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Changed Circumstances Review
Public Document

MEMORANDUM TO:	**Faryar Shirzad** **Assistant Secretary** **for Import Administration**
THROUGH:	**Jeffrey May** **Director** **Office of Policy** **Import Administration**
	Albert Hsu **Senior Economist** **Office of Policy** **Import Administration**
FROM:	**Barbara Mayer** **Shauna Lee-Alaia** **Athanasios Mihalakas** **Sirena Castillo**
DATE:	**February 28, 2003**
SUBJECT:	**Decision Memorandum Regarding Lithuania's Status as a Non-Market Economy Country for Purposes of the Antidumping and Countervailing Duty Law under a Changed Circumstances Review of the Solid Urea Order Against Lithuania**

SUMMARY

The Government of Lithuania ("GOL") has implemented comprehensive economic and institutional reforms aimed at establishing a market economy since regaining independence. Lithuania's currency, the *litas*, is fully convertible for trade and investment purposes. Wages are freely negotiated between employees and management. Workers have the right to unionize and engage in collective bargaining, and employers are free to transfer or fire workers. Foreign direct investment ("FDI") has been encouraged by the GOL in almost all sectors of the economy. Foreign investors compete on a level playing field with domestic investors. Lithuania's efforts toward privatizing the economy have been widespread and effective. Seventy-five percent of Lithuania's gross domestic product ("GDP") is in the hands of the private sector with only a few large state-owned enterprises ("SOEs") remaining. Land, including land for agricultural uses, is under private ownership and foreigners are permitted to purchase land for non-agricultural use. The GOL has eliminated its previous role as an allocator of resources by completely privatizing the commercial banking sector and eliminating price controls. Additionally, Lithuania has been a member of the World Trade Organization ("WTO") since May 2001 and is slated to join the European Union ("EU") at the beginning of 2004.

Notwithstanding, several areas of Lithuania's economy require additional reform. FDI remains relatively low. The commercial banking sector does not play a significant role in lending to the private sector. Small- and medium sized enterprise ("SME") growth is hampered by the reluctance of banks to provide credit.

Overall, however, Lithuania has made far-reaching changes in the structure of the economy. Under section 771(18)(B) of the Act, we recommend that the U.S. Department of Commerce find that Lithuania has a functioning market-economy. We have determined that the effective date for the consideration of Lithuania as a market economy is January 1, 2003. Lithuania producers and exporters will be subject, therefore, to the antidumping rules applicable to market economies with respect to the analysis of transactions occurring after January 1, 2003. In addition, the U.S. countervailing duty law will apply now to Lithuania where the proceeding at issue involves an adequate period of investigation after this effective date.

BACKGROUND

The Department has treated Lithuania as a non-market economy ("NME") country in antidumping duty investigations and administrative reviews. See, *e.g.*, Urea From the Union of Soviet Socialist Republics; Final Determination of Sales at Less Than Fair Value, 52 FR 19557 (May 26, 1987); and, Solid Urea from the Union of Soviet Socialist Republics; Transfer of the Antidumping Duty Order on Solid Urea From the Union of Soviet Socialist Republics to the Commonwealth of Independent States and the Baltic States and Opportunity to Comment, 57 FR 28828 (June 29, 1992). A designation as a NME remains in effect until it is revoked by the Department. See section 771(18)(C)(i) of the Act.

On May 15, 2002, the Department received a letter from the Embassy of Lithuania requesting a review of Lithuania's status as NME country. On June 5, 2002, the GOL submitted a document supporting its request for market economy status. On August 20, 2002, the Department received a letter from the Embassy of Lithuania requesting that the Department review this issue under a changed circumstances review of the solid urea order against Lithuania. In response to this latter request, the Department initiated an inquiry into Lithuania's status as an NME in the context of a changed circumstances review of the solid urea order against Lithuania pursuant to sections 751(b) and 771(18)(C)(ii) of the Act.

The Department published a Notice in the Federal Register requesting comments from the public concerning this matter on September 10, 2002. The comments due date was extended to November 8, 2002. Rebuttal comments were due no latter than December 9, 2002.

The GOL and some U.S. business interests have expressed support for giving Lithuania market economy status. The Department received one comment against revoking Lithuania's NME status. The comments are summarized below.

Parties Who Support a Determination of Lithuania as a Market Economy

The government of Lithuania, Ochoco Lumber Company, Baltic-American Medical & Surgical Clinic, RG Interiors, Pendulum Advisors, Inc, Anthony K. Grina, and Don Tijunelis, submitted comments summarized below in support of a determination of Lithuania as a market economy.

- The *litas* is freely convertible for the full range of commercial transactions required by domestic and foreign entities and since February 2, 2002, the *litas* has been pegged to the euro.
- According to the Law on Wages, as amended and supplemented on March 23, 1999, employees' wages depend on labor supply and demand in the labor market, quality and quantity of labor, and the results of the enterprise's activities.
- The main role of State is to set a minimum monthly wage and a minimum hourly pay rate.
- The Government of Lithuania has no policies barring foreign investment.
- Investment in Lithuania is widely supported by governmental institutions.
- Privatization or large scale enterprises is near complete with the state-owned and municipal property privatization implemented by the State Property Fund.
- Capital outflow is free of governmental restrictions.
- The government generally has no control over private business pricing, output, or resources.
- The number of prices subject to the Government control is very limited, kept in place due to absence of competition or dominant position of enterprise and for the specific nature of service.
- The Government is aiming for gradual opening of electricity and natural gas markets thus entitling eligible customers to choosing a supplier, having free access to monopolistic networks, and paying for services according to the set non-discriminatory tariffs. Since 1992, both state and private entities have been allowed to import and sell

natural gas and other energy sources without quantitative restrictions.

