

LITHUANIA



Polity: Parliamentary democracy

Economy: Mixed capitalist

Population: 3,700,000

GNI per capita at PPP \$ (2000): 6,980

Capital: Vilnius

Ethnic Groups: Lithuanian (80 percent), Russian (9 percent), Polish (7 percent), Byelorussian (2 percent), other (2 percent)

Size of private sector as % of GDP (mid-2001): 70

The scores and ratings for this country reflect the consensus of Freedom House, its academic advisors, and the author of this report. The opinions expressed in this report are those of the author.

↘↘ and ↗↗ indicate score changes of .25 or more. ↘ and ↗ indicate changes of less than .25.

NATIONS IN TRANSIT SCORES

	1997	1998	1999-2000	2001	2002
Democratization	2.15	↗ 1.95	↘ 2.00	↗ 1.94	↗ 1.88
Rule of Law	na	na	2.88	↗ 2.75	↘ 2.88
Economic Liberalization	2.50	↘ 2.58	↘↘ 2.83	↗ 2.75	↗↗ 2.42

KEY ANNUAL INDICATORS

	1995	1996	1997	1998	1999	2000	2001
GDP per capita (\$)	1,623.4	2,128.9	2,587.8	2,904.1	2,882.3	3,063.8	3,249.0
Real GDP growth (% change)	3.3	4.7	7.3	5.1	-3.9	3.9	4.0
Inflation rate	39.6	24.6	8.9	5.1	0.8	1.0	1.5
Exports (\$ millions)	2,706.0	3,413.0	4,192.0	3,962.0	3,147.0	4,050.0	4,415.0
Imports (\$ millions)	3,404.0	4,309.0	5,340.0	5,480.0	4,551.0	5,154.0	5,618.0
Foreign Direct Investment (\$ millions)	72.0	152.0	328.0	921.0	478.0	375.0	450.0
Unemployment rate	17.5	16.4	14.1	13.3	14.1	15.4	17.0
Life Expectancy (years)	69.3	70.4	71.2	71.6	72.1	72.6	73.0

INTRODUCTION

Lithuania is a parliamentary democracy in which basic political rights and civil liberties are secure and transfers of power are smooth. Following parliamentary elections in 2000, a profusion of relatively new players entered Lithuania's political scene. Since then, power has shifted from the center-right Liberal Union and the left-leaning New Union (Social Liberals) to a new coalition of the Social Liberals and the Social Democratic Party. Former President Algirdas Brazauskas now heads the government.

Despite the change in government, Lithuania remains politically stable. Its major political parties continue to display unity on the most significant issues affecting the country's development, including accession into NATO and the European Union and transition to a free market economy. President Valdas Adamkus, a Lithuanian American, has played no small part in this process.

In January 2001, the ruling coalition and major opposition groups signed a joint statement on encouraging and supporting speedier integration into the EU. A corresponding document on coordinating the adoption of laws in Parliament is already having a decisive effect. In May 2001, in another demonstration of solidarity, nearly every political party in the country, save for a couple of minor groups, signed an agreement that reaffirms the country's aspiration to join NATO. There is also widespread political consensus and support for strengthening the mechanisms of public administration and the rule of law.

In the economic sphere, Lithuania continues to maintain strong macroeconomic positions and economic growth, owing mainly to a strong and stable national currency, credible banking sector, cautious financial policy, and continued privatization of state property. The restructuring and privatization of the energy sector is under way, and the privatization of commercial banks is nearing completion. While business deregulation continues, structural reforms need to be accelerated in the pension system and in the agricultural and energy sectors.

DEMOCRATIZATION

Political Process

1997	1998	1999-2000	2001	2002
2.00	1.75	1.75	1.75	1.75

Lithuania's electoral system is multiparty based. Half of the nation's parliamentarians are elected in multimandate proportional balloting, while the other half are selected in single-mandate constituencies. Elections are valid if voter turnout is no less than 41 percent. The threshold for legislative representation is 5 percent of the vote.

Lithuania's most recent parliamentary elections took place on October 18, 2000, and the Supreme Electoral Commission of Lithuania acknowledged that they were free and fair. The Organization for Security and Cooperation in Europe and the EU ceased to observe elections in Lithuania in 1997, recognizing that public confidence in, and the conditions for, democratic elections is well established. Voter turnout exceeded 56 percent.

The leftist Social Democratic Party of former President Algirdas Brazauskas won 51 mandates in the 141-seat Parliament. The center-right Liberal Union took 34 seats; the center-left New Union (Social Liberals), 29; and the Conservative Party, 9. Several parties failed to cross the 5 percent threshold in the proportional voting, but another seven parties gained seats in single-mandate constituencies. These included the Peasants Party (4 seats), the Center Union (3), and the Modern Christian Democrats (3).

After signing a coalition agreement, the Liberal Union, the Social Liberals, the Center Union, and the Modern Christian Democrats formed the informal New Policy bloc and garnered the support of several more candidates who had been elected in single-mandate constituencies to secure a 71-vote parliamentary majority. However, the new government, which consisted of the left-leaning Social Liberals and the center-right Liberal Union, proved unstable. It collapsed in June 2001 when the Social Liberals withdrew from the New Policy bloc. The efforts of the Liberal Union and the Conservative Party to rally support for acting Premier Eugenijus Gentvilas and President Adamkus's efforts to form a more rightist government all failed, and in July, the Social Liberals formed a new parliamentary majority with the opposition Social Democrats. The new majority also has the support of 7 members of parliament from the New Democracy Party and the Lithuanian Farmers Party. Of the new government's 14 ministers, 4 are Social Democrats, 1 is a Social Liberal, and the rest are nonpartisan. The leader of the Social Democratic Party, Algirdas Brazauskas, became prime minister.

Observers of Lithuania's political scene anticipated that the new government would inspire increasing confrontation and antagonism between Parliament and society. Foreign and domestic investors expected the government to drag its feet on reforms and decelerate the privatization process. And the country's rightist parties feared that a shift from liberal to social democratic policies would create an imbalance between the government's social obligations and its available resources. Doubts were also expressed about whether the existing pace of EU and NATO integration would be sustained. In its first few months in power, though, the Brazauskas government largely maintained continuity in the country's foreign and domestic policy. That is, despite the introduction of a number of leftist policies that threaten to exacerbate the country's economic climate, the Brazauskas government enjoys the support of about 70 percent of the population—the highest approval ratings ever in post-Communist Lithuania.

Cognizant of the negative impact of disunity and emboldened by the arrival of Lithuania's Social Democrats in the halls of government, Lithuania's right-wing and moderate parties have begun to call for consolidation among their ranks. Fielding a joint candidate for president in 2002 might serve as a dress rehearsal for the 2004 parliamentary elections. The Liberal Union and the Conservative Party are now the two main opposition forces.

In Lithuania's most recent presidential election, which took place on December 21, 1997, voters delivered U.S. émigré and environmentalist Valdas Adamkus a victory in the second round of balloting. Adamkus defeated his rival, attorney (and currently parliamentary Speaker) Arturas Paulauskas by a margin of less than one percentage point. Voter turnout reached 73.78 percent. Since the election, President Adamkus has been one of the most popular figures in Lithuania. The next presidential elections are due at the end of 2002.

Any person who is a citizen of Lithuania by birth, has lived in the country for the three years preceding an election, and has reached the age of 40 may be elected president of the republic. To register for an election, candidates must collect the signatures of at least 20,000 voters. In 2001, the Social Democratic Party proposed abolishing the second round of presidential elections and holding the first and only round simultaneously with municipal elections, due in the spring of 2003. The opposition has severely criticized the idea as defying the principles of democracy.

The largest and the most influential political parties in Lithuania are the Social Democratic Party, the Liberal Union, the Social Liberals, and the Conservative Party. In January 2001, the Labor Democratic Party merged with the Social Democrats to form a strong leftist bloc. As a result, the popularity of the newly merged Social Democratic Party skyrocketed. Likewise, led by young, charismatic leaders, the Liberal Union and the Social Liberals have reinforced their positions since the 2000 parliamentary elections and together have breathed new life into Lithuania's stale political arena. Although the Homeland Union (Lithuanian Conservatives) and the Christian Democrats are no longer in power, the Conservative Party remains an influential opposition force. The once popular Center Union has lost public support.

