

EBRD strategy for Lithuania 1996-97: a summary

Operational priorities

Following major macroeconomic progress in Lithuania, a number of priority needs have been established:

- strengthening the banking sector;
- overcoming the lack of medium-term to long-term capital (loans and equity);
- strengthening the post-privatisation process;
- attracting increasing levels of foreign direct investment;
- transfer of know-how at the enterprise level;
- upgrading key infrastructure, with particular emphasis on the energy sector, as well as privatisation of and/or private sector participation in infrastructure.

Other areas are integration in the international economy as well as the environment. In response to these concerns, the future operational work of the European Bank for Reconstruction and Development (EBRD) will focus on the main priority areas identified below, where there is clear "additionality" for EBRD financial support.

- **Financial intermediaries:** The EBRD's interventions in the banking sector will be further expanded, covering debt, equity investments, and guarantee facilities as well as selected new institutions, with a view to both strengthening the banking sector which has recently been seriously affected by a crisis and in particular supporting development of small and medium-sized enterprises (SMEs).
- **Direct support for private sector enterprises:** While there will be a limited number of transactions that will be of sufficient size to justify EBRD financing, these will continue to be pursued actively. Further development of existing or new intermediaries will be undertaken as well as co-financing arrangements with these institutions if suitable project pipelines can be identified.
- **Infrastructure:** The EBRD will aim to improve critical infrastructure, particularly in the energy sector, in light of the need to assist with alternative power generation and energy efficiency projects related to the future closure of the Ignalina Nuclear Power Plant (NPP). The EBRD will assist with the commercialisation and/or privatisation of infrastructure-related utilities and enterprises (including telecommunications), and will support/

facilitate private sector participation. The Bank will not exclude state-guaranteed operations, particularly in the energy sector, as the transition to private sector financing is likely to require some time.

Other areas of activity will include:

- **transfer of know-how:** The EBRD has developed unique and cost-effective tools, such as the TurnAround Management (TAM) programme and the Business Advisory Service (BAS) project.
- **environment:** All EBRD operations in Lithuania are subject to the Bank's environmental procedures and incorporate, where appropriate, Environmental Action Plans. In addition, the Bank has established an environmental technical cooperation programme in all its countries of operations, encompassing environmental guidelines for investors and institutional support and training for financial intermediaries with which the EBRD is working.
- **advancing transition and integration in the international economy:** As part of the EBRD's efforts to facilitate transition in Lithuania, the Bank, in consultation with the European Union, will continue to support Lithuania's process of integration in the international community, of which accession to the EU is a major component. The Bank will give highest priority to the strengthening of the banking sector. The EBRD is already supporting investments aimed at security of energy supply. Assistance is being provided for the telecommunications sector in regulatory development. Assistance may also be provided for legal transition. The Bank will continue to support cooperation among the three Baltic states. For instance, the Bank will explore means by which it could financially support the regional integration of energy sector grids (e.g. electricity, gas).

Mobilising other sources of financing

In addition to syndications in the financial sector, the EBRD will continue to seek to mobilise external sources of financing, including export credit agencies (ECAs), the Export Import Bank of Japan, the European Investment Bank (EIB) and bilateral assistance agencies. The second phase of the Baltic Investment Programme has also made further funds available for co-financing of EBRD projects in support

of SME development in Lithuania. Co-financing with local financial intermediaries will be encouraged.

Financial and banking sector

Highest priority will be given by the EBRD in its operational strategy to the financial sector, in view of the considerable support which the sector will require over the short to medium-term, including the restructuring of local banks, and reflecting the fact that most private sector transactions in Lithuania will fall below the minimum size requirements of the EBRD, therefore requiring them to be funded through local financial intermediaries.

The EBRD's objective is to achieve maximum transition impact by:

- fostering confidence in the banking system, both domestically and internationally, by working with reputable and significant banks, thereby also encouraging a higher level of domestic savings;
- providing debt and equity financing as well as guarantees, where they are not yet available to Lithuanian banks via the international market;
- enabling banks to support the emerging private enterprise sector through medium-term loans;
- participating in the privatisation of selected commercial banks; and
- participating in the recapitalisation and strengthening of selected private banks.

Enterprise sector

The EBRD will seek to participate directly in a number of larger transactions for major companies which have already been privatised, and where possible, through financial support to infrastructure-related enterprises on their way to privatisation or as part of their privatisation.

The EBRD strategy will continue to rely substantially on financial intermediaries to reach SMEs, which account for a substantial number of enterprises in Lithuania. The Bank may seek to reach the smaller companies by establishing a small regional capitalisation investment fund (on a regional basis) to target companies which are now out of reach for the existing investment funds.

A number of direct transactions are being actively considered by the EBRD. Implementation of the Post Privatisation Fund has been initiated. Support for local commercial banks will be expanded. Activities of the Baltic Investment Fund are expected to increase and new regional equity funds are being considered.

Additional TAM projects are expected to be initiated in Lithuania. The number of enterprises receiving assistance under the BAS programme will be further expanded.

Legal transition

The EBRD is assisting the Ministry of Communications in the development of a regulatory framework for the telecommunications sector as a technical cooperation project. In addition, the Bank would consider providing assistance for the development of a modern secured transactions law, using the Bank's Model Law on Secured Transactions as a guide and its previous experience in the establishment of central registration systems.