Parties Who Support a Determination of Lithuania as a Non-Market Economy

The AdHoc Committee of Domestic Nitrogen Producers, as represented by Akin Gump Strauss Hauer & Feld LLP, submitted comments summarized below in support of a determination of Lithuania as a NME.

- The price of natural gas and energy prices are not market-determined in Lithuania.

ANALYTICAL APPROACH

In reviewing a country's NME status under section 771(18)(A) of the Act, section 771(18)(B) of the Act requires that the Department take into account the following six factors:

1. The extent to which the currency of the foreign country is convertible into the currency of other countries.
2. The extent to which wage rates in the foreign country are determined by free bargaining between labor and management.
3. The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country.
4. The extent of government ownership or control of the means of production.
5. The extent of government control over the allocation of resources and over the price and output decisions of enterprises.
6. Such other factors as the administering authority considers appropriate.

In evaluating the six factors listed above, the Department has recognized that it is not sufficient that a country's economy is no longer controlled by the state to treat the country as a market economy. Rather, the Department considers whether the facts, as applied to the statutory factors, demonstrate that the economy is generally operating under market principles. To this end, Congress has provided the above listed factors which the Department must evaluate to determine whether, in the judgment of the Department, market forces in the country are sufficiently developed to permit the use of prices and costs in that country for purposes of the Department's dumping analysis.

Prices and costs are central to the Department's dumping analysis and calculation of normal value. Therefore, the prices and costs that the Department uses must be meaningful measures of value. NME prices are not, as a general rule, meaningful measures of value because they do not sufficiently reflect demand conditions or the relative scarcity of resources used in production. The problem with NMEs is not one of distorted prices, *per se*, since few, if any, market economy prices are perfect measures of value, free of all distortions (*e.g.*, taxes, subsidies, or other government regulatory measures). The problem, instead, is the price *generation* process in NMEs (*i.e.*, the absence of the demand and supply elements that individually and collectively make a market-based price system work).

The Department's evaluation of the statutory criteria does not require that countries be judged against a theoretical model or a perfectly competitive *laissez-faire* economy. Instead, the Department's determination is based on comparing the economic characteristics of the country in question to how other market economies operate, recognizing that market economies around the world have many different forms and features. Although it is not necessary that the country fully meet every statutory factor relative to other market economies, the Department must determine that the factors, taken together, indicate that reforms have reached a threshold level such that the country can be considered to have a functioning market economy.

The Department used numerous reports and analyses produced by third parties such as the World Bank, the International Monetary Fund, the European Bank for Reconstruction and Development, and the Organization for Economic Cooperation and Development ("OECD") in evaluating and applying the statutory criteria.

ANALYSIS OF SECTION 771(18)(B) Factors

Factor One. The extent to which the currency of the foreign country is convertible into the currency of other countries.

A country's integration into world markets is highly dependent upon the convertibility of its currency. The greater the extent of currency convertibility, for both trade and investment purposes, the greater are the supply and demand forces linking domestic market prices in the country to world market prices. The greater this linkage, the more market-based domestic prices tend to be.

A. Legal Framework

The Bank of Lithuania ("BOL") was established by the 1994 *Law on the Bank of Lithuania* and operates independently of the government in setting exchange rate policy.[1] The BOL's primary function is to ensure stability in Lithuania's currency market, regulate and supervise commercial banks, and to set monetary policy. In particular, the *Law on the Bank of Lithuania* clearly defines the functions of the BOL as consistent with those functions normally granted an independent central bank, namely granting it the right to: issue money; form and implement the monetary policy; establish the system of regulating the exchange rate of the *litas*; license and supervise commercial banks and other credit institutions; establish accounting principles and the order of accountability with regard to banking

[1] Law No. I-678 *Law on the Bank of Lithuania* (1994).

activities.[2]

Since regaining its independence in 1991, Lithuania has put in place a currency regime that ensures the stability of the *litas* and full currency convertibility. The *Law on Credibility of the Litas*, enacted on March 17, 1994, is the main law governing the currency regime. The law stipulates that the BOL shall guarantee the viability of the *litas* by maintaining gold reserves equal to the amount of currency in circulation. The *Resolution of the Board of the Bank of Lithuania On the Anchor Currency and the Official Exchange Rate of the Litas* established the *euro* as the anchor currency in 2002, pegging 3.45 *litas* to 1 *euro*.[3]

B. Developments in the Economy

Lithuania was slower than its Baltic neighbors to introduce a national currency. Initially, the government issued an interim coupon currency in 1992, followed by the *litas* in 1993. After suffering from hyper-inflation in 1992 of over 1,000 percent, Lithuania implemented a currency board in 1994, pegging the *litas* to the U.S. dollar. The currency stabilized and inflation fell to 5.1 percent in 1998. As trade shifted to Europe, a plan was put in place to peg the *litas* to the *euro*. On February 1, 2002 the *litas* was successfully pegged to the *euro*.[4]

