68.51	68.65

	Average 1990-2001							
Series Name	Lithuania	Estonia	Latvia	Hungary	Slovak Republic	Slovenia	Europe and Central Asia	Lower middle income
GDP growth (annual %)	-2.08	-1.51	-3.36	0.66	0.46	1.95	-1.20	3.36
GNI per capita, Atlas method (current US$)*	3270	3810	3260	4800	3700	9780	1960	1240
GNI per capita, PPP (current international $)*	7610	10020	7870	12570	11610	18160	6990	5020
GDP per capita growth (annual %)	-1.62	-0.29	-2.26	0.83	0.29	1.99	-1.40	2.16
Agriculture, value added (% of GDP)	12.91	9.69	10.61	7.84	5.00	4.55	11.92	15.32
Manufacturing, value added (% of GDP)	25.12	21.72	22.45	23.44	22.16	29.79	..	25.95
Services, etc., value added (% of GDP)	51.22	58.48	56.36	58.15	57.24	55.82	50.96	45.33
Exports of goods and services (% of GDP)	48.50	75.58	51.38	39.86	58.91	60.10	32.87	27.23
Imports of goods and services (% of GDP)	54.95	82.24	53.65	42.07	63.96	59.45	32.62	26.59
Current account balance (% of GDP)	-7.34	-5.53	-3.48	-3.61	-4.69	0.46	..	..
Total debt service (% of exports of goods and services)	7.01	4.64	5.99	33.76	11.79	..	..	..
External debt (% of GNI)	22.25	30.31	24.02	65.48	33.86	..	..	..
Gross international reserves in months of imports	2.44	2.43	3.28	4.09	3.04	2.73	3.65	6.32
Current revenue, excluding grants (% of GDP)	25.25	30.87	29.83	42.03	36.27	39.41	26.00	14.81
Expenditure, total (% of GDP)	26.92	30.97	32.00	49.45	39.57	39.85	30.54	18.02
Overall budget deficit, excluding capital grants (% of GDP)	-3.16	0.13	-2.14	-3.63	-3.25	-0.50	..	..
Gross domestic savings (% of GDP)	16.53	22.11	23.73	22.49	26.22	23.42	24.33	29.28
Inflation, consumer prices (annual %)	62.62	24.57	45.11	20.05	8.98	13.17	..	..
Illiteracy rate, adult total (% of people ages 15 and above)	0.54	0.20	0.21	0.78	..	0.39	3.23	17.91
Immunization, DPT (% of children under 12 months)	90.00	91.14	90.38	99.31	99.00	95.75	87.06	89.62
Improved water source (% of population with access)	67.00	..	..	99.00	100.00	100.00	90.17	77.02
Life expectancy at birth, total (years)	70.64	69.24	68.91	69.93	72.23	74.01	68.68	68.47
Mortality rate, infant (per 1,000 live births)	11.80	12.21	14.89	11.57	10.44	6.22	24.75	37.91
Sanitation (% of population with access)	67.00	..	..	99.00	100.00	..	..	48.37
School enrollment, primary (% gross)	95.16	101.73	92.80	100.33	101.31	100.72	98.19	112.05
School enrollment, secondary (% gross)	86.89	101.21	87.23	92.15	88.09	91.96	83.31	62.80
Population, total	3.61	1.46	2.51	10.28	5.36	1.99	470.85	2043.02
Population growth (annual %)	-0.47	-1.22	-1.13	-0.17	0.17	-0.04	0.20	1.17
Urban population (% of total)	68.20	70.02	66.45	63.42	57.03	49.78	63.35	41.98

Annex Table 3: Lithuania - Development assistance and World Bank lending

Table 3a: Total Receipts (ODA+OOF+Private)*, CY 1991-2000

Amount ($USD Million or %)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
DAC Countries,Total	4.0	77.1	126.4	143.5	190.1	85.0	138.4	709.7	701.5	57.2
Multilateral ,Total	-	21.0	115.0	30.7	110.3	132.1	127.7	147.2	149.3	152.6
ALL Donors,Total	4.0	98.2	241.4	174.4	300.6	217.2	272.5	866.2	854.7	214.8
EBRD	-	-	2.3	9.5	25.6	43.4	35.5	35.0	35.4	-9.2
IBRD	**-**	**-**	**42.4**	**4.2**	**12.1**	**43.8**	**18.1**	**57.1**	**26.1**	**56.9**
UNDP	-	-	0.1	0.4	0.9	0.2	0.2	0.6	0.5	0.4
IBRD share of multilateral assistance, %	-	-	36.9	13.8	11.0	33.2	14.2	38.8	17.5	37.3
IBRD share of total assistance, %			17.6	2.4	4.0	20.2	6.6	6.6	3.0	26.5

* Development Assistance Committee (DAC) - The committee of the OECD which deals with development co-operation matters. Official Development Assistance (ODA) - Grants or Loans to countries and territories on Part I of the DAC List of Aid Recipients (developing countries) which are: 1.Undertaken by the official sector 2. With promotion of economic development and welfare as the main objective 3. At concessional financial terms (if a loan, having a grant element of at least 25%). Other Official Flows (OOF) - Transactions by the official sector with countries on the List of Aid Recipients which do not meet the conditions for eligibility as Official Development Assistance or Official Aid, either because they are not primarily aimed at development, or because they have a Grant Element of less than 25 per cent.
Source: OECD online database as of February 28, 2002

