This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.
Executive summary

- Productivity growth has resumed after every crisis
- The convergence process has not been inclusive enough
- The economy is volatile
Productivity growth has resumed after every crisis

Accession to the euro area confirms Lithuania’s commitment to sound and sustainable economic policies. The economy is expected to recover despite weak Russian demand. Labour and product markets are flexible. Productivity rose on average by 5% per year between 1995 and 2014, but remains one-third below the OECD average. Some firms lack skilled workers and the innovation intensity of the business sector is low. Greater spending efficiency needs to make a contribution to finance productivity-enhancing measures.

The convergence process has not been inclusive enough

Inequality and poverty rates are high, job satisfaction and life expectancy are low while emigration is high, although to a lower extent more recently. Social assistance is not effective enough at reducing poverty. Securing effective job search and programmes to get people back to work would foster inclusive growth. These challenges are addressed in the “New Social Model” reform package. Promoting healthy lifestyles and primary health care would also help to achieve better well-being outcomes.

The economy is volatile

Past fiscal consolidation has placed government debt at a sustainable level. Longer term challenges relating to population ageing and future potential macroeconomic shocks should be addressed by: 1) Further moving taxation away from labour towards less distortionary tax bases and continuing to improve tax collection. 2) Strengthening the sustainability of the pension system. 3) Continuing to strengthen the medium-term budgetary framework.
### MAIN FINDINGS

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### KEY RECOMMENDATIONS

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<td>Continue fighting tax evasion also beyond the VAT gap and improve spending efficiencies (especially in education and health care areas), to allow medium term fiscal consolidation and finance public spending needs.</td>
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<td>Further shift the tax burden away from labour, especially from employer social security contributions, and raise recurrent taxes on personal immovable property.</td>
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<td>Increase taxes on activities that damage the environment.</td>
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### Boosting productivity

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<td>Test scores for secondary school students are low.</td>
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### Promoting inclusive growth

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OECD 2016
Assessment and recommendations

- Growth is projected to gain momentum despite weak external conditions
- Fiscal and financial policies to support the economy
- Boosting productivity to accelerate convergence
- Promoting an inclusive labour market
- Improving health outcomes for all

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.
Lithuania is a small open economy with about 3 million inhabitants. The institutional environment is overall stable, transparent, and market-friendly. The country has taken significant strides to work more closely with the international community: it joined the World Trade Organization in 2001, the European Union in 2004 and, after operating under a currency board for the preceding 25 years, the euro area in 2015. Since 2011, economic growth has been one of the highest among European countries, reflecting a swift recovery from the global financial crisis thanks to the economy’s high flexibility. Market-friendly institutional arrangements have helped; Lithuania was ranked 20th in the World Bank Ease of Doing Business Index for 2015. At the same time, financial and fiscal frameworks have been strengthened with the adoption of the fiscal compact and participation in European system of financial supervision. However, inequality indicators are high and the share on informal activities is significant.

The economy has exhibited substantial volatility over the past 25 years (Figure 1, Panel A). The collapse of the central planning system in 1991 required a difficult transition to a market economy. Reforms during the transition period focused on price liberalisation, small-scale privatisation and the establishment of a national currency – the Litas. The share of military goods in production fell substantially, there was a diversification of supply chains and industrial restructuring, and the economy opened up to foreign trade (Černiauskas and Dobrovolskas, 2011). Following a domestic banking crisis in 1995, growth picked up.

Recent volatility of the Lithuanian economy has mostly reflected it being a small open economy; exports account for 81% of GDP. As a consequence, the Russian financial crisis in 1997-98 was the catalyst for a temporary slowdown and the impact of the global financial crisis in 2008 was severe. The main economic developments to note since 2000 are:

- The economy experienced an average annual growth rate of 7.5% between 2000 and 2007. An inflow of cheap finance and lenient credit standards (credit to the economy grew by 50% per year on average between 2003 and 2007), led to an increase in private loan-financed domestic demand and a housing bubble at a time when no counter-cyclical fiscal policy framework existed.

- The trend increase in house prices began to reverse in mid-2007, before the global financial crisis pushed Lithuania into recession due to a sudden stop of capital inflows. The drop in GDP in 2009 was dramatic although similar in scale to the experiences of Estonia and Latvia. The unemployment rate peaked at 18% in 2010, the fiscal deficit rose to 9% of GDP and the current account balance moved from -13% of GDP in 2008 to +2.1% of GDP in 2009, mainly due to collapsing domestic demand.

- The economy then recovered quickly, with average growth of 3½ per cent between 2010 and 2014, returning real GDP to its pre-crisis level. Unemployment declined to less than 11% in 2014 and the fiscal deficit fell below 1% of GDP. Competitiveness has been improved thanks to an internal devaluation (the currency was pegged to the euro in 2002) and as a result the current account remained in surplus.
Despite recent strong economic performance, Lithuania still faces several challenges. The informal economy is relatively large, creating an uneven playing field for firms and exacerbating economic inequality. The wounds from the financial crisis are also still yet to heal. The housing boom and its subsequent bust led to the loss of a large number of jobs in the construction sector and those jobs are unlikely to return. This has increased skill mismatch and structural unemployment, which is estimated at 10-12% (Ebeke and Everaert, 2014). Despite a pick-up, investment as a share of GDP remains well below its pre-boom level, further undermining future potential growth and productivity.

Lithuania has a rapidly declining population (Figure 2, Panel A). A low fertility rate, high mortality and significant emigration have all been contributing factors. United Nations population projections suggest that Lithuania’s working age population will decline by 15% over the next 15 years (United Nations, 2015). Such a trend implies mounting challenges for future potential output growth and fiscal sustainability.

Since 1990, 22% of the population (of 1990) has emigrated. The average emigration rate accelerated from 7% of the population in 1990-2000 to above 12% during the 2000s, and the average net rate of recent years is one of the highest in the EU (Statistics Lithuania;
Sipavičienė and Stankūnienė, 2013). Most Lithuanians leave for economic reasons, with the greatest proportion moving to the UK where net average earnings are more than five times higher. Since the financial crisis, emigration to Norway has increased while migrant flows to Russia and Belarus have fallen. A relatively high proportion of Lithuanian emigrants are female, young and well educated (Arslan et al., 2014, Figure 2). On the positive side, return migration has trended up since the global financial crisis and contributed to the lowest annual net emigration in 2014 since 2002.

Against this background, the Economic Assessment of Lithuania has two main messages:

- **Accelerating the convergence process.** Boosting productivity will be critical to raise further living standards. Despite impressive progress over the last two decades, GDP per capita remains relatively low, reflecting weak productivity (Figure 1, Panel B). Greater productivity gains can be achieved by further strengthening the institutional framework to ensure improvements in firm’s absorptive capacities and efficient resource allocation. Other major priorities are to guarantee the educational system provides the right mix of skills and that the policy environment promotes innovation.

- **Inclusiveness.** Inequality and poverty remain comparatively high (Figure 3, Panels A and B). Lithuania lags behind regarding indicators of well-being measuring the quality of life (Figure 3, Panel C). There is room for making social support and labour market institutions more effective at bringing jobless people back to the labour market, reducing social inequality and making Lithuania an attractive place to live and to work. The ongoing revision of the “New Social Model” is an opportunity for achieving these objectives (see Annex 1). Improving health status and life expectancy would make also an important contribution to well-being.

**Growth is projected to gain momentum despite weak external conditions**

In 2015, the volume of investment was 15.4% greater than a year earlier. Rising house prices since mid-2013 combined with low real interest rates have led to higher residential investment. Reflecting the high cash reserves of businesses, purchases of machinery and equipment have been particularly strong, buoying imports since mid-2014. This should
increase the potential output of the economy and thus help expand economic activity in the future.

Recession in Russia and counter-sanctions caused the value of Lithuanian exports to Russia to shrink by 40% in 2015 compared to a year earlier. Re-exports have traditionally made up a very high proportion of Lithuanian exports to Russia, meaning the direct impact on the domestic economy from slower trade activity with Russia may not be very large. Nevertheless, the transport sector has been negatively impacted and some pockets of Lithuanian industry, such as dairy and meat production, have experienced a sharp decline in sales. Lithuania has had some success in reorienting exports to a diverse range of countries. Export volumes of sanctioned goods of Lithuanian origin have particularly risen to the Middle East and Asian countries.
Growth is projected to gain momentum in 2016 and 2017 as export growth recovers in line with improvements in major export markets. This, combined with easier financing conditions, will spur domestic investment activity, especially in 2017. Private consumption growth will continue to be supported by improving labour market conditions. The unemployment rate will continue to fall and exert upward pressure on wage growth. Growth in unit labour costs will slightly increase, even assuming a solid rise in productivity. Compared to the past few years, which were marked by substantial fiscal contraction, fiscal policy will exert less drag on domestic demand (Figure 4, Panels E and F), as the government’s fiscal stance is expected to become broadly neutral. The European Commission sees a risk of Lithuania deviating from its medium-term fiscal objective under EU rules (European Commission, 2015d). However, the Commission has a different view on the cyclical position of the Lithuanian economy and did not take into account the full potential effect of recent tax administration improvements.