The *litas* is fully convertible for current account purposes, *i.e.* transactions involving trade, income and profit remittances. Lithuania has been a signatory to IMF Article VIII since May 1994 and there are no restrictions on payments and proceeds for invisible transactions and current transfers.[5] There are no FOREX surrender requirements and investors are allowed to freely repatriate profits.[6]

The *litas* is fully convertible for capital account purposes, *i.e.*, transactions involving international investment and lending activities. There are no significant controls on transactions in

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[2] *Republic of Lithuania, Financial System Ability Assessment including Report on Observance of Standards and Code on the Following Topics: Monetary and Financial Policy Transparency, Banking Supervision, Insurance Regulation and Payment System, Country Report No. 02/19* (Washington D: International Monetary Fund, 2002) p 12. *Banking, Finance and Insurance,* Lithuania Development Agency (2002), online at http://www.lda.lt/invest.law.banking.html#1.

[3] Resolution No. 15 *On the Anchor Currency and the Official Exchange Rate of the Litas (2002).*

[4] *The Economist Intelligence Unit; Country Profiles, Lithuania*, March 29, 2002, p 30- 33, 53.

[5] *Annual Report on Exchange Arrangements and Exchange Restrictions* (Washington DC: International Monetary Fund, 2002), p. 551–554.

[6] Law No. VIII-1312, *Law on Investment,* (1999), Art. 5 (3). See also *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris:Organisation of Economic Cooperation and Development, 200) p 35.

capital, bond and money market instruments, and investment securities.[7]

Assessment of Factor

The Lithuanian *litas* is effectively convertible for trade and investment purposes. Investors are allowed to repatriate assets without restriction. The currency regime is stable and fully backed by foreign currency reserves.[8] The BOL acts independently from the GOL in setting monetary policy and regulating the commercial banking sector.

***Factor Two. The extent to which wage rates in the foreign country are determined by free bargaining between labor and management*.**

This factor focuses on the manner in which wages are set because they are an important component of a producers' costs and prices and, in turn, are an important indicator of a country's overall approach to setting prices and costs in the economy. The reference to "free bargaining between labor and management" reflects concerns about the extent to which wages are market-based, *i.e.*, the existence of a market for labor in which workers and employers are free to bargain over the terms and conditions of employment.

A. Legal Framework

Lithuania has a legal framework which establishes the rights, obligations and guarantees of workers and employers that form both the basis for free bargaining over wages and other terms of conditions of employment. The 1972 *Labour Code* was replaced by the 2002 *Labour Code*.[9] The general procedures for drawing up, altering, and terminating employment contracts are regulated by the *Law on Employment Contract*. Under this law, workers are free to leave their employment at will.[10] Similarly, employers are free to terminate employment contracts.[11] On March 20, 2001 the *Law On Enterprise Bankruptcy* was adopted in order to make it easier for employers to shed excess labor.[12]

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[7] *Annual Report on Exchange Arrangements and Exchange Restrictions* (Washington DC: International Monetary Fund, 2002), p. 551–554.

[8] *The Economist Intelligence Unit; Country Profiles, Lithuania*, June 1, 2002, p 7.

[9] Law No. IX-926 *Labour Code* (2002).

[10] Law No. I-2048 *Law on the Employment Contract*, Article 28 (2001).

[11] Law No. I-2048 *Law on the Employment Contract*, Articles 29 &30 (2001).

[12] *The Economist Intelligence Unit; Country Profiles, Lithuania*, March 29, 2002, p 34.

In 1991, Lithuania adopted the *Law on Wages*, which is the basic law concerning wage development in Lithuania and establishes the right to a minium wage as determined by the GOL.[13] The 1996 *Law on Arrears Definition for Delayed Payments Related to Labor Relations* protects workers from wage arrears.[14]

The 1991 *Law on Trade Unions* governs the establishment, suspension, and termination of trade unions.[15] The right to collective agreements and collective bargaining are protected under law.[16] Only authorized unions may partake in collective bargaining.[17] A system of tripartite cooperation between government, trade unions and employers was established in 1995, with the ratification of the relevant ILO conventions.[18] The *Law on Regulation of Collective Disputes* specifies the process by which collective disputes will be addressed and resolved.[19]

B. Developments in the Economy

Employment in Lithuania is based on legally binding contractual relations, an essential component to freely negotiated wage formation. Wages are generally higher in the public sector, partially due to under reporting in the private sector in an effort to avoid social security taxes.[20] The European Union's latest review of Lithuania reports that there is sufficient labor mobility and no restrictions on labor mobility.[21] Wage arrears are not cited in the literature as a problem in Lithuania as they have been in other transition economies.

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[13] Law No. I-924 *Law on Wages* (1991).

[14] Law No. *Law on Arrears Definition for Delayed Payments Related to Labor Relations* (1996).

[15] Law No. I-2018, *Law on Trade Unions* (1991).

[16] Law No. I-1201, *Law on Collective Agreements* (1991) and Law No. I-2386, *Law on Regulation of Collective Disputes* (1992).

[17] Dovydeniene, Roma, *Trade Union Responses to Globalization in Lithuania, DP/111/1999* (Geneva: International Institute for Labour Statistics, 1999) p 24.

