Executive Summary

- GDP continues to converge
- Boosting productivity and inclusiveness
- Addressing an ageing society
Executive Summary

GDP continues to converge

Since renewed independence in 1991 and transition from a centrally planned to a market economy, Lithuania has substantially raised well-being of its citizens. Thanks to a market-friendly environment the country grew faster than most OECD countries over the past ten years. The financial system is resilient, and fiscal positions stabilised after a long period of deficits and rising debt. Yet productivity has remained subdued due to stringent labour market regulations, informality and skills mismatch. Wage and income inequality are high, fuelling emigration. The population is ageing fast and declining, particularly because of emigration, putting pressure on the pension system. A wide-reaching labour market, unemployment benefits and pension reform entitled “New Social Model” implemented in 2017 is expected to reinvigorate inclusive growth and underpin the sustainability of public finances.

Boosting productivity and inclusiveness

Catch-up and more inclusive growth will require raising productivity that still remains well below the OECD average, and has slowed down in recent years. In addition to the New Social Model, this calls for further easing regulations on the employment of non-EU workers, financial constraints for productive firms, and reducing informality. Moreover, continuing governance reforms would enhance the performance of state-owned enterprises. Recent reforms, such as more relaxed regulations for high skilled non-EU workers and a modernisation of labour relations are welcome. Greater inclusiveness also requires a better tailoring of education to labour market needs and more effective help for those out of work to find a good job.

Addressing an ageing society

Rapid ageing and high emigration shrink the labour force by 1% every year, requiring a comprehensive approach to address the economic consequences. The pension part of the “New Social Model” strengthened the sustainability of the pension system, but did little to reduce old-age poverty. Health care is improving well-being of the elderly, but outpatient and long-term care remain hospital-oriented. The need to upgrade skills, especially of older workers, calls for a broad-based life-long-learning system. Better access to childcare would allow families to have more children and improve labour market opportunities for working parents. Migration policy, including a focused outreach to emigrants and a less restrictive approach to immigration, could help slow down the labour force decline.
## EXECUTIVE SUMMARY

<table>
<thead>
<tr>
<th>MAIN FINDINGS</th>
<th>KEY RECOMMENDATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal And Financial Policies To Support Inclusive Growth</td>
<td></td>
</tr>
<tr>
<td>High taxation of labour and of low-incomes reduce labour supply and contribute to informality.</td>
<td>Reduce social security contributions, especially for low-income workers, while ensuring that benefits and deficit targets are maintained. Increase immovable property taxation, while exempting low-income households.</td>
</tr>
<tr>
<td>The public spending mix fosters inclusive growth, but spending efficiency is weak, especially in education and health care.</td>
<td>Assess spending efficiency by carrying out regular spending reviews.</td>
</tr>
<tr>
<td>Debt is stabilising but the fiscal framework allows for some fiscal slippage.</td>
<td>Set a debt target and establish a credible frontloaded path to reach it.</td>
</tr>
<tr>
<td>Low interest rates and growing credit fuel housing market activity and prices.</td>
<td>Actively use macroprudential measures once imbalances threaten to emerge.</td>
</tr>
</tbody>
</table>

### Promoting productivity and inclusiveness

| The business environment is good but foreign investment remains low, state-owned enterprises dominate many sectors and governance could be improved; firms face barriers to finance while weak insolvency procedures hold back business dynamism. | Strengthen the monitoring capacity of the Governance Coordination Centre, building on the recent increase in its budget. Simplify bankruptcy procedures and establish more favourable conditions for restructuring. |
| Innovation remains weak and collaboration between business and research sectors is limited. | Continue the implementation of the institutional reform of innovation policy by improving coordination, and consolidate agencies and support programmes where overlaps exist. Give more weight on collaborative research when allocating funds to public research institutions. |
| Skill mismatch remain high, weighing on foreign investment, productivity and inclusiveness. The low efficiency of the education system contributes to skill mismatch. | Strengthen work-based learning, including by linking the length of apprenticeships to the level of acquired competencies. Provide differentiated awards for tertiary courses with skills closely linked to labour market needs. Continue with overall reform of the education system at all levels, addressing skill mismatch. |

### Protection for the most vulnerable is low

| Further increase the level of social assistance, while ensuring strong work incentives. Increase investment in active labour market programmes upon a close monitoring of their outcomes. |

