

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

STRATEGY FOR LITHUANIA

**REPORT ON THE
INVITATION TO THE PUBLIC TO COMMENT AS
PART OF THE REVIEW PROCESS**

Strategy for Lithuania: Report on the invitation to the public to comment

1. Invitation to the public to comment as part of the review process.

In accordance with the EBRD Public Information Policy (PIP), an invitation to comment on the review of the Strategy for Lithuania, along with a Management Note on the issues to be addressed in the strategy were posted on the Web page on 9 November 2005. The public was invited to submit comments, based on the Note and the previous strategy already on the Web site since March 2004. The public was asked to submit comments no later than 6 January 2006 so that they could be taken into account in the review process.

No comments were received during the public comment period.

2. EBRD Management Note

Invitation to comment on the Bank's Country Strategy Review for Lithuania

The EBRD has started work on the revision of its Strategy for Lithuania. Comments are invited to help the Bank in revising its Strategy. Any comments should be submitted to the Bank no later than 6 January 2006 so that they can be taken into account. The current Strategy - which has been available on the EBRD Web site since 9 March 2004 - is attached as a basis on which to comment.

The first Article of the *Agreement Establishing the Bank* states that “the purpose of the Bank shall be to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics.”

In order to achieve these objectives, the Bank primarily provides finance for investment projects, with a special focus on the private sector, carefully selecting projects that promote transition, by:

- creating, expanding and improving markets;
- establishing and strengthening of institutions, laws and policies that support markets; and
- facilitating the adoption of market-oriented skills and sound business practices.

In addition, every Bank project is examined for its environmental impact and the EBRD lays special emphasis on projects that are oriented directly towards environmental improvements and energy efficiency.

At the time of the approval of the last strategy in 2004, the Bank noted that the Lithuanian economy had made substantial progress in transition in terms of price and trade liberalisation, enterprise privatisation and financial sector reforms and that Lithuania was expected to join the EU and NATO in 2004. The economy was growing at a robust pace and credibility in the fixed peg to the Euro remained strong. However, important challenges still remained, such as improvements in the business environment, further commercialisation and liberalisation in the infrastructure sphere and the strengthening of domestic savings as well as increased financial intermediation. Moreover, Lithuania was facing a number of important structural challenges at the time to progress in its transition to a market economy and to meet its long-term objective of successful integration into the EU and NATO.

Some of the transition challenges identified at the time included:

- Given ongoing weakness in the external environment, the continuation of prudent macroeconomic policies and increases in the domestic savings rate will be crucial in order to enable sustainable high growth rates necessary for rapid convergence to EU income levels.
- To promote a conducive environment for savings and investment, the authorities need to progress with improving tax administration, streamlining business registration and simplifying the cumbersome legal framework. Further efforts are

needed to improve the efficiency of public administration. Continued progress needs to be achieved in the fight against corruption, particularly administrative corruption in the fields of public procurement and customs.

- Continued efforts are needed to complete the privatisation process, restructure some of the large local companies and improve their corporate governance standards.
- To overcome regional income disparities and help reduce the high number of unemployed, the support to SMEs should be enhanced.
- As capital expenditures by municipalities have in recent years been restricted by budgetary constraints, priority should be given to promoting commercialisation and private sector financing of municipal infrastructure without recourse to the sovereign, to building of capacity, and to improving regulatory frameworks.
- The restructuring and commercialisation of the energy sector needs to receive continued priority, *inter alia* to help offset the progressive closure of the Ignalina Nuclear Power Plant (INPP).
- Further reforms may be needed to establish a well-capitalised pension system that is sustainable over the long term and develop the non-bank financial sector. In addition, the inadequately targeted and expansive social safety net needs to be reformed.

The Bank's strategy was developed to help address a number of these challenges, and to support Lithuania's accession to the EU. The strategic priorities for the Bank in Lithuania were therefore identified as:

Private Sector

The Bank will continue its support to the private sector through projects that need more extensive structuring, and cross-border investments, especially into CIS countries including Kaliningrad in Russia, and large investment projects in Lithuania. Particular attention will be given to improving corporate governance and increasing competitiveness in the enlarged EU market. The Bank will support growth in SMEs by providing medium- and long-term finance to financial institutions and by providing equity to equity funds.