[18] Dovydeniene, Roma, *Trade Union Responses to Globalization in Lithuania, DP/111/1999* (Geneva: International Institute for Labour Statistics, 1999) p 20-21. This agreement was designed to solve social, economic and labor problems on a tripartite basis, to cooperate in implementing social, economic and labor policy, to establish a Tripartite Council and to sign an agreement every year.

[19] Law No. I-2386, *Law on Regulation of Collective Disputes* (1992).

[20] *The Economist Intelligence Unit; Country Profiles, Lithuania,* March 29, 2002, p 34.

[21] *2001 Regular Report on Lithuania Progress Towards Accessions* (Brussels: Commission of the European Community, 2001) p 41-42.

Although the Lithuanian labor market is largely reformed, workers have complained that maximum workweek hour regulations are routinely not observed and that the minimum wage is not enforced.[22] Nevertheless, wages appear to be market-based. Although labor unions are protected by law, they are not popular and exert little influence.[23] Strikes are also rare because the *Law on Regulations of Collective Disputes* creates barriers, such as the requirement for an employee vote and a lengthy warning period, that make strikes ineffective. In addition, the law makes it relatively easy for employers to refuse to establish a reconciliation committee, which is the first step to resolving disputes.[24] Collective bargaining and labor representation is therefore still developing as a negotiating tool in the labor market.

Assessment of factor

Overall, Lithuania has a free labor market. Workers are able to freely negotiate wages and employers are free to transfer or fire workers. Although there are some concerns regarding the *de facto* bargaining power of collective labor associations, trade unions are nevertheless protected by law.

Factor Three. ***The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country***.

Opening an economy to foreign investment tends to expose domestic industry to competition from market-based suppliers and the management, production and sales practices that they bring. It also tends to limit the scope and extent of government control over the market, since foreign investors, as a general rule, demand a certain degree of autonomous control over their investments.

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[22] White collar employees in Lithuania are supposed to work a 40-hour workweek and blue collar employees a 48-hour work week with premium pay for overtime. *Lithuania Country Commercial Guide FY2001* (Washington DC: US Commercial Service, 2001).

[23] *Lithuania Country Commercial Guide FY2001* (Washington DC: US Commercial Service, 2001). See also Dovydeniene, Roma, *Trade Union Responses to Globalization in Lithuania, DP/111/1999* (Geneva: International Institute for Labour Statistics, 1999) p 8 & 26, stating "[s]trikes are not very popular in Lithuania, primarily because there is no tradition of strikes since they were prohibited in Soviet times."

[24] Dovydeniene, Roma, *Trade Union Responses to Globalization in Lithuania, DP/111/1999* (Geneva: International Institute for Labour Statistics, 1999) p 26.

A. Legal Framework

FDI is governed by the 1999 *Law on Investment*, which guarantees equal treatment for domestic and foreign investors.[25] Investors are protected against expropriation.[26] All forms of business enterprises are allowed, including wholly owned enterprises.[27] The law also designates which sectors are off-limits for foreign investors, *e.g.*, State security and defense, production and sale of narcotics and poisons, and the organization of lotteries.[28] The *Law on Enterprises* regulates licensing procedures.[29] The commercial activities that require a license include those related to a heightened danger to human health or environment and the manufacturing or trade in arms.

Other relevant legislation includes the new *Company Law* of 2000, the *Competition Law* of 1999, the new *Civil Code* of 2000, and the *Law on Protection of Intellectual Property for Imported and Exported Goods* of 2000.[30]

FDI is also protected by the 28 bilateral agreements that Lithuania has with most EU members, the United States and other countries. The bilateral agreements take precedence over Lithuanian national law.[31] Additionally, Lithuania is a signatory to the OECD's Declaration on International Investment and Multinational Enterprises. The Declaration promotes national treatment of FDI, and "encourages moderation and restraint in the use of investment incentives and conflicting regulatory requirements."[32]

B. Developments in the Economy

The GOL has actively encouraged FDI since the early 1990s with an increasingly strong legal framework. Since the tax incentives of the early 1990s have been phased out, foreign investors no

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[25] Law No. VIII - 1312, *Law on Investment*, Article 5(1) (1999).

[26] Law No. VIII - 1312, *Law on Investment*, Article 7 (1999).

[27] Law No. VIII - 1312, *Law on Investment* Articles 2(7) & 3 (1999).

[28] Law No. VIII - 1312, *Law on Investment*, Article 8(2) (1999).

[29] Law No. I-196 *Law on Enterprises* (1990).

[30] *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris: Organisation for Economic Cooperation and Development, 2001) p 35-37.

[31] *The Economist Intelligence Unit; Country Profiles, Lithuania*, March 29, 2002, p 52.