Table 3b: Lithuania - World Bank lending by sectors, FY 1993-2002

Fiscal year	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Total
Agriculture				**30**							**30**
Priv. Agric Development				30							30
Economic Policy	**60**				**80**				**99**		**239**
Rehabilitation	60										60
SAL					80						80
SAL 2									99		99
Education										**25**	**25**
Educaion Improvement										25	25
Electric Pwr & Engy.		**26**		**6**						**17**	**49**
Klaipeda Geothermal				6							6
Power Rehabilitation		26									26
Vilnus District Heating										17	17
Environment			**7**	**6**							**13**
Klaipeda Environment			7								7
Siauliai Environment				6							6
Finance			**25**								**25**
Ent&Fin Sect			25								25
Hlth, Nutn & Popultn								**21**			**21**
Health								21			21
Social Protection					**4**						**4**
Soc. Pol. Comm. Serv.					4						4
Transportation					**19**			**35**			**54**
Highway					19						19
Klaipeda Port								35			35
Urban Development					**10**		**20**				**30**
Energy Effic/Housing					10						10
Municipal Devt							20				20
Total	**60**	**26**	**32**	**42**	**113**		**20**	**57**	**99**	**42**	**491**

Source: Business Warehouse as of February 28, 2002

Table 3c: Lithuania - List of projects approved, FY 1993-2002

Proj ID	Project name	Approval fiscal year	Sector Board	IBRD Amt, $m	Latest DO	Latest IP	Latest Risk Rating	Port Stat	Exit FY	Outcome	IDI	Sustainability
P008534	REHABILITATION	FY93	Economic Policy	60.0					FY96	Mod. Sat.	Modest	Likely
P008537	POWER REHAB	FY94	Energy and Mining	26.4	HS	S	Modest Risk	Closed, not rated yet				
P008536	ENT & FIN SECT	FY95	Financial Sector	25.0					FY01	Sat.	High	Highly Likely
P008553	KLAIPEDA ENVIRONMENT	FY95	Environment	7.0	S	S	Modest Risk	Closed, not rated yet				
P036011	KLAIPEDA GEOTHERMAL	FY96	Energy and Mining	5.9	S	S	Modest Risk	Active				
P008538	PRIV AGRIC DEVT	FY96	Rural Sector	30.0					FY01	Unsat.	Modest	Unlikely
P035783	SIAULIAI ENVIRONMENT	FY96	Environment	6.2					FY01	Mod. Sat.	Substantial	Non-evaluable
P035163	ENERGY EFFIC/HOUSING	FY97	Urban Development	10.0					FY01	Mod. Sat.	Substantial	Likely
P008551	HIGHWAY	FY97	Transport	19.0					FY00	Sat.	Substantial	Likely
P044056	SAL	FY97	Economic Policy	80.0					FY98	Sat.	Substantial	Likely
P008539	SOC POL COMM SERV	FY97	Social Protection	3.7	S	S	Low Risk	Active				
P035802	MUNICIPAL DEV'T.	FY99	Urban Development	20.1	S	S	Modest Risk	Active				
P035780	HEALTH	FY00	Health, Nutrition and Population	21.2	S	S	Modest Risk	Active				
P035776	KLAIPEDA PORT	FY00	Transport	35.4	S	S	Modest Risk	Active				
P068706	SAL 2	FY01	Economic Policy	98.5	S	U	Modest Risk	Closed, not rated yet				
P070112	EDUC IMPRVMT	FY02	Education	25.4	S	S	Modest Risk	Active				
P063656	VILNIUS DIST HEAT	FY02	Energy and Mining	17.1	S	S	Modest Risk	Active				

Annex Table 4: A Selected List of Economic and Sector Work (CY 1993 to 2002)

Report name	Report date	Report No.	Report type
Lithuania - The transition to a market economy (Vol. 1)	03/01/93	11754	World Bank Country Study
Lithuania - Energy sector review (Vol. 1)	05/23/94	11867	Sector Report
Lithuania - Public Expenditure Review (Vol. 1)	07/12/94	12792	Economic Report
Lithuania - Country assistance strategy (Vol.1)	11/01/94	13677	Country Assistance Strategy Document
Lithuania - Agriculture and food sector review (Vol 1)	04/14/95	13111	Sector Report
Lithuania - Agriculture and food sector review (Vol 2)	04/14/95	13111	Sector Report
Lithuania - Private sector development (Vol. 1)	06/13/95	13845	Sector Report
Lithuania - An opportunity for economic success (Vol.1)	08/01/98	18383	World Bank Country Study
Lithuania - An opportunity for economic success (Vol.2)	08/01/98	18383	World Bank Country Study
Lithuania - Country assistance strategy (Vol.1)	04/19/99	19135	Country Assistance Strategy Document
Lithuania - Country assistance strategy public information notice (CPIN) (Vol. 1)	05/11/99	PIN12	CAS Public Information Notice
Increasing the efficiency of heating systems in Central and Eastern Europe and the Former Soviet Union (Vol. 1)	08/01/00	ESM234	ESMAP Paper
Lithuania: Country Economic Memorandum	10/7/2002	25005	World Bank Country Study

Source: World Bank Imagebank as of April 2003

Annex Table 5: Lithuania - OED and Supervision ratings

Table 5a: OED Ratings

Country	Total Evaluated $m	o/w Adjustment $m	Outcome % Satisf.	Outcome % Satisf. Adj.	Inst. Devel. Imp. % Substan.	Inst. Devel. Imp. % Substan. Adj.	Sustainability % Likely	Sustainability % Likely Adj.
Approval FY 1993-2002								
Bank	79979	44949	84	86	50	46	77	78
ECA	18605	13684	73	74	48	50	78	82
Lithuania	**208**	**139**	**95**	**100**	**67**	**58**	**95**	**100**
Estonia	98	29	100	100	71	0	100	100
Latvia	240	133	100	100	83	69	100	100
Hungary	769	375	91	100	79	100	84	100
Slovak Republic	130	80	100	100	100	100	100	100
Slovenia	99	80	100	100	100	100	100	100

1) The Institutional Development Impact and Sustainability ratings have been in use only since FY 89. Hence, the data for these two ratings for the period before FY 91 applies for smaller levels of total net commitment than shown in columns 2 and 3 of the table.
2) Source: OED ratings database as of 09/2002.
3) Excludes SIAULIAI ENVIRONMENT project, for which sustainability was rated non-evaluable.