Energy sector

In addition to on-going operations, the EBRD's future operational strategy will focus on the rationalisation of energy use and cost-effective investments required to offset the impact of the future closure of Units 1 and 2 at the Ignalina NPP. To improve general efficiency in the sector, the Bank intends to assist the government and sector organisations in on-going reorganisation and privatisation efforts. Particular attention will also be given to regional cooperation in the electricity and gas sub-sectors.

Whenever possible, new operations in the sector will be developed on a limited- or non-recourse financing basis involving private sector sponsors, but this will be dependent on the financial health of client institutions, and on the speed with which regulatory frameworks and privatisation are implemented in the sector.

The Government is expected to adopt a specific Action Plan containing measures which will enable closure of the nuclear power plant without rechannelling. The EBRD will seek to participate in the financing of these measures.

The current project pipeline under preparation includes the Kaunas and Vilnius Cogeneration Systems. Electricity transmission in the region is being studied as part of the on-going Baltic Regional Energy Development Programme. Recommendations from this study may lead to the identification of investment projects for regional transmission.

To extend energy efficiency improvement efforts started under the Energy Sector Emergency Investment Loan, the EBRD will furthermore examine possible involvement in the development of private sector energy service companies (ESCOs). Energy savings in industry will also be addressed where appropriate through direct lending by the Bank to the private sector.

The Bank's activities will, to the maximum extent possible, emphasise commercialisation, private sector participation and privatisation in the sector.

Transport sector

The Via Baltica and Lithuania Road Project is in its early stage of implementation. In addition, the Port of

Klaipeda has expressed interest in principle in EBRD assistance with the development of the port, notably the terminals. It is anticipated that in terms of future projects in the sector, the Bank will focus solely on private sector projects, including concessions for specific operations, as well as assistance to privatisation initiatives.

Telecommunications

The EBRD's aim is to bring about the corporatisation and facilitate ultimate privatisation of Telekomas. A three-pronged approach is being adopted which involves first, improving the company's management and profitability through pressure for reform of accounting and using technical cooperation. Secondly, the EBRD will continue to engage Lithuanian interest in privatisation, and pave its way, by supporting regulatory development: this will be facilitated by a consultancy funded by technical cooperation. Finally, the EBRD will pursue Telekomas' need for further fund-ing to meet capital expansion and reorganisation.

Municipal and environmental infrastructure

The EBRD's strategy will continue to be to assist with the improvement of municipal and environmental services in selected towns and to strengthen the way in which such services are being provided and financed. The Bank supports the restructuring of municipal utilities and a gradual move towards cost recovery in service provision. Following on from its leading role in the Kaunas Water and Environment Project, a medium-term objective is for the Bank to move towards limited-recourse lending and help selected municipal utilities graduate to a situation where they can become borrowers in their own right without the need for a sovereign guarantee.

The EBRD supports a decentralised approach, assisting the development of efficient utilities under sound financial and operational management at the municipal level. Restructuring of the municipal service enterprises, through improved revenue collection and cost recovery and other measures, leading to corporatisation, will be promoted. The Bank will encourage private sector involvement in the provision and possible financing of municipal services and infrastructure.

Environment

Considerable importance is attached to establishing a sound financial sector to support SME development. Supported by EC Phare financing, the EBRD has

conducted environmental due diligence training for commercial banks in Lithuania so that the EBRD's requirements could be incorporated into the banks' existing procedures. The EBRD will continue to provide training to Lithuanian banks and to investment funds established in the country. Through the Bank's Energy Sector Emergency Loan, important environmental measures have been implemented through a number of energy efficiency-related projects.

Comprehensive environmental investigations, including impact assessments and audits, will continue to be required for all operations which could have a potentially significant environmental impact. Such projects are likely to relate to improvements to existing infrastructure and to any major industrial developments or restructurings. Project sponsors will generally be required to incorporate Environmental Action Plans into the legal documentation to address issues raised during the due diligence process. These plans will incorporate steps to bring operations into compliance with regulatory requirements and in accordance with international standards.

Particular attention will be given to measures which will facilitate the gradual harmonisation of Lithuanian environmental standards with requirements under international conventions and protocols signed by Lithuania and those required to meet the accession criteria of the European Union.

Cooperation with other multilateral institutions

The EBRD cooperates closely with the European Commission (EC), the European Investment Bank (EIB), the Nordic Investment Bank (NIB) and the World Bank.

The EBRD participated in the High Level Working Party on the Via Baltica project, which included the NIB, the International Bank for Reconstruction and Development (IBRD), the EIB and the EC. Cooperation with the World Bank has included the Highway Maintenance Project (US\$ 19.0 million), co-financed with the IBRD, to preserve the road network and to improve the efficiency in road maintenance.

Resources provided to the EBRD by the Nordic countries under the first phase of the Baltic Investment Programme have been fully committed. A second phase of the Programme has now been approved, covering the period 1996-99.

Close coordination with the Nordic Investment Bank continues under the Baltic Investment Programme. NIB participated with the EBRD in financing a forest industry sector study in the region and has funded a study of emissions from agriculture in the Baltic states.

This document is based on the EBRD's Strategy for Lithuania, approved by the Board of Directors at its meeting on 6 November 1996.