Risks to the economic outlook are to the downside. A weaker-than-expected recovery in the euro area could hurt the export recovery. Empirical evidence suggests that 1 percentage lower growth in Lithuania’s trading partners would reduce GDP growth by 1.25 percentage points, mainly through the trade channel (IMF, 2013). A rise in geopolitical tensions may also weaken business confidence and delay the investment recovery, but an easing in tensions could have the opposite effect. On the upside, substantial stimulus from accommodative monetary policy and lower oil prices is currently supporting euro-area economies, including Lithuania. If coupled with progress in implementing structural reforms, especially boosting the volume and quality of European infrastructure, this could

<table>
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<tr>
<th>Table 1. Macroeconomic Indicators and Projections</th>
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<tr>
<td><strong>2013</strong></td>
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<tr>
<td>GDP</td>
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<tr>
<td>Private consumption</td>
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<tr>
<td>Government consumption</td>
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<tr>
<td>Gross fixed capital formation</td>
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<tr>
<td>Residential</td>
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<tr>
<td>Final domestic demand</td>
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<tr>
<td>Stockbuilding(^1)</td>
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<tr>
<td>Total domestic demand</td>
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<tr>
<td>Exports of goods and services</td>
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<tr>
<td>Imports of goods and services</td>
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<tr>
<td>Net exports(^1)</td>
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<tr>
<td><strong>Memorandum items</strong></td>
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<tr>
<td>GDP deflator</td>
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<tr>
<td>Harmonised index of consumer prices</td>
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<tr>
<td>Private consumption deflator</td>
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<tr>
<td>Unemployment rate</td>
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<tr>
<td>Output gap(^2)</td>
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<tr>
<td>General government financial balance(^3)</td>
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<tr>
<td>General government gross debt(^3)</td>
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<tr>
<td>General government gross debt, Maastricht definition(^3)</td>
</tr>
<tr>
<td>Current account balance(^3)</td>
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</table>

1. Contributions to changes in real GDP.
2. As a percentage of potential GDP.
3. As a percentage of GDP.
Source: Update from OECD Economic Outlook 98.
Figure 4. **Short term economic indicators**

A. GDP components growth (Year-on-year, %)

B. Inflation (Year-on-year, %)

C. Unemployment rate (% of labour force)

D. Loans to GDP ratio (% of GDP)

E. General Government financial balance (% of GDP)

F. General Government debt (Maastricht definition, % of GDP)

Source: Eurostat, OECD National Accounts Database, OECD Main Economic Indicators Database, Bank of Lithuania; OECD estimates, OECD Economic Outlook 98 Database.

[Stati Ink](http://dx.doi.org/10.1787/888933338569)
further boost external demand for Lithuanian goods and services. In addition, Lithuania could face shocks that are difficult to quantify in the projections, but which might have large repercussions if they materialise (Box 1).

### Box 1. Potential shocks not factored into the outlook

There are a number of low probability events that are not taken into account in the forecasts that would create significant challenges for the Lithuanian economy.

<table>
<thead>
<tr>
<th>Vulnerability</th>
<th>Possible outcome</th>
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<tbody>
<tr>
<td>Large rises in oil prices</td>
<td>The economy has benefitted from the substantial fall in the oil price since mid-2014. A heightening of geopolitical risks in the Middle East could reduce expected oil supply and send prices higher. This would reverse some of the recent improvement in Lithuania’s current account balance.</td>
</tr>
<tr>
<td>Increased financial risks</td>
<td>Renewed disturbances on international financial markets, potentially stemming from geopolitical tensions, concerns about sovereign debt sustainability in the euro area or a surprisingly rapid normalisation of US monetary policy, could have particularly large effects on small countries such as Lithuania.</td>
</tr>
<tr>
<td>Geopolitical events</td>
<td>Future geopolitical events relating to Russia are very uncertain in both directions, but could have large and unpredictable effects on neighbouring countries, including Lithuania.</td>
</tr>
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### Fiscal and financial policies to support the economy

As discussed, Lithuania faces important challenges to make economic convergence stronger and more inclusive, heightening the need for a robust fiscal and financial framework. Spending on health and labour market policies are a priority in the short-term and the ageing population will require greater public support in the longer-term (Box 2). Nevertheless, such government interventions are likely to enhance both economic growth and labour market participation, improving the future fiscal position. At the same time, measures that improve the efficiency of education and health spending and further promote tax compliance can also expand fiscal resources and contribute to medium-term consolidation. Adjusting the tax mix away from the most distortionary revenue sources would raise productivity and economic growth. A fiscal and financial architecture that protects the economy against the build-up of imbalances will also be important for ensuring that the income convergence process is sustainable.

### Strengthening long-term fiscal sustainability and growth

**The fiscal position is robust**

Lithuania’s fiscal position is strong with a small fiscal deficit (-0.7% of GDP in 2014) and government debt (41% of GDP; Figure 4, Panels E and F; and Figure 5). The current fiscal position has benefitted from significant consolidation efforts in the aftermath of the crisis. Two-thirds of the consolidation was done through cutting expenditures, including decreases in public wages, temporary cuts in pensions, and reductions in selected social benefits (Geng, 2013; IMF, 2014a; European Commission 2014a). This tight stance was needed to retain financial market confidence and to ensure euro adoption. The benefits of this effort are now apparent, as the government has appropriately shifted to a broadly
neutral fiscal stance, which will not depress demand going forward. Nevertheless, Lithuania has one of the fastest ageing populations in the EU and further measures will be needed to contain the associated fiscal costs (Box 2).

**Box 2. Long term costs related to ageing and sustainability of the pension system**

Lithuania is one of the fastest-ageing countries in the European Union (EU): the old-age dependency ratio is expected to rise from one senior (person above 65 years old) for every 2.4 workers in 2013 to 1 senior for 1.2 workers in 2040. This implies additional annual fiscal costs that will peak at around 2 percentage points of GDP in 2040 (European Commission, 2015b).

Reforms to the pension system are underway. Since 2012, the retirement age has been gradually increasing and will reach 65 in 2026 for both men and women. A new system was implemented from 1 January 2014 allowing the accumulation of additional pension rights in addition to the state social insurance contribution. A reform on indexation of pensions is planned for the second half of 2015 (NRP, 2015).

Those reforms are welcome but are not sufficient to meet the challenges. Although it has not yet been legislated, there is a plan to more closely link working age to life expectancy from 2026 as part of the ongoing reforms to the social model. Other planned measures include increasing the required length of service for eligibility for a full old-age pension (to 35 years by 2026 rather than 30 years now) and restricting the early retirement schemes (European Commission, 2015a).

Fighting tax evasion

Lithuania’s tax revenue potential is not fully exploited: when comparing revenues to the tax capacity of the economy, taking into account its structural characteristics such as the level of GDP per capita and the sectorial composition of GDP, Lithuania’s tax collection is estimated at 61% of tax capacity against 77% for other central European economies (IMF, 2014b). Recent work suggests that despite shrinking in recent years, Lithuania’s informal economy is one of the largest in the EU (Schneider, 2015).
Lithuania’s value added tax (VAT) collections are estimated to be 64% of potential VAT given the VAT structure and actual consumption. Closing this non-compliance gap would deliver revenues equivalent to 4.4% of GDP (Figure 6). Fighting tax evasion is therefore a priority, and the authorities have introduced a compliance action plan which delivered its first positive effects in 2013-14 (European Commission, 2015a). Steps taken to fight tax evasion include restrictions on cash payments, improving the tax administration information system, simplifying procedures on tax recovery and specific measures to fight abuse of VAT exemptions (NRP, 2015; Box 3). Efforts should be continued, paying attention to successful policy measures implemented in comparable countries. For example, the Slovak Republic’s “tax cobra” scheme – which promotes close cooperation among police, prosecution and tax administrations to fight major fraud – has proven quite successful: the VAT gap there was reduced to 32% in 2014 from 40% in 2012 (OECD, 2014a).

**Figure 6. VAT non-compliance is high**

2013, VAT gap,¹ % of VTTL

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1. The VAT Gap is the difference, in any given year, between the VAT Collections (as recorded by Eurostat) and the amount theoretically due, i.e. VTTL (VAT Total Tax Liability). The latter is the total amount of estimated VAT payments on the basis of national accounts aggregates and the existing structure of rates and exemptions.


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**Box 3. Measures taken to fight tax evasion**

- Law on Tax Administration: amendment aimed at optimising the processes of the provision of information for identifying undeclared income and unjustified sources of acquisition of property, setting a tax obligation and cooperating with tax administrations of other countries.
- Law on Excise Duty: amendment establishing a more efficient mechanism for levying excise duty on lubricant oils.
- The State Tax Inspectorate implemented the Strategy for tax compliance and tax collection for 2014-17. Measures include further control of income from unregistered and illegal activities and the implementation of targeted measures for the prevention of fraud.
ASSESSMENT AND RECOMMENDATIONS

Adjusting the tax structure to be more growth and equity-friendly

The tax structure could be made more growth and equity-friendly by shifting the tax mix towards less distortionary revenue measures and reducing economically or socially unjustified tax exemptions. Some steps have already been taken. For example, part of the tax burden has been moved from labour to consumption (European Commission, 2014c), helping Lithuania to have a relatively broad VAT base (European Commission, 2015c). However, additional specific further adjustments to consider are:

- Recurrent taxation on property accounted for only 0.3% of GDP in 2012, compared with 1.5% in European countries (European Commission, 2014d). Some steps were recently taken: in 2014, the threshold value above which properties are taxed was reduced from EUR 300 000 to EUR 220 000 (NRP, 2015). The 2013 land tax reform also increased the value on which the tax is applied by introducing, over a period of five years, market value as the basis for taxation (NRP, 2014).

- Personal taxation of capital gains from the sale of real estate is limited. Exemptions favour high-income earners and reduce the progressivity of the tax system, which is already low due to a flat personal income tax rate. From 2016, the tax exemption for capital gains on the sale of a non-principal residence will be restricted to property held for at least 10 years (rather than 5 years, as currently is the case). Going forward, the authorities should consider phasing-out such exemptions.

- Dividends, rental income, interest on deposits and gains on securities are subject to the standard personal income tax, at 15%. However, the gains from the disposal of financial instruments not exceeding EUR 500 per tax period are exempted from taxation. Such exemptions may generate distortions in investment and saving decisions and should be avoided (Mirrlees et al., 2011).

- There is scope to increase environmentally-related taxes which amounted to 1.7% of GDP in 2012 compared to 2.4% in European countries, including through raising taxes on motor and heating fuels and introducing a car tax (differentiated according to the fuel characteristics of the vehicle). The planned imposition of a landfill tax in 2016 should help reduce pollution.

- Personal income tax in Lithuania is calculated on an individual basis using a flat tax rate. The system includes some progressive dimensions through tax allowances. However, the contribution of taxation to reducing inequalities remains modest. Going forward, an in-depth analysis of the Lithuanian tax system is needed to assess if the advantages of

Box 3. Measures taken to fight tax evasion (cont.)