Table 5b: Lithuania - Projects evaluated by OED, FY 1993-2002

Proj. ID	Project Name	Net Commit.	Approval FY	Exit FY	Instr. Type	Sector Board	Outcome	ID	Sustaina-bility	Eval Type
P008534	REHABILITATION	59	1993	FY96	A	Economic Policy	Moderately Sat.	Modest	Likely	PAR
P008536	ENT & FIN SECT	25	1995	FY01	I	Financial Sector	Sat.	High	Highly Likely	ES
P008538	PRIV AGRIC DEVT	9	1996	FY01	I	Rural Sector	Unsat.	Modest	Unlikely	ES
P008551	HIGHWAY	19	1997	FY00	I	Transport	Sat.	Substantial	Likely	ES
P035163	ENERGY EFFIC/HOUSING	10	1997	FY01	I	Urban Development	Moderately Sat.	Substantial	Likely	ES
P035783	SIAULIAI ENVIRONMENT	6	1996	FY01	I	Environ.	Moderately Sat.	Substantial	Non-evaluable	ES
P044056	SAL	80	1997	FY98	A	Economic Policy	Sat.	Substantial	Likely	ES

Source: OED project ratings database as of 09/2002.
* Project P008537 closed in FY 2003 was not rated by OED as of 01-09-2003.

Table 5c: Supervision Ratings for Active Projects.

Country	No. of projects	Net commit., $m	Projects at risk, %	Commitment at risk %
Bank wide	1434	99696	17	15
ECA	289	16141	16	18
Lithuania	**7**	**129**	**0**	**0**
Estonia	1	25	0	0
Latvia	8	99	0	0
Hungary	1	32	0	0
Slovak Republic	2	201	0	0
Slovenia	2	25	0	0

Source: World Bank Business Warehouse as of 09/2002.

Annex Table 6: Costs of Bank Programs for Lithuania and Comparator Countries, FY 1991-2001.

Regions/ Countries	*Total costs, $m*	*Lending completion costs, $m*	*Supervision costs, $m*	*ESW completion costs, $m*
Bank	3478.1	1243.0	1150.8	1084.2
ECA	600.7	277.0	178.8	144.9
Lithuania	**13.0**	**6.6**	**3.9**	**2.5**
Estonia	7.9	3.5	2.2	2.3
Hungary	25.2	11.3	8.8	5.1
Latvia	14.7	7.2	4.6	2.8
Slovenia	3.9	2.3	0.8	0.7
Slovak Republic	6.8	4.4	0.6	1.8
		Percent		
Bank	100	36	33	31
ECA	100	46	30	24
Lithuania	**100**	**51**	**30**	**19**
Estonia	100	44	27	28
Hungary	100	45	35	20
Latvia	100	49	31	19
Slovenia	100	61	20	19
Slovak Republic	100	65	8	27

Efficiency Table

Regions/ Countries	*Total costs, $m*	*Number of projects approved in 1991-2001*	*Gross Commitment, $m*	*Gross commitment of satisf. & nonrisky projects, $m*	*Average costs per approved project, $1000*	*Average costs $ per $1000 of gross commitment*	*Average costs $ per $1000 of gross commitment of satisf. & nonrisky projects*	*Memo Average project size, $m*
Bank	3478.1	2671	242,060	208,551	1,302	14.4	16.7	91
ECA	600.7	535	43,607	36,999	1,123	13.8	16.2	82
Lithuania	**13.0**	**15**	**448**	**443**	**866**	**29.0**	**29.4**	**30**
Estonia	7.9	8	151	151	990	52.6	52.6	19
Hungary	25.2	18	1,991	1,768	1,401	12.7	14.3	111
Latvia	14.7	17	394	350	863	37.3	42.0	23
Slovenia	3.9	5	178	178	772	21.7	21.7	36
Slovak Republic	6.8	2	135	135	3,384	50.1	50.1	68

Source: World Bank Business Warehouse, Resource Management, Report 2.3. Direct Costs by Service Across Fiscal Years, as of August, 2001.

* The amount of total costs includes lending completion, supervision, and ESW costs.

** Lending, supervision, and ESW costs are actual costs for active, closed, dropped, and all other projects in FY 1991-2001.

