

USAID STRATEGIC PLAN FOR COOPERATION IN LITHUANIA



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**US AID STRATEGY
FOR COOPERATION
IN
LITHUANIA**

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RESULTS REVIEW AND RESOURCE REQUEST SEE SEPARATE DOCUMENT

Executive Summary

The United States Agency for International Development (USAID) strategy for 1996-1999 is designed to assist Lithuania to cope with major macro-economic and democracy challenges over the next four years. It builds on recent economic developments, future economic reform priorities, Government of Lithuania (GOL) commitment to reform, and the past three years of USAID programs. The strategy incorporates important US foreign policy objectives for Lithuania, including integration into the European Union, nuclear safety, and cooperation among USAID, the European Union, and its member countries.

Progress: Since regaining independence in 1991, Lithuania has made important progress in its transition from a centrally-planned to a market economy. Price and trade liberalization, macroeconomic stabilization, privatization, deregulation and development of a supportive legal framework have begun to create an environment conducive to the introduction of market forces. More than 150,000 new private firms have been created and, as of 1995, over half of total output was produced by the private sector. Lithuania has also made the transition from a totalitarian regime to a functioning democracy, as has been evidenced by the fact that it has held open, honest elections in which multiple parties have participated.

ECONOMIC TRENDS

Adjustments: The process of discarding central planning has not been easy. Real GDP in 1995 is close to half of the reported figure in 1990. The trade shock that occurred when Russia adjusted its oil prices to world market levels, combined with hyperinflation in 1993, wiped out private savings and forced many enterprises to close. The agriculture sector, which employs 23 percent of the workforce and includes many of the country's poor, has contracted far more than other sectors. Its share of GDP has declined to 8 percent from earlier subsidized levels of 25 percent. While total investment levels have remained high, most of this represents "lumpy" investments by state-owned enterprises. Foreign direct investment, averaging \$35 per capita, ranks among the lowest in Central Europe. Unemployment is also a rising concern, with surveys suggesting that more than 12 percent of the labor force are unemployed. In addition, there exists much hidden unemployment in over-staffed Government agencies and enterprises. Despite rising unemployment, real wages have begun to increase, with no apparent link to labor productivity.

Public Finances: Public finances are a serious concern. Government revenues have fallen to 12 percent of actual GDP, triggering a rise in energy payment arrears (\$115 million), tax arrears (\$3.75 million), social insurance (SoDra) fund arrears and directed political lending. Despite a prudent fiscal stance, revenue shortfalls fuel high rates of inflation and rapid accumulation of external debt. Under the currency board

arrangement, the Litas was pegged to the US dollar at a rate of 4 to 1. As domestic inflation greatly out-stripped inflation in trading partner countries, the Litas has appreciated in real terms, despite a fall in output and productivity.

Financial Markets: Domestic financial markets are shallow and dominated by insolvency, with 14 bankrupt banks out of 28. In December, the closure of three large private commercial banks ultimately led to a bank crisis and the resignation of the Prime Minister and Governor of the Central Bank. While the extent of bad loans in the total banking system is not known, the amount needed to bail-out the current bankrupt banks is estimated to be in the range of \$300 to \$400 million.

Social Issues: The ranks of the poor have increased during the transition process. Life expectancy has fallen, the rate of suicide and alcoholism has increased, and organized crime has become a major problem. Additionally, the country's weak economy has bankrupted the pension fund, which will affect approximately 20 percent of the population.

Economic Prospects: There are helpful signs that economic activity is starting to increase. To sustain this momentum, the GOL will need to address imbalances in public finance, in the banking sector, and in the energy sector. Longer-term economic reform will be needed to complete the transition to a market economy. This will include reforms that broaden the scope of private sector operations, a reduction in the scope and size of the public sector, price liberalization, a deepening of financial activity, trade and investment deregulation to create a non-distorting, enabling environment for private activity, improvements in the legal framework and the judiciary, creation of an affordable social safety net, and the use of market forces to restructure inefficient industrial and agricultural enterprises.

Obstacles to Reform: Many of the economic reform initiatives will be more difficult to achieve, both technically and politically, than earlier reform efforts. Adjustment costs may be high (and difficult to predict) in the near-term, while the benefits would tend to accrue only after a span of some years. Weaknesses in the financial environment, most notably in banking and in public finance, not only capture the GOL's immediate attention but also inhibit efforts to make significant progress in other reform areas. Restoring a sound financial environment will require improvements in fiscal policy (most notably tax policy and expenditure reform) and monetary management, together with the rehabilitation of the banking sector. Further efforts towards price liberalization and the development of legal mechanisms to resolve the backlog of pending commercial disputes are also needed if a healthy and stable financial environment is to be restored. Until this occurs, and until improvements are made creating an enabling environment for private sector development, it is difficult to envision Lithuania having a healthy economic climate and being able to meet the entry criteria for admission into the European Union.

DEMOCRATIC TRENDS

Political process and reform: Basic democratic reforms have been extensive since 1991. The 1992 constitution provides for fundamental human rights, free speech, and freedom

of assembly and organization. Free and fair national and municipal elections were held in 1992 and 1995, respectively. Political parties originally based on personalities are slowly developing into parties based on issues and platforms. More than 15 parties have participated in each of the elections since independence and 24 are registered for the 1996 national elections.

Independent media: Freedom of the press is legally protected by the constitution and subsequent laws. Additional legal reforms are still needed to complete the democratic process. Editorial independence exists and the media is considered free, although the GOL continues to intervene in the programming and business relationships of the independent media. The electronic and written press have organized intermediate institutions to promote media concerns and represent their views in discussions with the government.

Governance and public administration: Since independence, there has been a significant reorganization of responsibilities among the various governing institutions. The Parliament and the President working together this year managed a successful transition of power as the former Prime Minister and several ministers were replaced because of the banking crisis. While Lithuania lacks a tradition of decentralized authorities, local governments responsibilities were increased under the July 1995 Local Government Law, although managerial and budgetary weaknesses continue to restrict their efficacy, as the central government has not decentralized fiscal authority to municipalities. There has also been a recent trend to recentralize some of the rights and authorities given to the local governments and the formation of district government bodies has further complicated decentralization issues. Finally, Lithuania is slowly gaining experience in public participation in government management and policy development.

Non governmental organizations: There are approximately 2,500 officially registered NGOs. They include community organizations, charity groups, and not-for-profit organizations. In March 1996, the Parliament passed laws allowing the registration of foundations and associations. These groups have been granted a tax reduction rate compared to private businesses. NGOs remain weak, have limited organizational experience, and are chronically underfunded. Nonetheless, they are addressing many of the most important economic, political, social, and environmental issues facing the country.

USAID PRIORITIES

Lithuania and the donor community recognize the importance of addressing these pressing financial, private sector policy, and democratic concerns. The present review of USAID's assistance strategy to Lithuania provides a timely opportunity for the Agency to complement efforts of other donors and focus its resources on the most immediate bottlenecks to further economic and democratic reform.

Criteria: USAID undertook extensive routine and intensive consultations with all sectors of Lithuanian society to formulate its 1996-1999 strategy. The criteria used to develop the strategy were:

- activities that will lead to systemic change
- priority issues and assistance requested by the GOL
- increased citizen participation and public awareness
- increased economic growth, productivity, and employment
- improved financial and budget stability
- stimulation of the private sector.

From a management perspective, the following criteria were used:

- sectors where the US has a comparative advantage and is an established key player
- deeper allocation of resources to fewer activities
- reduced attention to sectors where other donors are increasing funding
- rapid transfer of the program to local counterparts
- results can be achieved in 3-5 years and will be sustainable
- USG management is efficient
- program activities are integrated and synergies are achieved
- activities that support priority US foreign policy objectives.

Strategic objectives: USAID/Lithuania is proposing to accord a high priority to strategic objectives aimed at:

- **strengthening fiscal management**
- **forging a more stable financial environment**
- **improving the enabling policy environment conducive to sustained private sector growth**
- **increased, sustained collaboration of NGOs and local government.**

The targets in fiscal management will be improved government budget management, tax policy and tax administration. In the financial sector, future assistance will focus on increasing confidence in the banking system, fiscal management, and establishing a viable capital market. In creating an enabling environment for private sector growth, assistance efforts will focus on eliminating major price distortions that impede efficient private investment and resource allocations, increasing access to markets through more effective

trade policies, and improving the legal framework for commercial activities. To further civic participation, USAID will strengthen non-government organizations (NGOs) advocacy, service delivery, and financial sustainability and increase responsiveness to public participation among municipal government officials.

1. Fiscal Management: To correct deficiencies in government policy and practices, USAID will focus assistance on:

- **Improving budget management:** This activity is one of the highest priorities and policy entry points in the existing program. It will continue until the last year of SEED funding and will remain under the guidance of the Treasury Department, working in cooperation with USAID.
- **Improving tax policy:** This activity will be undertaken with the Ministry of Finance and will consist of a policy advisory team. USAID will provide senior technical experts in tax policy, working closely with the Treasury Department. The main tasks will be tax simplification, restructuring the tax rate, and establishing the capacity for policy analysis.
- **Tax administration:** This activity will continue for an additional year with the Ministry of Finance under the guidance of the Treasury Department. One key issue will be to address the long-term sustainability of the program beyond the current funding levels.

2. Financial Sector: To achieve a more stable financial environment, USAID will focus on:

2.1 Restoring confidence in the banking system by:

- **Strengthening Central Bank policy and bank supervision:** Current efforts underway in the area of bank supervision will be combined with efforts in macro-economic and fiscal management. In the near-term, USAID and the Treasury Department will collaborate to ensure that sound fiscal and monetary policy options are coordinated with the World Bank and IMF, inflation continues to be a major focus, distressed banks are restructured, and prudential standards are tightened. By the end of USAID's program, the Central Bank should have greater capacity to undertake the analytical work needed to underpin monetary policy.
- **Developing a viable market-oriented private banking sector:** Technical assistance will be provided as part of the World Bank/IMF-financed bank rehabilitation program, and through efforts to supervise state-owned banks for their eventual privatization. In addition, USAID will continue to assist the Ministry of Environment to establish an Environment Investment Fund to provide incentives for economically sound waste minimization investments.
- **Improving banking legislation:** Several key provisions of the banking and bankruptcy laws will be modernized and improved through USAID assistance.

2.2 Developing the capital market by:

Lithuania's emerging capital market has the potential to direct capital flows to increasingly effective enterprises and serve as an alternative to the poorly functioning banking system. The current emphasis on market regulation will be expanded to include:

- **Improving regulatory oversight:** The initial foundation for the capital market has been the development of the laws and regulations required for sound oversight
- **Market development:** Through improved credit assessments, establishment of capital market trade and settlement systems, and increased public awareness.

3. Creating an enabling environment for private sector growth: Under this strategic assistance area, assistance efforts will focus on:

- **Elimination of major price distortions:** Major price distortions presently occur in the energy and environment sector. This activity will improve the energy sector's capacity to set prices and tariffs to reflect actual economic costs and take into account the social costs of readjustments.
- **Improved access to markets and trade policies:** This work will supplement the tax and central bank policy efforts. Emphasis will be on expanding the capacity in trade analysis in support of World Trade Organization (WTO) accession. USAID will continue to take the lead on this activity in cooperation with the Department of Commerce and consultants. One probable area of trade analysis will address agricultural pricing and subsidies. The key counterparts will be the Ministry of Foreign Affairs, Ministry of Economy, Ministry of Industry and Trade, and technical ministries.
- **Improved legal framework for commercial activity:** This activity will improve the economic regulatory environment and reduce the costs of expensive and time consuming litigation. Major legislative efforts will focus on commercial, collateral, and bankruptcy law, while low cost legal instruments such as arbitration, mediation, will be designed and promoted. American Bar Association's Central and East European Legal Initiative (ABA/CEELI) will be the primary implementor.

These are important areas of the economy where anticipated results from well-designed assistance efforts are attainable within proposed time and resource limits. As they focus mainly at the policy level, the multiple risks are also high, and this must be factored into consideration both in program design and in monitoring achievement of project results.

4. Citizen Participation: The USAID democracy program will focus on the unique need to foster cooperation between government authorities and non-government organizations (NGOs) and local citizens. A combined program to increase the ability of NGOs to responsibly work together with local governments to resolve community

problems and to work with local governments to increase their transparency and become responsible to citizens needs will result in heightened democracy at the local level, better relations between the government and the citizens they serve, and improved policies for and services to the citizens. USAID's program will complement those of other donors, which are focusing on strengthening NGOs and improving public administration skills. USAID/Lithuania plans to explore and, if feasible, establish a foundation to promote civic participation at the local level and will seek multilateral donor support for this foundation. The citizen participation objective will be achieved by:

- increased NGO activism encouraged by enabling legislation, strengthened management skills, and improved advocacy skills
- increased responsiveness to public participation by municipal government officials.

SPECIAL INITIATIVES

A number of activities have been funded from 1994-1996 funds and these will continue to receive funding or be phased down over the next few years. There are three special initiatives that USAID will continue to support, specifically in the areas of energy, environment and enterprises. Additionally, there are several regional activities supported by USAID through AID/W funding and two cross cutting training programs that linked to the strategic objectives.

Energy and Environment: Providing assistance to the Ignalina Nuclear Power Plant will help strengthen nuclear safety and inspection capacities. Continuing support to strengthen early warning and other nuclear safety measures is a very high priority, particularly in light of the potential risks from this reactor. Energy efficiency activities will contribute to overall electricity demand reduction and to price rationalization. As part of the USG's policy to foster cooperation among the three Baltic countries, USAID will continue to support one energy activity, the development of regional energy planning and cooperation and one environment initiative, establishment of a regional environmental monitoring system, which is managed by the US Environmental Protection Agency.

Improved Small and Medium Sized Enterprise Capacity: Since 1992, the enterprise-level assistance has helped to address the initial business management and technical barriers facing agriculture, environment, industry, energy efficiency, and tourism. This effort has achieved impact and supported the rapid transition from a state-run economy to the 150,000 private enterprises presently registered in Lithuania.

Lithuanian business services have appeared, however, since the early stages of the USAID program, and the USAID grant-based service risks crowding out an emerging business service sector. Further, the primary constraints facing enterprises continue to be the lack of private ownership for many state owned industries, continued subsidies, energy and tax increases, and the need for industrial restructuring.

USAID does not have the resources to continue a retail level technical assistance and training program. The EU-PHARE and the EBRD have started business advisory services which can provide commercially based assistance at a much higher funding level than

USAID, and USAID can not sustain funding for more wholesale level efforts.

Baltic Regional Programs: There are several regional activities supported by USAID through AID/W funding. These are the Baltic American Enterprise Fund (BalAEF) which provide capital for small and medium sized businesses; law and order activities managed and implemented through the Department of State with the FBI, ICNL, and the Department of Justice/ABA/CEELI program in criminal law. The criminal law program is presently transferring skills to address white collar crime, primarily money laundering. USAID/Lithuania is not responsible for funding or achieving results for these regional activities, but has a role in monitoring their implementation in conjunction with the Department of State, USAID/Washington, and the USAID offices and U.S. Embassies in Estonia and Latvia.

SUMMARY OF ACTIVITIES PLANNED FOR PHASE OUT

In order to achieve the results targeted in the new strategy, taking into account declining budgets, resources needed to be shifted in order to implement this strategy. It was decided to begin rapidly implementing the new strategy using the FY 1996 budget.

FY 1996 Funding: Considering these conditions, USAID will wind down the enterprise level assistance. The following organizations will receive limited funding in FY 96 for this transition: International Executive Service Corps (IESC), Volunteers for Overseas Cooperative Assistance (VOCA), Financial Volunteer Service Corps, (FSVC), WEC (World Environment Center's Pollution Prevention Center), MBA Enterprise Corps, environmental investment promotion, Enterprise and Entrepreneurial Management and Executive Development (EMED), and English language training. In addition, selected elements of the International Republican Institute (IRI), National Democratic Institute (NDI), and public administration activities will be incorporated into the new Civic Participation program.

FY 1995 Funding: The following activities have existing funds and will continue until the funds have been expended. No additional funding is planned for these activities: The Land O' Lakes dairy cooperative development program, WOCCU's credit union program, the Peace Corps small business grants, the Texas A&M business school strengthening, and USIA's academic top up, and the Federal Trade Commission.

Activities Closed: Projects which would have very limited impact, have implementation problems, are not consistent with the revised strategy or have completed their activities will not receive additional funding. These include bank training, small bank-to-bank assistance, environmental action plan investments with the EBRD, and energy efficiency at the plant level.

Customer Service Plan: USAID/Lithuania regularly meets with donors and counterparts to coordinate programming and develop synergies with other donor programs. Additionally, USAID/Lithuania is now a member of an innovative US-Lithuanian commission with representatives from all major parties in the Lithuanian Parliament and the Lithuanian American Community. Its purpose is to discuss priority program directions for USAID assistance in Lithuania. Future consultations with the commission will allow

USAID to continue to obtain input and feedback about the program and its implementation. The commission is already providing USAID with important additional forum for policy dialogue on selected issues.

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STRATEGIC PLAN

PART I: SUMMARY ANALYSIS OF ASSISTANCE ENVIRONMENT AND RATIONALE FOR FOCUSING ASSISTANCE IN PARTICULAR AREAS

1.0 Mission program and U.S. Foreign Policy

2.0 Overview and Priorities

3.0 Customer Focus

4.0 Transitional Issues

1.0 Mission Program and U.S. Foreign Policy

Lithuania regained its independence in 1991 after more than 50 years of illegal Soviet occupation. The United States never recognized this forcible annexation and after independence was instrumental in persuading Russia to withdraw its troops. Since 1993, U.S. policy has been to support Lithuania's integration into Western institutions, bolster its fledgling free market economy, support continued democratic reforms, and promote U.S. trade and investment. Excellent bilateral relations are expected to remain closely cooperative. Regional security is important and the U.S. promotes closer ties with Baltic and Scandinavian countries, while cooperation with NATO is of direct and material interest to the U.S. Close ties to the U.S., in the form of an extensive, technically qualified, Lithuanian-American community have facilitated the success of bilateral assistance. An active U.S. program is necessary to reduce the potential for political insecurity, a further rise in criminal activity, negative nationalistic trends, and economic instability. A recent banking crisis has shaken confidence in economic reforms and the Government of Lithuania (GOL). Lithuania's successful transition to a market economy closely integrated with the Europe Union, based on democratic principles, is key to U.S. policy.

2.0 Country Overview

This section summarizes progress in achieving past USAID strategic objectives (section 2.1), addresses recent economic and democratic developments (section 2.2), assesses the future economic and democratic challenges facing Lithuania (section 2.3), identifies lessons learned from four years of USAID experience in Lithuania (section 2.4), establishes the priority strategic objectives to support economic and democratic reforms between 1996 and 2000 (section 2.5), provides a rationale for reducing the emphasis of USAID's strategic objectives from nine to three areas (section 2.6), identifies four special, limited scope, or cross cutting objectives which will be continued (section 2.7), and notes considerations about Baltic regional programs (section 2.8).

2.1 Summary of Past USAID Strategic Objectives

The USAID program started in Lithuania in 1992 and has provided \$45.0 million in technical assistance, training, and equipment in Lithuania through 1995. Along with a decrease in resources available for Central and Eastern Europe, assistance levels to Lithuania have declined from \$12.5 million in 1995 to approximately \$8.25 million in 1996 and are projected to fall to \$7 million in 1997. Increased demands for external assistance to Bosnia have strained resource availability to USAID/Lithuania.

Initially, the USAID program was a broad based effort designed to reach as many segments of the transforming society as possible. Key activities were started in nearly all of USAID strategic areas and were successful in showing U.S. support for reform throughout the country.

Programs were encouraged to work separately and little effort was made to achieve synergistic and integrated results.

USAID activities have been designed to contribute to the achievement of nine ENI strategic objectives. Five of these were directed towards achieving the goal of fostering the emergence of a competitive, market-oriented economy, three objectives were pursued to develop an open democratic society, and one objective supported social stabilization. There are approximately 44 ongoing economic restructuring activities with an average size of \$180,000 per activity.

ENI Objective 1.1: Increased transfer of state-owned assets to the private sector

Through USAID contracts with KPMG, privatization models were established at thirteen medium-to-large sized state owned firms in the areas of manufacturing and agriculture. Of the completed projects, the most visible successes have been the tender for Klaipeda Tobacco by Phillip Morris and the sale of Audejas Textile. A lack of clear GOL commitment to cash-based privatization hinders future progress in this area. Sufficient resources to support cash-based privatization are being provided to Lithuania under an EU-PHARE Baltic regional accord for privatization technical assistance.

ENI Objective 1.2: Increased soundness of fiscal policies and fiscal management practices

Improvements in tax policy, tax administration, budget policy and currency stabilization has been devised and successfully implemented with the assistance of USAID-funded advisors. U.S. Treasury advisors helped the Ministry of Finance formulate fiscal policy, upgrade tax collection efforts through regular training, establish a functioning treasury within the Ministry of Finance, and develop needed management systems. U.S. Treasury advisors actively promoted and advocated the establishment of basic fiscal control and management systems in the Ministry of Finance including: active role in major coin and currency issues in terms of roles, ownership and form; first and primary advocate for establishment of the Treasury and centralized disbursement and collection; assisted in the establishment of the domestic securities program.

ENI Objective 1.3: Accelerated development and growth of private enterprises

This objective was supported through two major sub-objectives:

- **sub-objective 1.3.1** to support policies, laws, and regulations that are more conducive to broad-based competition and private sector growth
- **sub-objective 1.3.2** to provide support for enterprises strengthening in business management and technical areas

Sub-objective 1.3.1: USAID efforts focused on reform of the commercial legal system, WTO accession and institutional development of effective competition and consumer protection law. In the area of commercial law reform, ABA/CEELI helped establish a Commercial Law Center, has contributed to major legislative reform, most notably in the areas of foreign investment, bankruptcy and collateral law, and has mounted numerous training programs for a wide sweep of judicial sector reform and training issues. A special effort has been made to improve collateral law, including the design of an effective collateral registry. The Commercial Law Development Program (CLDP) of the U.S. Department of Commerce provides assistance in trade, WTO accession and protection of intellectual property rights. A major effort has been made to collect the information needed to apply to join WTO and to respond to WTO accession panel queries. The Department of Justice (DOJ) and the Federal Trade Commission (FTC) have sent experts to Lithuania to assist the government in devising and enforcing economic competition laws and consumer protection laws.

Sub-objective 1.3.2: Improved, more sustainable private business operations: USAID assistance in the area of improving private business operations has focused primarily on

enterprise level management and technology support (IESC, MBA, Peace Corps), agricultural development efforts (VOCA, Land of Lakes), business school (Texas A&M, USIA) and selected enterprise employee training (EMED). Together, IESC and VOCA have helped over 100 companies cut production costs and increasing output, leading to millions of dollars in savings. The Land O' Lakes program has pioneered the concept of an agribusiness-based outreach program aimed at strengthening the creation of dairy cooperatives and improving milk quality. With Land O' Lakes support, participating private farmers increased milk yields by 50 percent and improved milk quality by 100 percent within three months of project implementation.

ENI Objective 1.4: A competitive private financial sector that is more responsive to the needs of a market-oriented economy

USAID advisors in bank supervision played a key role in bringing to light the serious deficiencies in the commercial banks, and in assisting the GOL to design strategies and legislation to address the problems of widespread bank insolvency. Prior to the December 1995 crisis, USAID assisted the Bank of Lithuania (BOL) to revise its bank supervision strategy and provided on-site training in bank examination. USAID assistance to the capital markets has led to a strengthening in market regulation, increased turnover and improved reporting. USAID assistance to a nongovernmental think tank, the Free Market Institute, has focused public debate on key economic reform policy issues and, through local policy advocacy, helped to build a reform consensus in banking, tax reform, investor regulation and monetary policy. The \$50 million Baltic American Enterprise Fund, which became fully operational with the establishment of a local office in Lithuania in 1995, has provided much needed financial support for expansion of the private sector. First year lending has provided \$4 million to 20 enterprises.

ENI Objective 1.5: A restructured energy sector that better supports an environmentally sound, market-oriented economy

USAID has supported activities aimed at reducing dependency on the Ignalina Nuclear Power Plant, nuclear safety, electricity power plant restructuring, demand-side management, and tariff reform. The US Nuclear Regulatory Commission and the Department of Energy have provided assistance in nuclear safety training, management guidelines and provision of safety inspection equipment. Assessment of safety conditions in the Ignalina Nuclear Power Plant (INPP), scheduled for completion in late 1996, is expected to have a major influence on Lithuania's future electricity policy. Electricity power sector restructuring has been supported through a strategic partnership between Lithuanian Power System (LPS) and Alabama Power, through the Utility Partnership Program. Emphasis has been placed on developing strategies for energy conservation, market development and customer support under this twinning operation. USAID has provided support to the newly-formed Energy Pricing Commission, and has helped that agency develop procedures for regular review of energy tariffs.

ENI Strategic Objective 2.1: Increased better-informed citizens' participation in political and economic decision-making

This objective was supported through three sub-objectives: 1) political process and reform, 2) independent media strengthening, and 3) NGO strengthening.

Political process and reform: Basic democratic reforms have been extensive since 1991. USAID advisors from ABA/CEELI and other sources helped Lithuania to prepare its 1992 constitution, which provides for fundamental human rights and freedom of assembly and organization. Since 1994, IRI has provided training to all political parties and has made a major contribution to free and fair municipal elections which were held in 1995. With USAID-funded training, political parties originally based on personalities are slowly developing into parties based on issues and platforms which will help focus the 1996 parliamentary elections on issues of interest to the voters. More than 15 parties have participated in each of the elections since independence.

Independent media: Through legal assistance supported by USAID directly and through IAA's with USIA, the right to free speech and association is guaranteed in the constitution and recognized in practice. USAID-funded experts assisted Lithuanian lawyers to draft key constitutional provisions for the protection of freedom of the press. USAID supported training of journalists through USIA-implemented programs has increased their professionalism and investigative skills. Increased business opportunities and business capacity now exists in the media because of USAID and USIA training.

Nongovernmental organizations: Recent legislation passed with USAID-funded support through the International Center for Not-for-Profit Law (ICNL), established a comprehensive legal framework under which NGOs will operate in Lithuania. The Democracy Commission and the newly established Democracy Network (US Baltic Foundation) are providing development grants and training to local NGOs to address the most important economic, political, social, and environmental issues facing the country.

ENI Strategic Objective 2.2: Legal systems that better support democratic processes

ABA/CEELI has assisted to draft legislation on judicial ethics, and is training lawyers and judges. Under regional programs, assistance to the Prosecutor's Office and police helps to fight organized crime and money laundering activities.

ENI Strategic Objective 2.3: More effective, responsive, and accountable local government

The USAID program to strengthen public administration began in late 1995. The initial efforts include reorganization of one local government, establishment of a municipal economic development unit in another participating city, and establishment of a training program to increase citizen participation in municipal decision making.

ENI Strategic Objective 3.3: Reduced environmental risks to public health

Assistance in the environmental area has supported reduced environmental risks, improved fiscal policy, and enterprise development. With the support of the Harvard Institute for International Development (HIID), new, simplified pollution taxes and forest resource charges were introduced. The World Environment Center has promoted win-win pollution abatement programs in seven enterprises, with savings estimated at nearly \$500,000. Training in environmental analysis and environmental management has been provided by the Environmental Protection Agency.

2.2 Recent Developments

This analysis reviews economic developments and democratic trends in 1991-1996 and examines areas where further reform is warranted. External assistance priorities are identified based on changing requirements, the anticipated direction of future reform, and eventual graduation from US SEED assistance programs.

2.2.1 Recent Economic Developments

The Lithuanian economy is at a critical turning-point. Considerable progress has been made during the past five years. The economy is starting to grow, more competitive sectors are expanding while less-competitive sectors are shrinking, inflation has fallen, the budget deficit has been kept within manageable bounds, the currency is convertible and stable, employment remains high, and the private sector continues to expand. But serious macroeconomic imbalances have emerged, weaknesses in the banking sector have shaken public confidence, law and order conditions have deteriorated, the scope and span of GOL remains excessive and very little progress on structural reform has been made in the past year. To this must be added the fall 1996 elections, which have tended to thwart decision-making and inhibit speedy resolution of mounting economic predicaments.

Economic Growth: GDP has fallen since 1990, and by 38 percent and 24 percent in 1992 and 1993 respectively. Per capita GDP has fallen from about \$6,700 in 1990 to \$3,400 in 1994, less than half of the level experienced in Estonia and 70 percent of the level in Latvia. The main factors of this adjustment include the breakdown in normal trading relations with former Soviet Union (FSU) Republics, price rises for energy and other imports, domestic price rationalization, and adjustments as the economy moved away from central planning. Output began to recover in 1994 and 1995 with growth reported at 1 percent and 4 percent per annum. For 1996, growth is projected to reach between 3 (EU forecast) and 5 percent (IMF Forecast).

The decline in GDP during 1990-1994 was more pronounced in the agriculture, transport and energy sectors than in industry or services. Between 1991 and 1994, the share of agriculture in GDP fell from 27 percent to 8 percent, that of electricity and gas from 9 percent to 3 percent and the share of transport from 13 percent to 8 percent. Conversely, the share of industry increased from 18 to 23 percent while that of services increased from 20 percent to 52 percent of GDP. The pronounced shift towards services reflects both the severe under-development of these activities and the rapid movement of largely private resources into these areas following privatization and deregulation. The shift of resources from low-productivity agriculture to higher productivity services and manufacturing, together with a modest recovery in exports, are the main factors responsible for the recovery in growth in the mid-1990s.

Official GDP figures seriously under-report actual economic activity because of significant grey-market, or unrecorded economic activity. The Economic Research Center estimates that between 40 to 50 percent of total economic activity is unrecorded, primarily related to tax avoidance, smuggling, unlicensed exporting and other illegal activities. If estimates of informal activity are correct, then actual GDP is approximately twice the size reported by the GOL.

Investment: Between 1990 and 1995, GOL capital expenditures fell from 5 percent to 3 percent of reported GDP, while foreign direct investment levels totalled \$359 million, or an annual average of under 2 percent of reported GDP. Foreign direct investments per capita are among the lowest in Central Europe. Gross capital formation has fallen from 34 percent of GDP in 1990 to about 20 percent of GDP in 1992-1995. A few donor-funded projects in the energy, transport and waste water treatment subsectors, together with private investment in residential housing and small and medium-scale enterprises account for most reported capital formation. The 1995-1997 Public Sector Investment Program envisions an increase in the proportion of public investment, primarily in regional transport and energy projects.