Over the past decade, the formation of political parties has centered more on the personalities of leaders than on ideology. Examples include the Social Liberals, led by Paulauskas; the Homeland People's Union, led by Laima Andrikiene; and the Moderate Conservatives' Union, led by former Prime Minister Gediminas Vagnorius. A recent trend has been mergers of smaller parties. In October 2001, for instance, four right-wing parties—the Homeland People's Union, the Lithuanian Democratic Party, the Independence Party, and the Lithuanian Freedom League—established the Lithuanian Right Union. The Christian Democratic Party and the Christian Democratic Union merged in May 2001.

Citizens are free to form political parties or associations, provided their goals and activities do not contradict the Constitution and laws of Lithuania. To register, a party must have at least 400 members. Thirty-eight political parties are currently registered. One extreme nationalist party, the Lithuanian Union of National Social Solidarity, has been refused registration 10 times on the grounds that articles in its bylaws on the superiority of the Lithuanian nation contradict the constitutional principles of democracy and equality as well as the Law on Political Parties and Organizations. In 2001, the Lithuanian Socialist Party called on the ruling coalition to legalize the Communist Party, which was banned after the failed coup d'état in Moscow in 1991.

About 2 percent of Lithuania's population of 3.5 million belong to political parties. The former Women's Party was renamed the New Democracy Party, and five other parties have women's divisions. Female representation decreased from 17.4 percent, or 24 seats, in the previous Parliament to 10.6 percent, or 15 seats, in the current Parliament. The Union of Russians joined the Social Democratic Party in the 2000 parliamentary elections. The Polish Electoral Action won 2 seats in single-mandate constituencies.

Civil Society

1997	1998	1999-2000	2001	2002
2.25	2.00	2.00	1.75	1.50

On January 1, 2001, a new Law on Charity and Support came into effect. It simplified grant-giving procedures, removed ambiguities regarding the distinction between charity and support, and legitimized anonymous giving. The law defines charity as help extended to persons who are in a difficult financial situation; it designates support as the provision of assistance to organizations that engage in cultural, scientific, health care, educational, or other activities. One of the most controversial amendments to the law states that only officially registered nonprofit organizations are allowed to receive donations. Although this provision is aimed at preventing the abuse of concessions applicable to private giving, critics charge that the register actually creates conditions for corruption and increases bureaucracy.

The regulations concerning nongovernmental organizations were further eased in June 2001 when annual reports to the State Tax Inspectorate on given and received donations replaced quarterly reports to both the inspectorate and the Lithuanian Department of Statistics (LDS). The requirement that NGO heads and accountants must work under labor contracts and receive remuneration for work on a compulsory basis was repealed for associations and foundations but remains valid for other nonprofit organizations.

According to the NGO Information and Support Center, there are more than 3,000 active nongovernmental organizations in Lithuania. The NGO sector has been

developing steadily in recent years, and approximately 200 new groups are established annually. Volunteerism remains a rare form of NGO support, since nonpaid voluntary activities were legitimated only in July 2000. The Commission for NGO Affairs, which consists of NGO representatives, advises the government on NGO issues and participates in related public policy debates.

At the national level, NGOs register with the Ministries of Justice and Economy; regional groups register with municipalities. Detailed regulation of the structure and management of NGOs and restrictions on the ability of associations and foundations to carry out commercial activities are the main statutory weaknesses. Also, accounting regulations applicable to NGOs are overly complex and require professional handling.

According to the Women's Information Center, there are nearly 60 women's organizations in Lithuania, including 20 regional organizations, 23 national organizations, 10 branches of international women's organizations, and 4 women's studies centers. The Lithuanian Women's Association unites 12 organizations, and the Lithuanian Society of Women in Business unites 200 women entrepreneurs and managers from 13 towns and regions. Ethnic groups are quite active in the country's civic and cultural life. The Russian community, for example, has 60 NGOs engaged in cultural activities. Equally effective are the Polish community's cultural organizations.

Lithuania's various religious communities are vital, autonomous social institutions. About 70 percent of Lithuania's inhabitants consider themselves Roman Catholics. The second largest religious group, with 180,000 members, is the Orthodox Church. Other groups include the Old Believers (50,000 members), Lutherans (30,000), Evangelical Reformed Community (11,000), Sunni Muslims (5,000), and Jews (5,000). The main charitable activity of religious communities is the provision of care for the elderly and the disabled.

Organizational and managerial capacity of NGOs has improved steadily over the last decade, and today the quality of operation and management of about 200 NGOs is comparable to that of leading business enterprises. Efficient project administration, good management, and constituency building are increasingly viewed as key elements of an organization's sustainability. It is now more common for NGOs to have permanent staff and to recruit volunteers.

NGOs have learned to establish contacts with their local constituencies through local media channels, fund-raising events, and involvement of local stakeholders in their activities. In addition, a weekly broadcast about NGOs on Lithuanian National Radio has been a positive development and has helped NGOs increase visibility and public awareness of their work. Nevertheless, weak public relations skills and the absence of fully functioning boards of directors still pose constraints. Likewise, since advocacy remains an abstract concept for many groups, they are less effective at benefiting from the use of communications and political

access at the national and local levels. The NGO Information and Support Center, foundations, and other support organizations provide a number of technical, consulting, and training services to enhance the effectiveness of Lithuanian NGOs.

Beginning in 2002, NGOs will be exempt from paying the income tax, which is currently charged at a rate of 5 percent. Donations from companies of up to 40 percent of their taxable profits are tax-exempt. Most Lithuanian NGOs are not financially viable owing to a lack of permanent sources of income. Most of their funding still comes from international foundations.

The range of assistance provided by NGOs has expanded to include social, economic, and environmental services. Legislation allows NGOs to bid for government contracts, but this practice remains uncommon owing to a complex administrative process. Government support in the form of grants comes mostly from the Ministries of Culture, Education and Science, and Social Security and Labor, as well as from municipalities.

In the first half of 2001, the total amount of charity and support in Lithuania fell by almost 15 percent as compared with the same period in 2000. This phenomenon was largely the result of shrinking donations from abroad. A total of 78 percent of charity and support came from abroad, or 21 percent less than in 2000. Local private firms and individuals contributed one-fifth of all donations—a 17 percent rise over 2000. In addition, the share of donations from domestic corporations grew by 13 percent, and individual giving increased by almost 78 percent. The bulk of charity and support, 61 percent, takes the form of in-kind contributions. Cash funds constitute 38 percent and services a mere 0.5 percent.

The Lithuanian Alliance of Trade Unions, the Center of Trade Unions, the Lithuanian Labor Federation, and the Employees' Union unite trade union and labor groups. Although industrial restructuring, privatization, and bankruptcies of large state-owned enterprises have adversely affected the trade union movement, the number of workers belonging to trade unions is increasing steadily. There are about 80 professional organizations with a total of 200,000 members. There are also about 800 associations in Lithuania and more than 300 business organizations.

The activities of individual trade unions and the percentage of workers belonging to them differ significantly across areas of activity. The largest trade union memberships are in the chemicals industry, construction, the energy sector, and the food industry. Equally effective are trade unions in the educational sector.

Trade unions must sign collective agreements with employers on behalf of all employees. A recent amendment to the Law on Labor Contracts eliminated a requirement that employers must receive the approval of the trade union in order to dismiss one of its members. This provision remains valid for the dismissal of a member of a trade union's governing body.

Interest groups may take part in the political process through policy advocacy, counseling, and other activities. Business associations and trade unions are the most active and influential players in the policy-making process, and the Lithuanian Industrialists Confederation is the leading lobby in the country. Trade unions are growing more influential owing to their large membership bases and organizational structures. In most situations, government authorities are attentive, but not always responsive, to the opinions of interest groups.

The policy-making process relies increasingly on joint task forces and policy initiatives that involve government officials, businesspeople, specialists, and independent policy analysts. The Sunrise Commission, established in 1999 to formulate proposals for improving business conditions, comprises several task forces of government officials, independent experts, and business representatives. Public hearings of draft laws are now more frequently used in the policy-making process. The Lithuanian Free Market Institute is the most influential public policy group in the country.

Lobbying was legitimized in July 2000 to let individuals and legal entities engage in paid activities aimed at influencing the legislative process, improving legal acts, and streamlining the drafting of legislation. A person or a company wishing to engage in lobbying must register with the Central Commission of Service Ethics. The law bans former politicians and state officials from conducting lobbyist activities for a year after leaving their posts. Politicians and officials who are prohibited from being paid members of managing bodies of corporations or other private institutions may not engage in lobbying.