- The Law on Value Added Tax and the Law on Tax Administration: aim at establishing additional measures to combat VAT evasion and abuse of VAT exemptions notably by establishing a general obligation for VAT payers to provide VAT invoices through the “Smart Tax Administration System”.

Additional laws under discussion at the Parliament (October 2015):
- Law on Restriction of Payments in Cash: establishes restrictions on payments in cash (up to EUR 5 000 for natural persons, who are not engaged in any economic-commercial activities, and up to EUR 3 000 for other persons).

Source: NRP 2015; EC 2015a.
introducing a progressive tax system in terms of inclusiveness could offset some of its drawbacks on the labour supply of highly skilled workers.

**Ensuring the fiscal framework protects against the build-up of imbalances**

Against the background of further government spending needs, a robust fiscal framework provides a safeguard against unsustainable fiscal policy. The credibility of Lithuania’s fiscal framework has been strengthened by the adoption of the EU Fiscal Compact at the constitutional level in January 2015, the establishment of a multiannual budgetary framework and an independent fiscal council.

The adoption of a medium-term budgetary target and multi-year expenditure ceilings requires general government revenues and expenditures to be forecast for the following three years. In particular, if the budget records a deficit on average over the past five years, the annual growth of expenditures may not exceed half of estimated nominal potential GDP growth. However, recent studies highlight that adherence to the multi-year expenditure ceilings is not fully binding and the scope for applying escape clauses may be too wide (European Commission, 2015a). The national fiscal discipline legislation foresees counter-cyclical consolidation when the output gap is positive and allows automatic stabilisers to work when the output gap is negative, which is a welcome move toward fiscal sustainability. However, the escape clause which allows the fiscal consolidation needs over the past five years to be limited to periods when the output gap is positive may not be sufficient. This underlines the need for prudent fiscal policy in good times. More transparency regarding the assessment of the cyclical position, in particular technical issues such as the methodology used, is important.

The fiscal framework was further reinforced in January 2015 by the establishment of an independent fiscal council. This institution is a non-partisan authority, independent of the existing government institutions, currently tasked with endorsing the economic scenario contained in the government budget. In some OECD countries, such institutions also monitor the implementation of budget plans and provide macroeconomic forecasts for the preparation of the budget. Using a fiscal council for the latter has been found to be effective in reducing forecasting bias (Hagemann, 2011). Lithuania’s Fiscal Council is relatively small and currently operates within the National Audit Office (also an independent institution), an arrangement that is working well. Nevertheless, a divergence in the priorities of the two institutions in the future could hamper the effective operation of the fiscal council. In time, some adjustment may be needed to the legislative provisions governing the organisation. While the government has responded to the reports of the council in parliament, this is not a legal obligation. If legally adopted, such a practice could enhance the quality of communication between the fiscal council and policy makers. Further financial resources may also be needed to ensure the full range of operations included in its mandate (monitoring fiscal policies including of sub-national governments and assessing budgetary/macroeconomic forecasts and fiscal rules). Steps are already taken to hire two additional employees in 2016 in addition to the five persons working already for the department in 2015. A planned assessment by the European Commission will be helpful in providing direction for reforms.
Ensuring financial stability and the investment recovery

The financial sector is stable

Financial stability is critical for the capacity of the economy to absorb shocks and to promote further income convergence. Lithuania’s macro-financial framework provides the central bank with the power needed to undertake financial supervision and administer macro-prudential policies (Box 4). The Bank of Lithuania (BoL) has already demonstrated its capacity to deal with potential sources of financial instability. Between 2011 and 2013, bankruptcy procedures were initiated against two domestic banks (Snoras Bank and Ukio Bank) following excessive risk-taking by these institutions. As part of the European Banking Union, from 1 January 2015, a number of supervisory responsibilities of the largest credit institutions (including AB DNB Bankas, AB SEB Bankas and Swedbank) were assumed by the ECB.

Box 4. Macro-financial framework

Macro-prudential framework

The Law on Financial Stability was amended in November 2015, granting resolution powers to the Bank of Lithuania. The Law on the Bank of Lithuania, as amended in September 2014, obliges the Bank of Lithuania to conduct macro-prudential policy. Among its responsibilities, the Bank of Lithuania must ensure the resilience of the financial system and mitigate the build-up of systemic risk. This requires regular monitoring, analysis and the application of macro-prudential instruments.

A Macro-Prudential Policy Strategy was adopted in March 2015 with five objectives:

- limit and prevent excessive credit growth and leverage;
- limit and prevent excessive maturity mismatch, excessive currency and liquidity risk in the financial system;
- limit exposure concentrations by type of economic activity, asset class or other criteria;
- limit the systemic impact of misaligned incentives of financial institutions, with a view to reducing their moral hazard;
- strengthen the resilience of financial market infrastructure.

In line with the new Capital Requirement Directive two resolutions have been adopted:

- In addition to the 8% minimum capital requirement, since 30 June 2015, a 2.5% capital conservation buffer requirement is applied to institutions in Lithuania.
- Strengthening banks’ internal management and shareholder control were transposed into national law.

Financial supervision

Since 2012, the Supervision Service of the Bank of Lithuania supervises commercial banks, credit institutions, payment institutions, electronic money institutions, insurance market and financial instruments. The Bank issues licenses to financial market participants for the provision of financial services and supervises their activities.

The Bank of Lithuania monitors the compliance of financial market participants with laws and requirements set by legal acts of the Bank of Lithuania, International Financial Reporting Standards, and requirements recommended by international organisations for safe and sound activities.
Lithuania’s financial sector is dominated by Scandinavian-owned banks. While these institutions contributed to the excessive credit cycle during the pre-crisis housing boom, they have since been a source of stability. In the lead-up to the crisis, external financial conditions spilled-over to the Lithuanian banking sector through easy access to funding at low cost. The fixed exchange rate regime aggravated the impact on credit growth by putting downward pressure on real interest rates (Bakker and Gulde, 2010). Private sector debt rose to 85% of GDP in 2009 (Figure 7, Panel A). The onset of the financial crisis and a substantial decline in house prices created strong deleveraging needs, in particular for the subsidiaries of foreign-owned banks (Figure 7, Panel B). However, the reversal in capital flows was limited, as parent institutions provided substantial liquidity to their Lithuanian operations and absorbed asset losses (Purfield and Rosenberg, 2013).

The financial sector is sound following the swift recovery from the crisis. Private sector debt declined from 85% of GDP in 2009 to less than 60% in 2013. The banking sector loan-to-deposit ratio declined from a peak at 170% in 2009 to 90% in 2015 and the share of non-performing loans declined from 20% to less than 7%. At the end of the third quarter of 2015, the average capital adequacy ratio was 24.3%, far above the regulators’ requirement of 10.5%, which includes the capital conservation buffer of 2.5% (Figure 7, Panels C and D). According to stress tests, no banks are expected to breach the minimum capital requirement under a severe shock scenario (Bank of Lithuania, 2013). The three large financial institutions covered by the European Central Bank’s asset quality comprehensive assessment (AB DNB Bankas, AB SEB Bankas and Swedbank) all passed the review (ECB, 2014). In the insurance sector, a new risk-based prudential and supervisory regime (“Solvency II”) will be introduced from January 2016.

The credit union sector poses some risks (Bank of Lithuania, 2014), but it is small, as assets represent only 2.5% of all financial-sector related assets. Five of 76 credit unions went bankrupt in 2013 and 2014 due to large loan losses. The law on credit unions was subsequently amended. In 2015, Parliament’s Committee on Budget and Finance approved the Concept of Sustainable Operations of Credit Unions. Amendments of the law on credit unions particularly aimed at strengthening their capacities to absorb losses as well as their management and the framework for cooperation. More importantly, potential instability in Scandinavian financial markets is also a risk for the Lithuanian banking sector. Nevertheless, the decline in liabilities of Lithuanian banks to parent banks and the parallel rise in deposits in recent years suggest lower vulnerabilities to external financing conditions than in the past (Bank of Lithuania, 2014; Figure 8).

Credit and investment have not yet recovered

Investment collapsed at the onset of the crisis (Figure 9, Panel A). This followed the overinvestment experienced during the economic boom when the level of business gross
fixed capital formation peaked at 20% of GDP. International comparisons suggest, however, that the correction has been too strong. While investment growth has begun to recover, the investment-GDP ratio is below the average level in the euro area while Lithuania, as a catching-up economy, should have a relatively high share of investment in GDP (Figure 9, Panel B). Both supply and demand factors explain the evolution of investment and credit in Lithuania (Everaert et al., 2015). Stock market capitalisation in Lithuania fell from 24% of GDP in 2007 to 9% in 2013 (European Commission, 2014a).

Going forward, several measures could further boost investment such as improving the bankruptcy law. Closing a business is relatively time consuming in Lithuania as insolvency procedures take, on average, 2.3 years compared to 1.5 years in Latvia and 1.8 years in the OECD. In addition, the average recovery rate on insolvency is only 43 cents per dollar compared with 71 cents per dollar in the average OECD country (World Bank, 2015). Improvements in these areas could reduce costs and free up resources more quickly for new and growing enterprises. Structural reforms could also contribute to boost domestic and foreign investment, including through the Juncker plan and further promotion of venture

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**Figure 7. The financial sector has swiftly recovered**

<table>
<thead>
<tr>
<th>A. Private sector debt</th>
<th>B. Nominal house prices</th>
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<tr>
<td>% of GDP</td>
<td>2007 = 100</td>
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<tr>
<td>Non-financial corporations</td>
<td>Lithuania</td>
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<td>Households</td>
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<th>C. Capital adequacy ratios</th>
<th>D. Non-performing loans</th>
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<tr>
<td>% of risk-weighted assets</td>
<td>% of total gross loans</td>
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<tr>
<td>Overall</td>
<td>Overall</td>
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<tr>
<td>Tier 1</td>
<td>Tier 1</td>
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Source: IMF, Financial Soundness Indicators (FSI) Database and Eurostat tables on EU policy; OECD Housing Prices Database. http://dx.doi.org/10.1787/88893338591
capital and investment in R&D (Chapter 1). This will complement the easier credit conditions in the euro area that have resulted from quantitative easing (ECB, 2015).