Employment: 51 percent of the country's 3.7 million people are in the labor force. Between 1991 and 1995, public sector labor decreased from 70 percent to 34 percent. Total employment has fallen from 1.85 million in 1990 to 1.67 million in 1994 due to a decline in the labor force participation rate. Self-employment has risen from nearly zero in 1990 to about one-fifth of the labor force in 1994. Agricultural employment has dropped from 29 percent of total employment to 22 percent. The official unemployment rate has gradually increased from 4 percent in 1993 to 7 percent in December 1995, although a recent survey estimates actual unemployment at 12 percent.

Real wages increased modestly in 1994, fell sharply through the first three-quarters of 1995 and increased by close to 18 percent in the last quarter of the year. In US dollar terms, real wages more than doubled during 1994 to 1996. The weak link between wage developments and labor productivity remains a serious concern and has an important effect on competitiveness, inflation and employment creation.

Public Finance: As in other transition economies, Lithuania experienced a rapid fall in GOL revenues, from 44 percent of GDP in 1990 to 24 percent in 1995. During the first three months of 1996, revenue collections were 20 percent below targets, threatening to collapse the budget. As collections fell, the tax burden shifted more from capital (company taxes and VAT) to labor (e.g. income taxes). Company taxes have fallen because of a reduction in reported profits and the granting of numerous tax exemptions and preferences. VAT collections have fallen because of the administrative problems arising from collecting from many new (and small) private enterprises and numerous exemptions. Personal income taxes were lowered and

simplified (one rate and a standard exemption) in 1994, leading to a rise in collections.

The fall in actual collections is even more acute considering that close to half of total economic activity is unreported. This means the effective tax rate is 12 to 14 percent of actual GDP. This has two major implications. First, the tax system inspires evasion and avoidance and fails to capture a significant amount of revenue. Second, this has resulted in a sharp imbalance between the revenue necessary for GOL to fulfil the services expected of it and the resources actually at its disposal.

The GOL has maintained a prudent fiscal stance throughout 1992-1995 despite the severe fall in revenues. The fiscal balance moved into a small surplus in 1991 and 1992 as the GOL attempted to reduce domestic absorption and hence choke-off inflation. Between 1993 and 1995, the fiscal stance eased, with a deficit in the range of 3 to 4 percent of GDP, financed equally by domestic (Treasury bill) and foreign borrowing.

All sectors have experienced sharp budgetary cutbacks since 1990. The main trends in public expenditures are a growing wage bill; central government employment which continues to rise despite a fall in total real wage outlays; government loss of large numbers of highly skilled employees to the private sector; and public investment outlays and repairs and maintenance of public facilities which have been sharply compressed. GOL has made significant progress in developing a treasury and modernizing budget management procedures and creating a domestic securities program, although most expenditures are still managed on a cash balance basis.

Quasi-fiscal spending and tax arrears: Faced with revenue shortfalls, the GOL has increasingly resorted to quasi-fiscal spending (build up arrears and directing commercial credit) to meet public expenditure objectives. State budgetary entities have accumulated close to \$110 million in payment arrears to the energy complex companies; tax arrears and accumulated tax penalties (more than half of which are from government owned entities) for 1995 are estimated at \$375 million; payment arrears to the social fund (SoDra) rose sharply in 1995; and directed lending forms a significant part of the portfolio of the State Banks. Large quasi-fiscal government spending operations have contributed to the financial problems in the banking sector, to trade frictions with Russia (over natural gas imports), damage to the financial status of the state enterprises and threaten the solvency of the pension fund. A variety of mechanisms have been used to reduce arrears, including freezing and forgiveness of past tax arrears, exchange of arrears for enterprise shares and intensified collection efforts.

Inflation: In 1991-1992 inflation accelerated rapidly with a rate of 224 percent in 1991 and 1,021 percent in 1992. After mid-1993, the inflation rate fell to 410 percent in 1993, 72 percent in 1994, and 36 percent in 1995. Factors which contributed to high rates of inflation included price liberalization (1991-1992), increases in real wages, exchange rate devaluation and elimination of the large monetary overhang. Anti-inflationary measures in 1993 and early 1994 included tight monetary and incomes policy. Since April 1994, adoption of a currency board arrangement has limited growth in the money supply, and helped restrain imported inflation. In 1994 and 1995, monetary expansion above levels warranted with falling output, increases in energy prices, seasonal shortages of agricultural products, inter-enterprise borrowing, and imported inflation from Russia and Germany also added to inflationary pressures. For 1996, inflation is forecast at 22 percent. GOL sources, however, forecast 1996 inflation to be in the range of 35 to 40 percent due to the anticipated effects of money supply growth and energy price increases.

Monetary and Exchange Rate Policy: The Litas, Lithuania's national currency was introduced in June 1993 and in August 1993, it became the sole legal tender. Under the currency board arrangement, the Litas was pegged to the US dollar at a fixed exchange rate of 4 to 1. All Litas in circulation are fully backed by official foreign exchange and gold reserves and are freely convertible. Under the currency board arrangement, the central bank is bound by a money-creation rule that limits growth in base money to the growth in official foreign exchange reserves. Accordingly, the scope for government deficit financing through money creation is restricted by the nation's ability to accumulate official reserves, which in turn is influenced by developments in trade and capital flows.

The currency board arrangement was introduced to provide Lithuania with a nominal anchor that could break the spiral of devaluation, wage increases, expansionary fiscal policy, monetary growth and cost-plus inflation. Towards this end, it has enjoyed a considerable measure of success. Persistently high rates of domestic inflation vis-a-vis Lithuania's trading partners have, however, caused the Litas to appreciate sharply in real terms since 1994. The degree to which this dampens the competitiveness of the export sectors (crucial to recovery in a small nation) has been cited as a source of growing concern. Other concerns relate to the effectiveness of linking money supply growth to official reserve accumulation in an uncertain trade and capital markets environment and the degree to which an exchange rate peg can further reduce inflation when factors outside the financial markets (e.g. enterprise and government arrears) exert a considerable effect on domestic costs and prices.

Interest Rates: Interest rates remain well above international interest rates. Average interest rates on commercial loans peaked at 131 percent per annum in 1993 and fell to about 25 percent per annum in 1996. Deposit rates (for litas financing) have fallen from 61 to 10 percent during the same period. Spreads between lending and deposit rates are very high, and all rates have tended to lag inflation. As a result, average deposit rates were 22 percentage points below the rate of inflation during 1993-1995. Reasons for the high spreads and low real deposit rates include the high risk premium attached by commercial banks to lending activity, lack of competition for deposits, restrictions (prior to 1995) that limited enterprises to use a single bank account, and the ceiling placed on deposit rates by treasury bill rates.

Negative interest rates discourage growth in domestic saving and contribute to capital flight and a shallow financial system. The ratio of broad money to GDP was estimated at 23 percent of reported 1994 GDP, or closer to 14 percent of actual GDP (after accounting for grey market activity). The narrow, and short-term nature of the financial base limits the scope for lending operations and can translate relatively small increases in the money supply into rapid bursts of inflation.

Banking and Financial Markets: The banking sector is weak and public confidence in the banks has reached new lows, since the GOL liberalized private banking in 1992 and 1993. By mid-1994, 27 commercial banks were registered in Lithuania. By mid-1995, nine smaller banks were under administration, liquidation or were declared bankrupt. In December 1995, three large commercial banks were placed under administration and deposits were frozen. Public outcry about the related unethical behavior led to the resignation of the Prime Minister, Central Bank Governor, and several other senior officials, and prompted the introduction of a GOL deposit guarantee scheme for private commercial banks. The three state banks (Agriculture, State Commercial Bank, and the State Savings Bank) account for just over half of all bank assets and are all reported to have serious portfolio problems. Essentially, close to eighty percent of all deposits are also in banks that would normally be considered technically insolvent. No bank serves as a full service bank including extension of long term loans.

Reasons for the weak position of the commercial banks include: fraud, connected lending, political lending (directed uneconomic credits), initial under-capitalization, inadequate prudential standards, weak bank supervision, inadequate provisions for doubtful loans, weak management systems and the high risks associated with lending in a unpredictable, deflationary environment. Estimates of the resources required to recapitalize the distressed banks and repair their balance sheets are estimated to be in the range of \$300 to \$400 million. A variety of arrangements have been proposed for working-out the problems of the distressed banks. As of April 1996, GOL had not articulated a strategy to rehabilitate the banking system.

Lithuania's capital market was provided an initial boost by privatization, investment deregulation in insurance and credit unions, and the establishment of a treasury bills market. A Securities Commission was created in 1992, a stock exchange in September 1993, the Central Securities Depository in March 1993 and a Central Bank clearing facility for securities in July 1995. There are 51 registered brokerage companies on the exchange and 12 brokerage divisions of commercial banks. Close to 2000 companies are registered with the exchange of which 350 are registered on the current list. Securities turnover has been steadily rising. Monthly turnover of equities averaged 12 million litas in 1995. Trade in treasury bills peaked

at 113 million litas for the month of December alone. Outside of the securities market, 34 private insurance companies have been established, four credit unions have started operations, and a law on private pension funds is under consideration.

Trade and Trade Policy: In 1991 and 1993, Lithuania experienced a decline in its terms of trade of close to 50 percent of GDP as Russian export prices were adjusted to world market levels. Both exports and imports plunged as domestic producers adjusted to higher real import costs. Imports and exports have staged a strong recovery since 1992 due to exchange rate appreciation and steadily growing inflows of official external financing from the West. Lithuania's imports continue to be dominated by energy and mineral product purchases from Russia and other FSU republics. Exports, of food, other agricultural products, minerals, textiles, manufactured goods and chemicals, have shifted increasingly to the West, with a sharp increase in trade to the EU, EFTA and North American markets. Recorded trade has fallen as a share of total economic activity, reflecting an increase in domestic services and an increase in the domestic market orientation of the agriculture sector.

Lithuania's trade balance shifted from a surplus of \$100 million in 1992 to a deficit in subsequent years, bottoming out at \$330 million in 1995. The current account deficit peaked at 5 percent of GDP in 1993 before falling to an estimated 2.5 percent of GDP in 1995. The current account deficit has been financed equally by inward investment (mainly passive investment in treasury bills) and by official borrowing. The nation's foreign debt has reached a relatively modest 10 percent of GDP, although debt service rose from less than 2 percent of the nation's exports to the West in 1993 to 6 percent of exports to the West in 1995.

At Independence, Lithuania rejected any claims to the official debts of the former Soviet Union. In the five years since Independence, Lithuania's external debt reached \$554 million, of which 87 percent were official loans. Of total official external borrowing, nearly 60 percent was used to finance fuel imports and currency reserves. In 1995, Lithuania's net official foreign borrowing increased by approximately \$200 million, more than two-thirds of which was used to finance imports and bolster reserves. Rapid public debt accumulation to finance consumption and energy expenditures has been cited by GOL as a source of concern, although Lithuania's external debt situation remains manageable. Official reserves have increased from 1.8 months of import cover in 1993 to 2.7 months in 1995. In the aftermath of the December 1995 banking crisis, external reserves fell by 16 percent to the lowest level since 1993.

Tariffs were changed 13 times from February 1993 to 1995, including substantial increases in agricultural import tariffs. From 1991 to mid-1995, there have been over 80 government resolutions issued regarding foreign trade. Tariff rates are uneven across sectors; main agricultural products remain subject to both tariff and non-tariff protection; and custom's controls and trade administration are unevenly applied. Lithuania has entered into several free trade agreements and bilateral trade agreements during 1991-1995, with the result being that tariffs and trade restrictions vary markedly by source market.

Trade figures from Western partner countries suggest that Lithuania's exports are significantly under-reported. Import figures for Lithuanian product exports into OECD nations are 40 percent above reported exports from Lithuania, while import figures to Lithuania are within 10 percent of those reported by exporters to Lithuania. Weaknesses in custom's control, under-invoicing of exports and unrecorded trade appears to account for this discrepancy. If exports are, in fact, significantly under-reported, then capital flight would also be well in excess of that reported in the balance of payments.

Privatization: Lithuania embarked on privatization earlier than other Central European nations, using a decentralized system of publicly distributed investment vouchers. Between 1991 and mid-1995, 85 percent of the over 4,500 companies eligible for privatization were privatized. Almost all residential real estate and a large share of agricultural land holdings were privatized, the majority by conversion of investment vouchers. Three-quarters of all assets privatized were in exchange for vouchers (plus 5 percent in cash) and one quarter for cash or foreign currency sales (three large enterprises). Cash sales were in the form of

auctions by local privatization agencies. While asset transfer was rapid under voucher privatization, the process brought very little new financing or management into the enterprises and, in many instances, simply transferred ownership to employees or pre-privatization management. The new law on Privatization of State and Municipal Property, which came into effect on September 15, 1995 signals the GOL's intent to pursue cash-based privatization through public share subscriptions, auctions, tenders, direct sales and capital leases. An estimated 50 percent of economic output is still produced by enterprises in which GOL holds a majority interest. Many of these are in strategic sectors (energy, transport, communications, infrastructure, banking, health and education) although a number of large manufacturers still remain under public control. Little progress has been made on cash-based privatization since the law came into effect.

Energy Sector Developments: Lithuania's energy sector was designed as a major source of electricity for the FSU. With the FSU break-up, the gap between potential energy supply and demand has widened. Total energy production fell from 18.6 million tons of oil equivalent in 1989 to 8.5 million tons in 1994. Energy producers are plagued by excess capacity, high transmission losses in the delivery of home heating, incomplete metering of final and intermediate users, tariff levels set below operating costs and the build-up of energy payment arrears. In January 1996, energy payment arrears were estimated at approximately \$75 million for electricity and district heating, \$38 million for domestic gas and \$50 million to Russia for gas imports. Close to three quarters of the overdue payments are from "budgetary entities" (GOL and State Owned Enterprises). Within the energy sector, petroleum imports and oil exploration have been opened to private sector participation. All other activities have remained under GOL control. Strategies have been developed for least cost planning to evaluate future energy prospects in the event that the Ignalina Nuclear Power Plant (INPP) is decommissioned. With the support of the G-7 nations, \$30 million has been provided to strengthen safety equipment and procedures at INPP. Future energy investment plans accord high priority to completing the Baltic Ring, connecting transmission lines to Poland and upgrading existing gas pipelines.

Agriculture: The break-up of the FSU led to the breakdown of export markets for meat and dairy products and for the import of animal feed. Price liberalization and land reform resulted in a large number of small farms. Since 1991, agricultural output has declined by 55 percent and agricultural exports by 50 percent. Agro-input use has fallen sharply as has productivity in both livestock and grain crops.

Agricultural land reform was implemented nation-wide in 1989 and accelerated in 1991 with the adoption of a restitution program and voucher-privatization. Approximately 420,000 land restitution claims were filed and approximately 50,000 have been settled. Close to 60 percent of total arable land is now farmed by the private sector, about half of which is in small subsistence oriented plots of one to two hectares. About 30 percent of all land is in private farms which average 25 hectares and which by law may not exceed 85 hectares.

Privatization in rural areas has focussed on the rural agro-enterprises (*bendrove*). The process was based primarily on voucher sales. Many of these enterprises are owned by their workers, and almost all lack sufficient capital, effective management, and appropriate marketing and farmer outreach skills. Competition from private (small-scale) agro-processors, together with the steep decline in farm output has led to a sharp fall in capacity utilization in the agro-processing sector as a whole.

In the face of declining agricultural output, GOL has raised tariffs on five major agricultural products (meats, poultry, dairy, sugar, potatoes) and, in the Agriculture Law of December 1994, introduced a provision for threshold import prices to be defined as a minimum import price set by the GOL. Direct subsidies are paid to producers in the form of below-market interest rate loans (which are then not recovered) from the State Agriculture Bank. Budgetary transfers to the farm community have fallen as public expenditures as a whole have come under pressure.

Social Safety Net: Before independence, Lithuania had one of the highest standards of living

in the FSU. With the sharp fall in GDP, living standards have deteriorated. Poverty has intensified most among pensioners, the rural population and those receiving the minimum wage. There is evidence of an alarming rise in the rate of suicides and alcoholism, and a measurable fall in life expectancy. Public expenditures on health care and education have fallen sharply in real terms and social services are in a state of severe decline. Lithuania's social insurance expenditures have lagged inflation. Prior to catch-up pension awards in 1995 and growing enterprise payment arrears to the social insurance fund (SoDra), the system was financially balanced. Cash flow deficits in SoDra began to occur in 1995, leading to payment delays and benefit-arrears. The social welfare burden presently adds 31 percent to the wage bill and, under current demographic trends, would have to rise to close to 45 percent of the wage bill to meet future demands. A variety of measures aimed at improving the financial soundness of the social safety net are being implemented, including an increase in the retirement age, narrowing of coverage for unemployment and sickness benefits, establishment of private pensions, a shift of health care expenditures to the budget, health care deductibles, and better linking of pension payments to incomes.

2.2.2 Democracy Trends

Citizen Participation: Forty years of Communist rule left Lithuania with little basis upon which to develop along democratic lines. The problems found in Lithuania are common to the FSU and other parts of Central and Eastern Europe: gradual devolution of central power, central control of local finances, a legislative structure hindering due process, a weak NGO sector, poor understanding of civic responsibility of citizens and government representatives alike, and limited participation by individuals, political parties, emerging NGOs and government officials in processes which we would consider democratic. "Post-revolution apathy" is prevalent in Lithuania and confidence in political processes and the legal system is low. A survey conducted in April, 1996, found that the GOL has only a 21 percent approval rating among citizens. The media received the highest credibility rating, with 75 percent popular support.

In many regards, Lithuania is in a better position than many of its CEE neighbors. Ethnic tensions do not exist between the three nationalities, an independent media exists (although somewhat hindered by central attempts at control), a variety of political parties have developed and fair elections have been held since 1991.

Political process and reforms: Lithuania shared a legacy of Socialist governance with the Soviet Union for over 50 years. It also shared socio-economic, political, and institutional similarities. The sovereignty and independence movement in Lithuania grew during the late 80's, and culminated in a two year struggle from 1989 and 1991. After independence a new government emerged and was faced with a set of problems similar to those confronting all countries which were undertaking transition. Opting for an open democratic political system, a free market economy and the necessary institutions and policies to make the new economy and political system work has created a significant challenge for Lithuania's political leadership.

Lithuania had little experience with which to meet any of these challenges. The leading pro-independence voices, Vytautas Landsbergis, and others aspired to recreate the now idealized interwar republic of the 1920's and 30's. They saw the west as their salvation, especially Western security structures, which could protect them from Moscow. Their main opponents, most of whom served in the communist party and state structures in Soviet Lithuania, advocated gradualism and taking account of the interest of eastern neighbors while opening to the west. In neither case, however, was there a clear sense of how an open, free market economy worked or what democracy meant at the participation level; the role of officials as servants of the people and the role of citizens as responsible players on behalf the public were equally not understood.

On February 15 1993, Algirdas Brazauskas was elected President in a free and fair election. He was the first president in Lithuania's post independence history to do so. Subsequent elections, which brought the Lithuanian Democratic Labor Party to majority status in the Parliament, were also free and fair and were characterized by very heavy voter turn-out, nearly

80 percent. Through this exercise of their voting rights and their overwhelming participation in the independence struggle, the people of Lithuania showed that they understood the power of political participation. They also showed that they would exercise their right to choose elected officials based on pragmatic principles and on a vision of Lithuania's future.

Since the election, however, the level of political interest has fallen. This is partly due to the fact that economic life has become more difficult and long standing political and social habits have been slow to change. It remains common in Lithuania to expect the government to solve the problems of the individual, to right wrongs and to grant favors. Farmers, labors students, teachers, pensioners all seek special treatment from the government rather than working to resolve their own problems. When the government does not or can not respond, the public often perceives it to be incompetent or, worse, malfeasant.

Independent media: Legal protection for the press is encoded in the constitution and is further articulated in the laws on the press, passed in 1990. Much of the media has been privatized or is permitted greater independence. There is editorial independence and over the last few years the media has been considered free. The media's outspoken criticism of the government and the mafia, even in the face of bombings and criticism, has shown the press to be effective and willing to exert its independence.

Non governmental organizations: Limited registration has been available to NGOs since 1991, as the government has frozen registration because of the abuses by for-profit firms posing as NGOs. There are now about 2,500 officially registered NGOs, but it is estimated that only about 1,000 are active. Although the government taxes NGOs, requires yearly statistical information and performs minor monitoring functions there is no evidence of government abuse of the NGO sector. There is a certain level of indifference, however, on the part of the government towards independent NGO activity, which is compounded by the passive role NGOs maintain when communicating with the government.

Legal systems that better support democratic processes: The Constitution guarantees the rights of citizens to freedom of speech and association and provided the legal framework for the development of non-government organizations. Generally, the rights of free speech and assembly are recognized in practice and the media and citizens increasingly are able to seek justice in the courts when infringements occur. With nearly 2,300 new laws passed since 1991, the legal system is not yet effective. Lack of respect for law, limited legal enforcement, and corruption in enforcement, and disharmony between different laws are common. The judiciary suffers from skill shortages, is weak in the delivery of legal services, and is ill-prepared to address the backlog of potential adjudication. The in-country capacity for and strong financial commitment to judicial training is very weak.

Public administration: Although elections indicate that the country has made the transition to democracy, the national government has not shown a strong commitment to transparency, to making itself more accessible to the public, or to delegating more authority to the municipal level. Devolution has further been hampered by budgetary constraints, disinclination of the ruling party and political tensions between the LDDP majority at the national level and the Conservative Coalition majority at the local level.

Local governments are gradually receiving the authority to self-govern, although their power to effect change is severely restricted by the lack of taxation authority. The authority of local governments was substantially increased in July 1995 with the passage of the Local Government Law. In 1995, the Association of Municipalities was formed to collectively identify the major problems facing municipalities and to present the issues faced by local governments directly to government representatives and the press. The re-establishment and convening of the regional Baltic Council of Municipalities in September 1995 provides an additional forum for positive dialogue with the central government. There is a lack of continuity in local governance. Two year terms lead to high turnover in elected officials and the lack of a program to train newly-elected officials exacerbates efficient operations. Furthermore, salaries for local government officials and low and public criticism is high; of the approximate 1400 municipal officials elected last year, nearly 200 have already resigned.

2.3 Future Challenges

Lithuania's past record of economic management is relatively good, in comparison with other economies-in-transition. The World Bank classifies Lithuania as an intermediate reformer, trailing countries in reform performance such as Slovenia, Poland, Hungary, Czech Republic and Slovakia. More recent experiences also highlight the fact that Lithuania has fallen behind its Baltic neighbors in the speed with which it is transiting into a full market economy. The World Bank finds that countries which are more advanced in introducing market-oriented reforms are more likely to have higher real growth, lower inflation, more investment, and smaller external imbalances. While initially Lithuania made impressive strides to open its economy and society, it has not moved with equal speed as it faces many reform issues in pricing and trade liberalization and subsidy reduction.

2.3.1 Key Economic Challenges

There is a high degree of agreement among the GOL, the IMF and the World Bank regarding Lithuania's main economic transition challenges. There is less agreement, however, on the strategies to be pursued to address these challenges. Major near and medium-term economic reform challenges include:

Fiscal Policy: The single most serious fiscal management problem is inadequate revenues. This, in turn, is linked back to a tax system which encourages grey market activity and to the small tax base, unequal coverage, irregular enforcement, and other inconsistencies in the existing tax system. Inadequate revenues cause the GOL to resort to quasi-fiscal expenditures, through tax giveaways, the buildup of payment arrears by budgetary groups to energy companies, and directed lending (e.g. loans at sub-market interest rates through state banks to farmers and state owned enterprises). The budget deficit, together with quasi-fiscal activity, have contaminated the commercial banks, led to a rapid expansion of public debt and have crowded the private sector out of domestic financial markets. On the expenditure side, costly and poorly targeted subsidies to the farm sector and an inability to contain the wage bill have reduced spending on public investment and weakened the development impact of public spending. In the near-term, the GOL will be hard-pressed to mobilize the resources required to rehabilitate the commercial banks, clear energy arrears, and pay required pensions and other social benefits. In the medium-term, the main challenge is to increase revenues through tax policy reform and reduced rates, while enhancing the effectiveness of expenditures. More stringent controls on external borrowing need to be put in place to avoid excessive accumulation of foreign debt. Revenues collected need to be controlled and managed, within defined risk levels.

Monetary and Exchange Rate Management: Inadequate enforcement of prudential standards for commercial banks, political interference in bank supervision, outmoded central bank accounting practices and irregularities in bank licensing are the main deficiencies in present monetary management. A fixed nominal exchange rate may not be sustainable in the medium-term if domestic inflationary pressures persist and the current account deficit widens. Persistent negative real interest rates discourage savings and contribute to shallow financial markets. Broadening the scope of the Central Bank (BOL) authorities, which may eventually necessitate jettisoning the currency board arrangement, may be needed to inspire positive real interest rates. Government financing requirements to recapitalize the banks and address energy arrears may require significant expansion of the GOL's domestic debt. If the BOL was to assume a more classical monetary management role, the institution would urgently need to address weaknesses in its policy capacity, internal organization, and management.

Banking and Financial Market Development: The most immediate problem is to address the insolvent private commercial banks and to adequately identify and stem losses in all commercial banks. Consolidation of commercial banks, workout of distressed loans, more independent and objective commercial bank supervision, closure or recapitalization of distressed banks, unification of deposit insurance coverage systems, and introduction of modern banking practices to the commercial banks, are all high priorities. Barriers to entry for foreign commercial banks

encourages capital flight and results in a situation in which there is no single bank that can set standards for the others. In the medium-term, the challenge is to encourage a deeper financial system. Capital market development can make a significant contribution to increasing financial depth, particularly if the range of capital market instruments (leasing, factoring, private life insurance, private pensions) and intermediaries is expanded.

Trade and Pricing Policy: High rates of non-tariff barrier coverage for agricultural imports, multiple tariff rates, moderately high protection accorded the main agricultural products, inconsistent treatment of intellectual property rights, weaknesses in custom's administration, under-pricing of environmentally harmful products and practices, and under-pricing of publicly-provided energy supplies constitute the main price and trade distortions. The GOL is challenged to harmonize trade policies to meet European Union requirements, to meet IMF tariff unification and reduction targets, to obtain membership in the WTO, and to stem financial losses in the energy industry and reverse incentives to waste energy and pollute the natural environment.

Privatization: Voucher-based privatization has resulted in the lack of core ownership or professional management in many firms. Cash-based privatization has been stalled since mid-1995 and suffers because sectoral line ministers retain control of strategic industries, GOL's apparent reluctance to relinquish majority control in major companies, lack of an established track record in cash-based privatization, and GOL's exaggerated expectations regarding the value of assets to be privatized.

Enterprise Regulation: Entry barriers remain in 'bottleneck' sectors such as banking and telecommunications; slow and multiple licensing requirements which discourage new business start-ups; directed credits and a lack of clear enforcement of competition rules that favors inefficient public enterprises over SME private enterprises (particularly in agro-industry); and faulty collateral laws and ineffective implementation of bankruptcy laws which make it difficult for failing enterprises to transfer ownership. Considerable progress has been made in deregulating the enterprise environment and, as the ranks of private companies increase, there is a vocal constituency for further deregulation of enterprise activity.

Legal Framework for Private Sector Development: With nearly 2,300 new laws having been passed since 1991, the legal system is perceived as being turbulent and unsettled. There is a pressing need for a new commercial code, collateral law, competition law, pension fund amendments, environmental liability law, and customs code. Changes are required in the laws government VAT, the tax code, and social security. Regulations are needed in areas such as securities, investment funds, banking, deposit insurance.

Lack of respect for law, corruption in enforcement, and conflicts between different laws are common. Enforcement of the laws is weak and inconsistent. The judiciary suffers from skill shortages and weaknesses in the way legal services are delivered. Most importantly, the legal system is not prepared to address the twenty to thirty year backlog of potential adjudication associated with restructuring and the banking crisis. Low-cost mechanisms for resolving commercial disputes (e.g., arbitration, small-claims processes, private dispute mediation) are under-developed.

Energy Sector: The energy sector is plagued by over-capacity, customer payment arrears, tariffs set below marginal operating costs (particularly in gas and home heating), high rates of transmission losses (particularly in residential heating), constant borrowing from budget to pay for fuel purchases, overdue payments to Russian gas suppliers, minimal private sector involvement in almost all fields and the need to mobilize resources for particularly large future investments. In the medium-term, the decommissioning of Ignalina Nuclear Power Plant will be a high priority. Establishing utility tariffs and tariff setting and industry oversight procedures to cover producer costs, inspire industry cost-efficiency and encourage conservation and timely payment of energy obligations are needed to establish an incentive environment conducive to restructuring the main energy providers.

Agriculture Sector: The agriculture sector remains coddled by subsidies, directed credits and

trade protection. By international standards, the sector is both high-cost and low productivity. Agro-processors suffer from excess capacity and outmoded technology. Marketing infrastructure is under-developed and the product mix represents past patterns of demand for low-quality products. Greater reliance on market forces, together with investments in new technology and market information, will be needed if agriculture is to restore international competitiveness.

Social Safety Net: Social Fund expenditures are insufficient to meet the rising tide of pension, unemployment, heating subsidy and sick leave benefits. Under forecast demographic and employment trends, the gap between social fund expenditures and revenues is expected to widen. Reducing the social fund burden on employers, introducing private pensions, bringing benefit coverage within an affordable range and targeting subsidies more directly towards needy households is required.

Law and Order: Rising lawlessness, the growing role of organized crime, money laundering, illegal export activity, corruption and the limited ability of the nation's police and judiciary to adequately address these problems raises the costs and the risks of business operations in Lithuania. These problems are most acute in those cities where industrial and trade expansion prospects are the greatest.

IFI Leadership in Economic Policy Reform: The International Monetary Fund and the World Bank (IBRD) play key roles in providing loans to improve the domestic policy environment. Through its extended financing facility, the IMF and GOL are engaged in a three year program, ending in 1997, to bring inflation below 10 percent, sustain a stable exchange rate, lower tariff levels, and reform government revenue and expenditures. The IBRD is negotiating a Structural Adjustment Loan to address banking insolvency, reduce the public sector's role in banking, enhance banking regulation, restore financial solvency, and commercialize the energy sector, reduce market distortions, accelerate land reform and agricultural privatization, restructure the social insurance system (SoDra), create a framework for private pensions and improve SoDra administration and collections.