Registered lobbyists must report on whose behalf they are working, the amount of income received, and the issue addressed. As lobbyists note, the fact that associations are not subject to the aforesaid reporting requirements causes controversy when representatives of associations become delegates to official commissions and receive state remuneration for what is in essence lobbying activity. Although the law is aimed at regulating the influence exerted on the legislative process and curbing corruption, it is feared that the powers of well-organized interest groups may expand. That is, critics charge that the practice of establishing specific legal norms for particular business or social groups rather than general and equitable rules increases incentives to influence decision-making authorities.

Lithuania's educational system is considered to be free of political influence and propaganda. In the 1999–2000 school year, 1.5 percent of all educational establishments were private. A mere 0.8 percent of schools that offer primary (1–4 grades), basic (5–10 grades), and secondary (11–12 grades) education are privately owned. Eleven percent of all vocational schools and colleges and four of the country's 16 institutions of higher education are private.

Independent Media

1997	1998	1999-2000	2001	2002
1.75	1.50	1.75	1.75	1.75

The main sources of public information are radio, television, and national and local daily newspapers. The vast majority of Lithuania's mass media are privately owned. The state still owns part of the ELTA news agency and the public broadcasting company National Radio and Television.

The major national dailies are *Lietuvos Rytas*, with a circulation of 61,000; *Kauno Diena*, 43,000; *Respublika*, 41,000; and *Lietuvos Zinios*, 17,000. *Verslo Zinios*, with a circulation rate of 9,500, is the most popular business paper. The most popular television stations are TV3 and LNK, each enjoying about 24 percent of total viewership. Local and cable television channels account for 17 percent. Baltijos TV, with 13 percent, ranks fifth. The viewership of Lithuanian Television is 10 percent. Lithuanian Radio enjoys the largest radio audience, with 45 percent of all listening time. The next most popular radio stations are M-1, M-1 Plus, and Lietus.

Lithuania's leading private media are financially viable. Debates on introducing a subscriber's fee for the debt-laden Lithuanian Television are under way. If approved, each household would pay 4–6 litas (\$1–\$1.50) beginning July 1, 2002. Lithuanian Radio and Lithuanian Television also plan to move to a producer system and to sign annual contracts with employees.

Electronic sources of information are expanding, and traffic to the Web sites of news agencies, radio stations, television channels, and daily papers is increasing steadily. The most popular information portals are Delfi, the Web sites of the news agencies ELTA and BNS, and the Web site of the M-1 radio station.

Lithuania's mass media continue to enjoy the highest degree of public confidence (over 70 percent of the population) of all institutions. The Commission on the Ethics of Journalists and Publishers and the Inspector of Journalists' Ethics function as supervisory institutions. Attempts to establish an ombudsman's office for the media failed when the 2000 Law on Public Information was adopted. Notably, most influential media representatives act professionally in accordance with the Ethical Code of Journalists and Publishers.

Lithuania's newspaper distribution system is privately owned. The largest periodicals like *Lietuvos Rytas* operate their own subscription services. The only exception is the state-owned *Lithuanian Post*, which holds a small share of the market. It distributes small periodicals and targets mostly rural audiences. The largest distribution company, *Lietuvos Spauda*, was formed from a former Soviet monopoly. Several private companies distribute publications through a chain of gas stations, grocery stores, and hotels.

The media in Lithuania are editorially independent. Publications may be closed and journalists penalized only by court decisions. There has been some evidence of private owners influencing journalists. In addition, the new government of Social Democrats and Social Liberals has tried to limit communication with the media by allowing reporters and journalists to communicate with ministers only in a remote press conference hall and only if the ministers themselves agree. Direct radio feeds of cabinet sessions for reporters have been terminated. State-owned National Radio and Television remain under considerable pressure from the government, which controls budget allocations.

The Lithuanian Constitution guarantees the freedom to “pursue, receive, and disseminate information and ideas.” Yet the same article provides that this freedom may be limited by law if it is necessary to “protect a man’s health, honor, dignity, private life, and morals or to protect the constitutional order.” Although there are no special penalties for libeling public officials, the criminal code does provide for two years of imprisonment, two years of penitentiary labor, or a fine for libeling or disseminating false information that defames a person. Drawing on the civil code, the court can mandate an indemnity of 500 litas (\$125) to 10,000 litas (\$2,500) for publicizing false information that dishonors a person or for publishing information about a person’s private life without his or her prior consent. In the fall of 2000, for example, criminal charges were brought against the daily *Lietuvos Aidas* for inciting ethnic discord when it published about 50 anti-Semitic articles. However, in March 2001, the Lithuanian Jewish community asked the general-prosecutor’s office to drop the charges against the newspaper’s chiefs after they issued an apology.

The Journalists Union, the Public Relations Association, and the Journalists Center are the most prominent media organizations. In November 2001, the Lithuanian Journalists Federation was established. The federation aims to be more active than the Journalists Union in conducting different projects, organizing training sessions for journalists, and protecting journalists’ rights. Its establishment was viewed as a protest against the Journalists Union, which had ignored its members’ proposal to summon an extraordinary congress. The federation is expected to unite some 400 journalists from around the country.

According to recent public opinion surveys, 19.5 percent of the Lithuanian population use the Internet—a figure three times the world’s average. Some 8.5 percent of Lithuanian inhabitants use the Internet every day or several times a week, and a total of 5.8 percent of Lithuanian citizens have access to the Internet at home. There are no restrictions or regulations on the use of the Internet. However, the Internet market has been affected by the 1998 Law on Telecommunications, which granted Lithuanian Telecom a monopoly in terrestrial communications until 2003.

Governance and Public Administration

1997	1998	1999-2000	2001	2002
2.50	2.50	2.50	2.50	2.50

Reform of the civil service system has been initiated in Lithuania. At the close of 2001, Parliament was still debating a new bill that would help create an apparatus of professional civil servants; ensure continuity in the work of state and municipal authorities; and promote political neutrality, transparency, and responsible decision making in the provision of high-quality governmental services. The bill is also aimed at implementing a clear and transparent system of remuneration for public service and eliminating wage disparities and unjustifiably high layoff benefits.

According to the functioning 1999 Law on Civil Service, government employees are divided into politicians (ministers and elected officials), politically appointed civil servants, career civil servants, and civil servants engaged in the provision of governmental services. Municipal civil servants are employees of local governments. The law confers a considerable degree of independence on civil servants, and critics charge that this policy poses a serious hindrance to state governance and public administration reforms.

The new Law on Civil Service is expected to unify and streamline the system by specifying a unified list of civil service offices and excluding from it persons who provide public services or perform technical functions. The draft law also defines the responsibilities of civil servants and outlines general principles for applying punitive measures when those obligations are not fulfilled. Remuneration will be based on three levels of qualifications.

Although Lithuania’s Constitution and laws provide for a separation of legislative and executive powers, this system of checks and balances contains serious flaws. For example, there is disarray in the division of legislative and executive powers in drafting bills. Although the legislature is the effective rule-making institution, some two-thirds of bills are prepared by the government. The practice of delegating lawmaking powers to lower-tier executive institutions is widespread. Executive authorities have the right to enact legal provisions and statutory regulations that they themselves are responsible for implementing. They also define the procedures for inspecting and ensuring compliance with them. Such inappropriately extended powers can lead to excessive regulation and arbitrariness in law enforcement.

The Lithuanian legislature is criticized for over-regulation and interventionism, which can be attributed to the practice of outlining detailed requirements rather than general rules in laws. The high number and inconsistency of legal acts are two other serious complaints. These weaknesses are mainly the result of chaotically and hastily adopting laws without setting forth a clear conceptual framework that gives proper regard for the strategic objectives of the state. The legislature adopted more than 3,300 legal acts

and 15,500 government decrees from 1990 through 2001. The years 2000 and 2001 alone saw the passage of more than 800 laws and about 3,000 government decrees. To amend the situation, the Ministry of Justice adopted a resolution in December 2001 that enacts a methodology for preparing the conceptual frameworks of legal acts before drafting new laws or replacing existing ones. Each framework will indicate the rationale for adopting a new law; specify its goals, objectives, and content; contain an impact analysis and listing of legal documents that will be replaced or revoked; and analyze international legal norms. This measure is expected to be a watershed moment in legislative reform.

Lithuanian law provides for the disclosure of government documents and sanctions such as no-confidence votes and impeachments. Also in place are self-policing mechanisms such as ethics committees. The office of the state ombudsman is responsible for external monitoring of state behavior. Controversial amendments to the Law on the Legislature's Investigators have been proposed. If adopted, they would restrict the right of ombudsmen to review the actions of Lithuanian law enforcement bodies. The Human Rights Committee claims that narrowing the authority of parliamentary overseers would not be appropriate.