[32] *OECD Declaration and Decision on International Investment and Multinational Enterprises*, online at http://www.oecd.org/EN/document/0,,EN-document-9-nodirectorate-no-6-9259-9,00.html.

longer receive preferential treatment.[33] All types of enterprises are allowed under Lithuanian law and most FDI is in the form of either wholly owned or majority foreign owned companies. Joint ventures account for less than a third of foreign capital companies.[34]

Like most transition economies and many market economies, a special license is required for alcohol production, issuance of currency and stamps, postal services and fixed-line telephone services, for investors.[35] This requirement applies to domestic and foreign investors alike.[36]

The manufacturing sector, followed by the wholesale and retail trade sectors, have received the majority of FDI. However, with the privatization of the banking sector, the service sector has also seen an increase in FDI.[37] Initially FDI was dominated by large, mainly U.S., multinationals. More recently, however, Lithuania's Scandinavian and Baltic neighbors have increased investment into large-scale projects.[38] Investment into small- and medium- sized enterprises continue to constitute only a small portion of FDI.[39]

Despite recent incentives in investment, results in terms of FDI inflows have been modest. FDI per capita in Lithuania for 2001 was $127, compared with $390 for Estonia, $478 for Czech Republic, $245 for Hungary. Net FDI reached $926 million in 1998 and has decreased substantially each year thereafter; $487 in 1999, $379 in 2000, and $185 in 2001.[40] Part of the reason for the relatively low

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[33] *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris: Organisation for Economic Cooperation and Development, 2001) p 12.

[34] *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris: Organisation for Economic Cooperation and Development, 2001) p 10.

[35] *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris: Organisation for Economic Cooperation and Development, 2001) p 10.

[36] *The Economist Intelligence Unit; Country Profiles, Lithuania,* March 29, 2002, p 52.

[37] *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris: Organisation for Economic Cooperation and Development, 2001) p 20.

[38] *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris: Organisation for Economic Cooperation and Development, 2001) p 17-25 For example, U.S. multinationals such as McDonalds, Philip Morris, Cocoa Cola were some of the first investors into Lithuania, followed more recently by Amber Teleholdings Consortium(Swedish), Carslberg Brewery (Danish), Statoil (Norwegian), and Royal/Dutch Shell (British/Dutch). There are 584 companies with U.S. investment in Lithuanian, employing more than 9,000 people.

[39] *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris:Organisation of Economic Cooperation and Development, 200) p 25.

[40] *International Financial Statistics Yearbook 2002* (Washington: International Monetary Fund, 2002) p 673.

level of FDI in Lithuania is that the economy suffered more from the Russian financial crisis of 1997 than the other Baltic nations of Latvia or Estonia. In particular, the Russian crisis resulted in political instability in Lithuania that effectively stalled the privatization process.[41] Lithuania was also more dependent on exports to Russia than either Estonia or Latvia.[42]

Increasing FDI is a goal the GOL has targeted in recent years, by instituting procedures that are more enterprise friendly, as described in the discussion of entrepreneurship in Factor Five below.

Assessment of factor

Lithuania has attracted FDI since regaining its independence from Russia. Domestic and foreign investors alike enjoy the same benefits and protections. The legal framework is comprehensive and enforced. Overall, Lithuania has made substantial progress on this factor.

Factor Four. The extent of government ownership or control of the means of production.

The right to own private property is fundamental to the operation of a market economy, and the scope and extent of private sector involvement in the economy often is an indicator of the extent to which the economy is market-driven. In assessing this factor there are two areas to consider, 1) Lithuania's privatization program, and 2) land reforms.

1. Privatization

A. Legal Framework

Lithuania began its privatization program in 1991 with the *Law on Initial Privatization of State Property* under which small businesses, residential property, and collectivized farms were privatized.[43] The first phase of privatization used a voucher system, which largely excluded foreign participation and led to insider dominated ownership.[44] In 1995, the *Law on Privatization of State*

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[41] *The Economist Intelligence Unit; Country Profiles, Lithuania*, March 29, 2002, p 51.

[42] *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris: Organisation for Economic Cooperation and Development, 2001) p 13.

[43] Law No I-1115 *Law on Initial Privatization of State Property* (1991)

[44] *Lithuania: An Opportunity for Economic Success, Vol. 1 Main Report* (Washington: World Bank, 1998) p 8. *The Economist Intelligence Unit; Country Profiles, Lithuania,* March 29, 2002, p 26-27.

Owned and Municipal Property put in place a more flexible and open system of privatization.[45] The Privatization Agency was replaced by the State Property Fund and large infrastructure companies were put up for sale. The law was further amended in 1997 to clarify the functions of the State Property Fund and privatization procedures for large enterprises.[46]

B. Developments in the Economy

Like most former Soviet block countries, Lithuania started the 1990s with an economy almost completely in the hands of the state.[47] Under the initial phase of small-scale privatization beginning in 1991, the majority of small business, residential property, and collectivized farms were privatized through vouchers, using auctions, tenders, and public share subscriptions.[48]

The second phase of privatization, beginning in 1996, was aimed at large scale enterprises. New legislation regulating foreign investment and a new privatization law, *the Law on Privatization of State Owned and Municipal Property*, established national treatment for all investors.[49] This new phase was slow to start due to political opposition and bureaucratic procedures.

In 1998, the State Property Fund was created to address these issues and to rejuvenate the privatization process by addressing the problem of overlapping responsibilities and vested interests that had previously stunted the process. The second phase received a boost in 1998 with the privatization of Lietuvos Telekomas (Lithuania Telecoms) to a Swedish-Finish consortium for $510 million.

In the last few years the GOL has privatized several large enterprises, including several that are considered critical infrastructure components.[50] Lithuania is in the process of privatizing its oil industry.