**Enhancing energy efficiency**

High energy intensity (Figure 10, Panel A) combined with a recent fall in domestic energy supply has raised Lithuania’s dependence on energy imports and its vulnerability to energy price movements. The country’s reliance on imported oil has risen markedly since 2000 (International Energy Agency, 2015). Since the closure of the Ignalina nuclear plant in 2009, around three quarters of the country’s total primary energy supply has been imported. Reducing energy intensity would both reduce Lithuania’s vulnerability to shocks and help lower its relatively high greenhouse gas emissions intensity (Figure 10, Panel B).

There has been little decline in Lithuania’s energy intensity since 2005, and new policy measures will be needed if Lithuania is to reach its target of increasing energy efficiency by
ASSESSMENT AND RECOMMENDATIONS

Lithuania participates in the EU Emissions Trading Scheme, there are no direct subsidies that support fossil-fuels and the share of renewables has risen notably as a share of gross final energy consumption in the past decade (Eurostat, 2015a). But environmentally-related tax revenue is low by European standards (Figure 10, Panel C). There is no car tax or road-user charges for passenger cars, and taxes on motor fuels and on fuel used for heating are among the lowest in the EU – just above the minimum rates imposed by the Energy Taxation Directive in most cases (European Commission, 2014b).

In the medium term, reducing energy intensity of residential housing will be instrumental to raising energy efficiency (European Commission, 2015a). The government has recently implemented new policy measures. A renovation loan scheme has been established in partnership with the European Investment Bank (through the JESSICA and JESSICA II fund), whereby loans are offered at preferential terms to homeowners in multi-apartment buildings that commit to energy saving measures. The volume of renovations of such buildings has increased in the past few years, though the pace of activity will need to remain high given that two-thirds of the population still live in multi-apartment houses built before 1993 to outdated technical standards (Sirvydis, 2014). Similarly, a large portion...
of public buildings date to the Soviet era and are not energy efficient. The government has committed to improve the energy efficiency of public buildings and street lighting. An energy efficiency fund of 80 million euros has been established for this purpose, with the intention that it will be complemented by financing from private sources.

**Recommendations for fiscal and financial policies to support the economy**

- Continue fighting tax evasion also beyond the VAT gap and improve spending efficiencies (especially in education and health care areas), to allow medium term fiscal consolidation and finance public spending needs.
- Further shift the tax burden away from labour, especially from employer social security contributions, and raise recurrent taxes on personal immovable property.
- Increase taxes on activities that damage the environment.

**Boosting productivity to accelerate convergence**

The level of labour productivity in Lithuania today is about one-third below the OECD average. Improvements in living standards and the maintenance of Lithuania’s competitiveness in international markets will increasingly rely on productivity gains, especially given rapid population ageing. Since the financial crisis, productivity growth has been driven by both the reallocation of resources from less productive to more productive sectors and by efficiency improvements within each sector (Figure 11). Public policy settings enabling contributions from both these influences will continue to be crucial.

**Figure 11. Productivity has benefitted from both within-sector advances and between sector reallocation**

Labour productivity growth (%)

Note: “Within” measures the contribution to total labour productivity growth from productivity growth within sectors. “Shift” measures the contribution resulting from the movement of labour between sectors. “Cross” indicates whether the within-sector and between-sector effects are complementary. A negative value for the latter indicates that productivity growth is particularly strong in sectors that have a contracting labour share.

Source: OECD calculations, based on data from Eurostat Database.

http://dx.doi.org/10.1787/88893338632
Policies for better resource allocation

Better allocation of resources relies on a policy framework that promotes favourable firm dynamics – the easy entry of new firms, their access to the necessary resources to expand in the initial years of life and the swift exit of less productive entities. The contribution of between sector reallocation in Lithuania to productivity growth (i.e. the “shift” effect in Figure 11) over the past decade has been large by international standards (Molnar and Chalaux, 2015), consistent with relatively favourable policy settings.

The burden of some product market regulations protecting incumbents and deterring firm entry has fallen substantially. By 2013, the complexity of regulatory procedures was less stringent than in the average OECD country according to the OECD Product Market Regulation (PMR) Indicators. Specific measures have included a one-stop shop for online business registration and a new legal form of company (a “small partnership”) that has no minimum capital requirement and a reduced number of regulatory procedures. Between 2003 and 2015, the average time it took to register a business in Lithuania fell from 26 to 3.5 days (World Bank, 2015).

An area in which the PMR indicators suggest scope for further reforms concerns state-owned enterprises (SOEs), which have a relatively large presence in Lithuania (OECD, 2016a). Many of these institutions perform commercial functions poorly (State Property Fund, 2014), meaning that they absorb resources that could be reallocated to more productive firms. The government set a 5% target ROE for SOEs engaged in commercial activities for 2013-15, but in 2013 the ROE for this group was only half that (OECD, 2016a). Underperformance may partly reflect poor governance practices. In particular, the ownership and regulatory functions of SOEs are often undertaken by the same government institution (OECD, 2016a). The OECD Guidelines on Corporate Governance of State-Owned Enterprise suggest that there should be a clear separation between the state’s ownership functions and state functions relating to market regulation. SOE boards also tend to have a high concentration of representatives from government ministries (Baltic Institute of Corporate Governance, 2013), which raises the potential for political interference in business operations.

The PMR indicators also highlight an opportunity for reforming some barriers to trade and investment that restrict firm growth. In particular, burdensome regulations mean that it generally takes many months to employ a non-EU worker (for details, see Box 1.2). These include a labour market test which, as at 2013, existed in only 3 of the 34 OECD countries (OECD, 2013a). Such regulations may be particularly detrimental to Lithuania given that the domestic labour force often does not possess the skills required by industry. Over 40% of businesses surveyed in the first half of 2015 for Lithuania’s Investor Confidence Index characterised the availability of qualified labour as insufficient. Furthermore, cross-country surveys suggest that skill shortages are a larger constraint to businesses in Lithuania than in other comparable countries (Figure 12).

The size of Lithuania’s informal sector may also create a barrier to entry and misallocation of resources. By not paying tax, firms operating in the shadow economy are able to provide goods and services at a lower price, which may displace more efficient taxpaying firms. This means that informal sector firms absorb resources that would be allocated elsewhere if all firms operated on a level playing field.

Access to finance has improved but some firms may still face constraints. Around 16% of Lithuanian respondents to the EBRD-World Bank Business Environment and Enterprise
Performance Survey (BEEPS) cited access to finance as a major or very severe obstacle to their operations in 2013. This was higher than in Estonia (5%) and about the same as in Latvia (15%). Furthermore, unlike in the other Baltic countries, the Lithuanian firms facing financial constraints were generally those with higher levels of labour productivity (Figure 13). Lithuania's venture capital market is in its infancy, although the government is promoting its development by establishing new venture capital funds and investing in existing ones. An example is the Baltic Innovation Fund (BIF), jointly financed by each of the Baltic country governments, which invests in existing private equity and venture capital funds that then finance high potential firms in the Baltic countries. There is also scope for public policy to promote new forms of financing, such as through equity markets or crowd-funding platforms. Indeed, the government is currently considering proposals in some of these areas.

**Promoting within-firm productivity growth**

**Promoting the accumulation of intellectual and physical capital**

The EU Summary Innovation Index for Lithuania was well below the EU average in 2014, with firms reporting particularly weak product and organisational innovation activity (Table 2). In 2014, over 80% of Lithuanian Small and Medium Enterprises (SMEs) were classified as having “low-absorptive capacity” (Leichteris et al., 2015), which is concerning given the large productivity gap between Lithuania and more advanced economies. The share of researchers working in the business enterprise sector in Lithuania is low compared with the other Baltic countries. This may be exacerbated by administrative burdens associated with hiring foreign specialists and Lithuania’s elevated high-skill emigration rate. At the same time, weak business innovation may be one factor behind high-skilled emigration from Lithuania over the past decade (Figure 18 below).

Business R&D intensity is low despite generous R&D tax incentives (Figure 14). The take-up of R&D tax incentives is poor, with many firms unaware of their existence or
uncertain about the definition of eligible R&D. Despite carry-over provisions, tax incentives may disadvantage young firms that are often in a loss-making position. As a result, government R&D grants, loans and loan guarantees, which are often particularly conducive to supporting young innovative firms, should continue to play a prominent role in the innovation-policy mix.

Innovation, and within-firm productivity growth, would benefit from greater international knowledge spillovers and improvements in firm’s absorptive capacity, which would make Lithuania more attractive for FDI and boost the participation of Lithuanian firms in GVCs. While Lithuania’s inward FDI stock at 2012 was below that in the other Baltic countries (Figure 15, Panel A), there are signs of relatively strong growth in inward FDI flows since then (Invest Lithuania, 2014). Inward FDI to Lithuania is characterised by a relatively large share of greenfield investment, which may be more beneficial than other types of FDI for domestic job creation. Nevertheless, there was relatively low “backward participation” of Lithuanian firms in GVCs as at 2011 (i.e. A relatively low share of foreign value added embodied in Lithuanian exports; Figure 15, Panel B).
Figure 14. **Business R&D intensity is very low**  
% of GDP, 2013 or last available year

A. Total R&D  
B. Business R&D

Lithuania 2020  
Total R&D target  
(1.9% of GDP)

Source: OECD Main Science and Technology Indicators and Eurostat Statistics on Research and Development Database.

http://dx.doi.org/10.1787/88893338666

Figure 15. **FDI and participation in Global Value Chain are low**

A. FDI, % of GDP, average 2009-2012

B. GVC participation, 2011, % of gross exports

1. Foreign Value Added embodied in exports, as % of total gross exports.  
2. Domestic Value Added embodied in foreign exports, as % of total gross exports.  

http://dx.doi.org/10.1787/888933338674
The OECD Services Trade Restrictiveness Index (STRI) for Lithuania suggests that the regulatory framework is open to trade (Figure 16; OECD, 2016b). However, in addition to the restrictions on foreign workers already discussed, the prohibition of foreigners from some countries to acquire real estate may restrict foreign trade and investment. Furthermore, better integration into GVCs could be promoted by improvements to Lithuanian infrastructure (Kowalski et al., 2015).