*** Costs of projects P070112 and P063656 approved in FY 2002 are not included.

Table 7: Lithuania: Bank's Senior Management, 1992-2002

Year	Vice President	Country Director	Chief/Resident Representative
1992	Wilfried Thalwitz	Russell J. Cheetham	Everardus Stoutjesdijk
1993	Wilfried Thalwitz	Basil G. Kavalsky	Lars Jeurling
1994	Wilfried Thalwitz	Basil G. Kavalsky	Lars Jeurling
1995	Wilfried Thalwitz	Basil G. Kavalsky	Lars Jeurling
1996	Johannes F. Linn	Basil G. Kavalsky	Lars Jeurling
1997	Johannes F. Linn	Basil G. Kavalsky	Lars Jeurling
1998	Johannes F. Linn	Basil G. Kavalsky	Ramune Zabuliene
1999	Johannes F. Linn	Basil G. Kavalsky	Mantas Nocius
2000	Johannes F. Linn	Basil G. Kavalsky	Mantas Nocius
2001	Johannes F. Linn	Michael Carter	Mantas Nocius
2002	Johannes F. Linn	Roger Grawe	Mantas Nocius

Annex Table 8: Lithuania - Millenium Development Goals

Indicators	1990	1995	1999	2000
1 Eradicate extreme poverty and hunger				
Population below $1 a day (%)	..	2	..	..
Poverty gap at $1 a day (%)	..	0.5	..	..
Percentage share of income or consumption held by poorest 20%	..	7.8	..	..
Prevalence of child malnutrition (% of children under 5)	..	..	..	..
Population below minimum level of dietary energy consumption (%)	..	..	..	..
2 Achieve universal primary education				
Net primary enrollment ratio (% of relevant age group)	..	93.6	93.7	..
Percentage of cohort reaching grade 5 (%)	..	..	..	..
Youth literacy rate (% ages 15-24)	99.8	99.8	99.8	99.8
3 Promote gender equality				
Ratio of girls to boys in primary and secondary education (%)	93.5	97.9	95.9	..
Ratio of young literate females to males (% ages 15-24)	100	100	100	100
Share of women employed in the nonagricultural sector (%)	55.8	55	63.1	..
Proportion of seats held by women in national parliament (%)	8.1	17.5	..	..
4 Reduce child mortality				
Under 5 mortality rate (per 1,000)	13.5	16.2	12	11.4
Infant mortality rate (per 1,000 live births)	10.3	12.4	8.6	8.6
Immunization, measles (% of children under 12 months)	89	94	97	97
5 Improve maternal health				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	27	..	..
Births attended by skilled health staff (% of total)	..	..	..	..
6 Combat HIV/AIDS, malaria and other diseases				
Prevalence of HIV, female (% ages 15-24)	..	..	..	..
Contraceptive prevalence rate (% of women ages 15-49)	..	..	..	..
Number of children orphaned by HIV/AIDS	..	..	..	..
Incidence of tuberculosis (per 100,000 people)	..	..	99	..
Tuberculosis cases detected under DOTS (%)	..	..	2	..
7 Ensure environmental sustainability				
Forest area (% of total land area)	30	..	..	30.8
Nationally protected areas (% of total land area)	..	10	10	..
GDP per unit of energy use (PPP $ per kg oil equivalent)	2.3	2.5	3.1	..
CO2 emissions (metric tons per capita)	5.7	3.9	4.2	..
Access to an improved water source (% of population)	..	..	67	..
Access to improved sanitation (% of population)	..	..	67	..
Access to secure tenure (% of population)	..	..	..	..
8 Develop a Global Partnership for Development				
Youth unemployment rate (% of total labor force ages 15-24)	..	25.2	24.9	..
Fixed line and mobile telephones (per 1,000 people)	211.8	257.5	401.3	462.8
Personal computers (per 1,000 people)	..	6.5	59.5	64.9
General indicators				
Population	3.7 million	3.7 million	3.7 million	3.7 million
Gross national income ($)	11.5 billion	6.3 billion	9.8 billion	10.8 billion
GNI per capita ($)	3,060.00	1,690.00	2,640.00	2,930.00
Adult literacy rate (% of people ages 15 and over)	99.3	99.5	99.5	99.6
Total fertility rate (births per woman)	2	1.5	1.4	1.3
Life expectancy at birth (years)	71.3	69.3	72.1	72.6
Aid (% of GNI)	0	2.8	1.3	0.9
External debt (% of GNI)	0.5	12	43.5	43.7
Investment (% of GDP)	32.6	24.7	22.7	20.7
Trade (% of GDP)	112.8	117.7	89.8	96.7

Source: World Development Indicators database, April 2002

Note: In some cases the data are for earlier or later years than those stated.

Comments from the Government

Ministry of Finance of the Republic of Lithuania
(March 14, 2003)

Ministry of Economy of the Republic of Lithuania
(March 18, 2003)

LIETUVOS RESPUBLIKOS FINANSŲ MINISTERIJA
MINISTRY OF FINANCE OF THE REPUBLIC OF LITHUANIA

14 March 2003
Our Ref.: 13.12-02 - 0302945

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Country Evaluation and Regional Relations
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RE: Lithuania – Country Assistance Evaluation

Dear Sir,

The Ministry of Finance as well as other ministries has reviewed the draft OED report. We would like to thank the World Bank for this report that we consider to be an important document and to present our general comments as well as comments of statistical nature.

We have noticed that while the economic situation of 1992-1997 reflected in the document is more adequate, the situation of 2001-2002, in our opinion, remains undervalued. In 2000, the government has embarked the policy of fiscal consolidation. This enabled a significant improvement of the country's macroeconomic performance. The economic indicators achieved in 2001– 2002 even surpassed expectations. Over these two years Lithuania enjoyed impressive GDP growth of 5.9 per cent and all performance criteria under the IMF SBA were met. The remarkable progress of the country was indicated in the Third Review of Lithuania Under Stand-By Arrangement that was discussed by the IMF Board of Directors in February 2003. Therefore, we consider that the situation of 2001-2002 would be adequately reflected in the World Bank report.