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[45] Law No I-1001 *Law on the Privatization of State Owned and Municipal Property* (1995).

[46] Law No. VIII-480 *Law on the Privatization of State Owned and Municipal Property* (1997).

[47] *Transition Report 2001, Economic Transition in Central and Eastern Europe and the CIS* (London: European Bank for Reconstruction and Development, 2001) p 172. In 1992, only 20 percent of the economy was in the hands of the private sector.

[48] *The Economist Intelligence Unit; Country Profiles, Lithuania*, March 29, 2002, p 26-27.

[49] Law No VIII-480 *Law on the Privatization of State Owned and Municipal Property,* Article 1(3) (1997).

[50] *The Economist Intelligence Unit; Country Profiles, Lithuania*, March 29, 2002, 26-27. Completed large scale privatizations include, LISCO Shipping –76.4 percent share sold in 2001. Geonafta Oil exploration company –81 percent to a Polish-Swiss consortium. Lithuania Insurance (Lietuvos Draudimas)-majority owned now by Codan of Denmark.

Planned large scale privatizations include Lithuania Gas (Lietvuos Dijos)-Ruhrgas AG and E.ON Energie AG bought 34 percent share, Gazprom bidding for 34 percent in early 2003. Lithuania Energy (Lietuvos Energie)- 86.24 percent state owned (in talks with Russia's RAO). Vattenfall, a Swedish utility owns 10.1percent (DOE) Lifosa (phosphate-based fertilizer manufacturer)-In

Eight joint stock companies have been formed as a step towards privatization. The GOE is also planning to restructure and privatize Lietuvos Energija (Lithuanian Energy Company), of which it owns 86.5 percent. A commission has been established to draft plans to separate generation, transmission and distribution as well as announce privatization tenders.[51]

Lithuania has pursued a gradual path toward privatization of energy, with the formation of joint stock companies for the electric grid and various oil and gas companies.[52] The electricity distribution system has been decentralized in order to increase efficiency, reduce costs, and reform the rate structure.[53] Lithuania imports much of its oil and all of its natural gas from Russia. There is no evidence on the record of the instant proceeding, or in the Department's research, that the price Lithuania pays for Russian oil and natural gas is distortively low.

As of 2001, at least 75 percent of Lithuania's GDP was in the hands of the private sector.[54]

2. Land

A. Legal Framework

The *Constitution* of Lithuania of October 25, 1992 granted Lithuanians the right to own land. In 1996, Article 47 of the Constitution was amended to allow foreign entities registered and conducting business in Lithuania to acquire non-agricultural land. The law stipulates that the foreign enterprise must be either a member of the EU, an EU Association Agreement country, OECD, or the North Atlantic Treaty Organization. Additionally, the foreign state of registration "must provide equal rights to Lithuanian entities and the foreign enterprise has its main place of business in the state of registration for

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August court gave approval for Russia's Eurochem to buy Lifosa. See *Lithuania Investment Profile 2001* (London: European Bank for Reconstruction and Development, 2001) p 11.

[51] *An Energy Overview of the Republic of Lithuania* (Washington: Department of Energy, 2002) online at www.fe.doe.gov/international/lithover.html.

[52] *An Energy Overview of the Republic of Lithuania* (Washington: Department of Energy, 2002) online at www.fe.doe.gov/international/lithover.html.

[53] *An Energy Overview of the Republic of Lithuania* (Washington: Department of Energy, 2002) online at www.fe.doe.gov/international/lithover.html.

[54] *Transition Report 2002, Economic Transition in Central and Eastern Europe and the CIS* (London: European Bank for Reconstruction and Development, 2002) p 20. The EBRD's *Lithuania Investment Profile* puts the figure at 80 percent. *Lithuania Investment Profile 2001* (London: European Bank for Reconstruction and Development, 2001) p 10.

at least five years."[55] However, in order to meet EU membership requirements the GOL has agreed to phase out these last two restrictions by January 2004; Agricultural land will be available for purchase by foreigners upon EU accession.[56]

B. Developments in the Economy

Lithuania has made significant progress in the area of land reform. The process of restoring land ownership rights to the original owners is mainly complete.[57] Lithuanians were granted the right to own property, for both agricultural and non-agricultural use, by constitutional law. Foreigners are allowed to own land for the purposes of conducting business as long as they meet the requirements mentioned above. Lithuania has closed the EU *acquis communitaire* (the body of common rights and obligations which bind all the Member States together within the European Union) chapter on real estate and has agreed to allow foreigners to buy agricultural land immediately upon accession.[58]

Assessment of factor

After a slow start, Lithuania has for the most part completed the privatization process, with 75 percent of GDP in the hands of the private sector. Lithuania has made considerable progress in privatizing sectors that other transition economies have labeled strategic, for example, transport, energy, and telecommunications. Private land ownership is permitted, and there is a free market in land rights.

Factor Five. The extent of government control over the allocation of resources and over the price and output decisions of enterprises.

Decentralized economic decision-making is a hallmark of market economies, where the independent investment, input-sourcing, output and pricing actions of individuals and firms in pursuit of private gain collectively ensure that economic resources are allocated to their best (most efficient) use. Prices in such economies tend to reflect both demand conditions and the relative scarcity of the resources used in production.