Figure 16. **Lithuania’s regulatory framework is open to trade**

Services Trade Restrictiveness Index, 2015

While some infrastructure is well developed, such as the broadband network (Fibre to the Home Council Europe, 2015), businesses judge Lithuania’s infrastructure overall to be below the OECD average (Figure 17). For example, poor compatibility of the transport, electricity and gas networks with those in the rest of Europe may reduce competition and raise costs for Lithuanian firms. However, a number of noteworthy public infrastructure projects have been undertaken in recent years. These include a sequence of expansions to the Klaipeda port and the ongoing Rail Baltica project which will connect Finland, Poland, Germany and the Baltic States. The sources of Lithuanian energy supply have been diversified with the completion of the Lithuania-Sweden (“NordBalt”), the Lithuania-Poland (“LitPol”) electricity interconnections in late 2015 and a liquefied natural gas terminal in 2014.

**Providing the right mix of skills**

As suggested by Figure 12, finding workers with the right skills is a significant constraint to firms. Along with restrictions on non-EU workers and recent high skilled emigration (Figure 18), a lack of suitable labour in Lithuania may reflect the low quality of the domestic education system.

In 2014, 53% of Lithuanians aged 30-34 had tertiary education, compared with 38% in the EU. Nevertheless, firms report inadequate technical skills of graduates as a key factor behind labour shortages (European Parliament, 2015). This reflects both failings in the skills being taught and the fact that lifelong learning is low. In 2015, the proportion of 25 to 64 year-
olds participating in education and training in Lithuania was around half the EU average. The difficulty faced by firms in finding adequately-skilled workers highlights a need for more work-based training that teaches practical skills. The Lithuanian government has prioritised reform of the vocational education and training system (VET), which is largely school-based. Complementary measures that encourage participation by businesses in the training process and involve them in the development of VET curricula should also be considered.

There have been many important reforms to Lithuania’s higher education system over the past decade. For example, the introduction of student vouchers in 2009, in place of

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**Figure 17.** The quality of Lithuanian infrastructure could be improved

Quality of overall infrastructure score, 2014-15

Note: The score is based on the assessment of business leaders operating in the country to the question: how would you assess general infrastructure (e.g. transport, telephony and energy) in your country? [1 = extremely underdeveloped – among the worst in the world; 7 = extensive and efficient – among the best in the world].

Source: World Economic Forum Global Competitiveness Index Dataset.

**Figure 18.** High skilled emigration has reduced Lithuania’s pool of human capital

High skilled emigrants to OECD at 2010-11 that have moved in the past 10 years, % of domestic 15+ population

Note: High skilled workers are defined as those with tertiary education.

Source: Calculations based on OECD Database on Immigrants in OECD Countries (DIOC) 2010/11.
direct funding of education institutions, to make courses more demand-driven. Nevertheless, no Lithuanian university was ranked in the top 400 universities published by the Times Higher Education World University Rankings 2014-15. This contrasts with some smaller OECD economies, such as Finland and Denmark which have seven and five universities in the top 400 respectively. Scope for improvement in the quality of Lithuanian universities was highlighted by a study in 2015 that found that the short-run returns to university education were low relative to other forms of education (MOSTA, 2015). The higher education system may benefit from some rationalisation: there are 14 state universities and 13 state colleges in Lithuania: on a per capita basis, this is relatively high (Mitchell, 2014). There may also be some benefit from greater specialisation of institutions within the university system.

The inadequacy of skills may also reflect deficiencies in the education system at early ages. Lithuanian secondary students participating in the most recent wave of the Programme for International Student Assessment in 2012 (PISA; Figure 19, Panel A) scored particularly poorly for reading and mathematics compared with students in OECD countries. Participation in early childhood education is low in Lithuania, especially in rural areas (Figure 19, Panel B; Poviliūnas, 2014), which may contribute to students’ future poor test scores.

Figure 19. **Poor basic skills partly reflects low participation in early childhood education**

Note: Children of 4 years old in education at ISCED level 02-1.
Source: OECD PISA 2012, OECD Education at a Glance 2014; Eurostat Education Indicators Database.

http://dx.doi.org/10.1787/88893338719
Low PISA scores may also reflect the difficulty in attracting young, high-quality teachers. Up to one-third of the variation in PISA scores between OECD countries can be explained by differences in teacher salaries (Ali, 2009). In Lithuania, teacher salaries are in line with GDP per capita: they are around 20% higher than GDP per capita in the average OECD country (Figure 20, Panel A). Furthermore, teacher performance has typically not been adequately evaluated or improved.

Figure 20. Teacher salaries are low and there is scope for improving quality assurance

A. Teacher salaries
Ratio to GDP per capita, 2012

B. Quality assurance practices in schools, 2012
Percentage of students in schools whose principal reported that their schools have the following for quality assurance and improvement

C. School responsibility for resource allocation
Index, 2012, from high to low autonomy

Note: The ratios in Panel A are calculated as a simple average of those for lower and upper secondary education.
1. Including teacher and student attendance and graduation rates, test results and professional development of teachers.
2. Such as a school curriculum with shared instructional materials accompanied by staff development and training.

http://dx.doi.org/10.1787/88893338726
been a criterion for setting base salary and supplementary payments in Lithuania (OECD, 2013b). Evaluating the impact of an individual teacher on students’ results can be difficult, meaning a system based on the evaluation of good practices or group performance may be preferable. There also appears to be scope to improve the professional development of Lithuanian teachers, through more mentoring and observation by senior teachers (Figure 20, Panel B).

External evaluations of Lithuanian schools should be undertaken more frequently. Schools have a relatively high level of autonomy in making decisions about salaries, recruitment and budget allocations (Figure 20, Panel C). However, school principals report that external evaluations in Lithuania are less common than in the OECD. This suggests that the role of the school inspectorate or other external review body could be boosted.

The costs involved in further improving educational quality could be partly offset by efficiency gains. A decline in Lithuania’s school-aged population has prompted the government to consolidate schools. However, the student-teacher ratio is still low compared with most OECD countries (Figure 21). Furthermore, population projections by the United Nations suggest that the school-age population could fall by over 20% between 2010 and 2030 (United Nations, 2015). Some further consolidation of schools may enable cost savings and facilitate better coordination of curricula and teaching standards. However, this should be accompanied by measures such as improved transport infrastructure that ensure educational opportunities for students, especially those in rural areas, are not reduced.

Figure 21. The student-teacher ratio is relatively low and likely to further decline

Source: OECD PISA 2012.

Recommendations for boosting productivity

- Further increase the role of workplace training and cooperation with employers in the education system, especially in the context of vocational education and training programmes.
- Attract higher performing graduates to the teaching profession by paying higher wages and investing in teacher development.
- Promote participation in pre-primary education.
- Promote new forms of business financing and ensure that innovation policies support young innovative firms. Reform bankruptcy procedures.
Promoting an inclusive labour market

To ensure that higher productivity results in higher living standards for all and lower poverty risk, labour markets and social policies both have an important role to play. The labour market is the natural starting point, as being employed is the principal route for reducing the risk of poverty. Promoting institutions that are conducive to job creation, employability of the most vulnerable and better job satisfaction will improve both labour participation and well-being. The risk of being unemployed is, however, inherent to a decentralised labour market and providing adequate unemployment benefits is critical for avoiding job loss being associated with poverty. Along with people at risk of being temporary unemployed, there will always be more vulnerable individuals with low jobs prospect. Taking care of them requires a balanced social assistance system that provides incentives to seek work and adequate income support to alleviate poverty. In such a framework, effective public employment services are instrumental to reduce unemployment and inactivity by helping people getting back to work.

Providing more and better jobs for all

The Lithuanian labour market has proven to be flexible, which can make job creation more dynamic and is more conducive to growth (Bassanini and Duval, 2006; Andrews and Cingano, 2014). The relationship between GDP and unemployment (so-called Okun’s law) is estimated at 0.49, similar to the United States, which suggests a high degree of labour market flexibility (Ebeke and Evereart, 2014). Such flexibility allows quick reallocation of resources and increases the adaptability of the economy to shocks. This is important for a catching-up economy like Lithuania, where structural change, technical change and job reallocation are particularly necessary.

Labour code legislation is strict by international standards, especially the rules regarding individual dismissal and the use of temporary employment (Figure 22; OECD, 2015a). At the same time, the labour code is not always enforced. For instance, legislation sets redundancy payments of up to 6 average monthly wages, but recent studies suggest that only 8-9% of dismissed women and 5-6% of dismissed men received redundancy payments, mainly from the public sector (European Commission, 2015a). This generates uncertainty for firms and for workers, which, for instance, may undermine Lithuania’s attractiveness for FDI, as foreign firms are less aware of national practices to cope with an uneven implementation of labour regulations. The authorities plan a welcome reform of the labour code to better align practice according to the flexicurity model.

Providing more job opportunities for all, in particular for the most vulnerable workers, is instrumental to having an inclusive labour market. The performance of Lithuania’s labour market has been impressive since the start of the recovery (the unemployment rate has fallen by 2 percentage points a year on average since 2010). The unemployment rate for youth, which peaked at 35.7% in 2010, has been in particular reduced to 19.3% thanks to specific support measures including training, wage subsidies and a “youth guarantee” which ensures that all youth under 29 get a good-quality offer for a job, training or continued education within four months of leaving education or entering unemployment (OECD, 2015a). However, the overall unemployment rate is still above the OECD average and seniors and the low-skilled still face a high risk of unemployment (Figure 23, Panel A). Shifting taxation away from labour, by reducing employer social security contribution which accounts for almost 60% of the tax wedge, would improve the employability of the low-
skilled (Figure 23, Panel B; Giannella et al., 2008; IMF, 2014a). However, targeting low-skilled requires reliable information on wages which is not fully the case in Lithuania due to the relatively large use of informal wage payment (Eurobarometer, 2014; Schneider, 2015). An option is to limit exemptions to employers hiring low-skilled previously unemployed.