According to the Constitution, parliamentary investigators are prohibited from investigating instances of excessive bureaucracy and abuse of power only within the judiciary. There is already much concern that the current law does not allow them to investigate decision making in legal proceedings, and this clause remains in the new version of the law. Meanwhile, parliamentary investigators have uncovered numerous instances of abuse of office by law enforcement officials. Due to the efforts of parliamentary investigators, prisoners and detained suspects can now receive medical examinations from independent medical professionals.

Although Lithuania's legislative and executive authorities are becoming increasingly open, they are still criticized for lacking transparency. By law, bills and regulations must be announced on the Web sites of respective policy-drafting institutions, but laws are often adopted without prior notice or public scrutiny. Cabinet sessions take place behind closed doors. The Parliament is more open, but it is not obligated to inform the public or the media of its work. The practice of public hearings is being increasingly used in parliamentary debates.

In November 2001, Parliament amended the Law on Local Government to allow foreign citizens permanently residing in Lithuania to vote and contest seats in municipal councils. However, foreign citizens may not be elected mayors, deputy mayors, or members of boards of municipal councils. These amendments were adopted in order to bring the law in line with proposed constitutional amendments on the rights of foreign citizens to participate in municipal elections.

The existing system of subnational government was established on the basis of the 1992 Constitution and the 1994 Laws on Local Government and Administrative Territorial Units. Lithuania has one level of local government, which includes 60 municipalities mostly with 30,000 to 50,000 inhabitants. There are 10 regional administrations, or territorial units of the central government, that are headed by centrally appointed governors. At the municipal level, subnational officials are chosen in free elections. The tenure of municipal councils is three years. These councils, in turn, appoint mayors. The general opinion is that mayors, heads of territorial administrations, and governors of regional administrations should also be elected rather than appointed.

The responsibilities of the country's municipalities are divided into independent functions and duties delegated by the central government. Their main independent responsibilities include municipal development, management of local enterprises, and establishment and supervision of protected areas and objects. The main responsibilities delegated by the central government are primary and secondary education, primary health care and disease prevention, culture and sports, development of leisure and the tourism industry, environmental protection, the provision of social assistance, garbage collection, fire protection, heating, water supply, and sewerage. In some areas, such as health care and education, both central and local authorities are involved. Ambiguities in the division of power have impeded decentralization and the establishment of a stable fiscal structure for municipalities. They have also led to intergovernmental tension, inefficient provision of services, and unclear accountability.

Municipal governments generally lack funds to meet their expenditure obligations, owing mainly to mismanagement and expanding local government authority. Municipalities are free to allocate funds among expenditure categories, with the exception of functions delegated by the central government. Municipal revenues are raised and transferred by the central government, and changes are negotiated between municipalities and the central government and approved by Parliament every three years. Local authorities are not authorized to introduce or collect taxes, but they may levy some local charges and user fees. They can also lower tax rates at the expense of their own revenues. More than 70 percent of municipal revenues comes from personal income taxes and subsidies from the central budget. The fiscal capacities of local governments are equalized according to expenditure-need assumptions.

Professional skills and managerial abilities of local officials vary significantly across municipalities. In most locales, leaders and civil servants lack skills and are inclined toward excessive interventionism. Political connections and cronyism are widespread in the hiring of civil servants, but such influence on professional activities is weaker. In 2001, parliamentary chairman Arturas Paulauskas formed a task force to establish ethical prin-

ciples for politicians and civil servants, including honoring the individual and the state and exhibiting fairness, altruism, propriety, and openness in one's work. These principles are expected to provide the foundation for a planned official code of civil service ethics.

RULE OF LAW

Constitutional, Legislative and Judicial Framework

1997	1998	1999-2000	2001	2002
2.25	2.00	2.00	1.75	2.00

On July 1, 2001, a new civil code that is in accord with EU law and other international legal acts came into effect. The law comprises six volumes: general provisions, regulation of the legal status of natural and legal entities, legal relations for families, execution and defense of material rights, legal rights of inheritance, and legal regulation of different kinds of contracts and agreements. In 2001, several amendments to the Lithuanian Constitution were also initiated, each one relating to Lithuania's integration processes with the EU. In November, Parliament approved in its first reading an amendment to Article 47 that allows foreign citizens and corporations as well as Lithuanian companies to buy farmland. Lithuanian corporations will be able to buy farmland as soon as the amendment passes; foreigners will have to wait until Lithuania joins the EU. An amendment to Article 119, submitted to Parliament in July, envisages increasing the tenure of municipal government bodies from three to four years as well as giving EU citizens who reside permanently in Lithuania the right to vote and contest seats in municipal council elections. Changes to Article 36 would provide grant authority and functions in certain matters to the EU and supremacy to EU law over Lithuanian legislation.

The initiation of a constitutional amendment requires the consensus of one-quarter of the members of Parliament. The legislature must vote twice on the measure, with an interval of three months separating the two ballots. A two-thirds majority is required in both ballots for a constitutional amendment to pass. The Constitution may also be amended by referendum.

Lithuania's Constitutional Court has proved to be an independent, powerful, and reliable guardian of constitutional rights. However, rulings of the Constitutional Court are not always properly enforced. The Constitutional Court has adopted 65 rulings that find laws to be in conflict with the Constitution, but only 44 of its decisions have been implemented. According to the Constitution, a law loses its legal force on the day the Constitutional Court's ruling is published.

In November 2001, the Constitutional Court ruled that the government's 1998 protocol decision to allow

Denmark's Danisco Sugar to acquire about 90 percent ownership in Lithuania's sugar factories violates the Constitution. The Court was asked to judge whether the aforesaid decision did not contradict the constitutional articles banning monopolization of production and markets and protecting honest competition. The Constitution requires that market concentration issues be established by government resolutions, not protocol decisions. In July 2001, the Constitutional Court also ruled that legislation reducing judges' salaries violated constitutional clauses on the separation of powers. The former government of Gediminas Vagnorius had raised wages for judges significantly, but Prime Minister Andrius Kubilius later reduced them drastically as part of general budget cuts in 1999. In October 2001, the Constitutional Court found unconstitutional a provision in the Lithuanian code of administrative violations of law that allowed authorities to hold a person's driver's license until he or she paid an outstanding traffic fine.

Parliament has adopted a new criminal code that will take effect in 2003. The existing criminal code and Law on Criminal Procedure have been reformed through more than 300 amendments. A number of activities, including homosexuality, have been decriminalized, and capital punishment has been abolished. The court system has been modernized, and criminal prosecution is now subject to stricter procedures. Yet criminal penalties in Lithuania remain rather strict, and its prison population is among the largest in Europe. Public prosecutors authorize searches. Judges issue warrants.

A recent inspection and study by the European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment defined conditions of detainees in police lockup in Lithuania as inhuman and degrading. They found ill treatment, abuse, violence, and even torture of those detained by police to be of great concern. Compared to police facilities, relatively few allegations of physical ill treatment of inmates by prison staff were noted. However, a high level of interprisoner violence was recorded. Overcrowding in Lithuanian prisons was found to be a serious problem. The Lukiskes Prison in central Vilnius, with a capacity of 906, held 1,578 prisoners as of May 2001; 72 are serving life terms. President Adamkus has contended that even though conditions for inmates are good, international aid is needed to make improvements. On October 30, 2001, in spite of the Council of Europe's recommendation, Parliament rejected amendments to the criminal and penal codes that would have eased conditions for prisoners who are serving life sentences. The amendments would have allowed prisoners to be transferred from prisons to high-security work colonies after serving at least a decade of hard time without infraction.

Judicial decisions are enforced quite effectively in the criminal sphere, but the enforcement of decisions in civil cases is regarded as ineffective. There are serious concerns, though, over delays in probing criminal cases, even the simplest of which are dragged out for months. The process of court hearings is long, and witnesses and victims can be

called to court dozens of times. A new code on criminal process, currently under preparation, is expected to bridge these gaps, but the president has proposed improving the performance of Lithuanian law enforcement without delay.

The Constitution provides for human rights and their protection, including the rights to own property and to own and work in business. Lithuania has ratified major international conventions on human rights, including the European Convention on Human Rights. The Framework Convention on Protection of National Minorities has also been signed and ratified. All citizens are treated equally by law and in practice. In 2000, 183 applications regarding violations of human rights were registered in Lithuania. There is also some evidence of discrimination against women and sexual minorities. The 1999 Law on Equal Gender Opportunities defines and prohibits gender discrimination and regulates relationships in the areas of employment and education. A controller's office for equal gender opportunities has been established.