Since regaining the independence, Lithuania maintained mutual cooperation with the World Bank and other IFIs in terms of both policy advice and financial support. The Bank's support for Lithuania in most cases was well - tailored to Lithuania's needs and major constraints. It helped us to achieve key objectives of our transition to a market economy and to support structural reforms crucial for the EU accession. In the post - accession we foresee a new phase of our cooperation with the World Bank focusing on areas that compliment EU assistance.

The overall assessment of the efficacy of the World Bank assistance during 1992-2002 is positive. However, the Bank's involvement during the transition period in Lithuania could be

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criticized for sometimes following somewhat prescriptive approach to the country situation and making a lot of emphasis on the details. In this respect important conclusions can be drawn from SAL II implementation. We would like the last two sentences of Paragraph 2.13 be elaborated by sticking the wording of the report to the wording of Joint Statement of the Ministry of Finance and the World Bank dated 24 May 2002.

With regard to the Bank's investment lending, in some cases, projects preparation process was too slow and not sufficiently flexible for dynamic transitional economy. Therefore, at the time of implementation, some of the projects manifested themselves to be not relevant enough to respond to changing environment and country needs (i.e. Agricultural Project). Nevertheless, the country's economic development is benefiting from the projects in housing and energy efficiency, enterprise and financial sector, municipal development and social sectors. Given Lithuania's successful co-operation in various fields of the social policy, it is likely that further World Bank's assistance reflecting country's political realities and economic needs as a full-fledged EU member country would be justified in social security, labour policy, health care and municipal development.

Please find below some comments of statistical nature that we would like be incorporated in the document:

1. The first sentence of Paragraph 3 under the Chapter "Executive Summary" might be modified as follows: "***Unemployment according to the methodology of the International Labor Organisation, has decreased from 17.1 per cent in the first quarter to 11.9 in the third quarter of 2002,*** however, reforms in health, education, and agriculture have lagged behind, human capital and labor mobility need to be enhanced; ***further*** improvements are needed in the business regulatory environment (especially for small and medium scale enterprises)."

2. According to the data of population census made in 2001 by the Department of Statistics, Lithuania's population comprised **3481.3** thousand. Therefore, please update the third sentence of Paragraph 1.1 of the Chapter "Country Background" as follows: "Its population of ***3.5*** million is ***83.4*** per cent of Lithuanian origin." and the fourth sentence into : "In ***2001***, the income per capita was estimated at ***$3,444***." (the same update should be made in Table 2 of the Annex – for 2001 the population should be "3.48" instead of "3.49".

3. The fifth sentence of Paragraph 1.4 should be modified into: "GDP fell by ***3.9*** per cent in 1999 and unemployment ***(ILO definition)*** increased steadily from ***13.3*** per cent in 1998 to 17 per cent in 2001". The last sentence of the above paragraph should be changed to: "...and the ratio of ***goods and services'*** exports to GDP has increased from ***40*** per cent in ***1999*** to 50 per cent in 2001."

4. **In Table 1.1** GDP growth and inflation indicators should be changed respectively:

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
GDP growth	-21.3	-16.2	-9.8	3.3	4.7	7.3	5.1	-3.9	3.8	5.9	5.9*
Average inflation rate	1021	410	72.2	39.6	24.6	8.9	5.1	0.8	1.0	1.3	0.3

*Preliminary

GDP growth should be modified in Table 2 of the Annex as well.

5. The second sentence of Paragraph 1.7 should be changed as follows: "Total Government expenditure accounts for 36 per cent of GDP,…… " (According to ESA, government expenditure in 2001 made LTL 17327.3 million. GDP in 2001 at current prices made LTL 47958 million. Thus, the government expenditure made 36 per cent.)

6. Paragraph 1.10 characterizes the situation occurred in the banking sector in 1995 as a banking crisis. We would suggest changing the wording and instead of " crisis " to use the definition " banking sector encountered liquidity problems". In addition, we would like to clarify that deposits were not shifted to state-owned banks, instead, due to the lack of confidence by residents in commercial banks, deposits were withdrawn from commercial banks.

7. In the second sentence of Paragraph 1.11 the impact of Russian crisis in the banking sector is characterized as a second crisis of the banking system. However, there was no direct impact by Russian crisis on Lithuania's banking sector to the contrary than in Latvia and Estonia, where bankruptcy cases were raised for few banks.

8. The first sentence of Paragraph 1.12 should be changed as follows: "…declined from 27.6 per cent in 1990 to *7* per cent in ***2001***."

9. The first sentence of Paragraph 1.18 needs to be adjusted : "…estimated at ***11.9*** per cent of the labor force ***in the third quarter of 2002***, an increase from the very low ."

10. The information stated in Paragraph 3.1 is incomplete and, therefore, should be amended as follows: " Finally, Standard and Poor's raised the country long- term foreign currency rating from BBB- to BBB in April 2002, **Moody's – from Ba1 to Baa1 in November 2002 and Fitch – from BBB- to BBB in December 2002."**

11. In Table 3.1 the following data should be adjusted: " The Average Monthly Wage (US dollars) ***246*** in 2001", BOP Current Account Deficit/GDP ***–4.4*** in 2002 (estimate), as well as General Government Fiscal Balance (according to GFS):

	1998	1999	2000	2001	2002 (preliminary)
General Government Fiscal Balance/GDP (percent)	-5.5	-8.3	-2.7	-1.6	-1.2

Data on fiscal deficit in Paragraphs 1.4 and 3.3 should be changed respectively.