Energy Sector

In order to support the further development of the Polish-Lithuanian Interconnector project the Bank will work with the Lithuanian and Polish authorities as well as the EU Commission and financial institutions. The Bank aims to support the development of renewable energy sources and will continue its active role as administrator of the NSA and the IIDSF.

Infrastructure

The Bank will focus on financing state-owned and municipal entities, to support priority investment needs, while facilitating restructuring and private sector participation. Financing would be provided where feasible on a non-sovereign public or private basis to help reduce fiscal pressures. Priority areas will be the transport sector and municipal infrastructure. Instruments for lending to municipal entities through local banks will be developed. Assistance to local authorities will be provided to prepare, co-finance and

implement projects eligible for EU Cohesion and Structural Funds. In developing financing structures, the Bank will work closely with the EIB and other IFIs in order to generate synergies.

As of 30 September 2005 the Bank had signed 30 projects for Lithuania with a total project cost of €1.1 billion, including Bank financing of €467 million, or 43 per cent. The largest proportion, 40 per cent, of the portfolio relates to infrastructure, with municipal and environmental infrastructure representing approximately half of this and the loan to Lithuanian Railways being the largest single exposure. A significant proportion, 29 per cent, of the portfolio relates to FI, a reflection of the structure of the Lithuanian economy and the EBRD's significant role in the support of SMEs through credit lines, equity funds and insurance.

During the strategy period four direct operations were signed in Lithuania with a total volume of €56 million. EBRD's investment in various regional funds has in the same period resulted in an allocation of €7 million.

Since the previous strategy, ongoing progress with structural reforms has enabled Lithuania to join the EU and NATO. Since the last strategy, progress has continued on the reform front, and a number of high-profile companies have recently been privatised, including the national carrier Lithuanian Airlines, gas utility Lietuvos Dujos and the National Stock Exchange of Lithuania.

The Bank now intends to develop a new Strategy that will provide guidance for EBRD activities in Lithuania, identifying the main challenges which the Bank should consider addressing. As such, the Strategy cannot address all of the development issues a country faces and necessarily must be selective in identifying issues where the Bank has the experience and ability to play a constructive role.

Therefore to prepare the new Strategy for Lithuania it would be useful for the Bank to receive comments on the business and economic environment as it relates to the Bank's operational priorities and activities in the following areas:

1. Issues related to Infrastructure Needs and Development

This would include development needs in power and energy, municipal and environmental infrastructure, energy efficiency and transport sectors, with particular attention given to issues relating to restructuring, corporatisation, tariff reform, public-private partnerships and environmental improvements.

2. Issues related to the environmental impact of EBRD activities

This would include issues concerning environmental improvements and energy efficiency.

3. Issues related to the investment climate and private sector development

This would include issues concerning (i) the legal environment (the implementation and enforcement of laws), (ii) the regulatory environment for enterprises (such as issues related to establishing new businesses, taxation, trade protection, tariff and price-setting mechanisms, etc.), (iii) the functioning and efficiency of public administration, (iv) corporate governance and integrity, and

(v) fraud and money laundering. We seek your views on how serious these issues are for businesses and how you think the EBRD could help to overcome them.

4. Comments on the Financial System

This would include issues concerning: (i) the level of intermediation of the banking sector; and (ii) the development of non-banking financial sector (pension funds, insurance, leasing companies, other mortgage lenders); (iii) the development of the capital markets.

5. Issues related to the social impact of EBRD investments

This would include issues concerning (i) small and medium sized enterprises that enhance opportunities for entrepreneurship, innovation, job creation, regional development and social flexibility; (ii) the effect of investments in infrastructure on issues such as social impact and affordability.

The Bank's policy dialogue is always closely co-ordinated with the IMF, the World Bank, other IFIs and the EU in order to ensure the coherent implementation of its strategy. Co-financing opportunities with commercial banks, other IFIs and EU programmes are always strongly sought, to address among other things the social or environmental components in the restructuring projects and to support municipal services projects.

The Bank will take into account all comments received. A summary of these, with staff responses, will be posted on the Web site following the Board approval of the revised Strategy. The Country Strategy is, however, a Bank document and the responsibility for its contents remains with the Bank.