According to a survey commissioned by the United Nations Development Program in November 2001, almost 39 percent of Lithuanian citizens claim that human rights are systematically violated in Lithuania; only 3.2 percent think violations are totally or almost nonexistent. A total of 85 percent of the respondents complained about violations of the right to work, 77 percent about violations of the right to fair wages, and 79 percent about violations of a proper living standard. More than half of those polled expressed dissatisfaction with social safety, health care, and educational provision. The most secure rights, according to respondents, are freedom of religious conviction, freedom of expression, and the rights of ethnic minorities. In general, Lithuania's human rights record is very good, and the country stands out in the region in terms of activities performed by ombudsmen.

Minorities are free to establish their own educational, cultural, and religious institutions. Inciting ethnic discord is prohibited. Since 1999, the country's Jewish community has expressed concern over anti-Semitic remarks made by some politicians and fringe political groups. The daily *Lietuvos Aidas* faced criminal charges for inciting ethnic discord when it published about 50 anti-Semitic articles in 2000. The Lithuanian president, the prime minister, and some professional organizations of journalists strongly criticized the anti-Semitic attacks in the paper. As mentioned previously, the Lithuanian Jewish community asked the general-prosecutor's office to drop charges against the newspaper's chiefs, who had apologized for the publications and promised not to publish such material in the future. That same month, the parliamentary Ethics and Procedures Commission ruled that Vytautas Sustauskas, a member of Parliament, had behaved unethically and irresponsibly when he incited ethnic and religious discord with anti-Semitic remarks during an interview with a Swedish television station. The Center Union asked the Ministry of Justice to outlaw Sustauskas's populist Lithuanian Freedom Union based on the Law on Political

Parties, which forbids the incitement of ethnic, religious, and national strife by political parties.

The Lithuanian state recognizes nine religions as traditional: Roman Catholicism, Greek-rite Catholicism, Evangelical Lutheranism, Evangelical Reformers, Orthodoxy, Old Believers, Judaism, Sunni Islam (the traditional religion of Lithuanian Tartars), and Karaism. The Lithuanian Law on Religions mandates parliamentary recognition of other non-traditional religions as part of Lithuania's historic, spiritual, or social heritage if they enjoy public support and do not violate the country's laws and morals. Thus, there is a four-tier system of traditional, state-recognized, registered, and unregistered religious groups. The Law on Religions allows religious communities to ask for state recognition after 25 years have passed since their registration with the Ministry of Justice. In July 2001, Parliament granted the Union of Lithuanian Evangelical Baptist Communities (1,000 members) official state recognition but refused to give the group official status as a traditional religious community. Some members of Parliament have proposed naming pagans, adherents of the historic Baltic belief system, as a traditional religious community. Pagans have been refused legitimization until now. Around 18 percent of the population does not identify with any religious denomination.

Both traditional and state-recognized religious communities can receive state subsidies and do not pay social and health insurance for clergy and other employees. They are not charged a value-added tax on electricity, telephone service, and heating. Only so-called traditional communities have the right to teach religion in state schools and buy land to build churches. Others have to rent land. Religious communities that are registered by the Ministry of Justice cannot receive state subsidies, tax exemptions, or social benefits, but they can rent land for religious buildings. Unregistered communities may not rent land, but there are no reports that such groups have been prevented from worshiping or seeking new members.

The courts of the Republic of Lithuania include district and county courts, the court of appeals, and the Supreme Court of Lithuania. It is estimated that one-third to one-half of all judges are new appointees. The number of judges has grown from 456 in 1996 to 700 in 2001; of these, 450 are employed in district courts. Nevertheless, an increase in caseloads has caused a net deficit of judges, especially at the local level.

Recently, the administration of justice and separation of powers in Lithuania have appeared to be in serious disarray. A 1999 ruling by the Constitutional Court voided much of Lithuania's established law and legal practice regarding the courts, finding that the executive branch had undue influence in violation of the Constitution's system of checks and balances. The Court's ruling established a conceptual basis for judicial independence, but it also created a legal vacuum. While the aforesaid legal acts became void after the Court's ruling took effect, a new Law on Courts is still in preparation. As a result, the lines of administrative authority are currently unregulated.

A recent study by the Open Society Institute found that Lithuanian courts have inadequate financial autonomy and that judges work in unsatisfactory conditions. The study also found that a reduction in judges' salaries threatens to interfere with independence of the judiciary and create unacceptable pressures on judges' impartiality. The Ministry of Justice has no formal control over court decisions except in matters of technical support, but its influence is significant. Most lawyers and businesspeople claim that the state exerts pressure on judges, particularly in cases against state institutions regarding economic matters. There has been evidence of state officials exerting pressure on judges to deliver guilty verdicts in certain resonant criminal cases or to adopt favorable rulings toward particular persons in civil cases.

In November 2000, Parliament resolved by an absolute majority of votes that the country's prosecutor-general is appointed by the president with Parliament's approval. Until then, Parliament had made the appointment on the recommendation of the parliamentary Committee on Legal Affairs. Although most judges rule fairly and impartially, opinion polls still indicate that public mistrust of judges is high (about 80 percent). Politicians and members of the media also distrust the judicial branch. As a result, judges operate in a hostile atmosphere in which a significant part of legal costs are paid as bribes to them and to solicitors. Large companies are more likely to initiate lawsuits than small businesses and ordinary citizens, who find the expense in time and money too great.

Judges on the Supreme Court and court of appeals are nominated by the president and approved by the legislature. The president also appoints district court judges. All judges are appointed for life. The Constitutional Court has proved to be immune to political pressure. The chairman of the legislature, the chairman of the Supreme Court, and the president each nominate one judge to the Constitutional Court.

By law, the state must provide public defenders. Because of a dramatic decline in the number of available lawyers, who were poorly compensated, the government now requires that private lawyers provide a certain amount of service to the state. At present, the average monthly salary of lawyers is \$2,000, while the country's average is \$267.

Corruption

1999-2000	2001	2002
3.75	3.75	3.75

Since 1997, the Special Investigation Bureau within the Interior Ministry has been in charge of official anticorruption initiatives. The bureau reports to the president and Parliament. The president appoints and dismisses the director of the bureau at the recommendation of Parliament. Lithuania is the only European country with a special anticorruption institution of this kind.

In the fall of 2001, the government adopted a national anticorruption strategy that was prepared by the Special Investigation Bureau in cooperation with Danish and local experts. Key elements of the strategy include corruption prevention, investigation of corruption-related offenses, and public awareness of and support in disclosing corruption. The strategy envisages streamlining of interagency structure for fighting corruption by organizing, planning, and executing joint actions that will help deter and disclose crimes. The implementation of the strategy will involve state authorities, NGOs, educational institutions, auditing organizations, and the private sector.

This strategy is the first official Lithuanian document that recognizes deregulation and reduction of bureaucracy as keys to fighting corruption. Its main focus will be on eliminating legal loopholes that create conditions for abuse of official power by granting excessive authority to public officials. The strategy also envisages making public officials personally responsible for enacting inadequate legal provisions, regulations, or administrative decisions. A work plan for implementing the strategy is under consideration.

According to the Law on Civil Service, civil servants are not allowed to sit on enterprise boards, represent enterprises, or make contracts with related entities. Yet the press has featured numerous political ties to businesses. The worst situation is in state-owned sectors, where old *nomenklatura*-type appointees have close connections with central government and municipal authorities. Ethical standards concerning relationships between businesses and politicians are in place but are frequently ignored. Public opinion does not exert much pressure on politicians to obey these standards. On the other hand, the public is often suspicious about businesspeople in politics, even if there is no evidence of the abuse of official power.

By law, when persons accept employment in state service, they cannot represent any interest related to their former place of employment for one year. The law also prohibits conflicts of interest and requires financial disclosures by politicians, managers of companies, and their spouses. Presidential, parliamentary, and local council candidates must declare their property and income before elections. Elected politicians, political appointees in the civil service, and directors of companies must make annual declarations of their income and property. The criminal code includes provisions against, and prescribes severe penalties for, racketeering. Executive and legislative bodies operate under audit and investigate rules, but in many cases these are applied in a rather formal or fragmented manner.

In 2001, the Special Investigation Bureau exposed 194 crimes. Of these, 118 were against state office—an increase of 110 percent over the previous year. A total of 124 officials were determined to be under suspicion of crimes. The Special Investigation Bureau also launched 145 criminal cases in 2001, of which six were terminated. Most of the cases involved police officers, civil servants, and customs officers. Charges have also been brought against several lawyers,

solicitors, notaries, and officials of the State Border Security Department and the Investigation Department. A number of municipal officials who are involved in corrupt practices have been exposed and under investigation. Several lawyers, notaries, and tax officers have been prosecuted and convicted.