12. Following indicators in Parts "KEY ECONOMIC RATIOS and LONG-TERM TRENDS" of Annex E "Lithuania at a glance" should be changed to: "Gross domestic investment/GDP 21.5 in 2001"; "Exports of goods and services (average annual growth) 12.9 in 2000". In Part "STRUCTURE of the ECONOMY" should be "(% of GDP): Agriculture 7.7 in 2000; Manufacturing 20.9 in 2000, 22.5 in 2001; Private consumption 63.6 in 2001; Imports of goods and services 55.9 in 2001"; "(average annual growth): Agriculture –4.9 in 2001; Manufacturing 16.5 in 2001; Private consumption 2.0 in 2001, Gross domestic investment 25.3 in 2001; Imports of goods and services 18.6 in 2001". In Part "PRICES and GOVERNMENT FINANCE" it is necessary needs to correct: "Implicit GDP deflator 0.3 in 2001."

13. To specify the last sentence of Paragraph **2.19**: (As of January 1, 2002 the state or state controlled land for agricultural purposes comprised 47 per cent of total area of all land for

agricultural purposes. According to preliminary data as of January 1, 2003 such land comprised 42-43 per cent).

14. Paragraph **2.30** makes reference to FIAS study, which was prepared in 1999. Investment environment is an important component of business environment, therefore, it would be desirable if the World Bank included an update of FIAS study in its plans.

15. In Paragraph **3.5** instead of the definition "Commercial Code" we would suggest using the definition "Civil Code".

We would like to thank OED for their input. We appreciate World Bank's attention paid in order to satisfy clients' needs and to provide the highest quality service.

We look forward to further cooperation with OED.

Yours sincerely

Asta Ungulaitiene
Secretary of Ministry

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2003-03-18 No. (8.16-11)-3-1400

COMMENTS ON THE WORLD BANK DRAFT REPORT "LITHUANIA: COUNTRY ASSISTANCE EVALUATION"

The Ministry of Economy appreciates assistance that has been provided by the World Bank to Lithuania since 1991. During the said period Lithuania has radically changed, the transitional period has been actually completed; the national economy functions as the market economy; economic reforms have contributed to realization of the most essential principles of market economy – economic activity is defined by the law, operating private companies have substituted for state enterprises and competitiveness is maintained. Mr. Faryar Shirzad, Assistant Secretary for Import Administration of the United States of America, signed a memorandum on 8 February of the current year, which repeals the non-market economy status applied to Lithuania. The European Union recognized laws of the market economy as functioning as far back as 2001 in Lithuania.

The World Bank activity strategy outline for 2003-2005 provides for further co-operation guidelines in the areas of public administration, fiscal decentralization, rural restructuring, social care, health care, education and knowledge economy. We consider that this will contribute to further progress in Lithuania.

With reference to concrete assessment of the draft report "Lithuania: Country Assistance Evaluation", we could provide the following comments.

To our consideration, the wording of point 4 "the two Ignalina power plants need to be closed" should be replaced with the following" "Ignalina nuclear power plant needs to be closed";

with respect to point 3.9 "the two Ignalina Nuclear Power reactors which are considered unsafe"– the Nuclear Power Safety State Inspectorate and Lithuanian residents are confident that the Ignalina Nuclear Power Plant's operation is safe. However, as it is necessary to take into consideration a different opinion, the said point should be worded as follows: "there exists an opinion that safety of the INPP reactors cannot be enhanced to such a degree that it would meet the safety level of Western reactors."

Yours sincerely,

Gediminas Miškinis
State Secretary of the Ministry

Guide to OED's Country Assistance Evaluation Methodology

1. This methodological note describes the key elements of OED's country assistance evaluation (CAE) methodology.[31]

CAEs rate the outcomes of Bank assistance programs, not Clients' overall development progress

2. An assistance program needs to be assessed on how well it met its particular objectives, which are typically a sub-set of the Client's development objectives. If an assistance program is large in relation to the Client's total development effort, the program outcome will be similar to the Client's overall development progress. However, most Bank assistance programs provide only a fraction of the total resources devoted to a Client's development by donors, stakeholders, and the government itself. In CAEs, OED rates only the outcome of the Bank's program, not the Client's overall development outcome, although the latter is clearly relevant for judging the program's outcome.

3. The experience gained in CAEs confirms that program outcomes sometimes diverge significantly from the Client's overall development progress. CAEs have identified assistance programs which had:

- satisfactory outcomes matched by good Client development;
- unsatisfactory outcomes in Clients which achieved good overall development results, notwithstanding the weak Bank program; and,
- satisfactory outcomes in Clients which did not achieve satisfactory overall results during the period of program implementation.

Assessments of assistance program outcome and Bank performance are not the same

4. By the same token, an unsatisfactory assistance program outcome does not always mean that Bank performance was also unsatisfactory, and *vice-versa*. This becomes clearer once we consider that the Bank's contribution to the outcome of its assistance program is only part of the story. The assistance program's outcome is determined by the *joint* impact of four agents: (a) the Client; (b) the Bank; (c) partners and other stakeholders; and (d) exogenous forces (e.g., events of nature, international economic shocks, etc.). Under the right circumstances, a negative contribution from any one agent might overwhelm the positive contributions from the other three, and lead to an unsatisfactory outcome.

5. OED measures Bank performance primarily on the basis of contributory actions the Bank directly controlled. Judgments regarding Bank performance typically consider the relevance and implementation of the strategy, the design and supervision of the Bank's lending interventions, the scope, quality and follow-up of diagnostic work and other AAA activities, the consistency of Bank's lending with its non-lending work and with its safeguard policies, and the Bank's partnership activities.