2.3.2 Civic Participation Challenges

Although there have been many obstacles to the development of the NGOs in Lithuania, NGOs are increasing in numbers and support. The legacy of a socialist government and the association with the Soviet Union laid no groundwork for NGOs or an environment conducive to their development. It was not until the period of Glasnost that political shifts in the environment gave some space for civil society to begin to emerge in a rudimentary way. With independence, Lithuania began the process of recreating government structures within a democratic framework and started to build the institutions that would be needed to see the economy and society transformed into an open, democratic free market environment. It has been in this environment that the NGO sector has begun to grow and take root at a popular level.

The transformation of the economy has created a set of economic problems which has dampened the development of genuinely participatory NGOs. While real progress has been made in moving to a market economy, the immediate costs have been high. Inflation, recession, and economic dislocation have all presented real problems for the man in the street. Under such conditions, daily survival becomes a primary focus, leaving little time to work on the issues of local organization, advocacy, and social issues.

Legal Framework: While laws exist to guarantee free speech and the rights of the independent media, regulations that are needed to ensure that constitutional guarantees are applied remain somewhat uncertain due to the inexperience of legislators, lawyers and judges with regards to the legal process and their understanding of the kinds of laws and regulations needed to encourage this sector to grow and prosper.

NGO Constraints: In addition to this ongoing legislative rationalization, the following issues also need a higher level of attention if the NGO sector is to become a viable part of Lithuania's

democratic structure:

- Establishment of a higher level of cooperation and communication between the government and the NGO community
- Replacement of passive attitudes by active involvement on the part of the government
- Provision of training and education relative to NGO problems and needs
- Further encouragement of networking, coalition building, and stronger advocacy
- Attention of the academic community to analyze, study and support the NGO sector
- Development of a regular and dependable funding sources, to add to the human and financial resources the sector is mobilizing on its own.

Donor Role: While the donor community is playing a significant role in ameliorating many of the above issues, they need to continue their efforts and in many cases expand upon the strong start they have made. Grant-making facilities will have to be encouraged with both funds and institutional development assistance. There is a very well defined role for the donor community in helping to create this type of assistance through establishment of a wholesaling organization. Helping NGOs to mobilize funds both in and outside Lithuania will help them become financially sustainable. Beyond the encouragement and funding of grant-making institutions and NGOs, there is a strong need to encourage a positive relationship between NGOs and government.

Western NGO role: The western NGOs and foundations can play a significant role in strengthening Lithuanian NGOs, building international partnerships, and mobilizing the medium- and long-term **private capital** to nurture and foster a viable NGO community in Lithuania. NGO development could be a special area of consideration for US NGOs and members of the Lithuanian community.

Local Governments: Successful democratic local governance develops on two separate levels. From the top down, the national government must create laws and policies that empower localities to practice self-governance. From the bottom up, local municipal officials, NGO leaders, entrepreneurs and other private citizens must acquire the necessary skills, institutional capacity, and material resources to exercise the political authority explicitly or implicitly granted by the national government. Local governments are gradually receiving the authority to self-govern, although their power to make any substantive changes are restricted by their financial constraints.

Deepening democracy in Lithuania by spreading its practice to localities is an issue of some urgency. As the economic situation stabilizes and energy prices rise in late 1996 to reflect world-market rates, together with a public service sector on the verge of system collapse, Lithuanians face even tougher times ahead. It is to be expected that the current dissatisfaction and distrust of government officials will continue to rise as they increasingly take over control of the inefficient district heating units and other utilities dependent on public rate payers for their livelihood. It is crucial for the development of democracy in Lithuania that the negative image of civil service be reversed to attract youth and talent to government. As transparency of government increases and as the public becomes more aware of their rights and responsibilities as citizens it can be expected that a new generation of Lithuanian leaders will emerge, able to govern responsibly and honestly. The increased collaboration of local government with NGOs to develop community-oriented services and policies will be a positive step in that direction.

The national government has not shown interest in functioning more transparently or in making itself more accessible to the public. This is exacerbated in part by the severe restraints created by its dire fiscal situation. Opening the political process up at the national level is a long-term goal which external assistance cannot accelerate significantly over the next few years.

Whatever dynamic exists for innovative democratic reform in Lithuania is bottom-up.

2.4 Lessons of Past USAID Experience

Successful implementation of economic assistance efforts has helped USAID sharpen its understanding of Lithuania's needs and of the Agency's core competencies in anticipating and meeting those requirements. Key cross-cutting lessons of experience include:

- *Understanding Country Conditions:* past and ongoing activities provides USAID with a good understanding of the opportunities and impediments to Lithuania's economic growth and development
- *Special Assistance Advantages:* USAID has developed a core-competence in providing specialized technical assistance in economic reform, at a policy, institutional and enterprise level. The United State's ability to draw upon a large community of competent advisors/trainers having historical links to Lithuania provides it with a unique advantage. Also, as a Non-European assistance provider, the U.S. program is seen as more objective and less as a veiled source of competition.
- *Comparative Advantages:* US assistance has comparative advantages over other donors' programs in many instances. For example, NGO involvement in policy-making advocacy is much greater in the US than in Europe, and the advocacy-building component of USAID's program is unique in Lithuania.
- *Excessive Spread:* With a limited assistance budget, attempts to focus economic reform assistance activities on achieving nine ENI strategic objectives has led to an excessive dispersion of the US external assistance effort. In some instances, project activities have been under-funded, accorded an excessively broad mandate, or implemented at low cost without adequate attention to quality. Management, coordination, and administration costs of a large number of small projects are also high, despite solid efforts to streamline and efficiently implement USAID management procedures.
- *Country-Specific Adaptation:* The need to carefully tailor development assistance requirements to meet Lithuania's country-specific economic transition requirements is of considerable importance. Past efforts to transplant reform approaches and institutional models from the West have had less than successful results. Additional efforts will be needed to ensure the applicability of the approaches.
- *Demand-Driven, Participatory Assessment:* Between 1991-93, Lithuania welcomed assistance in almost all areas of economic reform. The GOL has become far more selective and quality-conscious in its assistance requests, underscoring the importance of maintaining high quality standards and ensuring that a regular process of client consultation to assess needs, monitor progress, and track results.
- *Growing Importance of Donor Coordination:* Limited absorption capacity combined with rapid growth in donor and IFI support provides opportunities to leverage USAID initiatives and to focus on high-priority areas not adequately addressed by other donors. USAID's experience in a broad range of activities, the special trust accorded the Agency in policy-sensitive assistance matters, and USAID's track record of sound cooperation with other development partners provides a solid foundation for future donor cooperation efforts.
- *Coping with Uncertainty:* The process of economic transition in Lithuania is fraught with uncertainty. It is very difficult to predict changes in Lithuania's external economic environment, the course of political developments, and the effects that economic reforms will have on actual economic activity. While it is relatively easy to identify economic reform requirements and constraints, it is far more difficult to predict the time required to achieve such reform objectives. One strategy would

concentrate assistance in areas which are relatively immune to changes in the policy and institutional framework, i.e. undertake "safe" investments. However, there are few assistance efforts of any importance that are not adversely affected by deficiencies in the policy and institutional framework. Instead, careful consideration must be accorded to the feasibility, timing and potential payoff of economic-reform assistance requirements. A certain degree of flexibility is advised, both to capitalize on emerging (and unanticipated) windows of opportunity and to be in a position to redeploy effort when willingness-to-reform comes into question. Not only should there be a focus on results, but there should be a focus on the possibility of achieving "significant" results.

- *Non-Government Sector:* While many of the economic programs supported by the donor community have operated through central government ministries, under the democracy program USAID has focussed largely on the smallest political, economic, or social units to implement this program. Under this direct approach, there is less opportunity for national level organizations to make value judgements regarding assistance, resulting in the need for donors to exercise judgement with regards to overall effectiveness of the assistance, given the interests and inclinations of the national government.

2.5 Priority Objectives to Support Economic and Democratic Reforms

Future USAID efforts to support economic and democratic reform will focus on crucial activities that help to:

- **strengthen fiscal management**
- **forge a more stable financial environment**
- **improve the enabling policy environment conducive to sustained private sector growth**
- **increase sustained collaboration of NGOs and local governments to develop policies and services which reflect community interests.**

The first three areas are the basis for the current economic reform effort, where the need for improvement is the greatest. Progress in these areas will have an immediate and long-lasting impact on growth, trade, employment, living standards, and on assisting the development of a non-government sector, and promoting local self reliance. Prompt implementation of needed reforms in these areas will help restore confidence in the ability of GOL to manage the economy responsibly.

Democracy and Economic Reform: Failure to vigorously implement economic reform would put Lithuania squarely on a collision course with democracy. Without economic reform, Lithuania will no doubt suffer from rising inflation and unemployment, falling output and growing isolation from the world community. To Lithuania's larger neighbors, the nation may come to be perceived as a source of regional instability. The combination of domestic instability and external discontent would provide ammunition to those who favor non-democratic forms of political decision-making and would serve as a disincentive to the growing numbers of citizens who resent their worsened quality of life to support democracy. An economy that is growing, is generating productive employment, and has relatively stable prices will help to restore the confidence of the population in their own economic future. If, and only if, the public perceives that there is a positive economic payoff to democratic decision-making, will democracy blossom.

Reform and Growth: Achieving high, sustained rates of economic growth is the single most important GOL reform objective at this juncture in the transition process. Lithuania has three main sources of economic growth. First, as a small country with quickly exhausted internal markets, exports in the form of tourism, goods in transit or domestic products provide an outlet for higher output. Second, reallocation of resources from those

areas of the economy where they are inefficiently utilized to those in which they can be more efficiently utilized will increase productivity and spur growth. And third, new investment can boost growth and output in the near-term, and, in the long-term, enhance competitiveness, enable higher rates of capacity utilization and foster technological transformation. However, exporting, reallocation of resources, and investment require a financial environment that is sound and in which a competitive mix of financial intermediaries can effectively mobilize and efficiently deploy capital. But even if this takes place, growth may not occur unless such resources are utilized productively. For this, the role of the private sector in the economy must increase and the operating environment for the enterprise sector must be made more conducive to private initiative.

2.6 Rationale for Reduced Emphasis

There are several areas which, while of considerable importance to Lithuania's economic development, will not be the focus of USAID future assistance. Infrastructure development and investment preparation, for example, is supported by all of the multilateral agencies, and very little contribution could be made in this area given USAID's current assistance level. Cash-based privatization (S.O. 1.1) is another very important reform area, and while USAID support to the domestic capital market development can help facilitate this process, the actual costs of privatization can be financed from the proceeds of the process. There are, furthermore, an ample number of investment banks and accounting firms willing to assist the GOL in cash-based privatization. Broad based fiscal reform (S.O. 1.2) is still needed in Lithuania, but USAID has only limited resources to address this area. Selected fiscal reform activities will be implemented as part of the enabling environment to support a more stable financial sector and will lead to benefits in private enterprise development.

Direct assistance to specific enterprises (under S.O. 1.3), while an important part of the USAID mission's portfolio in the past, will receive less emphasis in the future. Consolidated as a Special Initiative, ongoing activities can contribute to improved, more sustainable private business operations. Wherever feasible, these activities will be reshaped to focus at a more strategic level. Others will be rapidly phased-out and exit strategies identified. The reasons for this are as follows: First, there are a total of 150,000 private firms registered in 1995, and these totals continue to rise. USAID assistance can only reach a very small percentage of those private firms which require technical assistance. Second, EU-PHARE has committed close to \$10 million for enterprise assistance in 1996 (with somewhat less planned during 1997-99), an amount well in excess of USAID's total country budget. Third, the last few years have seen rapid growth in the numbers of local accounting firms, representatives of international accountants and business consultants, and domestic business consulting firms. There is now the danger that "free business advisory services" to enterprises could crowd-out local service providers. Fourth, Lithuania now has a sufficient number of trained managers to constitute the nucleus of a sound, domestic management training/advisory capacity.

Commercial banking (part of S.O. 1.4), both in terms of the resolution of the problems of the insolvent public and private banks, and the more long-term issue related to strengthening institutional capacity, are being addressed through twinning operations supported by EU-PHARE. Support in problem debt resolution has been offered by the Government of Sweden and financial support to help recapitalize distressed banks has been offered by the World Bank.

Resolving energy issues (S.O. 1.5) and widespread restructuring of the sector is key to Lithuania's future. USAID can not make a major contribution in all areas, but some activities will be continued to support the enabling environment for private business development (S.O. 1.3) or as a special initiative (S.O. 4.1).

The current political party development program (S.O. 2.1) will continue under its present grant to the International Republican Institute through the fall 1996 elections. Post election work in party development will not be part of the strategic vision under a refocused 2.1 objective.

Activities to develop legal systems that better support democratic process and market reform (S.O. 2.2) will be dropped from the democracy program. It is planned to continue the current programs and to provide additional, future year funding for these programs as results in this area supports strategic objectives in the economic reform and growth program.

Activities to establish a more effective, responsive and accountable local government will be allowed to close out with the existing contract. Given the size of the public administration needs both at the central and local levels of government, it does not seem feasible that USAID would have either the time or money to achieve meaningful results let alone work toward real sustainability in this area. Further, the lack of serious commitment to reform by national authorities does not auger well for the successful achievement of results in this area in the next few years.

Broad-based human resource development efforts (e.g. health care and education sector reform), and social-safety procedures and policies (S.O. 3.1), are being addressed by other donors and are areas in which USAID has relatively little track record in Lithuania. Environmental restructuring and biological diversity (S.O. 3.3) are potential areas for cooperation, but only a selected number of activities which support the core strategic objectives will be continued.

2.7 Special Initiatives

There are three special initiatives which USAID will continue to support. The first initiative encompasses three targeted activities in the energy sector including support to the Ignalina Nuclear Power Plant to help strengthen nuclear safety and inspection capacities. Continued support to improve the early warning system and other nuclear safety measures is a very high priority, particularly in light of the potential risks from this reactor. Energy efficiency activities will contribute to overall demand reduction and to price rationalization efforts. As part of the USG's policy to support cooperation among the three Baltic countries, USAID will continue to support a third energy sector activity, the development of regional energy planning and cooperation and one environment initiative, establishment of a regional environmental monitoring system, which is managed by the US Environmental Protection Agency. (See below for a discussion of other regional activities.)

The third special initiative seeks to improve enterprise capacity through an existing series of technical assistance and training grants in the areas of small and medium enterprises, agriculture, investment and demonstrations related to environment, and business training. To the extent feasible these activities will be refocused in line with USAID's four strategic objectives, including policy concerns and issues of sustainability. Others will be rapidly phased out. Short-term training is a cross-cutting activity which provides support in each strategic objective area. Within training, efforts need to be made to ensure that training activities closely complement achievement of other strategic activities.

2.8 Regional Programs

USAID supports several regional activities. These are the Baltic American Enterprise Fund (BaAEF), Democracy Network grants through the US Baltic Foundation (generally discussed under S.O. 2.1), democracy-and -law (fighting organized crime) activities funded by USAID, but managed and implemented through the Department of State with the FBI, ICNL, and the Department of Justice/ABA/CEELI program in criminal law. USAID/Lithuania is not responsible for funding or targetting results for these regional activities, but monitors their implementation in conjunction with the Department of State, USAID/Washington, and the USAID offices and Embassies in Estonia and Latvia.

The **Baltic American Enterprise Fund** is treated as a special case in the context of this strategy. Budgetary decisions and management guidance are made by USAID/Washington therefore the program is not part of the strategic plan and results framework. However, while

strictly not part of the bilateral strategy, this activity is closely linked to the Special Initiative that promotes enterprise development. It will be the only activity in this area after 1998.

The lack of investment capital in the Baltics has been lessened somewhat by the creation of the Baltic American Enterprise Fund (BaAEF), which began operations in mid-1995. It is the USG's largest single economic program in the three Baltic republics. BaAEF is helping to provide a more stable financial service, which will stimulate development of private sector enterprises through two avenues. One, its loans provide capital for expansion and improvement of small businesses. Two, it is acting as a model for other financial institutions on lending to small and medium enterprises.

In Lithuania, BaAEF has made 20 loans, totalling \$5 million. Because of high interest rates and prevailing lack of desire to lend to smaller enterprises, these five borrowers would have had a difficult time obtaining loans from local banks. BaAEF expects to increase its deal flow to about \$1,000,000 per month for the three Baltic countries.

Similarly, the criminal justice programs, which are funded and managed regionally and monitored by the Embassy, fall outside the scope of the strategy. USAID/Lithuania strongly supports the continuation of the DOJ/CEELI program, particularly as it focuses on regional money laundering and criminal issues related to the banking sector and mafia prosecution. Other law and order activities, while they appear to be beneficial, do not provide sufficient information to USAID/Lithuania to be able to assess their effectiveness or impact. The Country team is of the view that the program activities are helpful, albeit poorly coordinated, and not well adapted to local conditions. The FBI training center in Budapest has been viewed as having mixed success, but some significant flaws exist in its implementation. This program has generated complaints from recipients that some of the FBI training was too simplistic and not addressing specific conditions in Lithuania.

3.0 Customer Service Plan

USAID/Lithuania has developed a customer service plan outlining its continuous consultations with counterparts, NGOs, and other Lithuanian experts. Two special consultative structure are also used extensively. First, USAID is a key player in the in-country G-24 donor coordination meetings, particularly in areas where we have an active program. Through these regular meetings, close cooperation is established with the donors, World Bank, IMF, EBRD, and the counterpart ministries.

Second, USAID/Lithuania is now a key member of an innovative US-Lithuanian commission with representatives from all major parties in the Lithuanian Parliament and the Lithuanian American Community for the purpose of discussing priority program directions for USAID assistance in Lithuania. The commission was established by the Lithuanian-American Community, Inc and the Parliament to discuss broad-based issues of interest to United States citizens and Lithuanians. USAID, which had received criticism in the U.S. for not being more transparent in its program development, was asked by the U.S. partners in the commission to begin a dialog about country priorities. USAID has now become an active participant in the commission and has committed to holding routine consultations with this commission. The initial meetings were used to discuss recent trends in Lithuania's economic and democratic development, identify areas of mutual agreement about the future USAID program, and to discuss the main concepts of this strategy. The members of the Parliament have generally endorsed the concept of the strategy. Future consultations with the commission will allow USAID to continue to obtain input and feedback about the program, its implementation, and is already serving as an important additional forum for policy dialogue on selected issues.

4.0 Transitional Issues

**Improved enabling policy environment conducive to sustained private sector growth
Strategic Objective 1.3**

By improving the enabling policy environment, USAID will, by definition, help create a sustaining environment for private sector growth in Lithuania. As the playing fields are levelled through judicial and legal reform and through the ending of distorting price and subsidy structures, the private sector will grow and flourish.

A healthy non-distorted economy will become the foundation for sustainable economic growth and will be the principle factor in a successful transition. Factors that could impede this transition include a decrease in the GOL political commitment to reform, political unrest by enterprises that are forced to close in the course of transition, strong public resistance to increased energy prices and a rejection by the GOL of EU and WTO membership as primary goals.

A more stable financial environment: Strategic Objectives 1.2 and 1.4

The present financial environment in Lithuania is characterized by low confidence in banking, a lack of guidance from the Central Bank, low lending levels, a distorted high borrowing level by the government, and an underdeveloped capital market. By the year 2000, the USAID program will have helped to put into place a highly skilled Central Bank demonstrating strong leadership, a more professional banking sector, a well-functioning and transparent tax and budget system, and a viable stock exchange. Key measures of the successful financial transition will be reaching a bank deposit level of \$1.5 billion by 1998, attaining a \$70 million volume of stock exchange by 1998, and raising tax revenue to reach 26 percent of official GDP by 1999. Social unrest is one factor that potentially could undermine the expected transition, i.e. if the public demands the continuation or expansion of ambitious but unaffordable social programs. Other potential sources of disruption include another banking crisis (similar to that of last December), a scandal in the capital markets, or high fluctuations of exchange rates.

Increased, sustained collaboration of NGOs and local governments to develop policies and services which reflect community interests: Strategic Objective 2.1

Citizen participation is an integral part of democracy, and non-governmental organizations (NGOs) are increasingly serving to engage collected individuals in political decision-making throughout the world. Since independence, NGOs have slowly been created in Lithuania, for a variety of purposes, from delivery of services to promotion of group interests at the policy-making level. NGOs serve as an initiative to allow citizens of a community to participate in the decisions that are made which directly and indirectly concern them. USAID's grass roots initiative will focus on NGOs at the local level, and will provide assistance to participating local municipalities as well, to increase the willingness of local governments to involve the public in their decision-making. Important measures in transition include strengthening the ability of NGOs to be self-sustaining, to deliver services and promote their interests to the public and government, and an increased receptivity of local government in involving the public in their decision-making processes. Factors that could threaten the success of the democracy program are political instability caused by a GOL budget collapse, a more autocratic trend by political leaders at the national or local level, or invasion by Russia, should the Russian elections see a return of Soviet-style autocracy to the region.

STRATEGIC OBJECTIVE

STRATEGIC PLAN

S.O. 1.3

**"IMPROVED ENABLING POLICY
ENVIRONMENT
CONDUCTIVE TO
SUSTAINED PRIVATE SECTOR
GROWTH"**

PART II: STRATEGIC OBJECTIVE RESULTS FRAMEWORK

S.O. 1.3, Improved Enabling Policy Environment Conducive To Sustained Private Sector Growth

A.1 Statement of Strategic Objective

The ENI Bureau strategic objective is to accelerate development and growth of private enterprises. The USAID/Lithuania strategic objective is more focused and seeks to "improve the enabling policy environment conducive to sustained private sector growth."

A.2 Problem Analysis

Unleashing the productive potential of the private sector can help generate the productive employment and growth that the Lithuanian economy so badly needs. More specific reasons for USAID to focus future assistance efforts on fostering an enabling policy environment conducive to private sector initiative include:

- For the private sector to develop in a way that is both efficient and sustainable, it must learn to compete at prices that reflect the realistic costs of scarce resources. There are four main sources of price distortion in the Lithuanian economy: i) under-priced energy and other utilities; ii) taxes on leaded fuel and old cars which do not internalize the environmental damage resulting from the use of these products; iii) high levels of trade protection and producer subsidies on a wide range of agricultural products and iv) widely varying rates of tax coverage and compliance (e.g. the price of government) amongst similar enterprises. Unless relative prices reflect market conditions, firms will compete more on the basis of gaining access to low-cost inputs and preferential tax treatment than on the basis of sound business practices.
- Barriers to entry are still a problem for the private sector. Close to half of all economic activity remains in the hands of the State, and while there are plans for cash-based privatization of selected strategic industries, progress has been limited. For direct foreign investment, market entry in areas such as commercial banking, telecommunications, agricultural production and energy supply is restricted. Despite a great number of small joint ventures, Lithuania's ability to attract foreign direct investment has been disappointing. If Lithuania is to modernize its public utilities and larger state enterprises, greater reliance on foreign capital will be necessary.
- Barriers to exit are an even greater problem for the private sector. Firms accumulate bad debts to banks, the energy companies, the pension fund, their workers and the tax authority with little fear that the firm will be forced to go out of business. Companies may go into bankruptcy, but they will not technically be foreclosed unless the shareholders agree and the workers have received adequate

severance pay. Deficiencies in the collateral law and overall weaknesses in the judiciary make it exceedingly difficult for a company to collect on overdue commercial obligations, much less to take over a company that is in default on its obligations.

- The legal framework does not provide adequate protection to private property rights and suffers from a number of major deficiencies and shortcomings, e.g. commercial code. The legal system has been unable to adjudicate and enforce the large number of commercial claims resulting from the Bank failures, growing inter-enterprise arrears, tax arrears, land restitution claims and other, more normal business disputes, due to a lack of mechanisms to enforce legislation and little attention to the development of low-cost adjudication mechanisms. There is little public confidence in the ability of the legal system to impartially and expeditiously resolve commercial disputes.

The main rationale for concentrating assistance efforts in these areas of private sector policy support are:

Elimination of price distortions: Price distortions hinder rational private-sector decision-making and contribute to a political environment replete with rent-seeking and inequity. While considerable progress has been made in liberalizing domestic price and marketing arrangements, significant distortions remain in energy prices (and utility prices more generally), agricultural prices and the application of environmental fines and charges to discourage pollution-intensive activities. Removal of price distortions can level the playing field for the private sector, while relieving pressure on the GOL budget. USAID has made a start at addressing these issues through ongoing project efforts related to GATT accession, environmental pricing policy, and energy pricing.

Broadening the scope of work on environmental pricing policy issues to address transport (air pollution) issues and deepening efforts to reform energy pricing policy and design systems that can be enforced and monitored would build on ongoing (and relatively successful) projects to address the aim of deepening price liberalization. With regards to energy pricing and institutional support for SCC, donor coordination with EU-PHARE would be important.

Trade and Tariff Policies: Lithuania's future potential economic growth will come from increased trade, particularly with Western countries. However, current policy and trade barriers exist which are reducing Lithuania's access to markets, negatively affecting its competitiveness, and slowing down the rate of economic transformation by reducing competitive pressures on inefficient Lithuanian businesses.

Building on and broadening the GATT effort to include a component aimed at developing GOL's capacity to analyze tariff policy options (particularly in agricultural trade policy) is an effective means to speed up accession to WTO and lead to improved policy formulation.

Legal Framework Reform: Past efforts in the legal area have concentrated on addressing a wide range of regulatory deficiencies and weaknesses in the institutional capacity of judges, advocates, lawyers and notaries. While much progress has been made in passing new laws, relatively little progress has been made in establishing a more effective or efficient legal service system. The banking crisis, the accumulation of inter-enterprise arrears, and arrears to GOL has created a backlog of potential litigation well in excess of what the existing legal system could possibly address. Future efforts in USAID-supported commercial legal reform will be aimed at creating the institutional capacity to undertake low-cost, timely adjudication services (arbitration, small claims, private dispute resolution services) to clear the backlog of commercial disputes and to restore public confidence in the ability of the legal system to meet the needs of the business community.

At the same time, efforts made in key areas, such as collateral law, commercial law, and bankruptcy will be pursued, because of the important long range effects that this can have on the banking system and on the restructuring of post-privatization enterprises. Formal in-service legal training is badly needed. Building on lessons learned from ongoing legal reform assistance projects, efforts should be made together with the European Union to develop a regular training capacity in this area.