Along with more jobs for all, providing workers opportunities to improve their careers would raise well-being and productivity. According to the European Survey on Working Conditions, which assesses the quality of jobs, 30% of Lithuanians are not satisfied with their working conditions. This is significantly higher than the average of European Union countries (Eurofund, 2012). Job dissatisfaction reduces participation in the labour market and fuels emigration, in particular for youth (OECD, 2015a, Gruzevskis and Blaziene, 2013; Gataulinas and Zabarauskaite, 2014).

International experience suggests there is no trade-off between the quality and quantity of jobs (OECD, 2014d). Labour market institutions could both allow secure career paths and sufficient flexibility for job creation and reallocation. Promoting lifelong learning

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Figure 22. **Employment protection legislation is stricter than the average of OECD countries**

A. Indicators on Employment Protection Legislation 2013

Protection of permanent workers against individual and collective dismissals, scale from 0 (least restrictions) to 6 (most restrictions)

B. Labor code legislation is comparatively strict

Indicators on Employment Protection Legislation 2013, scale from 0 (least restrictions) to 6 (most restrictions)

1. OECD unweighted average.
2. Data refer to 2015.

http://dx.doi.org/10.1787/88893338742
is a key instrument for workers to move into better jobs (Bassanini et al., 2005; OECD, 2014a). Only 5% of workers are engaged in training activities, half the level in the EU, and the participation of low-medium skilled workers is even lower (Figure 24; European Commission, 2013). Ongoing plans to entitle workers to 5-20 days of training per year and to establish a new apprenticeship contract are welcome. The authorities should develop further complementary schemes such as vouchers training; individual loans for training or regulatory provisions that protect firms’ investment in training, all measures that have proven to be successful in promoting lifelong learning (OECD, 2005).

Wage inequality is another important determinant of job satisfaction and is comparatively high in Lithuania (Figure 25, Panel A). While increasing the minimum wage can reduce inequality of earnings, it may also undermine job creation for low skilled workers if set too high. The minimum wage is currently at 50% of the median wage, which is about the average observed in OECD countries, suggesting the room for further increasing the minimum wage is limited (Figure 25, Panel B). In the medium-to-long term, the best way for boosting earnings of the low skilled is to improve their productivity through better education and job training. In the shorter-term, in-work benefits schemes (discussed below) could also make a contribution to improve work satisfaction by increasing take-home pay.

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1. 2013 data for OECD (unweighted average).
2. 2013 data for Latvia and Lithuania.
Source: OECD Labour Market Statistics; OECD Education at a Glance Database; Eurostat LFS Main Indicators Database; OECD Tax Statistics; European Commission, Tax and Benefits Database.

StatLink [http://dx.doi.org/10.1787/88893338759](http://dx.doi.org/10.1787/88893338759)
Figure 24. **Underinvestment in skills contributes to poor jobs quality**
Participation in lifelong learning by education level\(^1\), 25-64 years old, 2014, %

1. Based on ISCED 2011 levels: low corresponds to less than primary, primary and lower secondary education (levels 0-2), medium corresponds to upper secondary and post-secondary non-tertiary education (levels 3 and 4), high corresponds to tertiary education (levels 5-8).

Source: Eurostat Education and Training Database.

StatLink: [http://dx.doi.org/10.1787/888933338769](http://dx.doi.org/10.1787/888933338769)

Figure 25. **Wage inequality is high**

A. **Earnings dispersion**
Ratio of 9th to 1th deciles limits of earnings, 2012 or last available year, from low to high dispersion

B. **Minimum wage**
Relative to median earnings of full-time workers, ratio, 2014

Source: OECD Earnings Distribution Database.

StatLink: [http://dx.doi.org/10.1787/888933338777](http://dx.doi.org/10.1787/888933338777)
Designing effective income support for out-of-work people

Income support to the unemployed is underdeveloped which increases vulnerability to poverty in the case of job loss and undermines skill matching. The net replacement rate of insurance benefits for low-paid earners is significantly lower than the average of OECD countries (Figure 26). Entitlement criteria are also among the most restrictive in the OECD (Lazutka, 2014a; Lagenbusher, 2015). The low level of unemployment insurance benefits and tight entitlement criteria provide an incentive for searching and taking a job. However, this may also inhibit labour market matching if financial constraints prevent the unemployed from devoting enough time to job search (Tatsiramos, 2009; Amable and Gatti, 2004). The weak level of unemployment insurance also reduces the incentive to work in the formal sector (OECD, 2008). It may also limit the effectiveness of job-search and training policies, because the opportunity cost of not taking these programmes is low. Steps to strengthen unemployment insurance are welcome (Box 5).

Figure 26. Income security for unemployed is low

Net income replacement rate for unemployment,¹ initial phase of unemployment, 2013, %

Box 5. Main planned changes to the unemployment insurance system

- The constant part of unemployment benefits will be computed based on a minimum monthly wage (at 30%), while previously it was equal to the State Support Income (set at EUR 100 since 2008), which is the reference for social benefits. This would strengthen the link between labour market insurance and wage development while the level of the state income insurance is for now set in an ad-hoc way and determined by political decision.

- The variable part of the benefits will increase: it will be equal to 50% of former earnings during the first three months of an unemployment spell and then be gradually reduced to 40% between the 4th and 6th month, and to 30% between the 7th and 9th month. In the current system, the variable part is equal to 40% of the former insured earnings and reduced by 50% after three months.

1. Simple average of the net replacement rates for the following households situations: single with no child and with two children at 67% and 100% of Average Wage (AW), one-earner married couple with no child and with two children at 67% of AW and 100% of AW. After tax and including unemployment and family benefits. Social assistance and other means-tested benefits are assumed to be available subject to relevant income conditions. Housing costs are assumed equal to 20% of AW.

Source: OECD, Tax-Benefit Models.

StatLink: [http://dx.doi.org/10.1787/88893338784](http://dx.doi.org/10.1787/88893338784)
With an underdeveloped unemployment insurance scheme, the social assistance programme plays an important role in Lithuania where the risk of poverty is high (see Figure 3, Panel A). Since the global crisis, the number of social assistance recipients has increased significantly and was at 5% of the population in 2014, while the number of unemployment benefit recipients remained broadly constant (Figure 27, Panel A). The increase in social assistance beneficiaries has been driven by the fact that the crisis has pushed more people below the minimum income threshold that determines eligibility (Table 3). This implies a wider coverage of poor. However, social assistance benefits are only at half the poverty line, and, despite performing relatively well compared to peer countries, half the poor are not covered at all (Figure 27, Panel B). The reform implemented in 2012 that reduces benefits along the inactivity spell adds to the problem by reducing even further the level of benefits. Overall, this suggests that there is room for reinforcing social assistance.

Box 5. **Main planned changes to the unemployment insurance system** (cont.)
- The eligibility rights will also be extended by reducing the required length of the period of contribution to unemployment insurance to 12 months instead of 24 months.
- The duration of unemployment benefit will be prolonged to 9 months compared to 6-9 months currently.

Figure 27. **Despite progress more needs to be done to fight poverty**

**A. Number of beneficiaries**

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash social assistance beneficiaries</th>
<th>Recipients of unemployment social insurance benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>2008</td>
<td>20</td>
<td>40</td>
</tr>
<tr>
<td>2009</td>
<td>30</td>
<td>60</td>
</tr>
<tr>
<td>2010</td>
<td>40</td>
<td>80</td>
</tr>
<tr>
<td>2011</td>
<td>50</td>
<td>100</td>
</tr>
<tr>
<td>2012</td>
<td>60</td>
<td>120</td>
</tr>
<tr>
<td>2013</td>
<td>70</td>
<td>140</td>
</tr>
</tbody>
</table>

**B. Effectiveness of SA programmes**
Measured by the coverage, % of poor covered

<table>
<thead>
<tr>
<th>Country</th>
<th>2009</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td>20</td>
<td>30</td>
</tr>
<tr>
<td>Estonia</td>
<td>15</td>
<td>35</td>
</tr>
<tr>
<td>Hungary</td>
<td>20</td>
<td>40</td>
</tr>
<tr>
<td>Latvia</td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>Lithuania</td>
<td>30</td>
<td>50</td>
</tr>
<tr>
<td>Poland</td>
<td>15</td>
<td>25</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>Slovenia</td>
<td>15</td>
<td>30</td>
</tr>
</tbody>
</table>

Source: Lazutka (2014); Avram (2013), update based on EU-SILC data; Ministry of Social Security and Labour.

Table 3. **The level of the minimum income benefit is low**

<table>
<thead>
<tr>
<th>Year</th>
<th>Minimum Income (in EUR)</th>
<th>Poverty line at 60% median income</th>
<th>Ratio, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>39.1</td>
<td>102.9</td>
<td>38.0</td>
</tr>
<tr>
<td>2005</td>
<td>39.1</td>
<td>126.7</td>
<td>30.9</td>
</tr>
<tr>
<td>2006</td>
<td>47.8</td>
<td>163.8</td>
<td>29.2</td>
</tr>
<tr>
<td>2007</td>
<td>59.4</td>
<td>205.6</td>
<td>28.9</td>
</tr>
<tr>
<td>2008</td>
<td>82.5</td>
<td>235.8</td>
<td>35.0</td>
</tr>
<tr>
<td>2009</td>
<td>101.4</td>
<td>201.5</td>
<td>50.3</td>
</tr>
<tr>
<td>2010</td>
<td>101.4</td>
<td>192.9</td>
<td>52.6</td>
</tr>
<tr>
<td>2011</td>
<td>101.4</td>
<td>216.9</td>
<td>46.8</td>
</tr>
<tr>
<td>2012</td>
<td>101.4</td>
<td>234.9</td>
<td>43.2</td>
</tr>
<tr>
<td>2013</td>
<td>101.4</td>
<td>241.2</td>
<td>42.0</td>
</tr>
</tbody>
</table>

Note: Poverty line calculated each year at 60% of the median income.
A major challenge is to design social assistance programmes that are effective at reducing poverty while not raising disincentives to work. However, the complete withdrawal of benefits when the recipient takes up a job makes employment less attractive (Navicke, 2015). An option to raise the incentive to work is to provide direct in-work benefits for social assistance recipients who take a job. Such measures boost the labour supply without increasing the labour costs of firms by widening the gap between income from work and out-of-work benefits (Box 6). In addition, they potentially have substantial beneficial effects on income distribution (Immervoll and Pearson, 2009). Since January 2014, in-work benefits (equivalent to 50% of previous benefits) have been provided for six months to the long-term unemployed who are entitled to social assistance benefits and take up a job. The duration and the eligibility for such benefits could be extended to a wider range of out-of-work individuals, for instance unemployed with a shorter spell of unemployment.