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[31] In this note, *assistance program* refers to products and services generated in support of the economic development of a Client country over a specified period of time, and *client* refers to the country that receives the benefits of that program.

Evaluation in Three Dimensions

6. As a check upon the inherent subjectivity of ratings, OED examines a number of elements that contribute to assistance program outcomes. The consistency of ratings is further tested by examining the country assistance program across three dimensions:

(a) a *Products and Services Dimension,* involving a "bottom-up" analysis of major program inputs -- loans, AAA, and aid coordination;

(b) a *Development Impact Dimension,* involving a "top-down" analysis of the principal program objectives for relevance, efficacy, outcome, sustainability, and institutional impact; and,

(c) an *Attribution Dimension,* in which the evaluator assigns responsibility for the program outcome to the four categories of actors (see paragraph 4. above).

Rating Assistance Program Outcome

7. In rating the outcome (expected development impact) of an assistance program, OED gauges the extent to which major strategic objectives were relevant and achieved, without any shortcomings. Programs typically express their goals in terms of higher-order objectives, such as poverty reduction. The country assistance strategy (CAS) may also establish intermediate goals, such as improved targeting of social services or promotion of integrated rural development, and specify how they are expected to contribute toward achieving the higher-order objective. OED's task is then to validate whether the intermediate objectives produced satisfactory net benefits, and whether the results chain specified in the CAS was valid. Where causal linkages were not fully specified in the CAS, it is the evaluator's task to reconstruct this causal chain from the available evidence, and assess relevance, efficacy, and outcome with reference to the intermediate and higher-order objectives.

8. Evaluators also assess the degree of Client ownership of international development priorities, such as the Millennium Development Goals, and Bank corporate advocacy priorities, such as safeguards. Ideally, any differences on dealing with these issues would be identified and resolved by the CAS, enabling the evaluator to focus on whether the trade-offs adopted were appropriate. However, in other instances, the strategy may be found to have glossed over certain conflicts, or avoided addressing key Client development constraints. In either case, the consequences could include a diminution of program relevance, a loss of Client ownership, and/or unwelcome side-effects, such as safeguard violations, all of which must be taken into account in judging program outcome.

Ratings Scale

9. OED utilizes six rating categories for **outcome**, ranging from highly satisfactory to highly unsatisfactory:

Highly Satisfactory:	The assistance program achieved at least acceptable progress toward all major relevant objectives, and had best practice development impact on one or more of them. No major shortcomings were identified.
Satisfactory:	The assistance program achieved acceptable progress toward all major relevant objectives. No best practice

	achievements or major shortcomings were identified**.**
Moderately Satisfactory:	The assistance program achieved acceptable progress toward *most* of its major relevant objectives. No major shortcomings were identified.
Moderately Unsatisfactory:	The assistance program did *not* make acceptable progress toward *most* of its major relevant objectives, *or* made acceptable progress on all of them, but either (a) did not take into adequate account a key development constraint or (b) produced a major shortcoming, such as a safeguard violation.
Unsatisfactory:	The assistance program did not make acceptable progress toward *most* of its major relevant objectives, *and* either (a) did not take into adequate account a key development constraint or (b) produced a major shortcoming, such as a safeguard violation.
Highly Unsatisfactory:	The assistance program did not make acceptable progress toward *any* of its major relevant objectives and did not take into adequate account a key development constraint, while also producing at least one major shortcoming, such as a safeguard violation.

10. The **institutional development impact (IDI)** can be rated as: *high*, *substantial*, *modest*, or *negligible*. IDI measures the extent to which the program bolstered the Client's ability to make more efficient, equitable and sustainable use of its human, financial, and natural resources. Examples of areas included in judging the institutional development impact of the program are:

- the soundness of economic management;
- the structure of the public sector, and, in particular, the civil service;
- the institutional soundness of the financial sector;
- the soundness of legal, regulatory, and judicial systems;
- the extent of monitoring and evaluation systems;
- the effectiveness of aid coordination;
- the degree of financial accountability;
- the extent of building NGO capacity; and,
- the level of social and environmental capital.

11. **Sustainability** can be rated as *highly likely*, *likely*, *unlikely*, *highly unlikely*, or, if available information is insufficient, *non-evaluable*. Sustainability measures the resilience to risk of the development benefits of the country assistance program over time, taking into account eight factors:

- technical resilience;
- financial resilience (including policies on cost recovery);
- economic resilience;
- social support (including conditions subject to safeguard policies);
- environmental resilience;
- ownership by governments and other key stakeholders;
- institutional support (including a supportive legal/regulatory framework, and organizational and management effectiveness); and,
- resilience to exogenous effects, such as international economic shocks or changes in the political and security environments.