ENI Objective 1.3
Accelerated development and growth of private enterprises

Strategic Objective 1.3
IMPROVED ENABLING POLICY ENVIRONMENT CONDUCTIVE TO SUSTAINED PRIVATE SECTOR GROWTH
TIMEFRAME: 4 YRS
DEVT. PARTNERS: Seimas Leadership, Office of Prime Minister, World Bank, IMF, EU PHARE, UNDP, Soros Foundation, Bank of Lithuania, Ministry of Foreign Affairs, Ministry of Justice, Ministry of Finance, Ministry of Economics, Ministry of Energy, Ministry of Environment, Lithuanian Energy Institute, Lithuanian Lawyer's Association, Lithuanian Judges Association

IR 1.3.1
ELIMINATION OF MAJOR PRICE DISTORTIONS THAT IMPEDE EFFICIENT PRIVATE INVESTMENT AND RESOURCE ALLOCATION
Timeframe: 2.5 YRS.
Devt. Partners: Ministry of Energy, Ministry of Environment, Lithuanian Energy Institute, WB, IMF, EU PHARE

IR 1.3.2
EFFECTIVE TRADE POLICIES DEVELOPED WHICH INCREASE MARKET ACCESS
Timeframe: 3.5 YRS
Devt. Partners: Ministry of Foreign Affairs, Ministry of Economics, EU, C&EE countries

IR 1.3.3
IMPROVED LEGAL FRAMEWORK FOR COMMERCIAL ACTIVITY
Timeframe: 3YRS
Devt. Partners: Seimas Leadership, Office of PM, MoJ, MoEcon, MoF, BoL, EU PHARE, SOROS, LLA, LJA

IR 1.3.1.2
Energy prices set to reflect actual economic costs
Timeframe: 2 YRS.
Devt. Partners: Min. of Energy, Lithuanian Energy Institute, SCC, WB, EU PHARE

IR 1.3.1.3
Environmental charges set to internalize cost to pollution
Timeframe: 1.5 YRS.
Devt. Partners: Ministry of Environment

IR 1.3.1.4
Reduced inter-sectoral price distortions*
Timeframe: continuous
Devt. Partners: WB, IMF

IR 1.3.2.1
Progress toward EU membership*
Timeframe: continuous
Devt. Partners: Ministry of Foreign Affairs, EU

IR 1.3.2.2
Enhanced trade policy development skills of GOL ministries
Timeframe: 3 YRS.
Devt. Partners: Ministry Of Foreign Affairs, Ministry of Economics, EU

IR1.3.2.3
Entry into regional trade accords without increasing overall protection*
Timeframe: 2 YRS
Devt. Partners: Min. of Foreign Affairs, CE&E and other countries

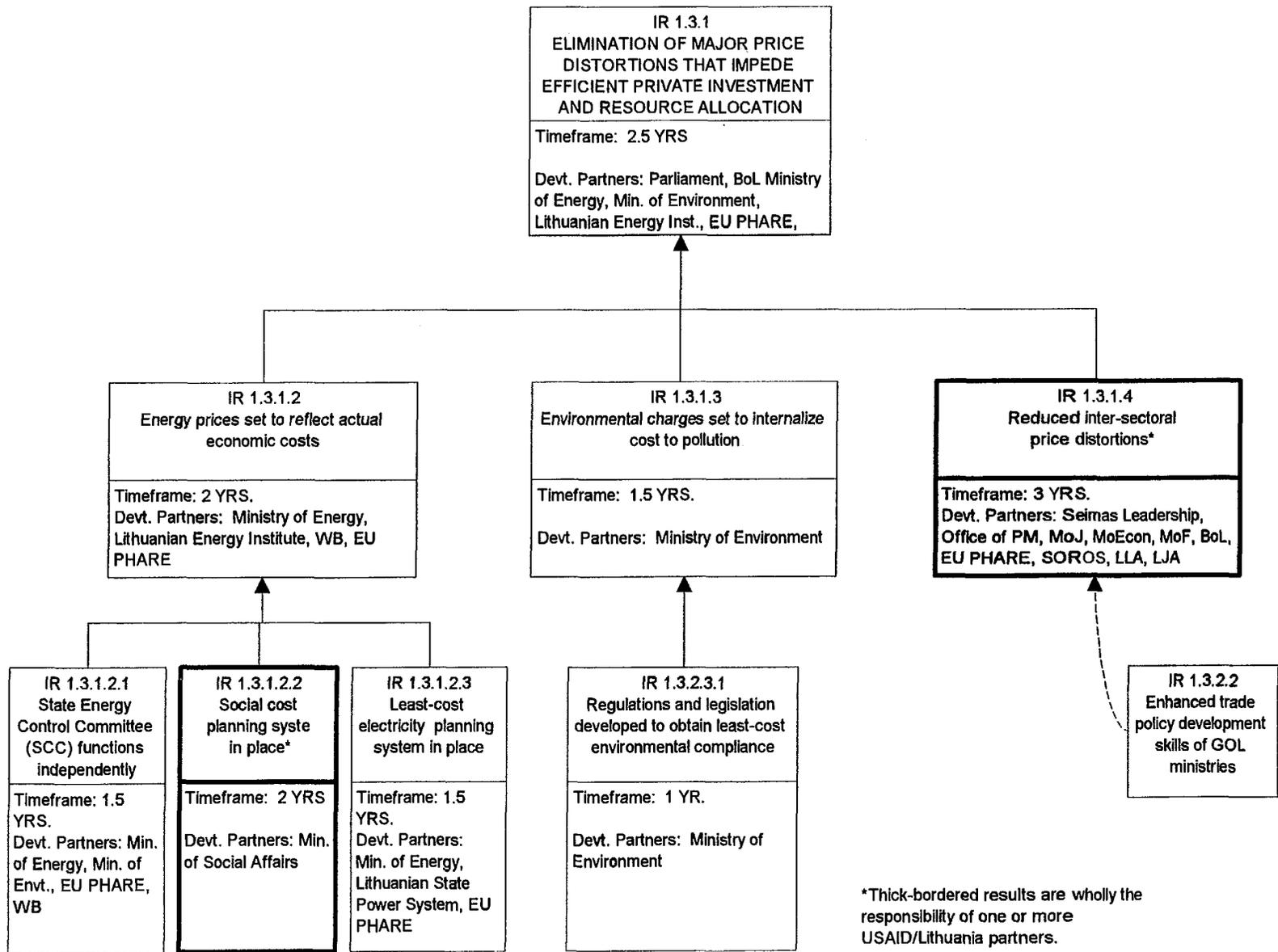
IR 1.3.3.1
Strengthened commercial and procedural skills of judiciary and bar
Timeframe: 2 YRS
Devt. Partners: MoJ, EU PHARE, SOROS, LLA, LJA

IR 1.3.3.2
Implementation regulations and enforcement mechanisms developed from key laws
Timeframe: 3 YRS
Devt. Partners: Seimas leadership, Office of PM, MoJ, MoEco, MoF, BoL, LLA, LJA

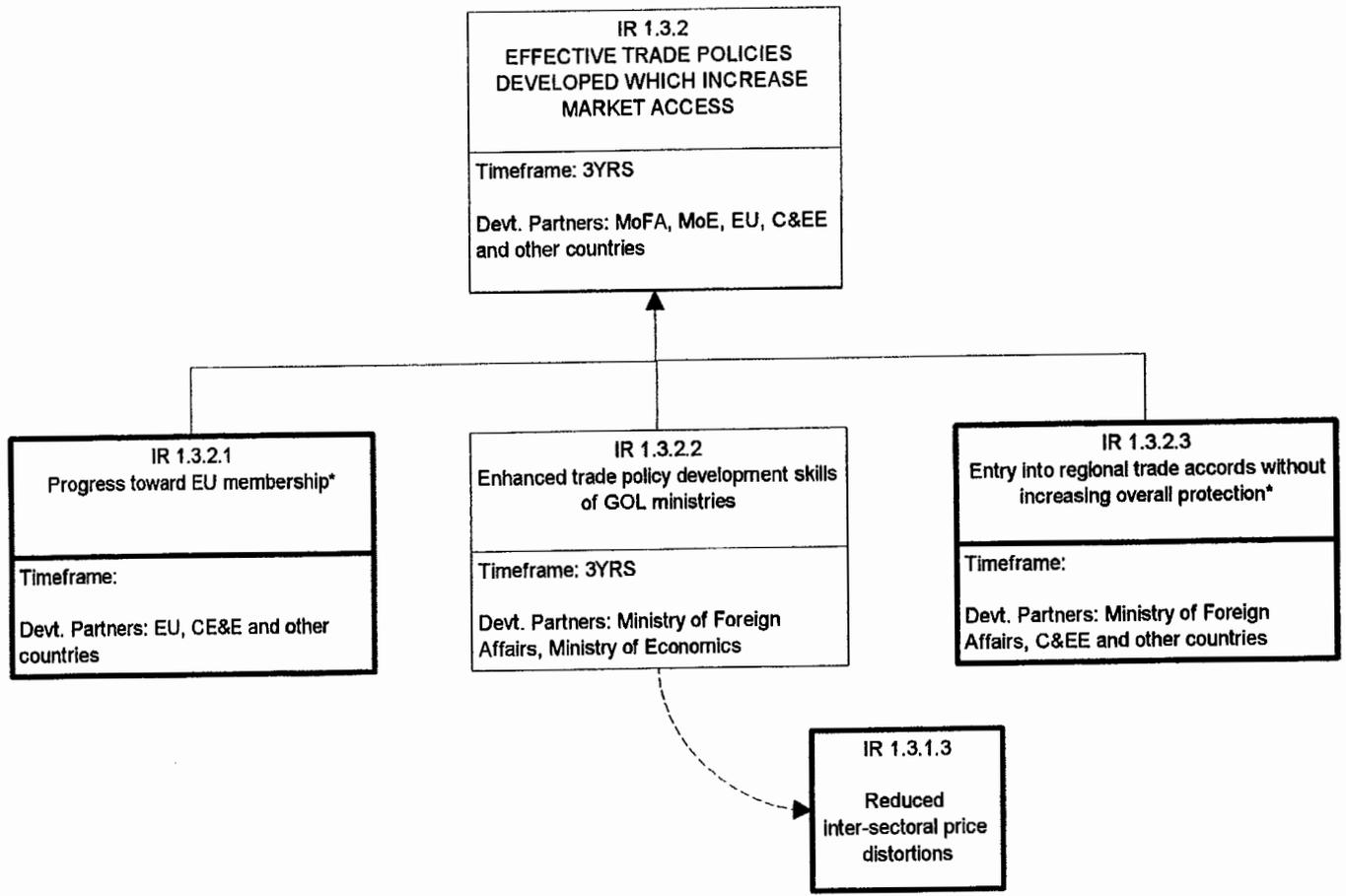
IR 1.3.3.3
Alternative, low-cost dispute resolution service designed and promoted
Timeframe: 3 YR
Devt. Partners: LLA, CLC, IHC

*Thick-bordered results are wholly the responsibility of one or more USAID/Lithuania partners.

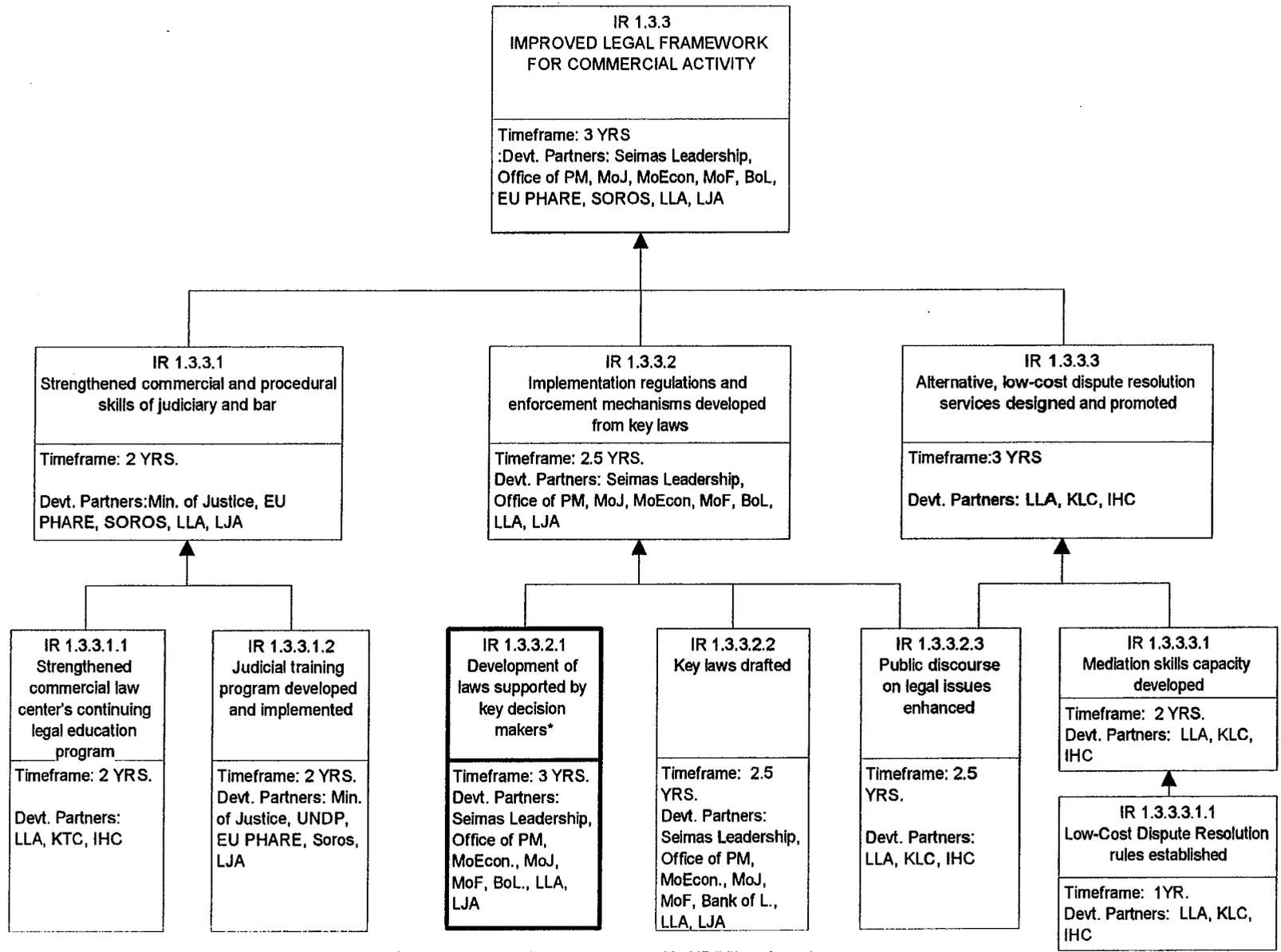
Abbreviations: BoL - Bank of Lithuania, CLC - Commercial Law Center, INC - In House Counsel, LJA - Lithuanian Judges Association, LLA - Lithuanian Lawyer's Association, MoF - Ministry of Finance, MoJ - Ministry of Justice, SCC- State Energy Control Committee



*Thick-bordered results are wholly the responsibility of one or more USAID/Lithuania partners.



*Thick-bordered results are wholly the responsibility of one or more USAID/Lithuania partners.



*Thick-bordered results are wholly the responsibility of one or more USAID/Lithuania partners.

TABLE 11 : PERFORMANCE DATA FOR STRATEGIC OBJECTIVE 1.3: BASELINE, TARGETS, AND ACTUAL RESULTS

LEVEL	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		TARGETS AND ACTUAL RESULTS											
				YEAR	VALUE	1996		1997		1998		1999		2000			
						Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual		
SO 1.3	Improved enabling policy environment conducive to sustained private sector growth	1. Value of exports	Definition: All transit and local product exported Unit: million US dollars	1994	2029	TBD*		TBD*		TBD*							
		2. Progress towards WTO general negotiations and legal reform accomplishments per WTO requirements	Definition: Progress as a percent of all WTO requirements Unit: percent	1995	0%	35% September		50% January		100% January							
		3. Contribution to GDP by energy intensive sector	Definition: It is expected that as energy prices increase to reflect actual economic costs, energy intensive sectors will shrink or grow less quickly than the overall economy Unit: percent per year	1995	TBD*	TBD*		TBD*		TBD*							
		4. Energy intensity in Lithuanian industries	Definition: Energy intensity means final energy consumption of GDP in kg of oil equivalent per US dollar** Unit: kg/\$	1995	0.95	0.90		0.85		0.80							
		5. Bankruptcy resolution	Definition: Ratio of bankruptcy cases finalized to those that have been filed Unit: percent per year	1995	0%	0%		25%		50%							
		6. Fully operational collateral system impemeted	Definition: Unit: yes/no										system implemented				
<p>COMMENTS/NOTES * Data to be developed by USAID/Lithuania by October, 1996 ** for EU this unit is 0.22, for Russia above 1.00</p>																	

TABLE 11 : PERFORMANCE DATA FOR STRATEGIC OBJECTIVE 1.3: BASELINE, TARGETS, AND ACTUAL RESULTS

LEVEL	RESULT STATEMENT	PERFORMANCE INDICATOR	DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		TARGETS AND ACTUAL RESULTS										
				YEAR	VALUE	1996		1997		1998		1999		2000		
						Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual	
IR 1.3.1	Elimination of major price distortions that impede efficient private investment and resource allocation	1. Accurate energy prices	Definition: Energy prices (average of electric, heat and gas) raised to a certain percentage of actual costs Unit: percent	05/1996	70%	80% December		90% December		100% December						
		2. System of environmental pollution charges that allocates costs to those who pollute implemented in Lithuanian regions	Definition: Percentage of Lithuania's 44 regions where the system is working Unit: percent	05/1996	0%	0%		50% September		100%						
IR 1.3.2	Effective trade policies developed which increase market access	1. Bilateral negotiations for WTO accession and tariff accords initiated	Definition: Unit: yes/no	1995	Not initiated	Preparation completed		In progress								
		2. Tariff and subsidy policy systems implemented by GOL ministries	Definition: Unit: yes/no	1995	Not implemented	TBD*		TBD*		TBD*						
IR 1.3.3	Improved legal framework for commercial activity	1. Number of disputes being resolved using alternative methods	Definition: Alternative methods include small-claims court, arbitration, and mediation Unit: number per year	1995	0	0		40		300		750				
		2. Number of loans secured through central registry	Definition: Unit: number per year	1995	0	0		0		200		500				
COMMENTS/NOTES *Data to be developed by USAID/Lithuania by October, 1996																

A. 5 Results Framework Narrative for S.O. 1.3

1. Transition Hypothesis

One of the areas where USAID/Lithuania will work during the upcoming period will be the improvement of an enabling environment for sustainable private sector growth. Development of such an environment together with reforms in the financial sector are the foundation of the current economic reform effort. In creating such an enabling environment, the need for assistance is critical at this stage of development of the economy.

The strategic objective identified is more narrowly focused than the corresponding objective within the ENI framework. The main reason for this focusing is a limited assistance budget. USAID only has resources to complement efforts of the other donors and work directly on the most immediate bottlenecks to create an enabling environment for the private sector. Such a view is realistic and the objective becomes achievable taking into consideration the assumptions listed below.

Achieving the strategic objective within four years will mean that 1) main price distortions are reduced and therefore conditions for efficient private investment and resource allocation are created; 2) the legal framework for commercial activities is improved; and 3) effective trade policies which reflect international conditions are developed. This will increase Lithuania's access to international markets and lead to more efficient allocation of resources.

There are several areas that are important for improving the enabling environment for private sector growth, which are not dealt with in this strategic objective. Infrastructure development is supported by most of the multilateral agencies and within current USAID's assistance levels, very little contribution could be made in this area. Also, restoration of a stable financial environment, which is defined by the mission as Strategic Objective 1.4, will create an improved enabling environment for sustainable private sector growth and therefore could be considered as contributing to SO 1.3 achievements.

2. Critical Assumptions

Together with development partners and clients some assumptions were made concerning conditions that must exist or changes that must occur in order that USAID will succeed in achieving the strategic objective:

- The GOL's political commitment to reforms necessary for private sector development will be kept at the current level or increase
- EU and WTO membership will remain a primary goal
- The new Parliament elected in the fall of 1996 will continue to focus generally on the same body of laws
- The Parliament will pass the laws that USAID will help to draft

- Elimination of some price distortions at the initial stage will impede private sector growth for inefficient business and cause bankruptcy in others. The true economic benefits will tend to accrue after a longer period of time.
- Uncertainties pervading the Lithuanian economy and the transition process make it difficult to forecast the time it will take to achieve the strategic objective
- Disagreements within the current government will be reduced and decisions will be more favorable to realistically reduce agriculture tariffs and eliminate economically unsound subsidies.

3. Causal Linkages

If Lithuania is to develop a strong, growing, internationally competitive private sector, key policy and regulatory reforms must be developed and implemented. In some instances, GOL ministries and other organizations must strengthen their skills in formulating appropriate policies and regulations. In other instances, the skills are in place but policies and regulations have not yet been developed. The essential causal logic is similar for each of the three IRs under S.O. 1.3:

- When needed, the Mission's implementors will work with the GOL and/or other development partners to enhance skills in formulating policies, laws and regulations
- With these skills in place, the Mission's implementors will work with appropriate organizations to draft key laws, policies and regulations
- When the policies, laws and regulations have been drafted, the Mission's implementors will work to facilitate their passage and initial implementation.

It is important to note here that the Mission believes that, with limited funds and a three-year time frame, it is realistic to take responsibility for drafting laws, policies, regulations, and for some of the effects of implementation of these policies, laws and regulations. As the Parliament is responsible for actual passage of laws, the Mission cannot take responsibility for their passage, but assumes that they will be passed. The focus of the Mission's activities under S.O. 1.3 is to create a policy and regulatory environment favorable to sustained growth of the private sector, and seek to achieve some implementation of the environment.

Principal IR 1.3.1: Elimination of major price distortions that impede efficient private investment and resource allocation

Distorting the cost of inputs leads to a misallocation resources for business activity. The result is inefficiency and a system that cannot economically sustain itself. At present, energy prices are set well below production costs and world market levels. This energy price policy misallocates resources, distorts the market, subsidizes inefficient users and, in effect, penalizes efficient energy users. Present energy pricing also creates a massive and unsustainable drain on the budget. Creation of a sustainable and efficient energy

policy will favor private investment and creation of efficient and competitive private firms.

At present, pollution regulation and enforcement is extremely lax. By penalizing polluters, the GOL will create revenue which, through the environmental investment fund (see S.O. 1.4), will be reinvested to favor efficient and environmentally sustainable firms.

Principal IR 1.3.2: Effective trade policies developed which increase market access

As exports are one of the main avenues for economic growth, trade policies must be reviewed and improved. Until Lithuania becomes a member of the World Trade Organization and enters into regional trade accords, Lithuanian exporters will not be able to take full advantage of regional trade preferences. Adoption of improved tariff regimes and trade policies will help allocate resources toward economically productive activity with greater trade potential.

Principal IR 1.3.3: Improved legal framework for commercial activity

A solid legal framework is the foundation for sustained business activity. The present Lithuanian judicial and legal system is a significant barrier to private sector growth and investment. Without a collateral law and supporting implementation actions, entrepreneurs have great difficulty in raising funds for investment. Numbers of potentially productive resources (land, buildings, factories, etc.) have been frozen as a result of a twenty year backlog of disputes awaiting adjudication and the absence of an implemented bankruptcy law. Without the skills to work within the framework of new laws, judges and lawyers function very inefficiently. By addressing these problem areas, key impediments in the legal framework for commercial activity will be reduced. This will help the Lithuanian private sector to function efficiently and competitively.

A.6 Summary Results Review for SO 1.3

This S.O 1.3, defined by the OAR as "Improved Enabling Environment Conducive to Sustained Private Sector Growth" works to assist the over 150,000 companies in Lithuania. In the past, USAID focused on enterprise-level assistance, with less of a focus on policy work. Many of the areas for future policy reform have either only recently started or will start this year.

Current efforts which are part of the new strategic objective have focused on reform of the commercial legal system, trade issues like GATT accession and building the foundation for reduced price distortions. In the area of energy pricing, USAID has worked with the State Energy Control Committee (SCC), to help develop pricing and tariff methodologies for rationalizing heat, electricity, and gas prices. Additional support to develop guidelines for energy regulation will be provided in the upcoming months. Under a previous Bechtel/Arthur Andersen contract, accounting assistance was provided to Lithuanian Power Station (LPS) to successfully meet a conditionality for a World Bank loan for rehabilitation of the power sector. The first phase of a joint effort led by Electrotek, supported by Bechtel and USEA to assist Lithuanian Power Company

"Lietuvos Energija" (LPC) with resource planning is almost complete. Assistance to LPC to improve business operations through the utility partnership program, as well as the Bechtel and Electrotek contracts have also contributed to improve the collection process.

In the environmental area, USAID has been very active in work on environmental pricing. The Harvard Institute for International Development (HIID) took the lead on reform of the system of mineral charges. The legislation on mineral charges was adopted and put into place on January 1, 1996. HIID recommendations on forest policy and forest finance have formed the basis of the critique of current forest policies, which are under active consideration at the government and president levels. A draft law on pollution charges is nearly completed.

Through the Department of Commerce program, assistance was provided in trade, WTO accession and protection of intellectual property rights. The Department of Justice (DOJ) and the Federal Trade Commission (FTC) have sent experts to Lithuania to assist the government in devising and enforcing economic competition laws and consumer protection laws. A major effort has been made to collect the information needed to respond to WTO accession panel questions. As a result of the above work, the Ministry of Foreign Affairs continues to improve its ability to participate in the extensive negotiations on joining the WTO.

In the area of commercial law reform, USAID's program with ABA/CEELI established a new Commercial Law Center which sponsors and facilitates a variety of seminars and continuing legal program, facilitates the translation of laws and legal material into Lithuanian and houses a modern, western-style legal library. USAID grantees provided commentary on draft laws and in several cases have assisted various ministries and associated drafting committees with the creation of legislative and regulatory drafts. Assistance has been provided to the government in identifying areas of currently and provisions which impede private sector growth. For example, CEELI provided the Ministry of Economy and the Parliament Legal Department with advice on preventing disguised foreign investment, which resulted in substantial revisions to the foreign investment law, passed in 1995. In the legal training area, USAID has conducted seminars in several commercial areas including franchising, contracts for the sale of goods, joint ventures, and bankruptcy. The seminars lead to enhanced understanding of the judiciary and bar about a variety of substantive areas of laws. Training programs for 125 new judges in civil and criminal procedures were given. This work has formed the base for improving the legal framework for commercial activity and introducing new legal services. A special effort has been made to improve the collateral law, including the design of a collateral registry. Training and public awareness efforts have been used to build a common understanding of the need for a sound collateral law to underpin commercial banking and enterprise affairs. Once implementation issues are resolved, the Parliament is ready to pass an improved collateral law

Although much of the foundation has been prepared for reducing major price and trade distortions and improving the legal framework, there continue to be barriers to progress. The problems encountered in this S.O have tended to come from political issues and a lack of understanding of the need for reform. Training has enhanced the capacity of those responsible for trade policy, resulting in increased understanding about the need for

reform. Furthermore, it is thought that USAID's participation in the Parliamentary/Lithuanian-American Committee meetings will heighten Parliamentarians' understanding of the necessity for change in these areas.

A.7 Sustainability of Progress

Achievements of the three main intermediate results, particularly elimination of major price distortions, development of an effective trade policy and improvement of the legal framework, will lead to an improved, policy-enabling environment conducive to sustained private sector growth. As the three areas are in different stages of development and because of the implied willingness and support of the counterparts in the three areas, different approaches need to be taken to ensure that the results achieved will be sustained after the USAID program is completed

In setting up energy prices which reflect actual economic costs, the State Energy Control Commission (SCC) will play a major role. Therefore, the major sustainability task is to strengthen the abilities of the SCC so that it can become an independent regulatory organization capable of developing fair, reliable and economically priced energy services.

Environmental charges which internalize the cost of pollution will be determined in conjunction with the Ministry of Environment. Sustainability will be achieved through introduction of economically sound policies and by building the capacity of the Ministry of the Environment to undertake environmental economic policy analysis.

Effective trade policy development is the most sensitive area within the strategic objective, as the trade policy depends more than the other sectors on the political situation and decisions made by the Government. Assuming the situation continues to develop at the pace and in the direction it is now heading, sustainability in this area will be achieved by working on enhancing the analytical skills for trade policy within the Government. Particular attention will need to be made to agriculture tariffs, as GOL resistance in this area is greatest.

By targeting a limited number of key laws for assistance (such as collateral law, bankruptcy, leasing and competition), the impact will be concentrated and lasting. They will solve major bottlenecks and help all 150,000 companies in Lithuania. Long-term strengthening of the commercial and procedural skills of the judiciary will be accomplished through the design and implementation of an indigenous judicial training program which will ensure that members of the judiciary receive quality training in substantive areas of law on an ongoing basis. An integral part of the program will be "train the trainer" instruction for senior Lithuanian judges to ensure that training continues after the Mission's phase-out. A similar capability will be developed for continuing legal education for lawyers.

Even if the above-mentioned problems are solved, growth will be impeded if access to the judicial system is too slow or costly to be effective. The development of an alternative low-cost dispute resolution system will provide a long term solution by training mediators and by implementing a "train the trainer" program to ensure that new generations of mediators are trained.

STRATEGIC OBJECTIVE

STRATEGIC PLAN

S.O. 1.4

"MORE STABLE

FINANCIAL

ENVIRONMENT"

PART II: STRATEGIC OBJECTIVE RESULTS FRAMEWORK

S.O. 1.4: More Stable Financial Environment

A.1 Statement of Strategic Objective

The ENI Bureau strategic objective is to establish a more competitive and market-responsive private financial sector. The USAID/Lithuania strategic objective is more focused and seeks to establish a "more stable financial environment."

A.2 Problem Analysis

In addition to the general links between such economic reform efforts and growth, there are a number of specific reasons why USAID should pursue activities aimed at forging a sound financial environment and an enabling environment for private sector development:

- Macroeconomic stabilization is by no means assured. Without further reform, there is a significant risk of a return to a downward spiral of high inflation rates, devaluation, centralized wage-setting, capital flight and further declines in output.
- The collapse of leading private commercial banks, and weaknesses in the State Banks has disrupted the payments system, forced enterprises to rely on informal financing arrangements, raised capital costs, spurred capital flight, and weakened public confidence in the domestic banking system.
- Financial constraints, combined with the banking crisis, discourages domestic savings and has forced enterprises and households to rely on internal resources, inter-enterprise financing, and curb markets to meet their financing needs. The growing stock of inter-enterprise arrears (particularly in the energy sector) spills over into non-performing loans in the banking system, adds to inflation and disrupts normal business activity.
- Capital markets have been primarily used as a vehicle for funding public sector deficits (through Treasury Bills). Despite the great number of public companies on the exchange, the equities market remains inactive, capital market instruments are limited, exchange mechanisms are awkward, and market information is scarce and unreliable. The capital markets can play an important role in concentrating ownership in newly privatized companies, facilitating cash-based privatization, and providing alternative financing instruments (equities, leasing, life insurance) for private investment.

One of the main reasons for concentrating assistance efforts on restoring a sound financial environment is that it will also be an important part of the effort to spur private sector development. Capital markets provide an arena for investment and for companies to identify sources of capital. Likewise, the restoration of a healthy banking environment is

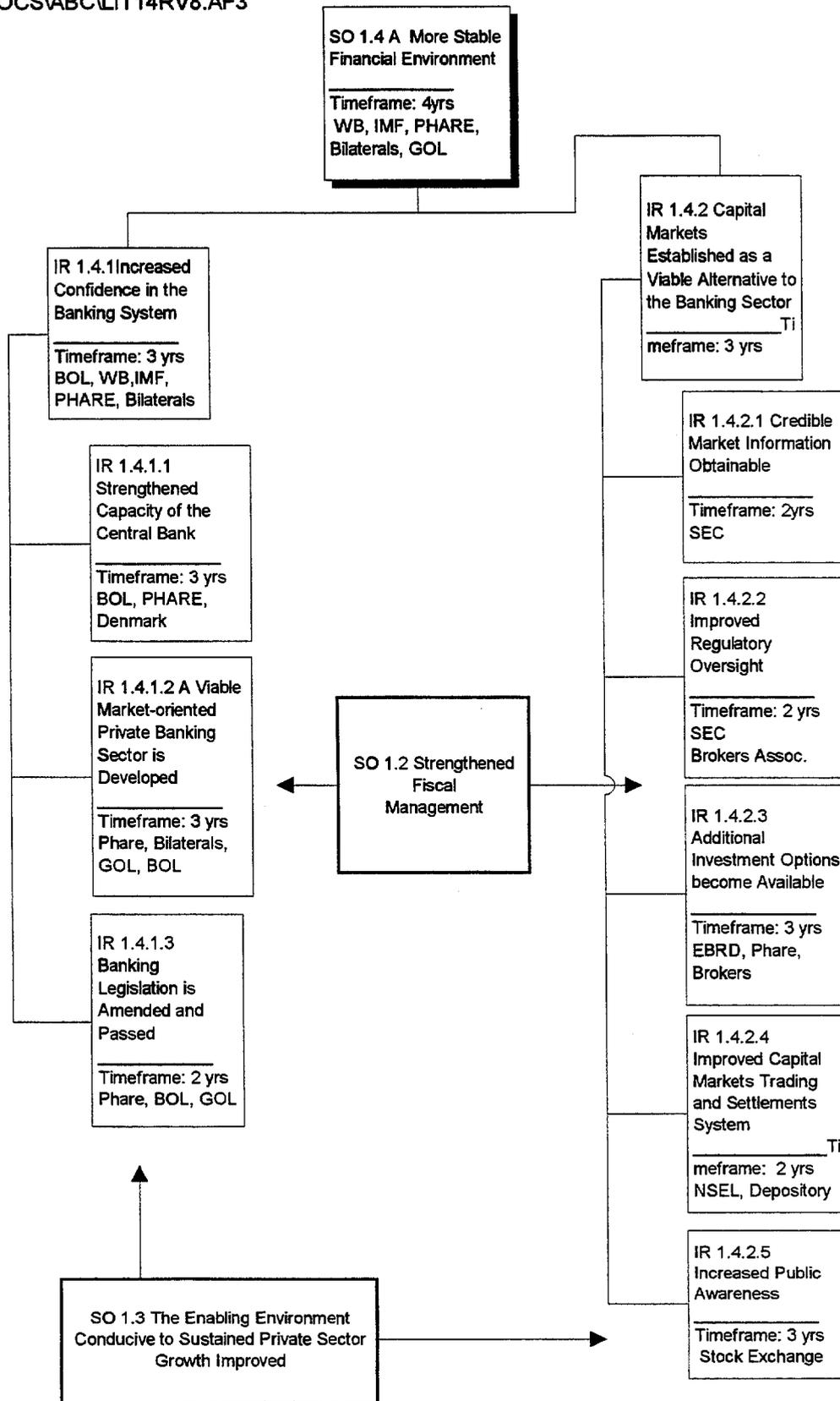
an essential prerequisite to private sector development.