Corruption and bribery are entrenched in many areas. As businesspeople report, the most vulnerable areas are customs, public procurements and tenders, the road police, offices that issue licenses and government permissions, courts, tax inspections, and municipal services. Investigations suggest that corruption occurs in at least 75 percent of public procurements. The mass media, schools, and the army are considered the least corrupt institutions.

Corruption is particularly pervasive within Lithuania's extensive regulatory system. The biggest cause for concern is the inconsistency and discretion that regulatory authorities exercise in interpreting, applying, and enforcing regulations. The leading complaint is related to the issuance of permits such as licenses, registrations, certificates, approvals, and consents or warrants, because they are predicated on vague rules and involve excessively complex procedures. In many cases, permissions must be obtained not only for entities to operate in the market, but also for particular products and professional activities or processes.

Most regulatory obligations are vaguely defined, change frequently, and are repetitive or even retroactive. Companies are subject to extensive employment, sanitary, and reporting requirements. Routine administrative procedures and decision-making processes are frequently protracted. Regulatory authorities have a right to perform on-site inspections for labor safety, fire prevention, hygiene, and other work conditions and to impose large penalties without court proceedings. This, in turn, creates ample opportunity for corruption.

The launch of the Sunset and Sunrise Commissions in 1999 by the Kubilius administration was a major contribution to Lithuania's efforts to curtail corruption. Their respective aims were to reduce bureaucracy and to improve the business environment by eliminating unjustified regulations. For example, 10 market regulation agencies responsible for controlling food and nonfood products were reorganized into 2 agencies, thus eliminating overlapping regulations and reducing the bureaucratic apparatus. In November 2001, Prime Minister Brazauskas revived the Sunrise Commission with the goal of implementing many significant proposals that had been formulated but never implemented owing to frequent cabinet reshuffles and a lack of executive discipline in executing government-approved policies. The adoption of a proposal that allows applicants to file all necessary documents for obtaining official permissions with one authority and the creation of automatic procedures for issuing those permissions will be vital in the fight against corruption.

The salaries of civil servants, both at national and subnational levels, are higher than those paid to individuals

with comparable qualifications and responsibilities in the private sector. The difference has been steadily widening since 1990. At present, the average net earnings of civil servants are \$276 per month as compared with the country's average of \$267.

The results of an opinion poll presented by the Lithuanian branch of Transparency International in early October 2001 show that 61 percent of Lithuanians are prepared to offer bribes if it might benefit them. Although most people condemn corruption, they also recognize it has become the norm. Some 72 percent said that bribes help solve problems; 36 percent of residents and 37 percent of businesspeople had given bribes over the last five years. Half of those polled thought corruption had increased over the same period. Yet 77 percent of residents and 60 percent of businesspeople maintained that corruption is a serious drag on civic and business growth. Although most residents of the country learn about corruption from the media, businesspeople claim to have personal experience with it. The likelihood of facing corrupt officials is estimated to be about 50 percent in the road police, 40 percent in health care institutions, and 30 percent in customs. As the Transparency International survey revealed, the average bribe a citizen offers is around \$200; businesspeople shell out an average of \$2,000.

ECONOMIC LIBERALIZATION & SOCIAL INDICATORS

Privatization				
1997	1998	1999-2000	2001	2002
2.25	2.25	2.50	2.50	2.25
Macroeconomic Policy				
1998	1999-2000	2001	2002	
2.75	3.25	3.00	2.75	
Microeconomic Policy				
1998	1999-2000	2001	2002	
2.75	2.75	2.75	2.25	

Steady macroeconomic stabilization, early and effective voucher privatization, the continued sale of state property, and business liberalization have been essential to the democratization process in Lithuania. Today, international organizations recognize that Lithuania is on track with economic restructuring and adjustments designed to meet the requirements of EU membership. Yet they still put pressure on the country to tighten fiscal policy and accelerate structural changes. The IMF, for example, has called for continued efforts to reform municipal finances, to clear

central government arrears to the state health insurance fund, and to overhaul the tax system in the run-up to EU accession. The continued privatization of state enterprises is another priority.

Lithuania is in the second phase of privatization, which is based on cash sales. The first round, voucher privatization, was completed in 1995 and absorbed 81 percent of state property that was slated for sale. Cash privatization was considerably delayed owing to prolonged debates on the sale of strategic items, especially state-owned banks. The merger of Lithuania's Hansabankas' with the Lithuanian Savings Bank, the second largest commercial bank and the biggest retail bank, and the sale of the Shipping Company LISCO in April 2001 marked the start of privatization of strategic enterprises. In November 2001, the German Norddeutsche Landesbank Girozentrale won the tender on the sale of a 76 percent stake in the Agricultural Bank, the last state-owned bank. Thus far, about 3,000 items have been sold during the second round of privatization; another 3,000 entities are slated for sale. The biggest sales will include the power utility Lithuanian Energy, the natural gas distribution company Lietuvos Dujos, Lithuanian Airlines, and Lithuanian Railway.

The 1997 Law on Privatization defines several methods of privatization, including public auction, public tender, direct negotiations, public sale of shares, rent-to-own, and transfer of control of state-owned enterprises. Foreign and local investors have equal rights. Buyers of large enterprises are subject to special qualification requirements and obligations regarding future investments and job preservation. This has often reduced the transparency and pace of privatization and resulted in artificial ownership concentration and lower proceeds. The state has the right to retain a so-called golden share that grants extra nonproperty rights when more than half of the public stock in a public utility or in a transportation, energy, oil, or communications enterprise is sold. Privatization through the stock exchange—the key to efficient and transparent privatization—has been scant. Of the 947 entities privatized in 2000, only 26 were sold on the stock exchange. In late 2001, a decision was made to expand the use of the stock exchange in this regard.

According to the LDS, the private sector creates about 75 percent of the country's GDP and employs 70.5 percent of all working individuals. Small and medium-sized enterprises account for about 96 percent of all registered companies. Of the more than 100,000 operating small and medium-size businesses, 43 percent are engaged in commerce, 32 percent in services, and 9.5 percent in manufacturing. Private ownership rights have been restored to 79 percent of all rural lands claimed in citizens' applications.

According to expert estimates, the informal sector shrank from 27 percent of gross domestic product in 1998 to 21 percent in 2001, owing mainly to the expansion of local enterprises and increased reliance on their good reputation. Unreported exports and imports decreased from an

estimated 20 percent of total trade in 1998 to 14 percent in 2001. The main factors that continue to stimulate informal undertakings are high taxes, excessive state regulation and market restrictions, price differences with neighboring countries, an underdeveloped public administration, and corruption. Informal activities are particularly widespread in commerce involving foreign countries, small businesses, and household services. An increase in excise duties has bolstered the illegal trade in fuel and tobacco products.

Over the past few years, Lithuania has maintained strong macroeconomic positions and economic growth, with low inflation and interest rates. Lithuania's GDP rose by 3.9 percent in 2000 and 5.7 percent in 2001. Expanding mining and processing industries, plus rising trade and exports, have contributed decisively to this growth. However, a decline has been recorded in transportation, warehousing, communications, and agriculture. Annual inflation was 2 percent in 2001, as compared with 1.4 percent in 2000, 0.3 percent in 1999, and 2.4 percent in 1998. The average rate of inflation was 1.3 percent in 2001 and 1 percent in 2000.

The year 2001 was marked by significant policy decisions, including the repegging of the national currency, the litas, from the U.S. dollar to the euro. The change is scheduled to take place on February 2, 2002. In addition, Parliament adopted amendments to the Law on the Bank of Lithuania that give the central bank more independence. It also made numerous changes to the tax system, owing mainly to EU integration and membership in the World Trade Organization. However, some of the changes to the tax system stem from the government's leftist policies and threaten to aggravate Lithuania's business environment.

The tax burden increased steadily until 1998 and has constituted 32 percent of GDP for the past three years. By some estimates, the tax burden may make up as much as 37 percent of GDP. Over 90 percent of tax revenues are collected from VATs, income taxes, excise duties, and customs duties. The 18 percent VAT is the most effective of all Lithuanian taxes. The personal income tax is charged at a regular rate of 33 percent but will fall to 29 percent starting in 2003. Tax-exempt minimum income will rise from 214 to 250 litas in April 2002. A 15 percent capital gains tax was abolished on January 1, 2001, but the ruling coalition is seeking to reimpose it.