### Addressing an ageing society

| The pension system is highly redistributive but not targeted at the poor. Social security contributions put a high tax wedge on labour contributing to informality. | Continue the shift of pensions from the pay-as-you-go system (“first pillar”) towards pension funds (“second pillar”), and make payments to pension funds compulsory. Fund the wage-independent basic pensions through the general government budget rather than social security contributions. |
| The health care system remains hospital-care centred, while outpatient and long-term care for the elderly lags behind. Life-long learning is modest. Older workers in particular do not take part in adult education. The workload for working mothers is high. Emigration is still high and immigration restricted, contributing to population decline and skills shortages. | Continue reorganising the hospital sector; and improve outpatient- and long-term care. Provide financial incentives for life-long learning, involving both firms and employees. Extend and improve support for childcare. Implement a well-integrated migration policy, including a focused outreach to emigrants and a less restrictive approach to immigration. |
Assessment and recommendations

- The economic situation is favourable
- Maintaining financial stability
- Fiscal policy for inclusive growth
- Greening the economy
- Promoting productivity and inclusive growth
- Ageing together
Lithuania, a country with less than three million people, has been successful in the transition from a centrally planned to a market economy since it renewed independence in 1991. The political and economic environment is overall democratic and market-friendly. Per-capita income growth over the last 25 years was above most OECD countries and exceeded other economies in the region, facilitating convergence towards OECD average incomes (Figure 1). Lithuania is closely integrated in the international community as it joined the World Trade Organization in 2001, the European Union in 2004 and the euro area in 2015. The country’s fiscal position is sound, after a protracted period of deficits and rising debt. Since 2000 living standards increased rapidly, dented only by the global financial crisis of 2009 when especially foreign investment stopped abruptly and unemployment reached almost 18%, and in 2014 when exports were hit by the recession in Russia and a slowdown in other major trading partners.

Despite strong economic performance and bold reforms over the last 25 years, Lithuania faces several challenges going forward. Labour productivity is still at around two-thirds of OECD average, partially influenced by labour informality and skills mismatch (Figure 1). Wage inequality is high and job quality often unsatisfactory. High social security contributions and, until recently, stringent labour market regulation weigh on labour market opportunities, exacerbating inequality and diminishing tax revenues, and contribute to informality. Despite low barriers, foreign investment remains subdued. Demography is of particular concern. Lithuania’s population is ageing fast and declining, particularly because of emigration of the young. The labour force continues to shrink by around 1% every year. Immigration of talent is held back by stringent regulation and the lack of attractive job opportunities.

Lithuania can be praised for having profoundly raised wellbeing of its citizens in the past, yet some areas remain below OECD levels and more could be done (Figure 2). The quality of housing is rapidly increasing as investment in residential housing is sustained, but many dwellings are still too small and poorly equipped. Health outcomes are improving thanks to a health care system which is becoming ever more efficient and more accessible, yet some health indicators such as low life expectancy suggest potential for improvement in the population’s health status. Surveys and polls indicate that many Lithuanians are unhappy with the social and psychological climate in the country, pointing at a lack of community spirit. Finally, environmental quality is good in this country, which is rich in natural beauty, except that water quality is low in some lakes and rivers.

Income inequality and poverty are relatively high, especially among older Lithuanians and those living in rural areas. Household income inequality is higher than in most OECD countries, driven by unequal earnings, low social benefits and a tax system which is not very redistributive (Figure 3). The number of low-skilled and vulnerable workers is above OECD average. Around 17% of the population lives in relative poverty with an income below 50% of the median. Women, the youngest and the elderly are particularly affected. As with other countries, the risk of poverty in Lithuania tends to fall with the level of education, as those not having completed secondary education are facing a high risk. Regional disparities in income and unemployment remain considerable (Statistics Lithuania, 2016).
Figure 1. Lithuania is growing faster than most OECD countries

A. Real GDP per capita

B. Labour productivity is low, 2017

Source: OECD Economic Outlook database. StatLink https://doi.org/10.1787/888933788187

Figure 2. Well-being could be considerably improved

1. Lowest OECD refer to the 17 countries with the lowest score among the OECD countries. Data are for 2016 or latest available year.

Source: OECD Better life index indicators database; Eurostat; Gallup database; and World Bank World Development Indicators.

StatLink https://doi.org/10.1787/888933788206
The government has acknowledged these challenges and has initiated deep-reaching and comprehensive reforms to make growth more inclusive. These reforms, which entered into force in 2017 under the umbrella “new social model”, bring a growth-enhancing labour market reform together with stronger social protection and more sustainable public finances (Box 1 and Figure 4).
Box 1. The New Social Model: a wide reaching structural reform

Reform efforts over the past years focused on the New Social Model, an encompassing reform of labour relations, unemployment insurance and pensions based on flexicurity. The reform entered into force in three stages in 2017 and 2018. The reform relaxed labour market regulations, increased unemployment benefits, strengthened active labour market policies, and put the pension system on a more sustainable path (Figure 4). In detail, the reform involved the following changes:

**Labour Code**

- Permanent employment contracts were eased by relaxing the rules on individual dismissal for employees with a permanent contract and reducing the notice period and severance pay for these employees. A central fund, out of social security contributions, will provide supplementary severance pay for workers with long tenure (five years or more).
- Temporary employment was also eased. As a safeguard, fixed-term contracts do not account for more than 20% of all employment contracts for a given employer. Moreover, the variety of contracts was increased, including for apprenticeships.
- Working-time arrangements also became much less regulated, including through the possibility of working-time averaging over a three-month period.
- Strengthening collective agreements through changes in collective representation. Work councils must be formed in all firms with 20 or more employees, apart from the cases where more than a third of employees belong to trade union. Moreover, the competencies of the trade unions and work councils at the company level are divided, with work councils having responsibility for all information and consultation activity and trade unions for representation and collective bargaining.
- Clarifying the procedure for minimum wage determination, strengthening the transparency of the payment system, applying the minimum wage for non-qualified employees.
- Lifelong learning is promoted by allowing employees to take up training for up to five partially paid days per year to attend non-formal adult education programmes.

The work–life balance is improved by offering parents more possibilities for part-time and remote working, flexible working schedules and individual working time arrangements. The new law introduces specific exemptions for small firms (up to 10 employees). Small-size firms are exempted from the obligation to approve the selection criteria for redundancy and to form a selection committee when dismissing employees on the ground on the initiative of employer, or to provide information to their employees regarding the company’s situation in terms of fixed-term contracts and temporary work. In addition, these firms are not obliged to provide a payment of study leave for employees participating in non-formal training, but rather this payment is based on an agreement between the employer and the employee.

**Pensions**

- Social security contributions for the first pillar pension system were reduced by one percentage point.
- Pensions not linked to former wage levels (“basic pensions”) will be gradually
moved from the pension fund to the general government budget.

- A first-time pension indexation rule links the growth of individual pensions to the average growth of the wage sum over 7 years: 3 previous years, current year and 3 coming years (projections made by the Ministry of Finance), replacing the former defined-benefit system.
- A transparent and simple formula (point system) by which contributions translate into pension rights was introduced.
- An increase of the mandatory insurance period for the full basic pension entitlement from 30 to 35 years will be gradually phased-in.

**Taxation**

Personal income tax exemptions for low-income households were increased by a factor of two.

**Figure 4. Strictness of employment protection legislation**

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

- **Boost productivity and inclusiveness:** Labour productivity growth has slowed and inequality and poverty remain high. Income convergence and high well-being require that this twin challenge is addressed through a systematic policy approach that promotes business dynamism, provides individuals with the opportunities and skills needed to meet their productive potential, and supports the most vulnerable. Less informality is a win-win for both productivity and inclusiveness.

- **Address the economic consequences of ageing:** Lithuania is ageing fast, and emigration exacerbates the demographic pressure and contributes to skills shortages. Addressing the economic consequences of an ageing population requires a comprehensive approach that embodies several policy areas such as the pension and health care system, adult education and life-long learning, migration, and family policy.

According to OECD simulations, structural reforms as discussed in this Survey could boost new sources of growth substantially (Box 2).
Box 2. Illustrative simulations of the potential impact of structural reforms

Simulations, based on historical relationships between reforms and growth in OECD countries, allow gauging the impact of structural reforms proposed in this Survey. The simulations are based on specific examples of reforms in the area of product and labour market regulation, investment policy, and fiscal policy, and include the effect of new labour market policies which were implemented in 2017 as part of the “new social model” package (Table 1 and Table 2). The estimates assume swift and full implementation of the reforms. Results should be taken with care, and countries are advised to assess growth impacts using methodologies that reflect the situation in their country.

Table 1. Potential impact of structural reforms on GDP per capita after 10 years

<table>
<thead>
<tr>
<th>Structural policy</th>
<th>Policy change 2016</th>
<th>Total effect on GDP per capita</th>
<th>Impact on supply side components</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>After reform</td>
<td></td>
<td>Productivity</td>
</tr>
<tr>
<td></td>
<td>in percent</td>
<td>in percent</td>
<td>Investment</td>
</tr>
<tr>
<td></td>
<td>in pp2</td>
<td></td>
<td>Employment</td>
</tr>
<tr>
<td>Investment specific policies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in R&amp;D expenditure</td>
<td>0.3%</td>
<td>0.6%</td>
<td>0.4</td>
</tr>
<tr>
<td>Fiscal policy</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduce social security contributions</td>
<td>40%</td>
<td>35%</td>
<td>0.8</td>
</tr>
<tr>
<td>Labour market policies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Improve labour market regulations (regular contracts)</td>
<td>2.4</td>
<td>2.1</td>
<td>0.7</td>
</tr>
<tr>
<td>Increase spending on activation</td>
<td>5.7%</td>
<td>8.9%</td>
<td>0.3</td>
</tr>
<tr>
<td>Increase family benefits in kind</td>
<td>0.7%</td>
<td>1.0%</td>
<td>0.6</td>
</tr>
</tbody>
</table>