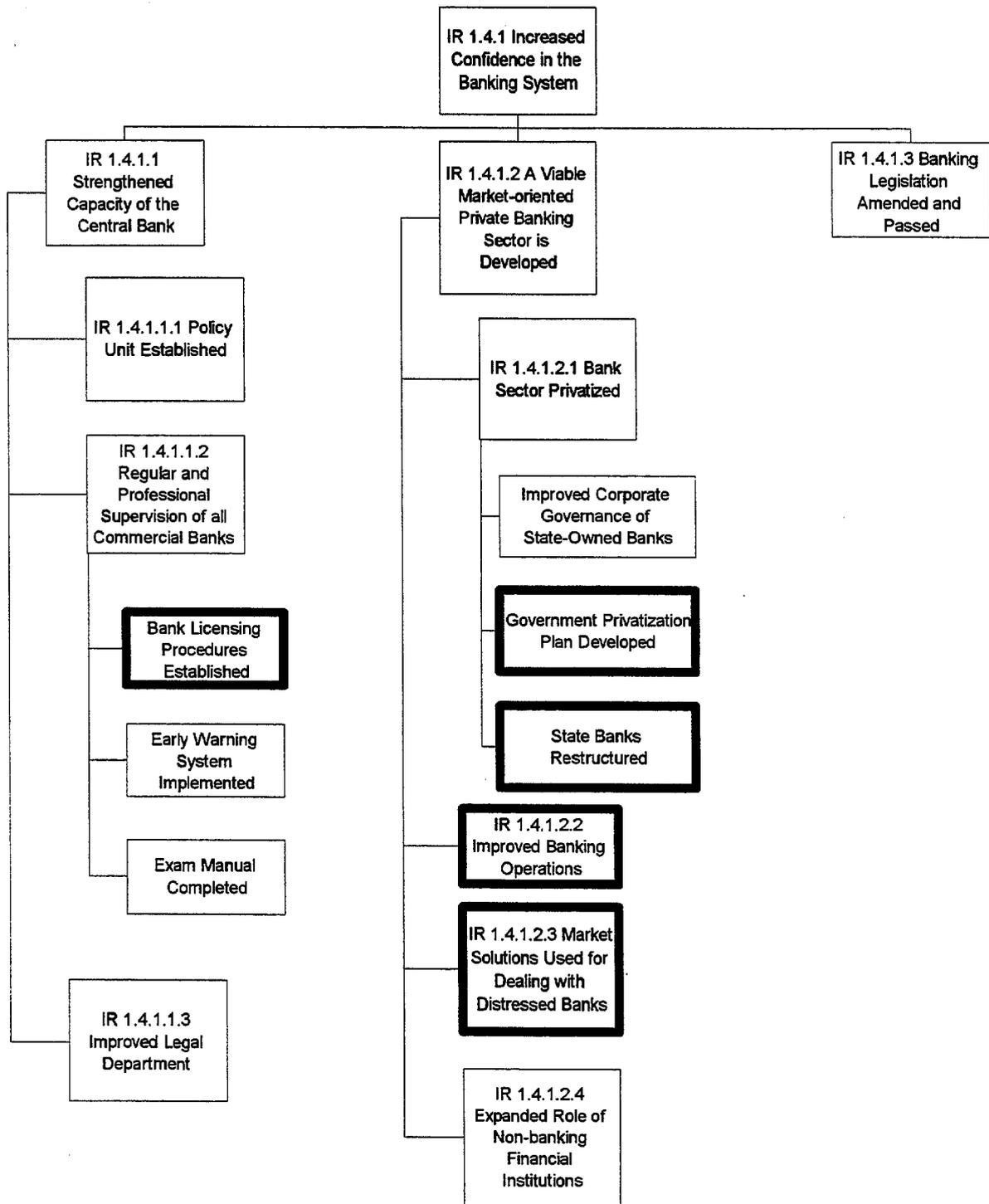
The main rationale for concentrating assistance efforts in these two areas is as follows:

Bank Policy and Supervision: Collapse of the private commercial banks, tolerance of political lending to enterprises, and the effective ban on foreign bank entry into the domestic financial market can be traced back to a lack of effective policy-making capacity and institutional weaknesses in the Bank of Lithuania. The combination of continued, high rates of inflation, together with a fixed exchange rate, has led to a situation in which abandonment of the currency peg (or realignment) appears likely in 1997-1998. During the next few years, the BOL will need to restructure the distressed banks, tighten prudential standards on all banks and develop the capacity to engage in a broader array of monetary policy efforts. The BOL has a new Governor who established a solid track record in his previous post as Finance Minister. The BOL has requested assistance in macroeconomic management and central bank policy-making. In addition to providing support to the office of the Governor, USAID can build upon its highly successful work in bank supervision, by helping the GOL think through policy options related to bank restructuring and the entry of foreign banks.

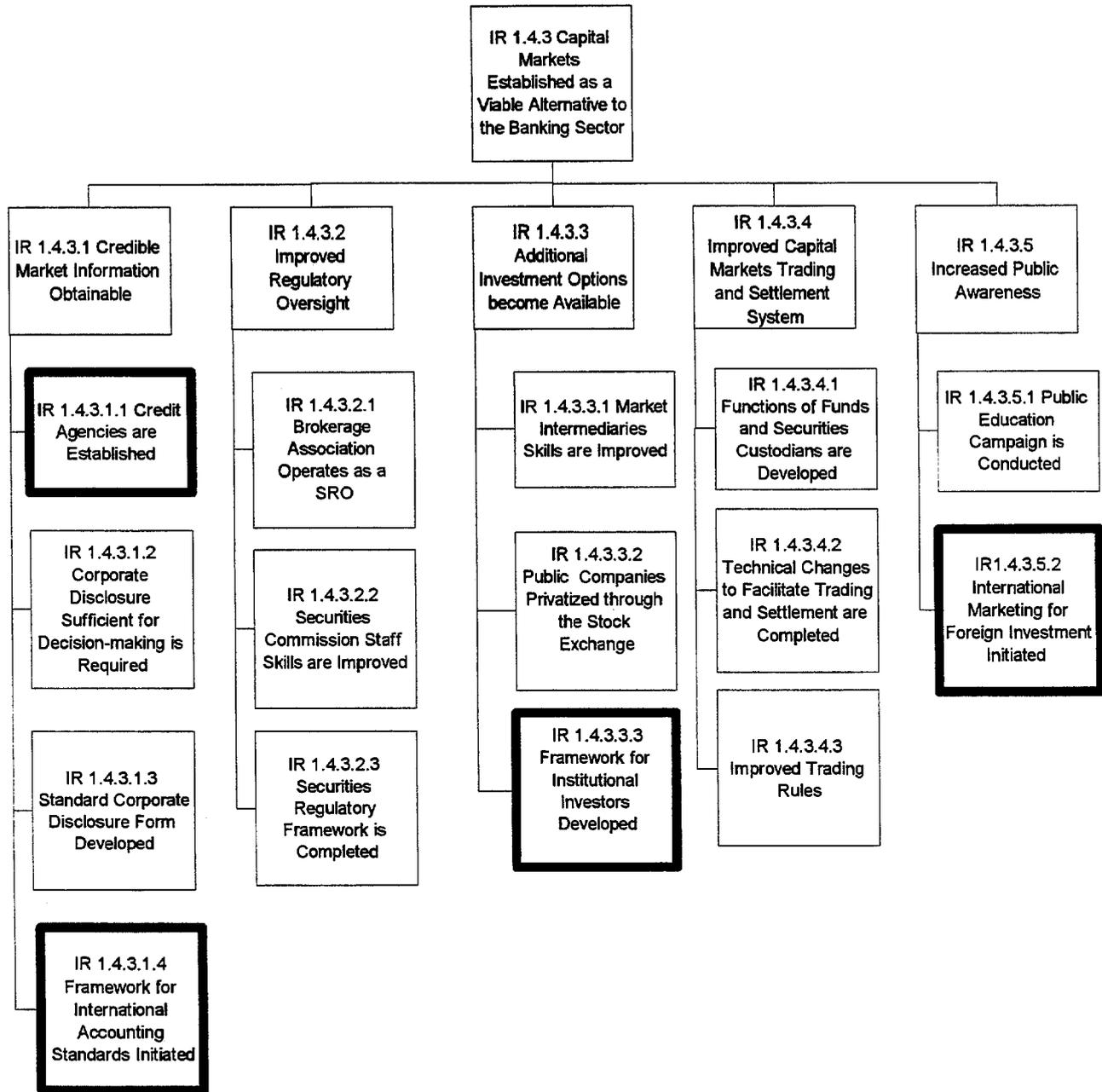
Capital Market Development: With a contaminated banking system, the capital market offers investors an alternative source of financial market services. In addition, the capital market can play a key role in facilitating/stimulating cash-based privatization and financing long-term investment. Key impediments to future capital market development include: high interest rates on treasury bills (driving investors away from other instruments), lack of readily available market information, inadequate trading arrangements, weaknesses in the regulatory environment, and a limited range of capital market instruments and market intermediaries. While a start has been made in the direction of market-development, much more will be required in this area in the future. Efforts that could contribute to capital market development include the introduction of a quote-based pricing system, establishment of a credit rating system, and establishment of the legal and supervisory framework for investment funds, leasing companies, and private pension management. Building upon ongoing successes in the regulatory area of capital markets, additional assistance resources should be directed towards capital market development.

NGO Policy Analysis Support: Support to the Free Market Institute, a local NGO, has had a significant effect on public opinion and the direction of public policy reform. Such efforts will be continued to ensure that Lithuania has sufficient capacity to intelligently analyze and chart the course of future economic reform initiatives, to supply mass media with informed economic analysis, and to serve as a sounding-board for policy debate. Future efforts in this area should also aim towards helping local policy-analysis NGOs build bridges to international sources of expertise.





Boxes framed by thick lines represent key results contributed exclusively by USAID's development partners.



Boxes framed by thick lines represent key results contributed exclusively by USAID's development partners.

TABLE 11 : PERFORMANCE DATA FOR STRATEGIC OBJECTIVE 1.4: BASELINE, TARGETS, AND ACTUAL RESULTS

LEVEL	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		TARGETS AND ACTUAL RESULTS									
				YEAR	VALUE	1996		1997		1998		1999		2000	
						Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
SO 1.4	A More Stable Financial Environment	1. Money Supply as a Percent of GDP	Definition: Money Supply will be measured by M2. Measurements done at year end. Unit: Percent	12/95	18%	17%		20%		24%		39%		35%	
		2. Real Interest Rates	Definition: Average nominal interest rates for domestic currency time deposits as reported by the Central Bank minus annual inflation reported by the Statistics Department. Unit: Percent	1995	-16%	-15%		-12%		-10%		-5%		-2%	
		2. Long-term commercial debt as a % of total debt	Definition: The value of loans granted to residents for more than one year as a percent of all loans outstanding. (average for end of each quarter) Unit: Percent	1995	15.2%	17%		19%		22%		25%		25%	
IR 1.4.1	Increased Confidence in the Banking System	1. Level of deposits	Definition: Level of deposits as reported by the Bank of Lithuania. Unit: Litas	12/95	4,630 million	4,865 million		5,060 million		5,300 million		5,500 million		5,800 million	
		2. Level of long-term time deposits.	Definition: Percent of time deposits that are for longer than three months. Unit: Percent	12/95	15%	17%		20%		25%		28%		30%	

LEVEL	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		TARGETS AND ACTUAL RESULTS									
				YEAR	VALUE	1996		1997		1998		1999		2000	
						Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
		3. Registered share capital.	Definition: Share capital registered with the Central Bank Unit: Litas	12/95	376 million	550 million		650 million		700 million		750 million		800 million	
IR 1.4.2	Capital Markets Established as a Viable Alternative to the Banking Sector	1. Volume	Definition: Annual Turnover of equity market. Unit: Litas	1995	148 million	200 million		260 million		330 million		400 million		500 million	
		2. # of IPOs	Definition: To obtain capital, a company goes to the stock market and issues new shares (IPO). Unit: companies	1995	0	5		15		19		22		25	
		3. # of listed companies (listed is equivalent to being identified as a blue-chip company)	Definition: To be listed, a company must meet certain disclosure, liquidity, and ownership requirements. Unit: companies	1995	0	5		10		20		25		30	

COMMENTS/NOTES Financial Data for banking and government revenue is collected for end of calendar year, and is only available no earlier than May 1 of the following calendar year. Capital markets information is typically available earlier.

A.5 Results Framework Narrative for SO 1.4

1. Transition Hypothesis

One of the primary areas that USAID/Lithuania will work in during the upcoming period will be the financial sector. The Mission has considered (a) realistic goals for the next four years and (b) impacts necessary to bring a substantial change to the financial sector, and has defined the S.O. as "a more stable financial environment."

To follow this strategic objective, the elements of stability need to be understood. Stability in the financial environment has three primary characteristics: confidence in the markets, predictability of the financial resource needs, and depth of the financial sector. When combined, these provide for a stable market. If one element disappears, financial stability can be undermined.

If Lithuania is to achieve the Bureau goal of a competitive, market-oriented economy with the majority of resources in private hands, it needs to have a stable financial environment. This is currently not the case. In the four-year time-frame it has to bring about change, USAID's efforts to produce such an environment will contribute greatly to improving and expanding the market economy.

2. Critical Assumptions

In creating the results framework, partners and clients were consulted to help ensure the validity of the model. Some assumptions have been made concerning others' accomplishments and the results of USAID's and its partners' efforts:

- EU-PHARE will continue providing technical assistance for commercial banking
- Future governments will continue to support financial sector reforms
- Honest bankers desire a healthy and transparent banking system
- The Central Bank will expand its range of necessary functions in the next three years
- The GOL will start privatization of the state-owned banks by the end of 1998
- The GOL will continue to consult with the IMF and WB in achieving its macro-economic and structural requirements.

3. Causal Linkages

This strategic objective has two primary intermediate results which focus on improvements to the banking and capital markets areas along with support from SO 1.2. These three areas are naturally intertwined in support of the strategic objective of a stable financial sector and the earlier stated elements of confidence, predictability, and depth.

The majority of the banking sector is insolvent and trust in the system is at an all-time low. Deposit levels are falling, leading to fluctuations in an already thin financial sector. This area links most directly to the "confidence element" of stability. Confidence will be strengthened when commercial banks begin to operate responsibly and when the Central Bank carries out its full responsibilities. For the Central Bank, this involves ensuring that the banks that operate are worthy of accepting deposits and performing other banking functions. It also includes leadership in dealing with banking problems, initiating legislation on banking reform and providing an anchor in an otherwise stormy sea. For private commercial banks, increasing their capacity to operate according to international norms (e.g., services, accounting, internal controls, lending) is the best way for them to increase the confidence of their clients. This multiple approach on commercial banking, Central Bank and legislative changes will provide for increased confidence and therefore a more stable financial environment.

As noted above, the S.O. 1.2 objective of improved fiscal management is closely linked to the S.O. 1.4 financial management objectives. The discussion in this paragraph relates to that S.O. 1.2 objective and is included here to provide a more comprehensive perspective and what needs to be accomplished. The Government of Lithuania (GOL) is the single largest borrower in the country. Through T-bills, the GOL's borrowings exceeds the amount of all loans granted by commercial banks. The funding needs of the GOL not only crowd out other borrowers, but its fluctuation sends shock waves throughout the financial sector. Therefore, the primary objectives for improving fiscal management are: 1) reversing the revenue collapse through a tax policy that reduces black market activity and generates sufficient revenues to minimize government demands on banks, on quasi-fiscal spending, and on external borrowing for budget support purposes, 2) improving the control and management of government funds and expenditures to reduce short-term financial uncertainty and to eliminate low-impact expenditures, and 3) carefully managing and limiting the GOL's international borrowing to ensure that Lithuania maintains its international creditworthiness. Such policies help reduce the fiscal deficit and, in doing so, will help ease inflationary pressures and reduce the crowding-out of the private sector from domestic financial markets. As revenues are increased and inflation is reduced, there will be scope for restoring positive real interest rates, which is essential if savings are to be drawn back into the banking system. The end result will be a level of predictability in revenue and maximization of government revenues (e.g., through a better tax system, improved forecasting, and improved treasury system, interest on idle balances, securitization of government funds held in the private sector) and a level of predictability in borrowing and expenditures (e.g., better budgeting, better debt management). These will combine to contribute to more stability in the financial environment.

The capital markets system is still in its early stages of development. Currently, it offers only a few investment options and is hurt by a lack of accurate information about companies. However, the market continues to expand and its success will contribute to stability by increasing the depth of the financial market. The deeper the financial market, as measured by the size of the money supply, the better the economy can withstand external shocks and fluctuations in its development. The capital market has established a strong base and continues to grow. Unlike the banking sector, the capital markets arena has remained relatively unscathed by fraud and criminal activities and has made solid

progress in improving regulation as the market has developed. As development continues, it can be an option for investment and a source of capital for people and companies that now go to the banking sector for these services.

It is also worth noting that strategic assistance at this point in the development of the capital markets can work to avoid potential problems in the future. Had it been possible to provide assistance to the commercial banking sector early in its development, many problems that will now cost hundreds of millions of dollars to resolve could have been avoided. If the capital markets system has large problems in a few years, much of the gains in the banking and fiscal strengthening areas could be wiped out. Improving the capital markets and the resulting competition will not only encourage the banking sector to improve, but will also broaden the base of financial instruments. The resulting increased depth will improve stability in the financial environment.

Although each of these areas supports the strategic objective 1.4, there are important linkages to be noted. The most important linkage concerns problems in the tax area which encourage companies to hide their true financial state. This tax avoidance hurts the budget, reduces government investment, and prevents the development of credible market information for both banks and the stock exchange. This further increases the need for the government to borrow. The banking sector, which was a main provider of tax revenue in the past, may become a net user of government expenditures. The government may provide support to shore up bank capital levels, however, with an initial estimated cost of \$300 to \$400 million for bank rehabilitation, the government cannot cover the cost from domestic sources.

A.6 Summary of results review - SO 1.4

This S.O 1.4, defined by the OAR as "A More Stable Financial Environment", is the means of introducing depth, confidence and stability into a shallow and unstable financial sector. Without a strong financial sector, growth in the private sector and improved capital investments by the GOL will be limited. USAID's continuing efforts have had strong results in well-established programs and have started to produce results in the newer areas.

USAID has been active in the banking sector since mid-1994, when it started its bank supervision program through the Barents Group (KPMG). After the first year of training and daily guidance, USAID assisted the Bank of Lithuania (BOL) to revise its bank supervision strategy and provided on-site training in bank examination. With USAID assistance, the BOL was able to examine commercial banks, identify major problems in ten banks and assist the BOL in closing down these banks thereby preventing further losses to depositors. In December 1995, two of the largest banks which had just been examined by USAID-trained BOL staff, were placed under a moratorium, which provoked a significant bank crisis.

USAID has been a major player in developing sound solutions to the crisis. During this time, the USAID and its advisors helped:

- Persuade the Prime Minister and the Minister of Finance to halt the development of *ad hoc* legislation which would have cost the government millions of dollars and benefitted only the managers and shareholders of the insolvent banks
- Introduce unprecedented changes to the labor law to allow the new administrators of insolvent banks to close operations immediately instead of in six months. This saved millions of dollars
- Help shape and revise the World Bank/IMF bank restructuring plan and introduce crucial policy changes, such as requiring international accounting standards and bank reporting on financial conditions to the BOL
- Provide both policy and technical input on many areas regarding the banking crisis. One example was to provide excerpts from US banking laws to the Minister of Finance and to BOL officials on the organization of a bad bank. This paved the way for acceptance of the concept.
- Critique two separate by-law drafts for creation of the bad loan enterprise. Both the drafts were substandard and could have worsened the situation had they been accepted in original form.
- Work closely with the audit firm of Ernst and Young who were contracted to perform independent reviews of two trouble banks. Assistance by the advisor and the team of inspectors reduced the time in-country from 30 days to 20 days and saved the BOL over \$200,000.
- Present less costly restructuring options to minimize the drain on the budget.

In addition to providing assistance to the BOL, USAID has worked to develop alternative financial institutions. The WOCCU program has helped put into place legislation allowing for the establishment of credit unions and assisted two credit unions in starting operations. The Baltic-American Enterprise Fund (BalAEF) has granted almost 20 loans for a sum of \$4.0 million.

USAID assistance to a non-governmental think tank, the Free Market Institute, has focused public debate on key economic reform policy issues and, through local policy advocacy, helped to build a reform consensus in banking, capital markets development, tax reform, investor regulation and monetary policy.

USAID assistance to the capital market began in late 1995 through the efforts of Price Waterhouse and the Financial Service Volunteer Corps (FSVC). USAID assistance to capital markets has led to a strengthening in market regulation, expanded services and improved reporting. The USAID implementors approached the sector by working with the four main bodies of the stock market: the stock exchange, the central depository, the securities commission and the Brokers' Association. While some initial progress has been achieved, most of the benefits will be realized in the near future. The Central Depository has started to implement changes needed for development of repurchase agreements. The Securities Law included key provisions at the suggestion of USAID advisors. Other

advisors are continuing this process by assisting in regulation development. The most significant change to date included introducing transparency into the pricing mechanism at the Stock Exchange. On the advice of a USAID advisor, the Exchange established a system that allows for prices in the central market to be made available to all buyers and sellers, to allow them to adjust their bids accordingly. This additional market information led to increased turnover on the first day it was used and is expected to lead to further improvements.

Most of the problems encountered have been political rather than economic in nature. The lack of agreement with needed changes in banking has been addressed by working to improve the understanding of the decision-maker on the importance of the issue or working with others who are in the position to promote needed changes. On occasion, the only choice has been to wait for personnel changes in key positions. Furthermore, it is thought that USAID's participation in the Parliamentary/Lithuanian-American Committee meetings will heighten Parliamentarians' understanding of the necessity for change in these areas.

In measuring progress on this SO, three indicators have been selected: depth of the market (M2/GDP), real interest rates, and long-term loans as a percent of overall loans given. Since the end of 1993, market depth has decreased from 22 percent to 18 percent, real interest rates have increased from -90 percent to -16 percent, and long-term loans have increased from 1.8 percent to 8.9 percent. These indicators and those developed for the key intermediate results reflect the increased focus on policy level work and as such, do not lend themselves as indicators of progress on the work performed thus far.

A.7 Sustainability of Progress

Lithuania's strategic plan for S.O. 1.4 embraces a phase-out approach. In achieving a stable financial environment, there is a minimum threshold that will be achieved in the areas of banking and capital markets. After that threshold point, progress is expected to either continue (capital markets) or be firm enough to avoid serious erosion (banking).

The banking sector is the backbone of a country's financial system. Lithuania is now paralyzed by its poor banking system. Most of the sector is insolvent, trust is low, and banks are performing few of their traditional functions. Solving this situation means going to the core of the problems -- lack of leadership in the banking sector. This leadership needs to come from the BOL, which, until recently, was not allowed to operate free from outside political pressures. Through capacity building at the BOL (coupled with intense commercial bank work by EU-PHARE), the Bank will be able not only to perform its current functions better (especially bank supervision), but also to skillfully take on the traditional functions of a Central Bank, such as macro-economic and monetary policy. Although the Central Bank currently has limited involvement in these areas, its responsibility is predicted to increase and its management seeks to be prepared to professionally undertake these responsibilities at the appropriate time. Once this capacity is in place, the Central Bank will be ready to perform its technical functions and provide leadership in the banking sector.

The capital markets system continues to grow, and more rapid results can be achieved

with greater experience and assistance. The primary opportunities for growth lie in increased transparency in trading and financial disclosure, improved enforcement, and better products for investors. USAID will target all of these areas. Once in place, they will not only be difficult to reverse, but will encourage stronger growth at the stock exchange. The engine of change will be improved transparency of the stock exchange's pricing system. Some progress has already been made in this area with positive results. As volume builds, more companies will see the benefits of using capital markets. With changes in the tax policy system and more stringent disclosure requirements from the banking sector, companies will also be pushed to improve their disclosure at the stock exchange. As the market builds and new products are introduced, there needs to be a constant balance with the regulatory framework. Proper introduction and enforcement of new regulations concerning new elements of the markets will be the key to continued growth after the termination of assistance.

STRATEGIC OBJECTIVE

STRATEGIC PLAN

S.O. 1.2

"STRENGTHENED

FISCAL

MANAGEMENT"

PART II: STRATEGIC OBJECTIVE RESULTS FRAMEWORK

S.O. 1.2: Strengthened Fiscal Management

A.1 Statement of Strategic Objective

The ENI Bureau strategic objective is "Increased soundness of fiscal policies and fiscal management practices." USAID/Lithuania's strategic objective echoes that of the Bureau in seeking to "strengthen fiscal management."

A.2 Problem Analysis

In addition to the general links between such fiscal reform efforts and growth, there are a number of specific reasons why USAID should pursue activities aimed at strengthening fiscal management:

- Serious deficiencies in the design of the tax system combined with poor enforcement procedures make it difficult to mobilize sufficient resources to meet necessary public expenditure requirements. Close to half of economic activity is forced into the black market by a punitive and highly discretionary and imbalanced tax system, making it ever the more difficult to mobilize sufficient public revenue. The rapid rate of external debt accumulation, the tendency to borrow abroad to finance public consumption, and the GOL's potential internal debt strains its ability to meet core public sector requirements.
- Unless public finances are put on a sound footing, the commercial banks will continue to be under pressure to finance GOL initiatives and the country risks accumulating levels of debt that cannot be sustained in the long-run. Also, high government borrowing through T-bills reduces crowds out private sector borrowing, negatively affecting private sector growth.
- Unless a greater share of financial activity is brought back into the formal financial markets, the GOL may lose control over the money-supply, and enterprises may be forced to operate using only internally generated resources.

One of the main reasons for improving fiscal management is its link to private sector development. A tax system that provides adequate resources for the Budget and encourages black market activity to be brought back into the formal economy can only be done through wise fiscal management. The next step when adequate revenues flows are obtained, is investing in the infrastructure of the country for continued economic growth.

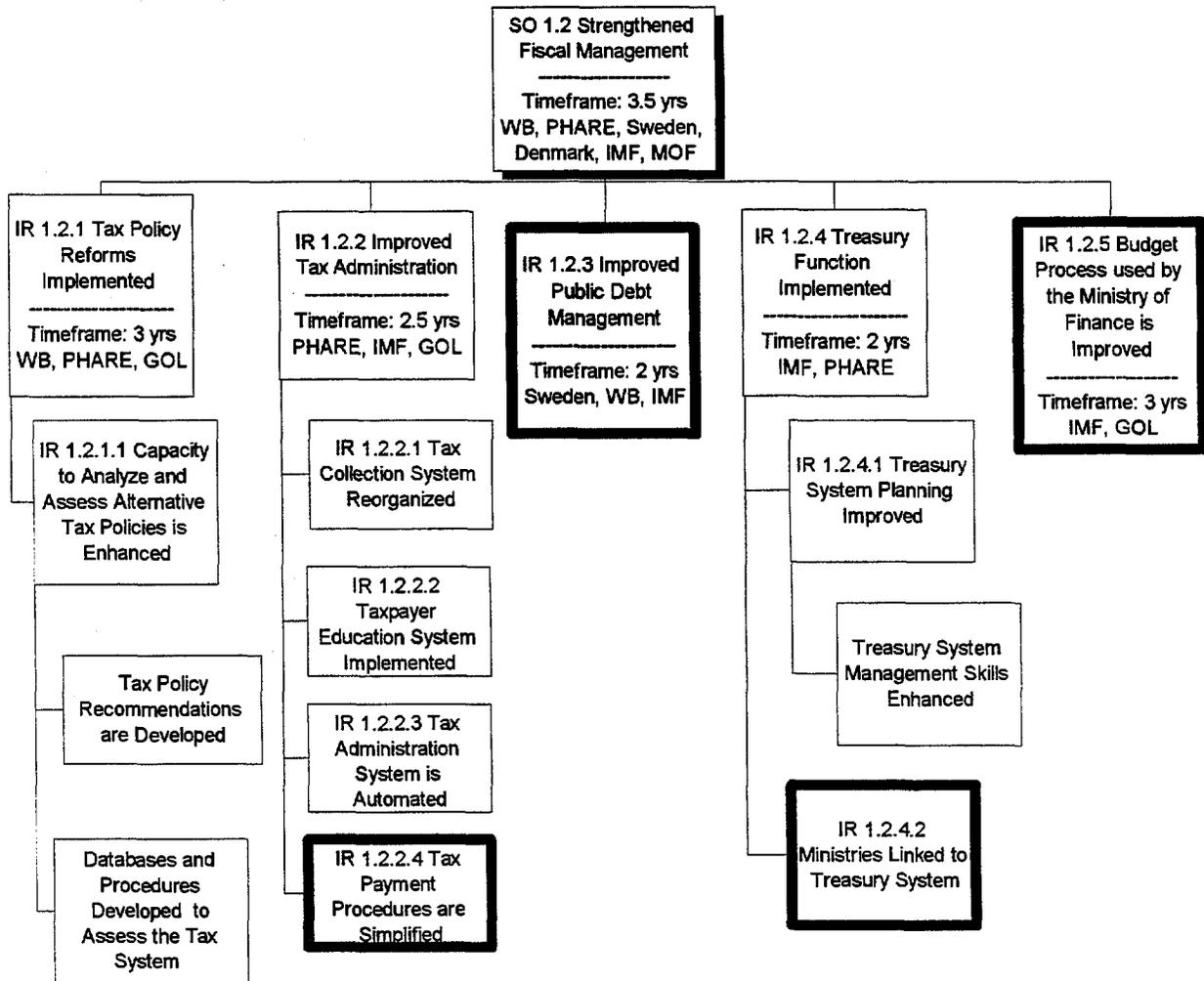
The main rationale for concentrating assistance efforts in the three selected areas is as

follows:

Tax Policy Reform: The tax system needs to be equitable, broad-based, relatively easy to comply with, and transparent in its functioning. These characteristics are lacking in Lithuania's tax system, resulting in over 40% of the economy being pushed into the gray market. The resulting inadequate revenue levels spill over into the GOL's use of the state banks for political lending, mounting tax arrears, and large energy arrears. Redesigning the tax system, while improving tax administration and enforcement would ease pressures on public expenditures, bring economic activity back into the formal economy, stimulate investment and reduce "rent-seeking" pressures for political exemptions and other preferential tax treatment. A concerted effort in tax policy has been requested by the Minister of Finance and will build-upon and complement existing ongoing efforts in this area by USAID.