The corporate income tax will drop from 24 to 15 percent in January 2002. At the same time, though, a zero tax rate on reinvested profits will be eliminated. This decision is likely to exacerbate the investment climate, reduce the competitiveness of Lithuanian enterprises, and increase tax evasion. Starting in 2002, excise duties will be charged only on alcohol, fuel, and tobacco, as required by the EU.

High tax rates and ambiguous rules have led to large-scale tax evasion. Lithuania's tax laws grant broad powers to tax officers who have the right to exact tax arrears from personal accounts and to seize a taxpayer's property without court proceedings. The object, scope, and time of an

inspection are left to an officer's discretion. In September 2001, amendments to the Law on Tax Administration took effect. These changes in law expanded the powers of tax officers by allowing them to impose various restrictions on business enterprises, to take copies of a taxpayer's documents or computer data temporarily, and to lift or reduce penalties and fines. On the positive side, bonus payments for exacted taxes and the right to terminate a business activity for violations of tax laws were abolished.

When the litas is repegged to the U.S. dollar, it will be neither devalued nor revalued during the shift. Since 1994, Lithuania's currency board system has backed cash in circulation with 100 percent hard currency and gold reserves. It has also secured full internal convertibility of the national currency, shielded the monetary system from political pressure, brought about a considerable decline in interest rates, and curbed inflation, which fell from 35.7 percent in 1995 to 2 percent in 2001.

The Bank of Lithuania is an independent institution. Amendments to the Law on the Bank of Lithuania, adopted in March 2001, redefined price stability rather than currency stability as the central bank's primary aim. Critics charge that the bank does not have the necessary instruments to ensure price stability, even though responsibility for it rests entirely in its hands. Under a currency board regime, the Bank of Lithuania has limited powers to regulate interest rates and curb inflation. Yet the amended law opens the way for an arbitrarily regulated exchange rate—a provision that has been criticized as superfluous given that the law precludes devaluation or revaluation of the litas during the repeg.

Lithuania's banking sector is stable. At present, nine commercial banks and branches of four foreign banks—the Polish bank Kredyt Bank S.A., the German Nord/LB and Bank Vereins-und Westbank, and the Finish Merita Bank Plc—are operating in the country. In April 2001, the Lithuanian Savings Bank merged with Lithuania's Hansabankas and was reorganized into Hansa-LTB. It has a combined share of about 36 percent of the Lithuanian deposit market. Vilnius Bankas, owned by the Swedish banking group SEB, holds 41 percent. Negotiations with the German Norddeutsche Landesbank Girozentrale are under way on the sale of the last state-owned bank, the Agricultural Bank. Since the start of reforms, bankruptcy proceedings have been instituted against 14 Lithuanian commercial banks, of which 12 have been declared bankrupt.

The banking sector relies on traditional governmental safety mechanisms. International accounting and risk management standards are being implemented. As of July 2001, Lithuanian banks must comply with five prudential requirements on a daily basis. These are capital adequacy, liquidity, maximum open position in foreign currency and precious metals, maximum exposure to a single borrower, and large exposure. A mandatory deposit insurance system has also been installed. In October 2000, the mandatory reserve requirement for commercial banks was reduced

from 10 to 8 percent; a further cut, down to 6 percent, is planned.

The National Stock Exchange of Lithuania (NSEL) comprises 56 companies, of which 7 are on the Official List and 49 on the Current List. While the Official and Current Lists have been quite stable, the number of nonlisted securities has shrunk owing to concentration trends and the reorganization of companies into limited liability enterprises. Every year some 50 companies withdraw from the NSEL. These trends are likely to intensify since the number of shareholders allowed in limited liability companies was raised from 50 to 100 in July 2001. At the end of September 2001, the capitalization of the NSEL totaled \$3 billion, with \$1.525 billion for listed securities and \$1.475 billion for unlisted securities.

A program for business deregulation, launched by the Kubilius administration in 1999, marked a watershed in the improvement of business conditions in Lithuania. A Sunrise Commission, set up for removing unnecessary market constraints, brought about long-awaited amendments to income tax laws and the liberalization of employment, customs, capital market, land purchase, and building regulations. A lack of political will and administrative discipline, a lengthy approval process, and cabinet reshuffles have prevented full implementation of the program. In addition, the current government is actually considering new regulations. In the fall of 2001, for example, it set a minimum purchase price for grain and reintroduced state regulation of refined sugar prices. Price regulations are still applicable to energy resources, agricultural commodities, pharmaceuticals, medicines and medical services, and transportation.

The main obstacles to running a business are excessive licensing, registration, closure, reporting, and other requirements. The regulations are vaguely defined, frequently changed, repetitive, and not readily available. More than 70 controlling institutions have a right to apply and prescribe rules at their own discretion, thus making compliance costly, cumbersome, and time-consuming, especially for small businesses. In addition to registering with the Ministry of Economics and municipal authorities, companies must register with the State Tax Inspectorate and the State Social Insurance Board. A single register of legal entities is still nonexistent. There is also no unified mechanism for the exchange of information among state institutions.

Licenses and official permissions are required for a wide range of business undertakings and professional activities, but the procedures for obtaining licenses and permissions are lengthy, complex, and often incoherent. According to a survey conducted by the LDS, 86 percent of firms consider the business environment in Lithuania to be unsatisfactory. Of the 230,000 small and medium-size enterprises that were registered as of January 1, 2000, only about 102,000 were in operation, 68,000 had closed down, and the remaining 60,000 had suspended their activities. Almost half of all new enterprises are liquidated during their first three years of operation.

The 1999 Law on Competition prohibits monopolistic practices as defined in EU law and lays down responsibility for violations of competition on the part of the state. The Competition Council, an independent public institution, oversees the implementation of the Law on Competition and competition policy in general. In July 2001, a new Law on Joint Stock Companies came into effect. Companies may now borrow from both their corporate and individual shareholders, but a limit is set on interest payable on such loans. New laws shorten bankruptcy proceedings and call for two rounds of responding to creditors' claims. However, these laws contain serious flaws.

The Constitution and corresponding laws guarantee and protect property rights. However, court delays are frequent, and the process of post-Communist property restitution has been protracted. Progress has been made in securing intellectual property. Violations of authorship rights and the volume of pirated materials have declined. Computer software remains particularly vulnerable to abuse, though, owing largely to a lack of experience and technical capacity, inadequate sanctions for offenses, and insufficient authority of supervisory institutions. Real estate registers are reliable but not entirely operational.

Lithuania became a member of the World Trade Organization on April 24, 2001. To meet WTO obligations, Lithuania reduced import duties on sugar, alcoholic drinks, agricultural and textile products, and certain household and construction goods. It also raised import duties on wine to the maximum allowable rates and increased tariffs on certain imported vegetables.

A small domestic market, scant natural resources, and a favorable geopolitical location make Lithuania open to, and dependent on, foreign trade. Foreign trade remains a driving force in the country's economic growth. According to the LDS, Lithuania's exports grew by 20.3 percent and imports rose by 15.1 percent in 2001. Exports to EU countries accounted for 48 percent of total exports; exports to CIS countries were 19.5 percent. Imports from the EU totaled 44.4 percent, while imports from the CIS made up over 29.7 percent. The trade balance remains negative; however, with exports growing faster than imports, the foreign trade deficit has shrunk.

Lithuania's applied tariffs currently average 5.4 percent on all products, 15.2 percent on agricultural products, and 2.5 percent on industrial commodities. The average tariffs Lithuania charges of countries with most favored nation status are lower than in all other countries in the region, except Estonia. More than 70 percent of total foreign trade is with countries that have free trade agreements with Lithuania, including member states of the EU and the European Free Trade Association, as well as Latvia, Estonia, Poland, the Czech Republic, Slovakia, Slovenia, Turkey, Hungary, Ukraine, and Bulgaria. Lithuania's main export partners are the United Kingdom, Latvia, Germany, and Russia. Its main import partners are Russia, Germany, Poland, and Italy. Mineral products, vehicles, and chemical

products constitute the bulk of imports. Exports include mostly mineral products, textiles, agricultural products, and foodstuffs.