The financial incentive to take up a job may depend too strongly on the size of the family in Lithuania: support for single individuals is comparatively low, at 24% of median income, far below the poverty line, while support for a family is 50-60% of median income (Lazutka 2014b, Figure 28). Reducing further the support to large families may, however, have strong distributional effects and increase the risk of poverty for children. Instead, designing in-work benefit schemes that target the family level have proven to be effective, notably as the second earner is more sensitive to financial incentives (Immervoll and Pearson 2009; de Boer et al., 2015). Some measures are planned to increase take-home pay for family earners in the context of the budgetary law for 2016 by raising the tax allowance for residents raising children from 60 to 120 euros and increasing the basic tax allowance from 166 to 200 euros. However, a universal tax allowance may come with high fiscal costs by supporting families with large incomes. The authorities should instead

---

**Box 6. Making work pay – In-work benefits schemes in OECD countries**

**Design**

In-work benefits strengthen incentives to work by widening the income gap between working and not working. Different designs of in-work benefits exist depending on the objective:

- Transitional benefits paid for a limited period following hiring (e.g. Australia, Belgium and Canada), which aim to increase the transition to employment.
- Permanent benefits can be paid, as long as the recipient meets the eligibility conditions (e.g. Belgium, Finland, Germany, France and United-Kingdom). These can take different forms such as tax concessions, social security contribution exemptions and refundable tax credits. Compared to transitory benefits, they have more pronounced effects on in-work poverty and distribution.

**Potential effect**

A 1% change in the income gap between working and non-working is on average found to increase participation by 0.2%. The elasticity is found to be higher for women and lone parents: between 0.3 and 1. The presence of children for women and being low educated also increases the elasticity. However, such elasticities should be interpreted with caution as they have been estimated during periods of strong labour market performance.

consider targeting family allowances at low income earners which would be less costly and more effective at reducing inequalities.

Making employment support services more effective

Adequate out-of-work benefits help connect jobless people with the public employment service (PES) and an effective PES helps to get people back to work (Immervoll and Scarpetta, 2012). Both social assistance and unemployment benefits recipients have to register at PES in Lithuania and to comply with the requirements in terms of job-search and programmes. However, only 0.18% of GDP in 2012 was devoted to active labour market policies (ALMPs) in Lithuania, compared with 0.43% on average in the OECD (Figure 29, Panel A).

Lithuania’s PES is understaffed, with almost 200 unemployed individuals per case worker compared to less than 50 in Germany, where Hartz reforms have significantly strengthened the effectiveness of PES and improved labour market matching (OECD, 2012b). More case workers would improve personalised support and other measures to help the unemployed and the low skilled to find jobs (OECD, 2015a). This is critical given the high level of structural unemployment, estimated at 10-12% (Ebeke and Everaert, 2014), and the outward shift in the Beveridge Curve, which suggest that the efficiency of labour market matching may have deteriorated since the 2008 global financial crisis (Chapter 2).

The effectiveness and efficiency of ALMP programmes could be improved by reallocating resources to the most efficient programmes. Spending on ALMPs should be further regularly monitored and evaluated in order to target resources to the most effective

---

Figure 28. The financial incentive to take a job is comparatively low for large families

Participation tax rate for a labour-market inactive individual¹, %, 2013

| Country | GRC | TUR | USA | CHL | SVK | PRT | KOR | ISR | CAN | AUS | OECD | GBR | NZL | DEU | EST | BEL | SVN | LUX | LTU | JPN | NLD | FIN | IRL | ISL | DNK | CZEPOL | SWE | AUT | NOR | LVA | CHE |
|---------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| Tax rate | 40  | 40  | 80  | 40  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60   | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  |

¹ Average effective tax rates measure the extent to which taxes and benefits reduce the financial gain of moving into work. The estimates here relate to the situation of a person who is not entitled to unemployment benefits (e.g. because they entitlements have expired). Instead, social assistance and other means-tested benefits are assumed to be available subject to relevant income conditions. Where receipt of such assistance is subject to activity tests (such as active job-search or being “available” for work), these requirements are assumed to be met in the out of work situation. Cash housing benefits are calculated assuming private market rent, plus other charges, amounting to 20% of the full-time wage for all family types. The percentage of AW relates to the earnings from full-time employment of the individual moving into work.

Source: OECD, Tax-Benefit Models.

http://dx.doi.org/10.1787/88893338807
programmes and tailor them in line with country-specific characteristics. Some directions for reform are suggested by the experience of the best-performing countries:

- Resources devoted to training could be increased, as they have proven to raise employability and the quality of jobs in the medium to long-term (Card et al., 2015; Wulfgram and Fervers, 2013). Experience in Denmark reveals that company-based training is the most effective at increasing employability. The new voucher programme implemented in 2012 provides more flexibility by allowing the trainee and the employer to choose the training provider. Progress has also been made in targeting the most vulnerable: long-term unemployed accounted for 20% of participants in training in 2013, compared with 9% in 2012. However, more needs to be done to develop the quality assurance of training (European Commission, 2014b; OECD, 2015a).

- Wage subsidies are efficient at improving the employability of low skilled workers (Card et al., 2010). However, overall ALMPs appear too skewed towards those programmes at the expense of programmes that increase long-term employability such as training. In
addition, the cost-efficiency of wage subsidy programmes could be improved by targeting the “Support for the first job” programme to the most vulnerable rather than to all youth without professional experience (OECD, 2015a).

- While public works programmes have proven to be the least effective at raising employability, including in Lithuania (Card et al., 2010; ESTEP, 2014), spending in that area has increased in the post-crisis period and still accounts for almost 20% of ALMPs spending in Lithuania (Figure 29, Panel B). Such schemes should be targeted at the hardest-to-place job-seekers, with a view to gradually bringing them back to market-based employment.

Getting social assistance beneficiaries back to work is underpinned by their mandatory registration in local labour offices. Some directions to strengthen the effectiveness to bring people back to work are:

- A first priority is to better coordinate PES and municipalities’ actions, in particular, by developing specific PES programmes for social assistant recipients. Jobseekers that have good prospects are rightly subject to standard job-search obligations, but the most vulnerable jobless individuals require specific assistance and intensive services if they are to escape unemployment (Immervoll and Pearson, 2009).

- Another direction is to revise municipalities workfare programmes which require social assistance recipients to take part in “socially useful activities” (40 hours per month) and cover one-third of social assistance recipients (European Commission, 2015a). These programmes aim at enforcing the availability to work and tackling informality (Lazutka, 2014b) However, international experience suggests that workfare programmes are weakly effective at improving the employability of participants (Crisp and Fletcher, 2008). They should hence be targeted for only the hardest-to-place recipients with the aim to develop some work habits.

Social assistance recipients who do not comply with administrative and job-search requirements can encounter sanctions, as in several OECD countries (Immervoll, 2015). However, sanctions appear comparatively strict in Lithuania where they imply either a full suspension (for at least three months) or a termination of benefits (Lazutka, 2014a; see Table 2.3 for details) while OECD experience suggests that moderate sanctions, such as a temporary reduction of benefits, could be effective (Immervoll, 2009). This suggests some room to design more balanced sanctions. In particular, a specific look should be given to the reasons behind the decline of social assistance recipients (see Figure 27, Panel A) to ensure that it is explained by better labour market performance and not associated with benefit termination leading to stronger poverty and social exclusion.

### Recommendations for promoting inclusive labour market

- Improve inclusiveness by providing in-work benefits for low-paid jobs, and increasing access to lifelong learning.
- Lower employer social security contribution on low-skilled workers while maintaining their entitlements.
- Implement the plans in the “New Social Model” to reform labour regulations and temporary income support for the unemployed.
- Strengthen active labour market programmes and the capacities of public employment services to implement programmes to get people back to work.
- Increase the income support to social assistance recipients while strengthening work incentives.
Improving health outcomes for all

Better health and higher life expectancy for all Lithuanians would make a direct contribution to well-being, labour utilisation and productivity. International experience suggests that better health raises employment, and that unemployment tends to weaken health (Barnay, 2014). Health policies thus appear integral to an inclusive growth strategy in Lithuania and priorities are to strengthen equity, effectiveness and sustainability.

Despite significant progress since the transition, life expectancy remains low at 74 years compared to 80 on average in OECD countries, and men have a life expectancy of only 68 years, compared with 78 in OECD countries. Comparatively poor life expectancy mainly reflects the prevalence of unhealthy life styles and a lack of access to modern medical treatment and prevention among lower socioeconomic groups (Jasilionis and Stankuniene, 2012). Access to health has improved and the proportion of Lithuanians self-reporting unmet needs for medical examination fell to 3.2% in 2012 from 7% in 2005 (Stamati and Baeten, 2014). However, only 44% of Lithuanians claim to have good or very good health, compared with 66% on average in Europe (OECD, 2014f; Figure 30).