Tax Administration: Inadequate revenues result from poor policy but also relate back to a punitive, excessively complex tax system with too many exemptions which is unevenly enforced and drives economic activity underground. Although a new tax administration law has been passed, true reform was blocked until recently by leadership which was not reform-oriented. With changes in this function and the Ministry as whole, there is a better chance for some improvements in the tax administration system, with a focus on tax collector and tax payer education efforts. The US Treasury has provided assistance in the past and will continue efforts in this area.

Treasury Function: USAID has had a senior advisor in fiscal policy to the Minister of Finance for several years, with a focus on implementation of a Treasury function. This system is needed for rapid and efficient transfer of government revenues to the budget along with disbursement on an as-needed basis. Such a system will provide for better control of collection and expenditures and stronger control of government monies.



Boxes framed by thick lines represent key results contributed exclusively by USAID's development partners.

TABLE 11 : PERFORMANCE DATA FOR STRATEGIC OBJECTIVE 1.2: BASELINE, TARGETS, AND ACTUAL RESULTS

LEVEL	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		TARGETS AND ACTUAL RESULTS									
				YEAR	VALUE	1996		1997		1998		1999		2000	
						Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
SO 1.2	Strengthened Fiscal Management	1. Tax revenue as a % of official GDP	Definition: Reported government tax revenue divided by GDP. Unit: Percent	1995	24.0%	24.0%		26.0%		29.0%		31.0%		33.0%	
IR 1.2.1	Tax Policy Reforms are Implemented	1. Level of grey market activity	Definition: Percent of the economy that is not accounted for in official government statistics. Unit: Percent	1995	50%	48%		40%		33%		29%		25%	
IR 1.2.2	Improved Tax Administration	1. Level of arrears to total tax collections	Definition: Amount of taxes and fines owed by companies to the Ministry of Finance divided by the amount of taxes collected. Unit: Litas	10/95	17%	10%		8%		6%		5%		4%	
IR 1.2.3	Improved Public Debt Management	1. Effective monitoring of external and domestic obligations	Definition: Ministry is evaluating obligations and making well thought out decisions concerning them. Unit: Yes/No	1995	No	No		Yes		N/A	N/A	N/A	N/A	N/A	N/A
IR 1.2.4	Treasury Function is Implemented	1. Treasury sub-systems operational	Definition: Specific elements of the Treasury system are implemented Unit: Yes/No	1995	System designed, prepared for implementation	Six Ministries linked to system		Twelve Ministries linked to system		All Ministries linked and govt deposits securitized		N/A	N/A	N/A	N/A

LEVEL	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		TARGETS AND ACTUAL RESULTS									
				YEAR	VALUE	1996		1997		1998		1999		2000	
						Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
IR 1.2.5	Improved Budget Process used by the Ministry of Finance	1. Level of capital expenditures	Definition: Government expenditures on capital projects as a percent of GDP. Unit: Percent	1995	1.8%	1.5%		2.0%		3.0%		4.0%		5.5%	
COMMENTS/NOTES Financial Data for banking and government revenue is collected for end of calendar year, and is only available no earlier than May 1 of the following calendar year.															

A.5 Results Framework Narrative for SO 1.2

1. Transition Hypothesis

Given the strong linkages and integration with SO 1.4, this issue is covered in the SO 1.4 transition hypothesis.

2. Critical Assumptions

In creating the results framework, partners and clients were consulted to help ensure the validity of the model. Some assumptions have been made concerning others' accomplishments and the results of USAID's and its partners' efforts:

- A simplified tax structure will be introduced with lower tax rates, which will motivate businesses to move from the shadow economy into the official economy and increase tax compliance.
- Financial distress will likely grow worse in the short and medium-term as inflation falls and as the number of failing enterprises and financial institutions increases.
- Future governments will continue to support financial sector reforms.

3. Causal Linkages

Given the strong linkages and integration with SO 1.4, this issue is covered in the SO 1.4 causal linkages.

A.6 Summary of results review - SO 1.2

This S.O 1.2, defined by the OAR as "Strengthened Fiscal Management", is the means of introducing depth and stability into a shallow and unstable financial sector. Without a strong financial sector, growth in the private sector and improved capital investments by the GOL will be limited. USAID's continuing efforts have had mixed results in the past. It is expected that additional efforts, coupled with new counterparts, will produce results in this area.

In the past, new legislation in fiscal management, tax policy, tax administration, budget policy and currency stabilization has been devised and successfully implemented with the assistance of USG-funded advisors. Work on fiscal management has been achieved through the efforts of the U.S. Treasury program. U.S. Treasury advisors helped the Ministry of Finance formulate fiscal policy, upgrade tax collection efforts through regular training, and develop needed cash handling and transfer systems. The Office of the Fiscal Assistant Secretary has worked to implement a modern, well-functioning financial management system, including accounting, reporting, centralized collection and disbursement, and the establishment of a main Treasury account, and a domestic securities system. Other Treasury advisors have focussed primarily on tax administration. Through their efforts, the Tax Administration law was passed on 6/95,

which clearly defined the rights and responsibilities of the tax payer and tax collector.

Most of the problems encountered in this area have been political rather than economic in nature. The political differences within the Ministry and Parliament to needed changes in government financial operations has been addressed by working to improve the understanding of the decision-makers on the importance of the issue or working with others who are in a position to promote changes. On occasion, the only choice has been to wait for personnel changes in key positions. Furthermore, it is thought that USAID's participation in the Parliamentary/Lithuanian-American Committee meetings will heighten Parliamentarians' understanding of the necessity for change in these areas.

In measuring progress on this SO, one indicator has been selected: tax revenue as a percent of official GDP. In 1995, this indicator stood at 24.0%. This indicator and those developed for the key intermediate results reflect the increased focus on policy level work and as such, do not lend themselves as indicators of progress on the work performed thus far.

A.7 Sustainability of Progress

Lithuania's strategic plan for S.O. 1.2 embraces a phase-out approach. In achieving strengthened fiscal management, there is a minimum threshold that will be achieved for tax policy, tax administration and treasury function operations. After that threshold point, progress is expected to either continue on its own (tax policy, tax administration) or be implemented in final form (treasury function).

The Government of Lithuania is in a precarious financial condition, as evidenced by a seriously deficient tax revenue stream, forcing a high level of borrowing, a rapidly increasing public debt, no visible means to repay upcoming due and payable international loans, and the inability to support a bare bones budget or accommodate a national disaster. With only minimal assistance in and focus on tax policy, the Ministry of Finance has not developed the ability to weigh or advocate the benefits and consequences of different tax combinations and rates. The impact on total tax revenues and voluntary compliance of individual changes in rates or taxes is poorly understood. The USAID assistance is expected to develop the institutional capacity to make informed decisions, which should both alleviate the above problems and reduce financial distortions in the private sector. Ministry of Finance institutional development has been shaped by having to continuously operate in a crisis mode. The USAID assistance should strengthen the Ministry of Finance's management and control of public monies, including investment of idle funds by putting the basic tools and procedures in place which every government needs to control, account for, and report on its funds.

STRATEGIC OBJECTIVE

STRATEGIC PLAN

S.O. 2.1

"INCREASED,

SUSTAINED

COLLABORATION OF

NGOS AND

LOCAL GOVERNMENT"

PART II: STRATEGIC OBJECTIVE RESULTS FRAMEWORK

S.O. 2.1: Increased, Sustained Collaboration of NGOs and Local Government To Develop Policies and Services Which Reflect Community Interests

Statement of Strategic Objective

After careful consideration and evaluation, the ENI objective 2.1 "Increased, better informed citizen participation in political and economic decision-making" has been refined in scope to "Increased, sustained collaboration of NGOs and local governments to develop policies and services which reflect community interests."

A.2 Problem Analysis

In Lithuania, the public and private sector do not have a clear understanding of participatory democracy. Highlighted below are major problems that need to be resolved to effect a fundamental change in Lithuania's political culture and in citizen participation:

- Lithuania's emerging democracy is still fragile and marked by a mutual and unhealthy distrust and tension between the government and the electorate. On the one hand, citizens have a limited understanding of their democratic rights, roles and responsibilities. NGO's, while relatively abundant, maintain a low profile and do not play an active role in public policy. On the other hand, the national government is reluctant to decentralize and to delegate power and authority to the local level. In turn, municipal government is not effective because it has few partnerships with NGOs and other community leaders, i.e. it has not created local institutional roots.
- NGOs are unable to make full use of their powerful potential. This is due to the depressed economy and to a general lack of NGO skills in advocacy and service delivery. There are few grass roots initiatives because the public does not believe that individuals have the capability to resolve problems for the community. Public apathy and cynicism, a legacy of the soviet period, discourage active citizen participation in NGOs. Not only does this dampen NGO development but it discourages as well the evolution of a new generation of young political leaders.
- Municipal officials are not aware of, or are disinterested in, the potential benefits of working together with NGOs in community projects. NGOs need to demonstrate to local government that they can play a role in local economic development and that they are capable of providing effective delivery of services

in the social safety net and environmental protection sectors.

- Fifty years of sovietized life deprived Lithuanians from acquiring the fundamental skills and experience in participating in a democratic civic society. To many Lithuanians, living in a democracy means obtaining and enjoying the well publicized and long awaited "Western life style," and making maximum use of newly acquired individual rights. That civic responsibilities are part of maintaining a democracy is not even considered. Consequently, non-payment of taxes, seeking special treatment from the government, and voter apathy are emerging as serious problems in Lithuanian democracy.
- NGO activity is largely parochial with interests that do not extend much beyond the limited circle of members. Networking, coalition building and national level advocacy are limited to relatively few NGOs.

These problem areas constitute a major impediment to Lithuania's emerging democracy, and it is in the following two areas that USAID/Lithuania will focus its democracy assistance effort.

Increased NGO Activism:

Increased participatory democracy is more likely to occur with the development of a strong, motivated NGO community operating within an enabling legislative framework. In Lithuania, NGOs need to acquire a greater level of professionalism if they are to become effective partners with local government in influencing community-level policies and in providing needed services.

In order to bolster NGO professional and organizational capacity, the Civic Participation program will specifically strengthen NGO advocacy skills, service delivery capability, and financial sustainability through establishing a core of local trainers who will work with NGOs to increase their managerial and technical abilities in these areas.

In order to maximize the impact of funds available and to conform to the strategic objective, agreement was reached with the Democracy Network grantee, U.S. Baltic Foundation (USBF), to reorient much of its remaining program funds to support predominantly local level advocacy. In addition to the Foundation work on basic participation at the local level, USAID's program will also encourage the building of government/civil society partnerships, which can be expected to lead to innovative solutions to promote civic education at the national level. USAID's efforts will be coordinated with programs of other donors in this area. However, it bears emphasizing that USAID has a competitive advantage over other donor programs, as US NGOs traditionally engage in advocacy and policy-making work, which is not true of European NGOs.

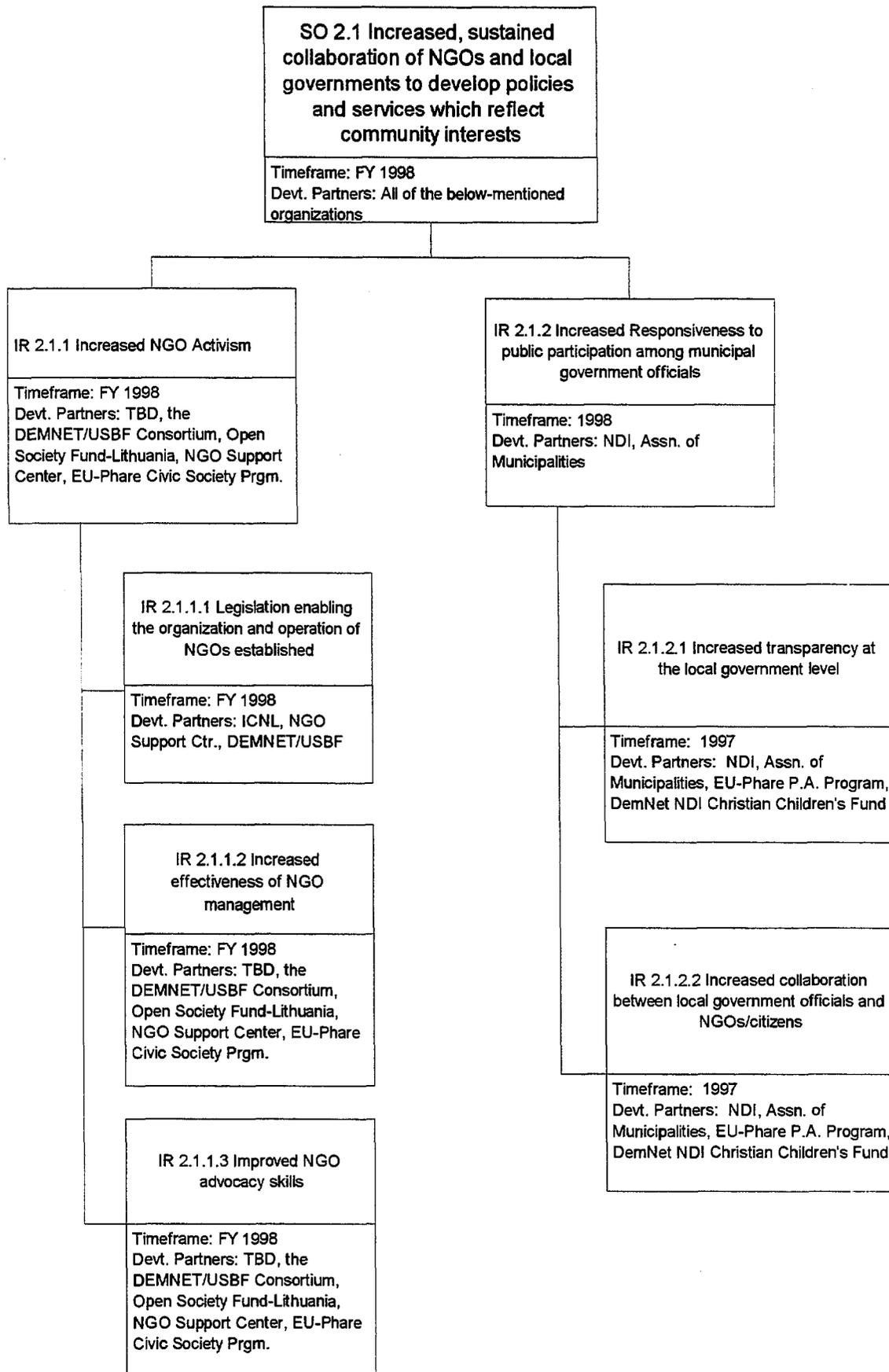
With USAID assistance, the legislative reforms which were recently passed, now regulate and integrate the legal existence of a non-profit NGO sector in Lithuania.

Increased responsiveness to public participation among municipal government officials:

One way to encourage effective citizen participation is to increase the willingness of local government to establish linkages to NGOs. For this to happen in Lithuania, there will have to be a change in attitude among a critical mass of local officials and motivated citizens (in the municipalities participating in the program), and in institutional approaches which will facilitate public participation and will serve as a sustainable mechanism.

The proposed program is assessing the feasibility of establishing an NGO foundation to support the development of NGO capacity and encourage interaction between the public and local government. In addition to the work of strengthening NGOs, the Foundation will support limited training programs for municipal officials in transparency of political processes and citizens participation, and will encourage local officials to increase the number of public fora used to involve citizens in municipal planning through a small grants program.

Lithuania SO 2.1



PERFORMANCE DATA FOR STRATEGIC OBJECTIVE 2.1: BASELINE, TARGETS, AND ACTUAL RESULTS

LEVEL	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA									
				YEAR	VALUE	1996 (1)	1997		1998		1999 (1)		2000 (1)
							Target	Actual	Target	Actual	Target	Actual	
SO 2.1	Increased, sustained collaboration of NGOs and local governments to develop policies and services which reflect community interests	Increase in the number of joint public-private projects taking place in cities participating in USAID's program. ¹	Definition: Collaborative projects between local governments and NGOs involving joint contribution of resources Unit: Projects each year (includes ongoing projects)	1995	2	7	15		25		30		
IR 2.1.1.	Increased NGO activism	Among NGOs receiving USAID support, increased incidence of NGOs developing public outreach programs that extend beyond their membership bases	Definition: Dissemination of advocacy information by NGOs (e.g., through press conferences, publications, and public fora). Unit: The average number of advocacy information projects per USAID supported NGO. ²	1995	30	45	55		65		70		
I.R. 2.1.2	Increased responsiveness to public participation among municipal government officials.	Municipalities that develop a joint public-private project.	Definition: Number of municipalities that jointly apply with an NGO partner and receive a grant from USAID for developing policy or delivering services. ³ Unit: Municipality	1996	0		6		8		12		

1. During 1995-97, cities include Panevezys, Kaunas, Alytus, Ukmerge, Utena. During 1997-98, cities that participate in DemNet special private-public grant competition. From mid-1988, cities participating in the proposed Democracy Foundation. The meager history of such private-public collaboration indicates to us that targets are realistic, but are expected to grow.
 2. In 1995, prior to receiving USAID support, the 8 DemNet Round 1 awardees had 237 such activities for an average of 30. The future pool of monitored NGOs is cumulative: 1996 reflects 14 awardees from DemNet Rounds 1 and 2, 1997 reflects those from Rounds 1,2,3,4,5 and so forth. The 1999 target reflects proposed Democracy Foundation. By 1999, the cumulative number of projects is expected to be about 7,000.
 3. During 1997-98, refers to applications within the expanded DemNet private-public grant program. After 1998, reflects applications to the Democracy Foundation

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A.5 Results Framework Narrative

1. Transition Hypothesis

USAID/Lithuania will continue to strengthen democracy in Lithuania through helping to cultivate the conditions for increased, sustained collaboration of NGOs and local governments to develop policies and services which reflect community interests. As such, the Mission has defined its SO as "Increased, sustained collaboration of NGOs and local governments to develop policies and services which reflect community interests."

Politics in Lithuania, whether at the local or national level, are marked by historical divisions (often masked as ideological) between political forces, as well as a chasm between the electorate and public officialdom. The political divisions render problem solving difficult and a lack of appreciation of the electorate's priorities skews public debate. The mistrust that often exists among citizens is further exacerbated by the public's lack of access to information, analysis, and above all, resources with which to understand problems and implement resources.

USAID/Lithuania has taken a targeted approach in dealing with the constraints mentioned above. In creating the strategic objective of increasing citizen participation through the participation of NGOs in political processes at the local level, several key elements were identified in which USAID could have a substantial impact. These elements are the building blocks for democracy in most developed nations and achievement of them will place Lithuania at a more sophisticated level of democracy. The elements identified were a need for an understanding of civic responsibility, stronger NGO institutions, and better linkages between government officials and the public. Together, these efforts form the base of the objective.

2. Critical Assumptions

The design of the strategic objective took into consideration potential roadblocks and barriers. USAID/Lithuania narrowly defined its activities to ensure that external factors which might influence the success of the program are minimal. However, certain assumptions were made which will influence the achievement of this strategy:

- **Lithuania will maintain its independence:** Recent events highlight the fragility of Lithuania's new independence. For example, several Russian presidential candidates who ran in the June 1996 elections expressed an interest in reuniting the former Soviet Union. In 1995 the Russian Parliament supported this concept by renouncing the Belovezsk Accord, which formally disbanded the Soviet Union. It is understandable that Lithuanians remain wary of the potential threat from the east. This assumption is critical to any USAID involvement in Lithuania.
- **Donor support for NGOs continues to be strong:** The EU-PHARE has pledged at least ECU 500,000 (\$625,000) annually through the year 2000 to help support the development of NGOs. Other bilateral donors are also providing significant assistance to support the emerging NGO sector. USAID's program is well-coordinated with EU-PHARE efforts and the scope and focus of activities

undertaken in this strategy assume that EU support for NGOs will continue, especially in the area of general NGO training (organizational development, financial management).

- **NGO legal framework is favorable for the development of NGOs:** As of July 1996, four laws necessary regulate different types of non-governmental organizations have been passed by the parliament. Numerous revisions to this NGO-related legislation are still necessary. Substantial work is required to identify the needed amendments and to assure that the NGO community is fully versed in the laws and their application.
- **Local governments possess a basic administrative competency to implement participation strategies:** Improved municipal management capacity, combined with a new understanding of the rights and roles of citizens in a democracy, are needed to maximize success. USAID along with the leading donors (EU PHARE, Denmark and Sweden) are working to improve the administrative capacity of local governments by providing training to municipalities, organizing conferences and seminars, and assisting the Association of Municipalities to become fully operational.

3. Causal Linkages

In an effective, participatory democracy, there exists an interactive flow of communication and activity between NGOs and local government. NGO leaders provide grass roots level input to local government and NGOs often provide critical local services for people when the government does not have resources or generally incapable of providing them. In turn, local officials use this feedback to help develop laws, policies and programs. In Lithuania, this feedback loop between NGOs and local government is virtually non-existent, thus changing this dynamic is the focus of the strategic objective. This feedback can be developed and strengthened through increased NGO activism and increased responsiveness to public participation by municipal government officials. If results are achieved in these two primary areas, then there will be an increased cooperation between NGOs and local government and civic participation will be more effective - the feed-back loop will be in place and effective.

I.R. 2.1.1 Increased NGO Activism: The unique power of NGOs lies in their ability to fill the gaps that government neglects and to generate a push for public reform. It also serves a critical role in working to consolidate reform by holding the state accountable for its actions. Specifically, NGOs can provide local and national services, advocate on behalf of the public, analyze policy issues, serve as government "watchdogs," and mobilize constituencies in support of policy dialogue. To fulfill this role, Lithuania's NGOs need to change from loosely organized, poorly coordinated, underfunded organizations to vehicles that can effectively present special interests and needs to the government.

It is therefore crucial that NGOs have the capacity to operate responsibly, effectively raise funds, deliver services and present their interests to the government. To achieve this, an

important first step is to establish a local training program for Lithuanian NGO activists. In addition to its immediate utility, preparing local professional trainers will contribute to NGO long-term sustainability. The second element is the development of local service delivery skills. The third element, financial sustainability, will require NGOs to learn fundraising techniques to exploit revenue opportunities through provision of local services, membership and user fees, and donations by local private businesses. Combined, these elements will strengthen the NGO structure and the ability for them to effectively work with local governments.

At this stage of NGO development in Lithuania, USAID resources will be focused at the local level where the ground appears more fertile. Due to the current political environment, USAID believes that true success at the national level will not be seen until after the parliamentary elections, and after more progress has been made in strengthening the advocacy capacity of NGOs. However, given the relatively small size of Lithuania, there is a somewhat cloudy distinction between local and national level advocacy. The program will take advantage of specific opportunities, if they arise, to enhance the role and effectiveness of an NGO addressing a national level issue. The impacts from USAID's program are general in nature and will empower NGOs to seek the attention of all levels of government.

I.R. 2.1.2 Increased responsiveness to public participation among municipal government officials: Effective local governance is the backbone for the resolution of many community problems. To be successful, local government must acquire the skills and material resources to responsibly self-govern. Yet, as an institution, municipal government was created only five years ago, after Lithuania regained its independence. Since then, municipalities have focused more on day-to-day management issues than on "customer service." As a result of this, public satisfaction and confidence in governmental officials has plummeted. A further complication is that most public officials are task-oriented, and do not realize the political importance of including citizens in their decision-making.

This is beginning to change, however. One area where USAID will assist in this process is in encouraging greater citizen participation in the local decision-making process. This can best be done through strengthening NGOs so they have a legitimate voice in the community, by encouraging citizens to participate in town meetings and other planning fora, having NGOs monitor government compliance, and by building government-civil society partnerships. With such changes and resulting increased responsiveness, collaboration at the municipal level will increase in both frequency and intensity.

NGOs and local governments are both unaccustomed to public relations. Transparency needs to be marketed to both as a desirable characteristic of government operations. Through establishing mechanisms to ensure that the lessons learned from government/citizen cooperation is disseminated, several results can be expected. Firstly, NGOs and municipalities will develop their public relations skills, which are crucial to their operations. Secondly, it will ensure that the successes of government/civic cooperation are spread to a wider population than the participating municipalities, and can be expected to result in a snowball of comparable projects, as other regions understand the value of citizen participation in local government decision-making. Thirdly, this is

the sustainability link. As participating municipalities and NGOs gain increased attention as a result of this dissemination, they will continue to employ public relations practices and to seek the public light.

A.6 Summary Results Review S.O. 2.1

Narrative Analysis: AID/Lithuania will change its democracy activities beginning in FY96, the major operational innovation being the introduction of the NGO Foundation concept. Below we discuss progress that has been made by existing democracy programs and describe intermediate results that we expect to see during the near term to achieve the new strategic objective. These previous democracy activities will be the basis for the new Civic Participation program. USAID will incorporate resources/outputs from those activities to help in the transition to the new program.

Through small grants, the Ambassador-chaired Democracy Commission (DC) supports a wide range of individuals, NGOs, educational institutions that seek funding for one-time projects that promote democratic development in Lithuania. It has an annual budget of \$100,000. The original DC strategy was to provide a "quick response" vehicle to support democracy development opportunities identified by the Embassy, USAID, USIS and other members of the country team. This flexibility makes the DC grant a unique and useful mechanism. At the same time, the Embassy has observed that urgency and timeliness have not really been a criteria in awarding most of the DC grants. The DC therefore has agreed to re-assess its charter and to consider reserving a portion of its FY96 budget for NGO-municipal collaboration grants that would help launch the proposed new program.

In FY '94 and '95, the Democracy Commission gave out 31 grants totalling \$176,000 for one-time activities by NGOs, institutions and individuals promoting democracy in Lithuania. While these grants are approved by consensus of the Democracy Commission, many projects which have been approved also support USAID's objectives. Among these are three (\$22,000, or 13%) in support of municipal training, two (\$9,450, or 5%) in support of legal reform and ethics, and one (\$6,650, or 4%) in support of independent media.

Another successful Democracy program, which will be completed by the fall of 1996, has been the political party training workshops organized by the International Republican Institute (IRI). USAID is the only donor providing training at the grass roots level for political parties in Lithuania. Since 1994, IRI has trained representatives of all democratically-based political parties and has had a significant impact in the nature of party identity and operations. This training included the preparation and distribution of 200 Lithuanian-language training models to local political parties. As a result of IRI training, political parties, once based on personalities, are now turning towards platform-oriented identities, as was evidenced during the municipal election of March 1995. New campaign tactics were also employed. For the first time, political activists engaged in door-to-door campaigning and distributed handouts to promote their parties at the local level. IRI training has also achieved a change in the Lithuanian political culture as it introduced the concept of "peaceful disagreement" at meetings between members of opposing parties, whose prior attempts at communication bordered on being abusive.

During 1995-96, the International Center for Not-for-profit Law (ICNL) worked with the legal departments of the Ministry of Economics and the Parliament to draft and pass Lithuania's four NGO laws. This legislative reform effectively introduces, regulates and integrates the legal existence of a non-profit NGO sector in Lithuania, which consists of community organizations, foundations, associations, and Public Benefit Institutions, the only NGOs allowed to conduct commercial activities. A key provision of the legislation is that it provides a near tax-exempt status for NGOs.

In late 1995, the US-Baltic Foundation's Democracy Network (DemNet) program was implemented, to provide grants and training to NGOs for projects that will have a high public policy impact. The initial round of grant awards in February disbursed eight grants to NGOs, and the second round in July made another 11 grants. Another five rounds are scheduled during 1996-98. The training portion of DemNet is being administered by NDI and began programs in Vilnius in May. In light of the USAID's newly structured strategic objective, and by mutual agreement, funds remaining under the USBF Demnet program will be granted predominantly for local level advocacy and service programs.

An independent media can be a natural ally to NGOs in the movement for reform in any democracy. Since 1991, USAID has worked through an IAA with USIS to implement media programs to improve the journalistic skills of the local press. This training has sent over 60 journalists, reporters and representatives of the media on site visit training programs at U.S. journalism schools, newspaper and media offices. USAID also assisted with the drafting and subsequent revisions of an advertising law in 1994. In FY '96, USAID and USIS will jointly implement a media program to improve governmental attitudes towards media legislation, train journalists to present news from a more professional perspective, and work with the media to develop public outreach civic messages.

Two other Democracy-related programs began in mid-to-late 1995 and represent early stages of implementation. In September, a Public Administration program was initiated in two cities to improve capacities for municipal self government. Initial results include a new organizational model in one of the cities, complete with office, department and department head positions and creation of a program of public education on environmental issues through a working group involving citizens at large. The second advisor has helped his city to improve its business climate and facilitate the creation of a viable and enduring public/private partnership in support of economic development through the creation of an economic development unit with the local government. In December, the National Democratic Institute (NDI) started a program to increase citizen participation, through the municipal training center at Kaunas Technological University.

A.7 Sustainability

Sustainability will be achieved through the training of indigenous trainers to promote lessons learned, through changes in the attitudes of local officials and NGO leaders, and by establishing a foundation to promote citizen participation.