Cumulative foreign direct investment has grown to \$2.53 billion, or \$775 per capita. The bulk of FDI comes from Denmark, Sweden, the United States, Germany, and Estonia and is directed to processing industries, commerce, financial intermediaries, and telecommunications. During the period covered by this report, 62.7 percent of FDI went to the capital, Vilnius, while the cities Kaunas and Klaipeda received 10.3 percent each. In September 2001, tax breaks for large-scale investors were revoked. These had included a 5-year freeze on direct tax rates for investors who pledged to invest at least \$50 million within 3 years and a freeze of up to 10 years for strategic investors. Corporate tax breaks remain valid for foreign companies that received them prior to their elimination in 1997. Profits can be taken out of the country freely. Interest payable to foreign entities is taxed.

Around 80 percent of Lithuanian power plants are owned by the state, and restructuring of the energy sector has been seriously protracted. Enforcement of the Law on Electricity, which was adopted in July 2000 and provides for the creation of a competitive market and free competition between producers and suppliers, has been postponed twice. Lithuanian Energy, a vertically integrated monopoly in which the state holds an 86 percent stake, was reorganized at the end of 2001 into two electricity distribution spin-offs and two power-generating facilities. Although the intention is to privatize these new entities, the transmission networks and the function of the market operator will be left to the state.

In November 21, a plan for privatizing the natural gas distribution company Lietuvos Dujos was also adopted. A strategic investor and a gas supplier will be offered 34 percent of the stock each. The state will retain 24 percent and sell the remaining 8 percent to local enterprises. Since gas suppliers and their related companies will not be allowed to become strategic investors, this prevents the Russian suppliers Itera and Gazprom from participating in the tender. The sale to a Western strategic investor is set for completion by mid-2002. One of the requirements of this investor is the ability to link Lithuania's natural gas network to EU pipelines and thereby ensure alternative supplies.

The state-owned Ignalina nuclear power plant supplies around 76 percent of all electricity consumed in Lithuania. Lithuania has pledged to decommission the first of Ignalina's two reactors by January 1, 2005. A decision regarding the closure of the second reactor will be made in 2004. Since Ignalina is the largest electrical energy producer in Lithuania, its closure will affect the country's entire electricity market. As a result, its closure is closely related to the overall process of energy reform. That is, it will create conditions for new market entrants and link Lithuania's overall energy market to those of west and north Europe. Lithuania is dependent on gas and oil pipelines from the CIS countries. The launch of the Butinge oil terminal has provided facili-

ties to import oil. Other facilities include the Klaipeda oil terminal and railways.

A fraying social safety net, high unemployment, and delayed pension, health care, and education reforms have been serious drags on Lithuania's democratization process. The launch of mandatory fully funded pension insurance is scheduled for 2004. In addition, in December 2001, the World Bank agreed to grant Lithuania \$693,700 for technical assistance in reforming its pension system. A partial voucher funding system is being introduced in secondary education. These reforms, along with continued business deregulation, are expected to accelerate changes in other social areas and thus in the overall development of the country. According to the UN's *Human Development Report* released in July 2001, Lithuania is among those countries with high levels of human development (based on life expectancy, adult literacy, per capita GDP, and purchasing power indicators) and ranks 47th out of a total of 162 countries.

As the 2001 population census shows, Lithuania's population has decreased by 5 percent over the past 10 years, owing mainly to emigration. It now totals 3.491 million, down from 3.675 million in 1989. A 2000 report by the LDS shows fewer marriages, more unregistered couples living together, and a threefold increase since 1990 of children born to young mothers out of wedlock. The number of crimes committed by young people has almost doubled.

Lithuania's demographic trends are rather varying. According to the UN's recent *Human Development Report*, the country's birth rate fell from 12.7 per 1,000 inhabitants in 1993 to 9.2 in 2000. At the same time, its mortality rate continued a downward slide from 12.3 per 1,000 in 1993 to 10.5 in 2001. The most common causes of death are cardiovascular diseases, malignant tumors, and nonmedical deaths. Nonmedical death is the most common cause of death among young people.

Infant mortality decreased from 15.4 per 1,000 live births in 1993 to 8.5 in 2000. The number of abortions was 69.6 per 100 births in 2000. Women's life expectancy grew from 75 years in 1993 to 77.9 years in 2000; for men, it fell from 69.1 to 67.6 years. The difference between these gender indicators is due mainly to a higher rate of death resulting from nonmedical causes among young men. The divorce rate grew to 6.4 divorces per 10 marriages. The number of suicides rose dramatically until 1996, hitting 46.4 per 100,000 inhabitants. It dropped to 41.9 in 1999 and rose to 44 in 2000, as compared with an average of 20 in EU countries.

A total of 70.5 percent of working persons were employed in the private sector. In 2001, the average annual rate of unemployment was 12.5 percent, compared with 11.5 percent in 2000. As demand for labor and seasonal jobs decreased, the rate of unemployment reached 12.9 percent at the end of 2001, up from 12.6 percent at the end of 2000, 10 percent in 1999, and 6.9 percent in 1998. Regional disparities in unemployment are quite sizable. The

rate of unemployment was 8.7 percent in Vilnius, 8.5 percent in Kaunas, and 9.4 percent in Klaipeda. However, Siauliai and Panevezys reported 14 and 16.2 percent, respectively. The highest unemployment, over 25 percent, was recorded in the resort towns Druskininkai and Mazeikiai. The overall rise in unemployment in 2001 was due mainly to delayed structural reforms, excessive employment regulations, and increased labor costs.

Unemployment benefits depend on a person's state social insurance record and are paid for no more than six months in a given year. They range from the amount of state-supported income, \$34 per month, to the sum of two minimum living standards, \$63 per month. In March 2001, liberalization of the labor market began in spite of heavy pressure from trade unions. The main changes include legitimizing a free format for labor contracts and reducing unemployment benefits.

The average monthly gross wage has continued its upward slide and now stands at \$267, up from \$155 in 1996. It is \$275 in the public sector and \$259 in the private sector. Blue-collar workers receive on average \$203, while white-collar employees earn \$328. The minimum mandatory monthly wage is 430 litas, or \$107.5. Nearly 36 percent of employees receive no more than \$125 in gross monthly wages.

The bulk of consumption expenditures, 44.4 percent, are on food. Another 10.8 percent goes for public utilities, 7.5 percent for transportation, 7.5 percent for clothing and footwear, and 4.5 percent for culture and recreation. Pensioners, agricultural workers, the disabled, and low-income individuals are entitled to heating and transport concessions.

Sixteen percent of the population is estimated to live below the subsistence level. In a recent survey by the LDS, about half of respondents reported that their living standards had declined over the past 12 months. Forty-seven percent said conditions had not changed, and only 4.9 reported improvements. A total of 66.2 percent of those polled put themselves in the middle-income category. One-third rated themselves poor, and only 1.1 percent claimed to belong to the upper-income category.

The start of mandatory fully funded pension insurance with private pension funds is scheduled for 2004. The current national pension system operates on a pay-as-you-go basis. Social security contributions are charged at 34 percent on companies' wage bills, with 30 percent paid by the employer and 4 percent by the employee. A widening gap between liabilities and the financial capacity of the social insurance fund has caused a growing deficit. In 2001, the average old-age pension was \$79.25, or 29.7 percent of the country's average monthly gross wage. Special state pensions are paid to distinguished persons, military and internal affairs officials, scholars, and others, including victims of the Soviet occupation and the Chernobyl nuclear accident. The retirement age is being increased gradually until it reaches 60 years for women and 62.5 years for men in 2006.

Lithuania's public education system is costly and ineffective. Partial voucher funding will be introduced in secondary education starting in 2002. Under this scheme, a set amount of funding will be allocated to every pupil, and schools will be financed based on actual levels of enrollment. Municipalities, rather than the schools themselves, will administer these funds and will have the right to redistribute 10 percent of the total allocations. Although such redistribution may interfere with reform, the new voucher scheme is seen as an important step toward injecting market principles and competitive forces into the educational system. It is thus expected to enhance the quality and efficiency of educational service provision and to improve the use of resources. Expenditures on education rose from 21.8 percent of the national budget in 1995 to 32.7 percent in 2000. They constituted 6.64 percent of GDP in 2000, up from 5.6 percent in 1995.

The health care system in Lithuania is also costly and inefficient. The requirements for the availability and quality of services are vaguely defined, and patients' choice of doctors and medical establishments is limited. Despite decentralization, many health care establishments remain centrally managed. The scope and fees for medical services are centrally defined, and the financing of health care establishments is based on quantitative rather than qualitative indicators. Over the past two years, many hospitals and clinics have appeared on the verge of closure. Central government debts to pharmacies alone have reached \$29 million. The number of doctors and hospital beds remains too high. The proportion of GDP expended on health care fell from 4.83 percent in 1998 to 4.3 percent in 2001.

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