An important measure of government control over production decisions and the allocation of

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[55] *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris: Organisation for Economic Cooperation and Development, 2001) p 39.

[56] *The Economist Intelligence Unit; Country Profiles, Lithuania*, March 29, 2002, p 37. The EU Commission has subsequently granted Lithuania a 7 year delay on allowing foreigners to purchase agricultural and forest land.

[57] *The Economist Intelligence Unit; Country Profiles, Lithuania,* March 29, 2002, p36.

[58] *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris: Organisation for Economic Cooperation and Development, 2001) p 39-40. See also *The Economist Intelligence Unit; Country Profiles, Lithuania*, March 29, 2002, p 37.

resources is the degree to which the government is involved in the allocation of capital. Given that banks are important allocators of capital, the degree to which the State exercises control over the commercial banking sector is an important consideration.

The three relevant issues to consider under this factor for Lithuania are price liberalization, the commercial banking sector, and the degree to which individuals and enterprises can freely engage in business activities.

1. Price Liberalization

A. Legal Framework

The 1990 *Law on Prices*, as amended in 1993, established that prices for most goods would be set by the market.[59] Prices for certain items can be set by the GOL provided they are on the predetermined list. These goods and services are limited to areas normally regulated by the state, such as: registration of vehicles, railway transportation, municipal and state government services, service provide by customs intermediaries, post, telecommunications, registration of real estate, issuance of quality certificates, and services related to potentially dangerous equipment. Pursuant to Article 3, 4 and 8 of the *Law on Prices*, the Competition Council is authorized to execute these price controls.

Gas prices for households and small enterprises are regulated by the *Natural Gas Law* of 2000.[60]

B. Economic Developments

By 1993, prices in Lithuania had stabilized and were largely liberalized.[61] Only a few areas of price regulation remain. For example, the Lithuania Competition Council, under the *Law on Prices*, has the authority to regulate prices on a few items, such as vehicle registration, railway tariffs, telecom tariffs, *etc.* The *Law on Natural Gas* of 2000, allows the GOL to regulate transmission, distribution, storage, and some customer's prices.

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[59] Law No. I-41*3 Law on Prices* (1990).

[60] Law No. VII-1973 *Natural Gas Law* (2000).

[61] Dovydeniene, Roma, *Trade Union Responses to Globalization in Lithuania, DP/111/1999* (Geneva: International Institute for Labour Statistics, 1999) p 3.

Commercial Banking

A. Legal Framework

The BOL was established by the 1994 *Law on the Bank of Lithuania* and operates independently of the government. The BOL is authorized to license and supervise commercial banks and other credit institutions as well as establish accounting principles.[62]

The *Law on Commercial Banks* of 1994 regulates the activities of commercial banks in order to assure a stable, reliable, efficient, and safe banking system.[63] The law further establishes the procedures and terms for licensing banks as well as regulating banking activities. Foreign banks operating in Lithuania are also regulated by this law.

B. Economic Developments

Lithuania has aggressively reformed the commercial banking sector. With the privatization of Lithuania Agricultural Bank in August 2002, the financial sector is now completely in the hands of the private sector.[64] Foreign participation in the banking sector increased from 32 percent in 1996 to 88 percent by January 2002.[65] Regulation and supervision of banking markets are well-developed and there is a high degree of transparency in monetary and financial policies.[66]

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62 *Republic of Lithuania, Financial System Ability Assessment including Report on Observance of Standards and Code on the Following Topics: Monetary and Financial Policy Transparency, Banking Supervision, Insurance Regulation and Payment System, Country Report No. 02/19* (Washington D: International Monetary Fund, 2002) p 12. See also *Banking, Finance and Insurance,* Lithuania Development Agency (2002), online at http://www.lda.lt/invest.law.banking.html#1. See also Law No. I-678; *Law on the Bank of Lithuania* (1994).

63 Law No. I-720 *Law on Commercial Banks* (1994).

64 *Privatization in Lithuania: Country Fact Sheet,* Multilateral Investment Guarantee Agency, World Bank, online at http://www.panet.net/documents/WorldBank/databases/plink/factsheet/lithuania.htm. See also 2002 *Regular Report on Lithuania Progress Towards Accession* (Brussled: Commission of the European Community, 2002) p 39. The sector is dominated by the largest bank, Vilniaus Bankas, which merged with Hermis Bank in 1999. Vilniaus Bank controls 42 percent of total assets in Lithuania's banking system. *Lithuania Investment Profile 2001* (London: European Bank for Reconstruction and Development, 2001) p 25.

65 *2002 Regular Report on Lithuania Progress Towards Accession* (Brussels: Commission of the European Community, 2002) p 38.

66 *Republic of Lithuania, Financial System Ability Assessment including Report on Observance of Standards and Code on the Following Topics: Monetary and Financial Policy Transparency, Banking Supervision, Insurance Regulation and Payment System, Country Report No. 02/19* (Washington D: International Monetary Fund, 2002) p 4.