The institutional vehicle that will contribute to post-program NGO political sustainability,

financial self-reliance and long-term stability is the proposed Civic Participation Foundation. Two options are presently being considered in the design of this foundation. The first is for USAID to make a grant to a local NGO legally registered as a foundation which would then invest the Foundation's funds locally or offshore. The endowment would provide income to cover core administration costs, as well as some funding for seed grants or matching grants for its own operating programs or for other NGO applicant programs.

Alternatively, USAID is exploring the possibility of establishing a much larger local grant-making foundation by entering into a donor consortium. In either model, the constraints include hurdles such as identifying the candidate foundation, ensuring the endowment is wisely invested, resolving issues of governance and transparency, trustee training and accountability.

Through the establishment of trainers able to continue USAID's work after its program ends, USAID ensures that the knowledge is institutionalized and will continue to be used. USAID will work with trainers who provide training for the Democracy Network project and the NGO Support Center, a UNDP initiative, which is working closely with EU-PHARE's NGO development program and with bilateral donors. The Center's efforts compliment the proposed Civic Participation program and provide a vehicle to ensure that a trained core of trainers exists beyond the focus of USAID's program.

USAID will work with Kaunas Technological University's (KTU) Municipal Training Center and Master's of Public Administration Program to ensure that necessary lessons of heightened transparency and increased citizen participation continue to be core units of the MPA curriculum and training materials. The Municipal Training Center has been providing training on an ad-hoc basis to municipalities requesting training. USAID is further examining the possibilities of working with the Association of Municipalities, an umbrella organization combining four local government organizations, which was founded in July, 1995 and has developed significantly in the past year. The Association is committed to promoting decentralization, and professionalism in public service and could serve as a natural vehicle to institutionalize training on a national level.

Through the dissemination of best practices information to a broader audience, sustainability will be maximized in the impacts made in bringing local governments and NGOs together in joint projects. USAID believes that as other municipalities, NGOs and the national government learn of the successes in working together with the public, the impacts will have a multiplier effect.

As NGOs learn the value of combining their efforts, they will continue to forge new ties with counterpart organizations. The Civic Participation program will empower NGOs to present their issues and will encourage them to work collectively to form a critical mass to advocate for selected issues. To the extent that NGOs are able to make their concerns heard at the national level, the successes seen by NGOs can be expected to prompt them to continue building coalitions and networking with similar NGOs.

STRATEGIC OBJECTIVE

STRATEGIC PLAN

S.O. 4.1

"CROSS-CUTTING

PROGRAMS AND

SPECIAL INITIATIVES"

PART II: STRATEGIC OBJECTIVE RESULTS FRAMEWORK

SPECIAL INITIATIVES

There are three special initiatives and two cross cutting activities that will be undertaken between 1996 and 2000. They are 1) energy sector, 2) environmental monitoring, 3) improved enterprise capacity, 4) cross-cutting participant training, and 5) cross cutting English language training.

1.0 Reduced Dependency on Ignalina Nuclear Power

With independence, Lithuania gained control of the two largest nuclear reactors in the world - Ignalina Units 1 and 2. Both are RBMK 1,500 MW soviet-designed, boiling-water, graphite-moderated, pressure-tube reactors with no containment. The Chernobyl disaster 10 years ago in the Ukraine and subsequent safety analysis reports of western experts have confirmed that without significant safety improvements, RBMK reactors are more dangerous to operate than western reactors.

Therefore, closure of Ignalina-1 in mid-1998 has become an important foreign policy issue for the U.S., and it is addressed through the State Department and the NSA in coordination with G-7 countries. The activities under this special initiative all contribute to Ignalina closure. The nuclear safety activities will reduce the risk of a nuclear accident during the remainder of the plant's operation. The Baltic Energy Regional Planning work will consider alternative, least cost power supply and demand investment scenarios necessary to support shutdown. The energy efficiency work will build capabilities that will allow energy efficiency to reduce the need for electricity from Ignalina. The special initiative will also be supported by our work under S.O. 1.3 to remove energy pricing subsidies and to improve the energy regulatory system by providing motivation for energy users to reduce their usage, and therefore the need for Ignalina power, and by satisfying conditions of World Bank loans for rehabilitation of other non-nuclear power plants.

Safety improvements are needed at all soviet-era Nuclear Power Plants (NPPs) to reduce the probability and severity of nuclear accidents. In Lithuania, in addition to the obvious need to minimize risk, the economics of power generation options and the implications of relying on Russian oil for power generation pose serious threats to economic stabilization and consolidation of national sovereignty. (GAZPROM, the Russian natural gas supplier, has recently cut off virtually all natural gas to Lithuania for non-payment of arrears.) Lithuania currently spends between \$70 and \$100 million on nuclear fuel annually, and it is estimated that the fossil fuel import bill could rise to \$340 - \$400 million if all generation were shifted to fossil fuel. Lithuania would also lose its already limited export market (Belarus and Russia) for electricity, as the current export price of \$0.01375/kwh is far below fossil fuel costs.

1.A Nuclear Safety

The USG is supporting Nuclear Safety in Lithuania through the following mechanisms:

- SEED-funded USAID/DOE IAA for Reactor Safety
- SEED-funded USAID/NRC IAA to strengthen the local Nuclear Regulatory Body
- SEED-funded US contribution to the Nuclear Safety Account
- DOE-funded (follow-on to USAID) Reactor Safety Program
- DOE-funded physical protection program-Ignalina Nuclear Power Plant (INPP).

1995 was the last year of SEED obligations to the DOE and the Nuclear Safety Account. Future (1996 and beyond) SEED funding will be provided only to the NRC. The DOE will continue with non-SEED funded activities for the next few years.

Rationale for Incorporating the Activity in the Plan

Lithuania relies on INPP for 88 percent of its domestic electricity requirements, making it the most intensely nuclear country in the world. The current high nuclear intensity does not translate into a necessarily high dependence on nuclear generation, as Lithuania has a 1.8 gigawatt (GW) heavy-fuel oil plant at Elektreniai, and other Central Heating Plants (CHPs) in Vilnius, Kaunas and Mazeikiai, for a total non-nuclear generating capacity of 2.2 GWs. Historic base and peak loads in Lithuania are 1 and 2 GWs respectively. It is for cost and sovereignty reasons that the country relies so heavily on nuclear power, and not for lack of alternatives.

The economics of producing electricity at INPP are not yet fully clear. The current price paid to INPP is \$0.015/kwh, which is thought to be less than a full-cost recovery price, even without decommissioning costs. Estimates of the true full-absorption cost vary between \$0.025 and \$0.03/kwh. The costs of producing electricity at heavy-fuel oil and/or natural gas generating plants varies from \$0.05 to \$0.12/kwh. The IBRD estimates that substituting fossil for nuclear generation would cost the Lithuanian economy between \$250 and \$300 million annually.

As RBMKs lack containment, the risk of widespread catastrophe following a Level 4 or 5 nuclear accident is magnified. However, the fundamental risk is in the reactor chamber and western assistance is largely focussed on those safety improvements that contribute to increased reactor safety.

In Soviet times, the regulatory oversight was provided from Moscow. Following independence, Lithuania inherited a large, nuclear generating capacity, but no regulatory institution, and it began the process of establishing and strengthening the Lithuanian Nuclear Safety Inspectorate (VATESI), the nascent regulatory body. Factors that have constrained this organization's development include the following: 1) the small professional staff of 15 precludes extensive staff training, as the few officials on board

also have operational roles at INPP; 2) the dearth of trained nuclear engineers, 3) more competitive salaries offered at INPP than at VATESI, which pays government salary rates. The absorptive capacity at VATESI is extremely limited, which constrained the USAID/NRC assistance program in the past.

VATESI has an extremely important and key role to play in Lithuania. A G-7 funded "Safety Analysis Report" (SAR) is under preparation and will be completed by the end of 1996. The SAR will contain hundreds of recommendations for improvement and changes in operating procedures, all of which will have to be digested, implemented, and certified as adequate by VATESI, prior to the issuance of a new operating license.

VATESI also has an ongoing direct nuclear safety role at INPP. 17% percent of the inspectors (4 persons) are on-site at INPP, approving plant modifications and operating decisions. Western experts agree that this is inappropriate and that the regulator should monitor the implementation of NPP safety inspections and procedures, not function as the inspectors themselves. Thus VATESI needs to move away from being the "accountant" to being the auditor of the NPP accountants. The ultimate goal of this and other donors' programs is to help VATESI develop into a competent and independent nuclear regulatory authority.

Although electricity prices need to and will be increased to cover fixed and variable costs, it is recognized that nuclear power is the cheapest source for Lithuania. The flow-through effects of a shift to fossil fuels would be: a significant increase in the balance-of-payment deficit; a significant increase in inflation, and a significant impact on the most vulnerable Lithuanians.

DOE and NRC Activities

Activities are funded by means of 632 (a) IAAs with DOE and NRC. The current DOE activities are: to develop the RBMK 1500 nuclear plant analyzer at the Lithuanian Energy Institute (LEI), to continue configuration management work at INPP, to develop emergency operating instructions for INPP, to develop management and operational controls for INPP, to conduct reactor safety training courses, to expand the Ignalina Source Book, to conduct industry workshops, and to conduct a Barselina Peer Review Phase 1V.

Potential new DOE activities are: to replace electronic modules, to develop advanced RBMK analytic applications, to access the International Nuclear Safety Center Database, to develop a Maintenance Technology Transfer Program, to develop a Reliability and Maintenance Management System and Safety Parameter Display System (SPDS).

The current NRC activities are: to develop NPP safety norms and standards for VATESI & INPP, to develop a systematic self-evaluation program for INPP, and to develop INPP-specific inspection guidance for VATESI.

Planned NRC activities will be selected in a collaborative process with NRC from the following possibilities:

- assist VATESI in the INPP certification exercise
- to expand norms and standards for quality insurance and technical specifications and Basis to serve as a model to develop other norms and standards
- to assist VATESI in evaluating the EBRD?NSA safety review documents

Time frame for completion

The safety norms and standards and the self-evaluation program for INPP will be completed by June, 1996. The INPP-specific inspection guidance will be completed by October, 1996. The DOE reactor safety activities will be completed over a period of two years. The time frames cannot be precisely determined, as the DOE received a direct appropriation from Congress for overseas reactor safety work and still has a large unexpended pipeline from the last USAID obligation of \$1 million in late FY 1995. As such, the activities will be funded from two different accounts (SEED and DOE) and the termination dates of each cannot be precisely determined until DOE completes its program plan.

Expected Results

The objective of USG assistance in nuclear safety in Lithuania is to prevent the number and/or severity of nuclear accidents.

Indicators:

Targets:

Number of accidents/year

zero

Type of accidents (Level I-V)

Level I

To achieve this objective, the following intermediate results will be important:

1.0 Analytic and operational capacity at INPP and support organizations improved:

Indicators:

- the RBMK plant analyzer is used to support INPP analysis needs and to support VATESI in their review of the SAR
- progress is made to complete the configuration management system through obtaining additional blueprints of the NPP
- management and operational controls are in place at INPP

2.0 Safety culture at INPP improved:

Indicators:

- nuclear engineers at INPP use the configuration management system
- emergency operating instruction in place at INPP

- operators and line management at INPP use improved management and operational control systems.

3.0 VATESI moves closer to the Western model for a functioning nuclear inspectorate and away from the current practice of continuous management:

Indicators:

- VATESI puts in place a system of inspection rules and standards
- VATESI adheres to inspection rules and standards
- VATESI and INPP put in place safety norms and standards for INPP operations
- VATESI and INPP adhere to safety rules and standards for the operation of INPP.

Criteria for Judging Performance

Targets for most intermediate results cannot yet be determined. The DOE is still finalizing its 1996/97 program plan, which is funded from both SEED and DOE appropriations. Until that plan is finalized, dates for achievement of the intermediate results would be premature.

Nuclear reactor safety analysis techniques permit calculation of the reduction in risk of operating and support system modifications or reconfiguration. These techniques can be used to evaluate results of activities, such as replacement of electronic modules. These techniques cannot, however, be used for the DOE's non-plant configuration activities, such as management controls, emergency operating instructions, and training programs. These activities and the NRC activities will be judged successful or unsuccessful by monitoring the frequency and severity of nuclear accidents at INPP.

Unfortunately, USAID/Lithuania cannot develop better indicators for this special objective because the G-7 and Lithuania have all agreed to use the SAR as the only official agreed-upon prescription of what needs to be done at INPP for the plant to continue operations. The SAR will only be finished at the end of CY 1996.

The RBMK 1500 nuclear plant analyzer at the Lithuanian Energy Institute will be improved to allow more advanced operating simulations. Configuration management will be expanded and used by plant personnel when making operational modifications. Emergency operating instructions and management and operational controls, which do not exist at the present time, will be in place at INPP. Finally, a data network to improve the current data collection and distribution system will provide more timely and complete operating information to plant operators.

By June, VATESI is scheduled to have 1) inspection rules and 2) safety standards. These do not exist at present and will be an important improvement in their capacity to function as a nuclear regulatory and inspection body. An additional impact is VATESI's willingness and commitment to follow the NRC model for defining its relationship with

INPP, rather than the on-site, continuous management role it is currently playing.

1.B Baltic Regional Energy Planning Project

USAID, through the Regional Energy Efficiency Project and the Utility Partnership Program, has been implementing the Baltic Regional Energy Planning Project in Lithuania, Latvia and Estonia since mid-1995. The objective of the program is for the Baltic countries to develop the analytical capacity to prepare an investment plan for region-wide, least-cost power generation and transmission and to create a viable power pooling mechanism. By examining alternative energy supply and demand scenarios for the Baltic countries, the regional planning will begin the process of studying the need for, and methods of financing, options that may enable the countries to forego power from the Ignalina NPP and Estonia oil shale power plants.

Rationale for incorporating the activity in the plan

Background: In Soviet-times, the interconnected grid functioned as a tight power pool. Long-term planning was done in Moscow, and only short-term planning and dispatch were done in the Baltics. Following independence, each country acquired control of its generation and transmission infrastructure, set its own energy policy, and began to do its own capacity planning. Dispatch continued to be handled by the Baltic Dispatch Center in Riga, but the coordination mechanism increasingly ran aground on the shoals of national and utility self interest.

Independence occasioned a step back from regional power cooperation, and a more parochial outlook was quickly adopted in all three countries. However, the small size of the Baltic market, the different costs associated with the variety of generation facilities (nuclear, hydro, fossil fuel, shale oil) and the economic costs of pursuing non-integrated power sector planning and investment all argue for an integrated approach.

Current Situation: All three Baltic countries have limited natural energy resources. Regional power sector cooperation is needed to:

- ensure a reliable and cost-effective energy supply
- avoid duplication and unnecessary investment
- find alternatives to dependency on Lithuania's Ignalina Nuclear Power Plant and Estonia's oil-shale
- reduce dependency on Russian oil and gas.

The IBRD and the EBRD have stated that they will not entertain new generation or transmission loans in the absence of a regional planning framework. For reasons of economic dispatch and cost reduction, the Baltic countries need to establish a power pooling mechanism. Finally, regional cooperation, in the energy sector as in other areas, is one of the indicators that the Baltic Countries are ready to discharge their regional

responsibilities, which is a pre-condition for EU membership.

This activity will seek to develop:

- a reliable electricity supply in the Baltic countries
- a least-cost electricity supply in the Baltics
- a least-cost alternative to Ignalina when the reactors are decommissioned.

Activities

- Production of electricity demand forecasts for all three countries
- Production of an electricity demand forecast for the region
- Production of a least cost generation and transmission plan for each country
- Production of a least-cost generation and transmission plan for the region
- Creation of a re-formulated power-pooling arrangement.

Time frame for completion

The country and consolidated demand forecasts will be completed by 12/96. The least-cost generation and transmission plans will be completed by 3/97. Improvements in the power pool will be institutionalized by 12/97.

Expected results

The objective is for the Baltic countries to develop the analytical capacity to prepare an investment plan for region-wide least-cost power generation and transmission and to create a viable power pooling mechanism.

Indicators:

Targets:

Country-specific electricity demand forecasts judged adequate by Western experts	(12/96)
Country-specific, least-cost plans produced are judged adequate by Western experts	(3/97)
A power pooling arrangement is put in place	(12/96)

To achieve this objective, the following intermediate results will be important:

1. Regional least-cost planning models are produced for national power sector investment planning

Indicators:

- Costs of country planning versus regional planning will be determined (12/96)
- Environmental costs will be quantified (12/96)
- Planning and analytic capability at the utility, regulator and Ministry levels will provide a technical basis for informed investment decisions (3/97)

2.0 Utilities will form and operate a loose or tight pool and use an economic dispatch approach for load sharing

Indicators:

- a split-savings approach is used for allocating benefits of power pooling (12/97)
- a management structure supporting closer coordination is in place (12/97)
- a pool accounting system for allocating costs and benefits is in place (12/97).

Criteria for Judging Performance

Dialogue with the Ministries of Energy (Lithuania) and Economy (Lithuania, Latvia and Estonia) will be maintained to determine the extent to which national investment plans reflect and incorporate the regional planning framework and analyses. Likewise, periodic contact with the energy pricing councils of each country will be maintained to determine the extent to which least-cost planning results and power pooling savings are incorporated into the decisions on new investment and purchase arrangements to be included in the rate bases.

1.C. Regional Energy Efficiency Program

The objective of this special initiative is to reduce inefficient demand for electricity and, thus, further facilitate the closing of Ignalina. Energy efficiency activities are funded with obligations from 1994 through 1996.

Rationale for incorporating the activity in the plan

Background: Energy use in Lithuania is highly inefficient, reflecting the Soviet era's subsidized energy prices and emphasis on meeting production quotas rather than controlling costs. As prices rise to reflect market conditions, significant efficiency improvements become cost-effective. If implemented, the efficiency improvements would reduce the need for electricity from Ignalina. The improvements would also aid the transition to a market economy of providing relief from energy costs, allowing industrial customers to survive and expand, and helping their products become competitive in the market. Efficiency improvements would also improve customers' ability to pay their

energy providers, and minimize the utilities' capital investment requirements.

Activities:

- Creation of an Energy Efficiency and Customer Service Department within the Lietuvos Enerģia
- Conducting a targeted DSM demonstration program with a state or municipally-owned customer
- Identification and training of candidates for energy service companies
- Development of pilot projects with energy service companies for their industrial customers.

Time frame for completion

The Lietuvos Enerģia Customer Energy Efficiency Program Implementation and Evaluation Plan will be completed by 1/97. The targeted DSM demonstration program will be implemented by 1/97 and evaluated by 10/97; ESC training will be completed by 10/96; and industrial pilot project contracts will be executed by 5/97.

Expected results

Expected results of the Energy Efficiency work are that Lietuvos Enerģia will be able to work with its customers to identify and implement cost-effective energy efficiency improvements, and ESCs will be trained and able to obtain financing for profitable energy efficiency projects.

Indicators	Targets
DSM programs implemented by Lietuvos Enerģia	3
Number of private energy efficiency projects implemented by USAID-trained ESCs	2

To achieve this objective, the following intermediate results will be important:

1. Lietuvos Enerģia works with customers on cost-effective energy efficiency improvements

Indicators:

- Energy Efficiency and Customer Services Department implementation plan is prepared and implemented (9/96)
- DSM programs are designed (1/97)

- Targeted DSM demonstration project implemented (1/97)
- Targeted DSM demonstration project evaluated (10/97)
- Seminar conducted for municipal officials describing DSM demonstration project process and results (11/97).

2. ESCs are capable of developing profitable energy efficiency projects

Indicators:

- ESCs are trained (10/96)
- Business plan developed for pilot project (1/97)
- Energy performance contract executed among ESCs, private industrial facilities, and lenders/investors (5/97)
- Evaluation report prepared and information dissemination workshop presented on pilot project process and results (3/98).

Criteria for judging performance

Lietuvos Energia progress will be monitored by examining the status of program design and implementation. Documents produced associated with designing and marketing the programs will be reviewed. Program implementation will be monitored by examining the program database concerning the number of customers contacted and the energy improvements identified and installed. Comparison of customer billing records before and after demonstration programs will be used to measure savings from the target demonstration program and any other programs implemented. ESC activity will be monitored by contacting the trained ESCs quarterly to determine whether they have developed any projects. The pilot project results will be determined by reviewing the monitoring associated with the financing arrangement.

2.0 Regional Environmental Monitoring Program

The objective of this special initiative is for the Baltic countries to standardize their data monitoring, assessment, and laboratory procedures for detecting air- and water-borne pollution.

Rationale for incorporating the activity in the plan

Background: Lithuania's, Latvia's and Estonia's environmental air and water monitoring infrastructure and systems are unable to meet current national environmental management needs, international commitments, or provide for environmental security and regional stability, for which reliable and timely information as to the source and characteristics of pollution affecting the individual countries and the region is critical. The three Baltic countries share air- and watersheds, need to pool information to arrive at compatible management strategies and have not institutionalized systems to provide for transboundary environmental governance. EPA has completed Phases I and II of the review of the environmental monitoring and data managements systems, culminating in presentation of a basic monitoring and laboratory system needs analysis to each Baltic Environmental Ministry. It also ensured the basic capacity for data management by providing the skeleton framework and strategic approach for computerized data management systems for both administration and geographic based environmental data analysis.

Current Situation: The anticipated result of the activity - that all three Ministries would use the EPA recommendations to secure equipment and make institutional changes has not been fully achieved. The host countries have not had the funds to invest in the regional monitoring approaches or to strengthen existing working relationships. While Estonia has used the report to obtain a EU PHARE grant for \$3.1M USD, Latvia and Lithuania is just now submitting their PHARE applications based on the recommendations. Of the 3 countries, only Latvia has made major institutional organizational changes as per recommendation (merging Hydromet environmental monitoring functions into the Environmental Ministry). While EPA has developed with the host countries a basic data management framework and skeleton administrative and environmental data management networks, the three countries still do not have integrated environmental data management systems in place. As such, all three countries, while having made progress, still do not have the needed equipment, standardized analytical and reporting protocols in place to support a regional monitoring and reporting system meeting international standards and national needs.

In order to produce the intended results, EPA needs to increase efforts, in conjunction with the three Ministries, to encourage donor collaboration, and co-funding in this area.

Activities

- support the Ministries in securing donor funding for upgrading Baltic monitoring systems
- work with HELCOM, UNEP and the European Environmental Agency and other

donors to establish regional data reporting

- assist the Ministries to develop and implement compatible laboratory analytical methods and protocols
- assist the Ministries to optimize monitoring networks to provide data for control programs and to meet international obligations.
- Work with other donors to focus transboundary monitoring funding on activities fostering optimization of monitoring networks and away from routine data collection.

Time frame for completion

All work under this activity will be completed by 1998. Ministries will have the necessary Global Positioning capacity to accurately locate their monitoring networks and have initiated their first review of by the networks by June 1997. A second Baltic- wide Environmental Data Management Conference will be held in Jurmala by July, 1997, with sponsorship initiating transition to other donors. Standard Operating Procedures for hazardous waste sites completed by December, 1996. Central Laboratories have initiated procedures to secure national certification and regional coordination committee established to ensure compatibility of monitoring data. By December, 1996. The donor coordination effort will continue through FY 1997 and 1998.

Expected results

The objective of this cross-cutting program is for Lithuania and the other Baltic countries to standardize their reporting, monitoring and laboratory analysis procedures for identifying and quantifying air and water borne pollutants, determine origin of such contaminants, and make the data readily available to both the decision makers and the public.

Indicators:

- Monitoring infrastructure in place in each country
- Monitoring and laboratory systems standardized
- Computerized data management systems in place and information exchanged

To achieve this objective, the following intermediate results will be important:

1.0 Other donors fund laboratory and monitoring equipment

Indicators:

- At least one donor provides essential equipment (9/97)

- Baltic Ministries continue to seek funding of at least the minimal EPA recommended technology (continuous).

2.0 EPA guidance and recommendations on equipment and systems standardization is followed.

Indicators:

- At least one Ministry makes the necessary organizational management changes to streamline monitoring systems
- At least one Central Laboratory receives national certification and adopts standard procedures
- Two or more Ministries develop environmental Home pages on the INTERNET presenting annual environmental status, national priorities and accomplishments. fora (continuous).

3.0 EPA guidance and recommendations on regionalization of monitoring is followed.

- Baltic Ministries continue stressing the need for integrated transboundary monitoring systems in public fora (continuous)
- Environmental community (including the NGOs) continues to support integrated transboundary monitoring and governance in public fora (continuous)
- At least one donor joins EPA in providing assistance on regional data sharing and transboundary governance initiatives

Criteria for Judging Performance

Dialogue with the Ministries of Environment will be maintained to determine the extent to which monitoring systems are upgraded and standardized. Performance will be evaluated based on the total value of system improvements and the extent to which systems implemented are compatible.

3.0 Improved Enterprise Capacity

The ENI Bureau strategic objective is to accelerate development and growth of private enterprises. The USAID/Lithuania special initiative relates directly to this strategic objective but is more focused and seeks to "improve enterprise capacity."

Rationale for incorporating the activity in the plan

Since 1992, enterprise-level assistance has helped to address the initial business management and technical barriers facing agriculture, environment, industry, energy efficiency, and services. This effort has achieved impact and supported the rapid transition from a state-run economy to a free-market one, resulting in the 150,000 private enterprises presently registered in Lithuania.

USAID does not have the resources to continue a retail-level technical assistance and training program. The EU PHARE and the EBRD have started business advisory services which can provide commercially-based assistance at a much higher funding level than USAID can, and USAID cannot sustain funding for greater wholesale level efforts. Therefore, these activities will be phased out with other activities receiving their final funding in FY 1996. During the closeout phase, to the extent feasible, USAID is encouraging grant recipients to shift focus to policy-related activities and/or to address issues of sustainability after USAID financing expires.

Activities

USAID assistance in the area of improving private business operations has focused primarily on enterprise level management, technology support and agricultural development efforts. USAID activities have improved the operations of over 300 enterprises. Though localized, there are various positive highlights:

- The Land-of-Lakes program pioneered the concept of an agribusiness-based outreach program to introduce modern technology to dairy farmers. Their efforts helped participating private farmers increase milk yields by 50 percent and improve milk quality by 100 percent within the first three months of the project.
- Through assistance provided by the World Environment Center, dozens of firms saved \$475,000 through investments in pollution reduction and energy efficiency equipment. The savings resulted from decreased costs of energy and materials and use.
- VOCA assisted two poultry producers to improve feed nutrition and flock health practices resulting in a combined savings of \$918,000. The new approaches also increasing the demand in Lithuania for US soybeans. Further results of this program included decreasing bird mortality by over 50 percent and increasing egg production by seven percent at the four participating poultry farms.
- IESC provided crucial product design and management assistance to a privatized

Lithuanian television tube manufacturer. Company exports to Europe were boosted by \$33 million and 1,000 new jobs were created. Management improvements resulting from IESC volunteers enabled a company to participate with IBM in assembly and delivery of \$1 million of computers for the Lithuanian school system. IESC services introduced international accounting practices in several plants, reorganized one company which is now one of the most successful travel agencies in Vilnius, and increased production with new technology at a major glass factory.

- Under the Environmental Action Program Support Project (EAPS), the business plan for a major cement plant was prepared and assistance was obtained to secure a loan of between \$18-24 million from the EBRD. EAPS assisted a private tannery by providing crucial cost-effective technical solutions, which will allow the tannery to save approximately \$20,000 annually and reduce pollution.

FY96 is the final year of funding for six eligible activities under this special initiative. An additional three activities will conclude with the pipeline from prior year funding:

Small and Medium Enterprises

- International Executive Service Corps (IESC) Private Enterprise
- MBA Enterprise Corps
- Peace Corps

Agriculture Sector

- VOCA Grant
- Dairy Farming (Land O'Lakes)

Investment/demonstration

- Environmental Action Program Support Project (EAPS)
- World Environment Center (WEC) Waste Minimization

Business Training

- Management Training (Texas A & M)
- Management Training (EMED)

Timeframe

The majority of the programs will be completed by October, 1997. EMED training and VOCA are expected to be the first to be completed early in 1997 while select activities such as WEC Waste Minimization and MBA Enterprise Corps may extend into 1998.

Intermediate Results

Unleashing the productive potential of the private sector can help generate the productive employment and growth that the Lithuanian economy so badly needs. For the private sector to develop in a way that is both efficient and sustainable, it needs to obtain the necessary technical and managerial capacity necessary to operate in a market economy. These form the two intermediate results for this special initiative.

Expected Results

The main indicators for measuring results in this homestretch initiative are increased profitability of the enterprises assisted, increased, effective employment, and business growth. A simple cost-benefit analysis can be used to judge the quality and effectiveness of each intervention proposed. The target for increases in these three indicators is 1997, to match the close-out of the activities.

Indicator:

Target

Economic benefit measured in Benefit/Cost ratio: economic performance of recipient to value of resource provided by USAID 2/1

Management skills improved: Management skills such as marketing, managerial and cost accounting, business plan development, organization structures, personnel planning, health and safety programs, are generally lacking in Lithuanian businesses. Improvement in these skills can lead to improved efficiency of operation, reduced costs, and increased business opportunities. An intermediate result for each assisted enterprise will be the development and adoption of new management techniques. This will include, but will not be limited to, preparing a business plan to submit for bank financing or a marketing strategy which is prepared and subsequently implemented. The general indicator would be management skills adopted to business practices. A companion indicator would be the strengthening of business service training through the Universities. This can be measured in terms of courses taught by assisted universities and schools and the quality of the training offered.

Indicator:

Target

Number of companies assisted adopting new management techniques 100 percent
University capacity increased TBD

Technical improvements adopted: Lithuanian businesses had limited access to modern technology or information about technological approaches due to the isolated orientation of the Soviet Union and the lack of private sector source of Western technology, combined with state production models and the absence of competition. Access will increase dramatically through privatization, as companies gain the initiative to obtain technology appropriate to its needs and as they increase partnerships with Western companies. The introduction of new technologies will rapidly allow a company to improve its efficiency, decrease the waste of energy and natural resources, and will thereby lead to increased profitability. The indicators will be the increased access to and adoption of technological solutions to enterprise production problems. In the case of the industrial sector, this will be equipment obtained or technological changes implemented; in the tourism industry it will be improved technology and broader services, and improved production in the case of agriculture. In all cases, the simplest indicator is increased productivity and efficiency.