LITHUANIA COUNTRY ASSISTANCE EVALUATION
MANAGEMENT ACTION RECORD

OED Recommendations	*Management Response*
Lithuania Country Assistance Evaluation	
The next *CAS* should explicitly address the issue of continuing an IBRD lending program with EU accession. The Bank should be willing to lend in response to a government request, provided that loans will support further policy reforms. In such cases, the Bank should seek cofinancing opportunities with EU programs.	The Government has explicitly requested that the next CAS be formulated around a non-lending program. Given the continued rapid growth of the Lithuanian economy (we estimate that Lithuania could exceed the Bank graduation threshold income levels as early as 2006), its high and improving credit rating and ease of access to finance on competitive terms, this is an understandable and legitimate perspective. We also agree that there remains an unfinished structural agenda to which WB lending could contribute in addition to the planned AAA support. The CAS will indicate that the lending option remains open on a highly selective basis, should the Government change its views.
Social Sectors:	
• *Health.* The Bank should increase its outreach program to enhance support among the public and the medical profession for needed reforms, as would be promoted by timely implementation of the health project, in order to help Lithuania's health indicators improve towards EU standards.	We agree, subject to resource constraints.
• *Education.* The Bank should follow through on the reforms pursued under the Education loan by offering technical assistance and lending, if requested, to improve efficiency and further strengthen curriculum. In addition, the assistance to further develop the knowledge economy appears warranted.	We agree; our focus will be on life-long learning in the context of follow-up to the Knowledge Economy Assessment.
• *Pensions* The Bank should continue to offer technical assistance to enable Lithuania to pursue pension reform more effectively.	The draft CAS proposes a focus on social vulnerability which will include further TA on pension reform options.
Agriculture. The policy reforms needed in this sector for Lithuania to more effectively attack poverty argue for continuing AAA as well as lending, should it be requested. Although the EU will supply a substantial amount of funding for this sector through the SAPPARD program, cofinancing will be needed, which could come from the Bank or other sources.	The draft CAS foresees a cross-cutting approach to rural issues focusing on activities within the proposed business environment and social vulnerability clusters.
Municipal Governance. The Bank should maintain and enhance its assistance to promote reforms in this sector.	The draft CAS proposes a cluster of activities linked to public sector management which will feature municipal capacity building.

Chairperson's Summary
Committee on Development Effectiveness (CODE)
Meeting of November 5, 2003

1. The Informal Subcommittee (SC) of the Committee on Development Effectiveness met on November 5, 2003 to discuss the Country Assistance Evaluation (CAE) for Lithuania.

2. OED remarked that Lithuania had made good progress since regaining independence in 1990. The most important force driving the country's sound economic management and sustained reform effort had been the desire to join the EU, and the country had worked diligently to meet EU standards. However, systemic reform is still needed in health care, pensions, and municipal governance. Progress must also be made on improving the business environment, agriculture and land reform, and financial sector reform. OED noted that the Bank has played a useful role in assisting Lithuania—with 97 percent of closed and rated projects having "satisfactory" outcomes and sustainability rated as "likely". Future Bank activities in Lithuania will need to be highly selective: in areas where the Bank has comparative advantage and does not duplicate the efforts of other partners. These include health and education, poverty alleviation, and social development and social protection, including pension reform.

3. Management noted its agreement with the CAE, and that its findings and recommendations would be incorporated in the new CAS. They further commented that they expected to present the new CAS to the Board in Spring 2004 following the finalization of the framework for Bank interaction with new EU members.

4. The Chair representing Lithuania thanked OED for an important document reflecting the country's economic situation over a decade as well as the Bank's important role in supporting its development. She noted that the authorities endorsed the main conclusions and the potential areas of Bank involvement going forward. She further remarked that while the country had enjoyed impressive growth in 2001-2002, this was not sufficiently emphasized in the CAE. The Chair also stressed that Lithuania is currently among the best prepared candidates for EU membership. In this context, she asked about progress in preparing the next CAS and the Bank's plans for coordinating with the EU.

5. The SC welcomed the CAE and thanked both OED and Management for their participation. The main points of the discussion are summarized below:

6. **Coordination with the EU**. The Subcommittee stressed the importance of coordination with the EU and other partners noting that the Bank needed to focus on areas that complement EU assistance and where the Bank has a comparative advantage. Management agreed that coordination with the EU was critical and noted that they were focusing on instruments that would allow for easier technical assistance to and related co-financing of sector programs and broader public sector reform efforts.

7. **Competitiveness of the Bank.** The Subcommittee discussed the often cumbersome nature of Bank procedures and processes and asked if the Bank is still competitive in Lithuania given the availability of alternative and more efficient sources of financing for the country. In this regard, the Subcommittee asked about the competitiveness of IBRD lending in MICs in general. Management responded that the efforts underway to simplify Bank procedures could address this

issue. They further noted that the Bank needed to improve the marketing of its package of services to help client countries better understand the wide range of products available to them.

8. **Role of IFC.** The Subcommittee emphasized the importance of a role for IFC in Lithuania. Members asked about IFC's future intentions in the country, given impending EU membership, and also stressed the importance of finding more innovative and flexible approaches for IFC investments. The Subcommittee emphasized the importance of Bank Group coordination and asked whether the upcoming CAS would be a joint Bank-IFC CAS. Management responded that IFC's strategy in the Baltic countries is selective and limited to a role that cannot be filled by the private sector. IFC projects would have high development impact, promote privatization or public-private partnerships, have an export-orientation, or be regional projects across the Baltic region. Three such regional projects benefiting Lithuania were committed in the past year. Management also confirmed a joint CAS was planned.

9. **Privatization.** The Subcommittee stressed that privatization, property rights, and land reform were critical to successful transition. Some members asked why the Bank had not done more in these areas. Management responded that the authorities had necessarily concentrated on the demanding agenda of EU accession and had agreed with the Bank to focus on areas more directly related to that objective. Management agreed that these issues needed to remain on Lithuania's development agenda.

10. **Poverty Assessment.** The Subcommittee questioned why there had been no poverty assessment. Management responded that the Bank had worked as a first priority on promoting reforms to facilitate EU accession. However, the recent CEM had focused on poverty and labor market issues.

Rosemary Stevenson
Acting Chairperson
CODE Subcommittee