Better primary care and prevention policies could contribute to better health and efficiency. Significant progress has already been achieved, as the number of family physicians has increased from 5 per 10 000 inhabitants in 2000 to 9 in 2012. However, the Lithuanian healthcare system still relies too much on hospital care (Murauskiene et al., 2013). Potential additional reforms include further promoting out-patient care. Strengthening the role of nurses in primary care services has proven effective in improving health in other countries, such as Denmark and the UK, where nurses can visit patients with minor health problems and prescribe drugs (Masseria et al., 2009).

Tackling health status inequality related to differences in socio-economic backgrounds is instrumental to inclusive growth and requires a multi-pronged approach:

- Health status differences are pronounced between rural and urban areas: The population in rural areas tends to make fewer visits to physicians than those in urban areas and their life expectancy is three years lower (Statistics Lithuania). The Lithuania Health Programme 2014-25 includes the development of a monitoring system of health inequalities to help target the at-risk population and the promotion of an integrated health policy that involve health, education and social institutions. While the causes of excess mortality of the lower educated are mainly related to the prevalence of unhealthy life styles (Jasilionis and Stankuniene, 2012), the room for raising excise taxes on alcohol may be limited as it is already above the European average.

- Another factor behind health inequalities may be out-of-pocket payments, in particular for pharmaceutical products, which amount to 64% of pharmaceutical expenditures (Figure 31, OECD, 2014f). Pharmaceuticals are reimbursed for certain people (children, pensioners, disabled and patients suffering from certain diseases) but others pay the full cost. The “programme for the third stage of the restructuring of health care institutions and services”, adopted in 2009, has reduced payments on pharmaceuticals and the average price of a prescription (Stamati and Baeten, 2014). However, Lithuania is still one of the countries that experienced the highest increase in co-payments between 2007 and 2012 (OECD, 2014f). There is also room for promoting further generic drugs (IMF, 2015).

- Another important dimension for promoting inclusive health is to tackle corruption in the health sector; a recent study reported that 35% of Lithuanians have paid a bribe in exchange for health care services (OECD, 2015c). The government programme 2012-16
Lithuanian spending on health care has increased to 6.7% of GDP in 2012 from 5.8% in 2005, which is low by international comparison but similar to regional peers (Figure 32). Efficiency could derive from merging more hospitals and improving further governance. The number of beds has been reduced from 8.8 for 1 000 inhabitants in 2000 to 7.3 in 2013, but this is still higher than the European average at 5.2 per 1 000 inhabitants. The launch of the fourth stage of the hospital network consolidation in 2015 goes in the right direction to the extent that access to health care services is guaranteed, in particular in rural areas.

Since 2012, the financing method for hospitals, based on diagnostic-related group (DRG) has also improved efficiency by imposing the same level of hospital resources for patients with the same diagnosis. Going forward, more can be done to improve governance, in particular by strengthening further the notion of open government, including by making more visible the results of policy actions and further involving stakeholders and patients. (OECD, 2015c).

There is also scope for further promoting the use of the newly established e-health

Figure 30. **Health outcomes are poor**

A. Life expectancy at birth, 2013

B. Self-reported health status

Population aged 16 years and over, %, 2013

1. Unweighted average.

Source: OECD Health Statistics; Eurostat Health Statistics Database.
infrastructure (e.g. electronic records) to make it an effective instrument of communication among health care service providers while fully respecting privacy concerns.

Figure 31. **Out-of-pocket payments in health care are high**
Expenditure on health by type of financing, % of current expenditure, 2013 or last available year

![Graph showing out-of-pocket payments in health care are high]

Source: OECD Health Statistics.

Figure 32. **Spending in health care is low but in line with peers**

![Graph showing spending in health care is low but in line with peers]

Source: OECD National Accounts Statistics; OECD Health Statistics.

**Recommendations for improving health outcomes for all**
- Further promote healthy lifestyles and primary care services especially in rural areas through general practitioners, greater role for nurses and the recently established network of public health bureaus.
- Increase health sector efficiency and effectiveness of health policy by continuing to merge hospitals and widening the scope for the newly established e-health infrastructure while fully respecting privacy concerns.
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Main areas for reforms planned by the authorities in the context of the “new social model”

Reform of the labour code
- Increasing the variety of the available types of contracts.
- Easing regulation of working hours.
- Easing the regulation on individual dismissal.
- Reducing the administrative burden on employers.
- Introducing specific exemptions for small firms (up to 10 employees).

Improving employment relationships
- Strengthening collective agreement.
- Clarifying the procedure for minimum wage determination, strengthening the transparency of the payment system, applying the minimum wage for non-qualified employees.
- Promoting lifelong learning.
- Promoting work-life balance, equality and non-discrimination.

New employment programmes
- Targeted active labour market measures.
- Developing service vouchers for low skilled, vulnerable groups.

Social insurance
- Increasing the coverage of individuals subject to social insurance.
- Reducing the social insurance tax rate and introducing a ceiling.

Pension system
- Changing the pension indexation rules.
- Phasing-in an increase of the mandatory insurance period for the full basic pension entitlement from 30 to 35 years.
- Adjusting the retirement age to life expectancy.
ANNEX 2

Selected policy indicators
Figure A1. **Product market regulation (PMR) and FDI Regulatory restrictiveness index**

A. PMR, Overall indicator (2013, index scale of 0-6 from least to most restrictive)

B. PMR, State control (2013, index scale of 0-6 from least to most restrictive)

C. PMR, Barriers to entrepreneurship (2013, index scale of 0-6 from least to most restrictive)

D. PMR, Barriers to trade and investment (2013, index scale of 0-6 from least to most restrictive)

E. FDI Regulatory Restrictiveness Index (2014, index scale of 0-1 from open to closed)

[Stattlink](http://dx.doi.org/10.1787/888933338851)
Figure A2. **OECD indicators on Employment protection legislation (EPL)**
2013 or latest year available, index scale of 0-6 from least to most restrictive

A. Protection of permanent workers against individual dismissal

B. Specific requirements for collective dismissal

C. Regulation on temporary forms of employment


StatLink  
http://dx.doi.org/10.1787/888933338861
Figure A3. **Student performance and equity**

![Student performance and equity chart]


Figure A4. **Science and innovation indicators**

![Science and innovation indicators chart]

Figure A5. Environmental indicators

A. Greenhouse gas emissions per unit of GDP (kg CO2 eq per unit of GDP 2005 USD), 2010

B. Energy intensity (total final energy consumption per unit of GDP, toe per thousand 2005 USD of GDP calculated using PPPs), 2012

C. PM10 emissions (micrograms per cubic meter, 2011)

Source: OECD/IEA Energy Database and World Bank, WDI Database.
Figure A6. **General government expenditure**¹

**A. Health expenditure, % of GDP, 2013**

**B. Education expenditure, % of GDP, 2013**

**C. Social protection expenditure, % of GDP, 2013**

1. According to the Classification of the Functions of Government (COFOG).
2. OECD average of available countries.
Source: OECD National Accounts Statistics.

[StaLink](http://dx.doi.org/10.1787/888933338900)
Figure A7. **Income redistribution**
Gini coefficient, scale from 0 “perfect equality” to 1 “perfect inequality”, 2012

2. OECD Secretariat calculations from EU-SILC – preliminary results.
Source: OECD Income Distribution Database and OECD Secretariat calculations.

http://dx.doi.org/10.1787/888933338913

Figure A8. **Government tax revenues**
2012, % of GDP


http://dx.doi.org/10.1787/888933338922
Figure A9. **Trade of goods by destination**
2014, % of total

Source: Lithuanian authorities.

StatLink [http://dx.doi.org/10.1787/888933338934](http://dx.doi.org/10.1787/888933338934)

Figure A10. **Trade of goods by product**
2014, % of total

Source: Lithuanian authorities.

StatLink [http://dx.doi.org/10.1787/888933338945](http://dx.doi.org/10.1787/888933338945)
Chapter summaries

Chapter 1. Scaling new heights: achievements and future challenges for productivity convergence

GDP per capita rose from one third to two thirds of the OECD average level between 1995 and 2014, despite internal and external crises. Productivity catch-up was critical to this process, although the level of labour productivity also remains around one-third below the OECD average. Further convergence will partly rely on improvements in resource allocation. In particular, the government should promote better governance of state-owned enterprises, effective bankruptcy procedures and new forms of business financing. Convergence will also depend on policy settings that encourage advances in within-firm productivity growth. Improvements to the quality of education at all levels and increasing the role of workplace training will be important. However, so too will be further measures that encourage the innovation capacity of the business sector, including innovation policies that further promote the absorptive capacity of firms and do not favour incumbents at the expense of young firms.

Chapter 2. Growing together: making the convergence process more inclusive

Although Lithuania’s growth has been impressive, inequality is high, the risk of poverty is one of the highest of European countries, and life expectancy is comparatively low and strongly dependent on socio-economic background. The low job satisfaction reduces well-being and feeds high emigration. Labour market, social and health policies can all contribute to improve both well-being and growth. Priorities include providing more and better jobs for all, especially for the low-skilled, by making work pay while keeping the labour costs under control. More accessible and adequate income support combined with more ambitious job-search support and training programmes would better-integrate out-of-work individuals into the labour market. Strengthening equity, effectiveness and sustainability of health policies is also instrumental to inclusiveness.
This Survey was prepared in the Economics Department by Lilas Demmou and Ben Westmore under the supervision of Andreas Wörgötter. Research assistance was provided by Corinne Chanteloup and secretarial assistance by Heloise Wickramanayake. The draft also benefited from the contribution of consultants; Silvia Avram, Jekaterina Navicke, John Earle and Solomiya Shpak.

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This is the first Economic Assessment of Lithuania.

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Further information

For further information regarding this overview, please contact:
Andreas Wörgötter, e-mail: andreas.woergoetter@oecd.org; tel.: +33 1 45 24 87 20 or;
Lilas Demmou, e-mail: lilas.demmou@oecd.org; tel.: +33 1 45 24 94 08 or;
Ben Westmore, e-mail: ben.westmore@oecd.org; tel.: +33 1 45 24 15 18.
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