Indicator**Target**

Productivity increased in assisted firms
Quality of milk in targeted regions increased

20 percent
30 percent

It should be noted that the majority of opportunities for increased access to technology will come through direct private investments or purchases, which will depend upon a sound business plan, access to capital, competitive trade and tariff policies, and a legal system conducive to business development. These enabling conditions are not yet fully developed, and further opportunities for growth in private enterprises will be constrained more by the policy and legal barriers than by anything else. The USAID assistance outlined in previous sections under S.O. 1.3 and S.O. 1.4 will seek to address these systemic problems resulting in a broader impact on the business climate in which firms operate.

Realignment with Strategic Objectives

OAR examined the 9 activities under this S.O.4.1 Special Initiative to determine which could be revamped to contribute more directly to the four main strategic objectives, either at the policy level or in support of systemic or institutional improvements.

Two of the grant programs were successfully redirected. The Land O'Lakes cooperative agreement was amended in July, 1996 to fund activities requested by the Lithuanian Government to raise regulatory standards in the dairy industry to international levels. Progress in installing a systematic approach to milk quality management will not only make Lithuanian dairy products more competitive internationally, but it will also have a positive impact on domestic food safety. Secondly, IESC will continue to enhance collaboration with USAID to identify and place additional short-term volunteers needed in the financial sectors to support institutional improvements in banking, financial markets, brokerages, and other financial institutions.

Two of the programs in their current form target institutional improvements judged of sufficient merit, and supportive of the USAID strategic objectives in a broader sense, to continue as planned. The WEC Waste Minimization activity will design a workplan that will assist the Kaunas Pollution Prevention Center to install a sustainable business plan for future programs. Likewise, the Management Training activity under the auspices of Texax A & M has as its goal to install a self-sustaining management training center at the Kaunas Technological University. As the opportunity arises, these activities may be able to contribute to NGO and local government initiatives under the S.O. 2.1 objective.

In examining the other six grants for increased alignment with the strategic objectives, it was apparent that several factors effectively precluded shifts in programs. Clearest cases were those where it was inefficient to consider revisions to grants with extremely limited time and funds remaining. VOCA, EAP Support Project, EMED, USIA Small Grants and Peace Corps all fell into that category. The MBA Enterprise Corps is in a slightly different category. The cycle associated with selection and placement in Lithuanian firms of recent MBA graduates from the U.S. did not lend itself to flexibility. FY96 funds

were fully programmed for the group that arrived in Lithuania in September, 1996. No additional funds are requested in FY97 for any of these terminating activities.

4.0 Participant Training Project for Europe (PTPE)

The USG is supporting PTPE in Lithuania through a SEED-funded contract with Partners for International Education and Training (PIET).

Rationale for incorporating the activity in the plan

Over the last four years, PIET has provided training to 65 individuals in the areas of Environment, Agriculture, Energy, Democratic Institution Building, Legal Sector Reform, Financial Sector Reform and Management Education in Business Development. PTPE provides short-term training opportunities in the United States for Lithuanian decision-makers and those who hold senior positions in institutions which contribute to the transformation of Lithuania's economy and the development of democracy.

The PTPE program will be linked to the new strategic objectives. The PTPE program has already undergone a significant revision in approach and programming. The program is focused to train key implementors and collaborators in areas where USAID expects to leverage significant development results, as described in the Results Framework. The training activities will be highly integrated into the rest of the program, responding to the needs of the country strategic objectives. The training will assure a consistent approach and quality of training in policy making, financial, and democracy sectors.

Time frame for completion

Training is an ongoing activity and does not have readily definable interim time parameters. The program will be completed by September 31, 1998.

Expected results (indicators, targets)

This program provides individualized training. The impacts that will accrue from this program will be measured at the individual level when the participant returns from his training program and begins to implement the lessons learned in the U.S, in support of USAID's other strategic objectives.

Approximately 50 person months in FY 96, 60 person months in FY 97, and 10 person months in FY 98 of training will be provided to approximately 120 decision makers in the areas of mission's interest, according to SOs.

Criteria for Judging Performance

Participants will present their training intentions prior to their departure for the training program in the U.S. PIET will coordinate the evaluation of the degree to which the participants succeeded in meeting their goals while on training six months after the participant's return. Contractors and grantees will be involved in the process.

5.0 English as a Second Language

For the past four years, USAID has funded a program to train and requalify teachers of English through a 632(a) IAA with USIS. This program cuts across all of USAID's programs and falls within the U.S. Embassy Country Strategy and USIS' strategy, as it serves to increase and improve the English-language teaching methodology among teachers of English, as well as the English-language abilities of students throughout Lithuania. The lack of English-language skills is a barrier throughout professions, particularly for business, government, journalism, and other professional sectors. There is a current deficit of English teachers in Lithuania and it is estimated that the country needs 500 more to meet the needs of schools and students in Lithuania. At present, it is estimated that over 600 teachers currently teaching are not qualified, some having no more English instruction than secondary school and lacking a professional teaching background.

It is estimated that 684 teachers of English have been trained or requalified to teach English between 1994 and 1996. In the 1996-97 academic year, it is projected that 1,197 more instructors and students in specialized fields will be trained. This includes 130 teachers who are qualified English-language teachers.

The impacts can only be measured in the long-term, as English-language skills are applied. Furthermore, there is limited mechanism with which to measure the impact that this program is having. The Ministry of Education is in the third year of a pilot project to administer a "year-12 exam," which is serving to standardize teaching standards and evaluation of language abilities throughout Lithuania.

ENVIRONMENTAL ANALYSIS ISSUES

Biological Diversity: Lithuania signed the Biodiversity Convention in 1992, the Ramsar Convention in 1993, and the Bern Convention in 1994. These agreements must still be ratified by Parliament. A system of territory protection is being created to cover over 10 percent of Lithuania's territory. Environmental policy does not directly address the need to preserve biodiversity. Limited work is being done to inventory endangered species and critical locations (Red Book). There is no monitoring of the status of protected species (except within nature reserves), nor are there any programs to preserve selected biomes and species. The World Bank is helping to develop an action plan for biodiversity conservation and considering funding a program. Norway and EU-PHARE are also providing assistance in this area. Biodiversity is not addressed as part of the program, since the ENI Bureau, USAID/Lithuania, and GOL priorities are to address environmental health issues and integrate environmental considerations into the economic and democratic reforms.

Integration of environmental issues into strategy: Environment and energy issues are an important cross-cutting theme in the USAID strategy for Lithuania. The activities are integrated into the main strategic objectives. The estimated budget for these activities is \$1,515,000 for 1996 and \$650,000 for 1997.

SO 1.3: Energy pricing to make energy prices reflect costs of production, which will lead to energy conservation and energy sector restructuring; Environmental Policy and Legal Reform to improve environmental economics and policy; Waste Minimization to introduce private sector approaches, increase efficiency, achieve environmental benefits, and establish a Pollution Prevention Center.

S.O. 1.4: Environmental Action Program Support to develop Lithuanian Environmental Investment Fund, which will provide loans to enterprises for financially sound environmental projects.

S.O. 2.1: Democracy Network small grants and training for NGOs seeking to impact high-level environmental policy.

S.O. 4.1: Baltic Regional Energy Planning to introduce least-cost planning and address environmental concerns; Regional Environmental Monitoring to increase capacity to monitor and manage data, and standardize data management in the Baltic countries.

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STRATEGIC PLAN

PART III

"RESOURCE REQUIREMENTS"

October 15, 1996

STRATEGIC PLAN

PART III: RESOURCE REQUIREMENTS

- A. Program Funding Requirements**
- B. Program Management Requirements**
- C. Discussion of Programming Options**

Part III A: PROGRAM FUNDING REQUIREMENT (tables)

All program funds for the Lithuania country program in all years are appropriated through the provisions of the SEED (Support for Eastern European Democracy) Act of 1990.

	SO	Pipeline* (\$000)	FY 95 CO# (\$000)	FY 96# (\$000)	FY 96 CO# (\$000)	FY 97 (\$000)	FY 98 (\$000)	LOP
ECONOMIC RESTRUCTURING								
180-0014.b		1.1	127		0			
		1.2						
180-0027.01			300	100	150	150	100	500
180-0027.01			721	100	0			100
180-0014.xy					625	800	500	1,925
180-0023.06			0		0			0
ENABLING ENVIRONMENT PRIVATE ENTERPRISES								
		1.3						0
ELIMINATE PRICE DISTORTIONS								
180-0030.01			200		200	300		500
180-0004.11			593		250	250	0	500
MORE EFFECTIVE TRADE POLICIES								
180-0026.05			262		160	0		160
180-0014.xy					300	400	250	950
IMPROVED LEGAL FRAMEWORK								
180-0020.02			17		525	0	400	925
			0			100		100
180-0026.13			0		0			0
180-0026.02			29		0			0
180-0026.02			59		0			0
MORE STABLE FINANCIAL ENVIRONMENT								
		1.4						0
BANKING SYSTEM CONFIDENCE								
180-0027.01			621	200	310	600	400	1,510
180-0023.03			66		0			0
180-0023.03			0		200	300	300	800
180-0014.04			1,204		475	450	250	1,175
180-0014.04			0	310	0			310
180-0014.04			0	0	0			0
180-0027.02			16	200	44	0		244
FINANCIAL MARKETS								
180-0014.02			522		700	700	250	1,650
180-0039.10			180		290	0	0	290
180-0023.06			460		0			0
DEMOCRACY								
		2.1						0
CITIZEN PARTICIPATION								
180-0021.05			243	0	100	0	0	100
180-0002			1		100	100	100	300
180-0032.09			250	250	200	0	0	450
180-0026			0		0			0
180-0021			264		75	0	0	75
						1,000	300	1,300
180-0022.02			49		100			100
180-0022.03			15		0			0
180-0021.08			161		0			0
180-0019.			22		0			0
180-0020.2		2.2						0
180-0019.07a		2.3	809		0		0	0
CROSS CUTTING/SPECIAL INITIATIVES								
REDUCING DEPENDENCE ON NUCLEAR ENERGY								
		4.1.1						0
180-0030.00			1,000		0			0
180-0030.05			428		0	150	200	450
180-0030.09			0		0			0
180-0030.01			400		150			150
180-0030.04			200		150			150
			246		0			0
			582		0			0
								0
REGIONAL ENVIRONMENT								
180-0039.01		4.1.2	403		0	100	100	200
IMPROVED ENTERPRISE CAPACITY								
		4.1.3						0
180-0023.01			500		250	0	0	250
180-0023.05			308		200			200
180-0023.07			205	0	0	20		20
180-0024.01			42		300		0	300
180-0024.07			3,429		0			0
180-0039.10			204		125	0	0	125
180-0004.01			697		400	0	0	400
180-0029.01			1,280		0	0	0	0
180-0023.11			300		478	0	0	478
180-0029.02			42		0			0
180-0002		4.1.4	506	5	572	600	100	1,277
180-0245.02		4.1.5	4		100			100
PROGRAM SUPPORT								
180-0249.01			0		0	100	100	300
180-0249.02			0	10	447	36	450	1,193
			17,968	1,175	7,976	406	7,000	19,557
		1.4	2,744	1,206	7,975	375	7,000	19,556
				1,206	16,975		9,000	27,000
				31	(1)	0	0	30
					8,382			
					32			

	SO	Pipeline* (\$000)	FY 95 CO# (\$000)	FY 96# (\$000)	FY 96 CO# (\$000)	FY 97 (\$000)	FY 98 (\$000)	LOP
PRIVATIZATION	1.1	127	0	0	0	0	0	0
FISCAL MANAGEMENT	1.2	1,021	200	775	0	950	600	2,525
ENABLING ENVIRONMENT FOR PRIV SECTOR DEVELOP	1.3	1,160	0	1,435	0	1,450	250	3,135
FINANCIAL ENVIRONMENT	1.4	3,070	710	2,019	0	2,050	1,200	5,979
CIVIC PARTICIPATION & POLITICAL PROCESS	2.1	1,005	250	575	0	1,100	400	2,325
LEGAL SYSTEMS	2.2	0	0	0	0	0	0	0
PUBLIC ADMINISTRATION	2.3	809	0	0	0	0	0	0
CROSS CUTTING/OTHER								
-Reduced dependency on Ignalina NPP	4.2	2,856	0	300	150	200	100	750
-Regional Environmental Monitoring	4.3	403	0	0	100	100	0	200
-Improved enterprise capacity	4.4	7,007	0	1,753	20	0	0	1,773
-Cross cutting training	4.5	506	5	572	0	600	100	1,277
English language/academic top up	4.6	4	0	100	0	0	0	100
PROGRAM EVALUATION AND SUPPORT								
	4.1	0	10	447	136	550	350	1,493
TOTAL		17,968	1,175	7,976	406	7,000	3,000	19,557
BalAEFUND		2,744	0	0	0	9,000	9,000	27,000
GRAND TOTAL		20,712	1,175	7,976	406	16,000	12,000	46,557

*Pipeline based on 9/30/95 data
 #Revised based on 12/20/96 data

U.S. ASSISTANCE FOR LITHUANIA
TABLE A.2 - R4 FUNDING REQUEST BY PROJECT
FY95 CO - FY 98 Budget

06-Jan-97 Print Date
06-Jan-97 Last Revised

Proprietary Procurement Information: Criminal and Civil Penalties Apply for Disclosure Outside the USG

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Project No.		FY 95 CO	FY 96	FY 96 CO	FY 97	FY 98	Sum Reqst
A. STRENGTHENING DEMOCRATIC INSTITUTIONS							
		250	1,000	0	1,500	300	3,050
180-0019	Democratic Governance & Public Administration	0	0	0	0	0	0
180-0020	Rule of Law	0	525	0	500	0	1,025
180-0021	Political and Social Process	0	175	0	1,000	300	1,475
180-0022	Independent Media	0	100	0	0	0	100
180-0032	Non Governmental Organization (NGO) Development	250	200	0	0	0	450
B. ECONOMIC RESTRUCTURING							
180-0014	Privatization and Enterprise Restructuring	310	2,100	0	2,350	1,250	6,010
180-0023	Technical Assistance to Enterprises	0	1,128	20	300	300	1,748
180-0026	Competition Policy, Laws and Regulations	0	160	0	0	0	160
180-0027	Business Services	600	504	0	750	500	2,354
180-0010	Enterprise Funds	0	0	0	0	0	0
180-0057	South Balkan Development Initiative	0	0	0	0	0	0
180-0002	Human Resources	0	0	0	0	0	0
180-0045	Participant Training	5	572	0	600	100	1,277
180-0029	Management Training	0	0	0	0	0	0
180-0024	Restructuring Agriculture and Agribusiness	0	300	0	0	0	300
180-0046	Agriculture Development Program - Albania	0	0	0	0	0	0
180-0049	Restructuring Albania Agriculture	0	0	0	0	0	0
180-0030	Regional Energy Efficiency	0	500	150	500	100	1,250
C. IMPROVING QUALITY OF LIFE							
180-0016	Trauma, Social Welfare & Humanitarian Assistance	0	0	0	0	0	0
180-0054	Bosnia Emergency Rehabilitation	0	0	0	0	0	0
180-0056	Bosnia Reconstruction Finance	0	0	0	0	0	0
180-0002	Human Resources - Social Sector Restructuring	0	0	0	0	0	0
180-0033	Labor Market Transition	0	0	0	0	0	0
180-0034	Housing Sector Assistance	0	0	0	0	0	0
180-0037	Partnerships in Health Care	0	0	0	0	0	0
180-0038	Promotion of Health Markets	0	0	0	0	0	0
186-0002	Romanian Family Planning	0	0	0	0	0	0
180-0039	Improved Public Sector Environmental Services	0	415	100	100	0	615
180-0004	Environmental Initiatives	0	650	0	250	0	900
180-0041	Environmental Training	0	0	0	0	0	0
D. MISCELLANEOUS							
180-0249	Audit, Evaluation and Project Support	10	447	136	550	350	1,493
180-XXXX	Reserved, Withheld or Transfers	0	200	0	100	100	400
TOTAL SAI-APPROPRIATED ASSISTANCE		1,175	7,976	406	7,000	3,000	19,557
CEE Budget Plus Enterprise Funds		1,175	16,976	406	16,000	12,000	46,557
TOTAL SAI/DA APPROPRIATED ASSISTANCE		1,175	16,976	406	16,000	12,000	46,557

A.3 Supporting Narrative Rationale

1. Focus and Concentrate

The number of activities in the Lithuania bilateral program will drop from 44 with an average size of \$180,000 per activity in FY 1995 to 10 in FY 1998 with an average size of \$300,000 per activity. The trend will be:

	FY 1995	FY 1996	FY 1997	FY 1998
Activities	44	29	14	10
Average Value	\$180,000	\$285,000	\$500,000	\$300,000

This is a three-fourths cut in the activity portfolio over three years. Certain programs do not fit within the Lithuania Country Strategy for 1996 - 2000 (April 1995). Generally, with the new strategy, the activities shift from a heavy emphasis on "retail" level activities (individual businesses, farmers, local municipalities, trainees, multiple laws) to a more "wholesale" or policy and consolidated program.

The most significant reduction in activities lies in the enterprise assistance area. There will be a shift to the policy and enabling environment affecting businesses and, in combination with a high degree of business activity, and other donor support far in excess of USAID funding, this will allow the successful completion of VOCA, IESC, MBA, Peace Corps small business activities, and Environmental Action Plan investment promotion, and EMED training. The Texas A&M business school program was late in starting and is not likely to achieve the initially hoped for results. The lack of financial investment in this project by Texas A&M, and in combination with a program focused in a city which will not be the business center of Lithuania, allows a more modest refocusing of the program within the existing large pipeline.

In addition, the legal assistance programs are being consolidated under the American Bar Association, as separate programs, e.g., collateral law, have been phased out.

Where possible, the retail activities have shifted to the establishment of an in-country institutional capacity and will be fully funded from the FY 1996 budget. Since the strategy is being prepared late in the year, and the last year of funding was only determined in April, it has not been practical to reduce the number of activities more quickly without serious programmatic or political affects (mostly on the U.S. side).

We conclude that the combined FY 96 budget and existing pipelines will enable the following programs to achieve impact and terminate during FY 1997 without additional FY 96 or FY 97 funding: U.S. Department of the Treasury work in corporate governance, U.S. Department of Energy (we understand that some DOE directly appropriated funds will be used to continue aspects of their nuclear safety program), the development assistance funded earmark for the Land of Lakes program.

In the democracy area, several activities are coming to a natural conclusion, e.g., International Republican Institute (IRI) will have successfully completed its political party training. In addition, the work with the National Democratic Institute (NDI), IRI, public administration, and Democracy Network with the U.S. Baltic Foundation will form the foundation and preparatory background to establish a foundation devoted to supporting civic participation through NGO and local government cooperation. Consequently, the democracy program will be reduced to two activities in FY 97: the Democracy Commission and the new civic participation foundation.

A number of teaching and training programs implemented by USIS with USAID budget pass-throughs are not directly contributing to achievement of the country program's strategic objectives. By FY 1997 all of these activities will have been eliminated from the country budget (English teaching, Books for Democracy, Muskie scholarships and "top-up" higher education grants). In one case, Media Training, USIS and USAID programs have converged and a budget line item for this activity will be concluded with FY 1996 funding, with the intent of close coordination between USIS and USAID at the country level.

Firm plans and programs of other donors significantly influence USAID's work at the central government level, especially under strategic objectives 1.3 and 1.4 ("Improved enabling policy environment conducive to sustained private sector growth" and "More stable financial environment").

In the strategic objective to support a more stable financial sector, a number of activities will be phased out before the FY 1997 budget. These include bank training, direct assistance to banks, and credit unions. These activities have served a useful purpose in earlier stages of the banking program, but the efforts will be far less than other donors or the assistance will not have a significant systemic impact at the funding levels available. The FSVC program, which has been highly effective and supportive of Mission objectives, will be completed in FY 1996 to reduce program size and to simplify program management for work in capital markets and tax policy under two contracts.

The energy assistance activities generally do not fit in the framework of the new strategy and with insufficient funding, will be closed out with FY 1996 funds. The only exception will be the continuation of work on energy pricing and identification of the social and economic impacts of increased energy tariffs. This activity will be completed in FY 1997 with a planned hand-off to the EU-PHARE funded specialists.

Environmental activities at both the central and local government levels have offered opportunity to apply new technical and organizational techniques towards solution of some of Lithuania's numerous environmental problems. One activity will be completed with FY 1997 funding, the establishment of a regional environmental monitoring system, which has been approved by Lithuania, Latvia, and Estonia. In addition, the EPA has provided support to the Ministry of the Environment on a broad range of issues, which can continue as part of EPA's normal bilateral cooperation with non-SEED funds. As the EPA program draws to a close, this institutional support is being continued, albeit with a different emphasis, by EU-PHARE.

2. New Initiatives

The only new initiative planned for FY 1997 is to establish a foundation to promote increased civic participation through cooperation between NGOs and local governments, S.O. 2.1. This activity is in the early design stage. USAID has already contacted the US Baltic Foundation, the Lithuanian Community Inc, the UNDP, EU-PHARE, and members of the Lithuanian Parliament to promote a partnership approach for this initiative. USAID will continue to explore establishing an endowment and obtain other donor funding for this activity. It is anticipated that this foundation could continue beyond the phase out of the USAID bilateral program and provide a legacy to support grass-roots democratic ideals.

3. Funds Request

The funding requested is to fully support the four strategic objectives: S.O. 1.2, strengthened fiscal management; S.O. 1.3, improved enabling policy environment conducive to sustained private sector growth; S.O. 1.4, more stable financial environment; and S.O. 2.1, increased, sustained collaboration of NGOs and local government to develop policies and services which reflect community interests. In addition, three special initiatives will focus on supporting regional and international cooperation in addressing nuclear safety, regional energy planning, and regional environmental monitoring. The one cross cutting training and evaluation program directly support and are highly integrated with the three major strategic objectives.

While overall program levels are projected to decline compared to FY 1996, funding for the core strategic objectives will increase by approximately \$900,000 and will be a significantly greater percentage of the overall budget.

The country budget demonstrates a close relationship between country, Bureau, and Agency goals and objectives. Three major Bureau objectives are directly supported by the country program and the results anticipated are adjusted to realistically reflect resource availability. The Agency's "sustainable development" mission is broadly supported by the Lithuania country program.

U.S. ASSISTANCE FOR LITHUANIA

(in dols. thousands)

Project No.		CY 92	CY 93	CY 94	CY 95	CY 96	CY 97	CY 98	CY 99	CY 00
A. STRENGTHENING DEMOCRATIC INSTITUTIONS										
1. Political Process and Governance										
180-0019	Democratic Governance and Public Administration									
.01	* Tech. Assis. & Equipm. (Frost)									
.08	* OSCE Parliamen. Assis.									
.07	*Public Administration									
180-0020	Rule of Law									
.02	* ABA Grant									
.03	* Democ. & Law: DOJ/AOJ									
.04	*Dem. & Law: Anit-crime Trng/ TA									
2. Democratic Pluralism										
180-0021	Political and Social Process									
.02	* Civil Society & Ethic Rels									
.05	* polit. orgs. (incl. elec. monitoring)									
	IRI									
	NDI									
.08	* FTUI									
180-0022	Independent Media									

U.S. ASSISTANCE FOR LITHUANIA

(in dols. thousands)

Project No.		CY 92	CY 93	CY 94	CY 95	CY 96	CY 97	CY 98	CY 99	CY 00
.02	* Media training (USIA)									
180-0032	Non Governmental Organization (NGO) Dev. Project									
.09	*Democracy Networks									
xy	*Civic participation foundation									
B. ECONOMIC RESTRUCTURING										
2. Privatization and Assistance to Enterprises										
180-0014	Privatization & Enterprise Restruc.									
.01	Privatization									
.02	Capital Markets									
.03	Enterprise Restructuring									
.04	Banking Sector (supervision)									
.xy	Tax (\$625k) and trade (\$300) policy									
180-0023	Technical Assistance to Enterprises									
.01	* IESC Private Enterprise									
.03	* CIPE (Chamber)									
	Lith Free Market Institute									
.05	* MBA Enterprise Corps									
.06	*WOCCU									
.07	* Peace Corps									
.11	* Entrepren. Mgmt & Exec. Dev.									
3. Improving the Business Climate										
180-0026	Competition Policy, Laws & Regulations									

U.S. ASSISTANCE FOR LITHUANIA

(in dols. thousands)

Project No.		CY 92	CY 93	CY 94	CY 95	CY 96	CY 97	CY 98	CY 99	CY 00
.02	* Antitrust law advice (DOJ/FTC)									
.05	*Commerce (Gov't to Gov't)									
.06	*Intl Dev Law Inst (IDLI) (Leg. Ed.)									
.13	* Collateral Law (IRIS)									
.19	*Legal & Judicial Training									
180-0027	Business Services									
.01	* TA/Finan Serv (Treas), incl. tax									
.02	* F SVC grant									
	4. Investment and Trade									
180-0010	Enterprise Funds									
.05	* Baltics Enterprise Fund									
	5. Human Resources									
180-0002	Human Resources Program									
.09	* English Teaching (USIA)									
.10	*University Continuing Educ.									
180-0045	Participant Training									
.01	* PIET									
.02	* Top Up - Academic Trg (USIA)									
.06	* Muskie Grad. Schoshp (USIA)									
180-0029	Management Training & Market Economics Education									
.01	* Large grants competition TEXAS A&M IU									

U.S. ASSISTANCE FOR LITHUANIA

(in dols. thousands)

Project No.		CY 92	CY 93	CY 94	CY 95	CY 96	CY 97	CY 98	CY 99	CY 00
.02	* Small grants competition (USIA)									
	6. Agriculture and Agribusiness									
180-0024	Restructuring Agriculture and Agribusiness									
.01	* VOCA									
.07	* Dairy farming/Land O'Lakes									
	8. Energy Efficiency									
180-0030	Regional Energy Efficiency									
.01	* Indus. Contr.: Restruc. & Effic.									
	* Regional Hagler Bailly									
	* Electrotec									
	* Bechtel									
.02	* PASA/IAA with DOE									
.04	* grant to USEA									
.05	* IAA with NRC									
.09	* EBRD Nuclear Safety Fund									
	C. IMPROVING THE QUALITY OF LIFE									
	5. Environment									
180-0039	Improved Public Sector Environmental Services									
.01	* IAA with EPA									
.10	*EAP Investments									
180-0004	Environmental Initiatives									

U.S. ASSISTANCE FOR LITHUANIA

(in dols. thousands)

Project No.	CY 92	CY 93	CY 94	CY 95	CY 96	CY 97	CY 98	CY 99	CY 00
.01									
.11									

* World Environmental Ctr

* HIID

B. Workforce Program Management Requirements

B.1. OE Requirements

Materials required in this section are being defined in USAID/Washington's Management Bureau. Some delay in their submission has been approved by Washington.

The materials will cover staffing, workforce requirements and operating expense requirements for OAR/Lithuania.

The expected OE funded direct hire and program support staff are:

	1996	1997	1998	1999	2000
US DH	2	2	1	0	0
US PSC			.5	1	.5
FS PSC (admin only)	6	6	5	3	1.5

The expected program funded staff are:

	1996	1997	1998	1999	2000
US PSC	4	3	2	1	.5
FS PSC (admin only)	3	3	2	2	1

B.2 Field Support by AID/W

Field support is needed from either AID/W (ENI or Global) or from a contractor for key project design and evaluation tasks. With the exception of PIET training program processing, no specific support from the Global Bureau to OAR/Lithuania is built into the country program for FY 1996 - FY 1998. While close and cordial consultative relations are maintained, no formal financial linkages are anticipated.

S.O 1.3 Development of Scopes of Work/Contractor Selection

IN PREPARATION

- development of tax and tariff policy SOW, contractor selection, and mobilization seminar

S.O 1.4 Development of Scopes of Work/Contractor Selection

IN PREPARATION

S.O. 2.1 Increased, sustained collaboration of NGOs and local government

Restructure public administration contract: In order to make the current contract consistent with the new strategic objective and ensure that the existing resources in the contract are utilized to maximum benefit.

- technical specialist in civic participation/public administration 1 month

New Initiative Design: In order to design the foundation to support the achievement of Strategic Objective 2.1: Increased, Sustained Collaboration of NGOs and Local Government To Develop Policies and Services Which Reflect Community Interests, it is estimated that the following expertise will be required from ENI or Global:

- technical specialist in NGOs 1-2 months
- technical specialist in local government/
civic participation 1 month
- legal advisor 1 month
- contract officer (from USAID/Warsaw) 2 weeks

Monitoring and Evaluation

- Assistance to design M&E system SOW 3-4 weeks

C. PROGRAMMING OPTIONS: IMPACT OF REDUCED FUNDING LEVELS IN FY 1998

The FY 1998 budget is \$3.0 million and a 10 percent reduction is for \$300,000. The budget request for fiscal year 1998 changes between high and low levels for strategic objective 1.4 only. S.O. 1.3, 2.2 and 4.1 will remain the same. The exceedingly small overall budget does not allow for additional major shifts without a damaging impact on any of the programmed activities.

It is important to note that the funding for the country budget does not include capital funding requirements of the Baltic American Enterprise Fund (BalAEF) and regional criminal law supported activities, which are expected to continue and be funded from the SEED budget without being included in the bilateral program. If USAID/Lithuania is obliged to meet the BalAEF's authorized capital requirements, then there will be a need to significantly raise the overall budget to include funding for the Lithuania portion of the program. However, this is not anticipated since the fund is for all three countries.

SUMMARY TABLE SO 1.4 (\$US)

	FY 97	FY 98	FY 98 LOW
Central Bank policy (TBD)	750,000	500,000	500,000
Policy advocacy: Lithuanian Free Market Institute (NGO)	300,000	300,000	300,000
Bank Supervision (KPMG)	450,000	250,000	0
Tax Policy (TBD)	800,000	500,000	450,000
Capital Markets (Price Waterhouse)	700,000	250,000	250,000
TOTAL	3,000,000	1,800,000	1,500,000

Funding below the low budget level in FY 1998 will result in cutting back core activities, delaying achievement of targets and reducing program momentum. The impact of the low funding level on the target for the strategic objective will result in delaying achievement of a sustainable result in some elements of bank supervision at the central bank. This could jeopardize previous funding efforts and reduce the ability to achieve program impacts. In addition, the reduction in tax policy efforts would have the net effect of provided two months less of key short-term technical expertise or training.