Although the financial sector has undergone considerable reform, it still does not play a significant role in lending to the private sector. Credit to the private sector is one of the lowest in the region at 11 percent of GDP.[67] The low level of lending to the private sector, however, appears to be based on market dynamics as opposed to government intervention.[68]

3. Entrepreneurship

A. Legal Framework

The GOL quickly moved to implement laws designed to encourage enterprise development after gaining independence, including the 1990 *Law on Enterprises*, as amended March 16, 2000.[69] As economic development continued, subsequent amendments and laws were passed to facilitate the development of SMEs. The 1998 *Law on Small and Medium Sized Business Development* defines micro-, small-, and medium-sized enterprises and specifies which entities are entitled to government assistance.[70]

B. Economic Developments

The great majority of enterprises in Lithuania are small and medium sized, with 95 percent of all enterprises having less than 50 employees and 4.5 percent of all enterprises having between 50 and 250 employees. The 1990 *Law on Enterprises* laid the initial ground work for free enterprise in Lithuania. The law had several restrictions on registration requirements and procedural red tape that hampered enterprise development. Thus, the law has been amended several times, ultimately putting in place a legislative regime that protects enterprises and encourages economic development. Recent changes reducing red-tape in tax and registration regulation have been cited as positive progress in encouraging SME development.[71]

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[67] *Transition Report 2002, Economic Transition in Central and Eastern Europe and the CIS* (London: European Bank for Reconstruction and Development, 2002) p 176.

[68] *Republic of Lithuania, Financial System Ability Assessment including Report on Observance of Standards and Code on the Following Topics: Monetary and Financial Policy Transparency, Banking Supervision, Insurance Regulation and Payment System, Country Report No. 02/19* (Washington D: International Monetary Fund, 2002) p 23. *Transition Report 2002, Economic Transition in Central and Eastern Europe and the CIS* (London: European Bank for Reconstruction and Development, 2002) p 176.

[69] Law No. I-196 *Law on Enterprises* (1991).

[70] Law No. VIII-935 *Law on Small and Medium Sized Business Development* (1998).

[71] *Transition Report 2002, Economic Transition in Central and Eastern Europe and the CIS* (London: European Bank for Reconstruction and Development, 2002) p 23.

Furthermore, upon adopting the European Association Agreement in 1998 and subsequently closing 24 chapters of the EU *acquis communautaire,* including the chapter on enterprise law, Lithuania has in place an enterprise environment consistent with EU requirements. In 2000 the GOL set up two commissions to further reduce bureaucratic procedures and promote a more business-friendly environment. The "Sunset Commission" identifies overlapping and redundant administrative functions, and the "Sunrise Commission" is tasked with speeding up the implementation of measures to streamline the functions and procedures dealing with business and economic matters.[72]

Assessment of factor

The GOL no longer allocates resources in the economy and prices have been liberalized. The financial sector functions independently of the government. In addition, entities are free to engage in business activities and are protected by law and in practice against government interference.

Factor Six. Such other factors as the administering authority considers appropriate.

Under this factor, the Department can address any additional issues relevant to its consideration of market economy status. There are three main areas where Lithuania has made progress that merit discussion but do not fit entirely into the factors addressed above; WTO membership, EU membership, and corruption. In all three areas Lithuania has made considerable progress.

Lithuania joined the WTO in May 2001 and is expected to join the EU in 2004, adopting the *euro* a few years following accession. Corruption is not a significant hurdle to doing business in Lithuania. In fact, Transparency International ranks Lithuania 38 out of 91 countries, above many market economies.[73]

ASSESSMENT

Although section 771(18)(B) of the Act enumerates six factors that the Department must consider in determining whether a country operates on market principles, the statute provides no direction or guidance with respect to the relative weight that should be placed on each factor in assessing the overall state of the economy. Therefore, the Department must weigh the degree to which economic reforms have been implemented based upon the unique facts in each case.

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[72] *OECD Reviews of Foreign Direct Investment: Lithuania* (Paris: Organisation for Economic Cooperation and Development, 2001) p 33-34.

[73] *Corruption index 2001* (Transparency International, 2001) online at http://www.transparency.org/cpi/2001/cpi2001.html#cpi

Lithuania has achieved economic reform in a relatively short period of time. The independent BOL has maintained a stable currency regime that recently oversaw a smooth transition from the U.S. dollar peg to the *euro* in February 2002. The Lithuanian *litas* is effectively convertible for trade and investment purposes. There is a functioning labor market where wages are slowly rising. FDI has been low, nevertheless, it has played a crucial part in stimulating growth and moving the privatization program forward. Recent civil code amendments and a lower tax burden on businesses provide the basis to attract additional FDI. Privatization of medium and large SOEs is mainly complete. Prices in Lithuania are liberalized and inflation is low. The commercial banking sector has also been completely privatized, although financial intermediation remains low. Entrepreneurship in Lithuania is not only protected by legislation but encouraged by the government through laws such as the *Law on Small and Medium Sized Business Development*. On the basis of the comprehensive economic and legal reforms discussed above, the Department believes that it can use prices and costs within Lithuania for purposes of its antidumping analysis.

RECOMMENDATION

Based on the evidence on reforms in Lithuania to date, analyzed as required under section 771(18)(B) of the Act, we recommend that the Department determine that (1) revocation of Lithuania's non-market economy status under section 771(18)(A) is warranted, and (2) Lithuania has operated as a market-economy since January 1, 2003.

Agree _____ Disagree _____

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Faryar Shirzad
Assistant Secretary
for Import Administration