Table 2. Type of reforms used in the simulations

<table>
<thead>
<tr>
<th>Structural policy</th>
<th>Structural policy changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase business spending in R&amp;D</td>
<td>Increase business expenditure in R&amp;D for 0.3% of GDP to 0.6% of GDP, bring it to around half of the OECD average.</td>
</tr>
<tr>
<td>Reduce social security contributions</td>
<td>Reduce social security contributions, which fund pensions, health care and unemployment benefits, from 40% of gross wages to 35%.</td>
</tr>
<tr>
<td>Improve labour market regulations</td>
<td>Implement the regulations of the new labour code (individual and collective dismissal, severance pay etc.) adopted in 2017 as part of the new social model</td>
</tr>
<tr>
<td>Increase spending on activation</td>
<td>Increase expenditure per unemployed as a percentage of GDP per capita from 5.7% to 8.9%..</td>
</tr>
<tr>
<td>Increase family benefits in kind</td>
<td>Increase family benefits in kind, such as childcare support, from 0.7% of GDP to 1%.</td>
</tr>
</tbody>
</table>
The economic situation is favourable

*Growth has strengthened*

Economic activity strengthened in 2017, recovering from a slowdown in 2015 and 2016, and remains solid into 2018 (Table 3 and Figure 5). Household consumption is supported by falling unemployment, rapid wage increases and favourable credit conditions. After last year’s impressive performance on the back of broad based external demand recovery, export growth weakened. Domestic investment rebounded in 2017, largely due to growing business investment in double digits. Knowledge-based investment growth was particularly strong. High capacity utilisation continues to spur private investment, although the investment rate in the business sector is well below its pre-crisis level (Figure 6). Low business confidence may be part of the explanation but other factors, including the difficulties faced by firms in finding adequately-skilled workers, and large informality can also deter investment. As a catching up economy Lithuania needs more investment to boost productivity and close the income gap. Inflation has receded in early 2018 as the impact of last year’s hikes in some excise duties is abating (Figure 5, Panel E). Service price inflation remains elevated, however, reflecting strong wage and domestic demand growth.

### Table 3. Macroeconomic indicators and projections

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Gross domestic product (GDP)</strong></td>
<td>36 568</td>
<td>2.0</td>
<td>2.3</td>
<td>3.9</td>
<td>3.4</td>
<td>2.9</td>
</tr>
<tr>
<td><strong>Private consumption</strong></td>
<td>22 777</td>
<td>4.0</td>
<td>4.9</td>
<td>3.8</td>
<td>3.7</td>
<td>3.5</td>
</tr>
<tr>
<td><strong>Government consumption</strong></td>
<td>6 073</td>
<td>0.2</td>
<td>1.3</td>
<td>1.0</td>
<td>0.9</td>
<td>0.8</td>
</tr>
<tr>
<td><strong>Gross fixed capital formation</strong></td>
<td>6 905</td>
<td>4.8</td>
<td>-0.5</td>
<td>7.3</td>
<td>7.6</td>
<td>5.3</td>
</tr>
<tr>
<td><strong>Final domestic demand</strong></td>
<td>35 756</td>
<td>3.5</td>
<td>3.3</td>
<td>3.9</td>
<td>3.9</td>
<td>3.4</td>
</tr>
<tr>
<td><strong>Stockbuilding¹</strong></td>
<td>3.8</td>
<td>-0.8</td>
<td>-0.9</td>
<td>-0.5</td>
<td>0.0</td>
<td></td>
</tr>
<tr>
<td><strong>Total domestic demand</strong></td>
<td>35 809</td>
<td>7.2</td>
<td>2.3</td>
<td>3.1</td>
<td>3.7</td>
<td>3.4</td>
</tr>
<tr>
<td><strong>Exports of goods and services</strong></td>
<td>29 658</td>
<td>-0.4</td>
<td>3.5</td>
<td>13.6</td>
<td>6.9</td>
<td>4.4</td>
</tr>
<tr>
<td><strong>Imports of goods and services</strong></td>
<td>28 898</td>
<td>6.2</td>
<td>3.5</td>
<td>12.8</td>
<td>7.1</td>
<td>5.1</td>
</tr>
<tr>
<td><strong>Net exports¹</strong></td>
<td>-5.2</td>
<td>-0.1</td>
<td>0.8</td>
<td>-0.1</td>
<td>-0.4</td>
<td></td>
</tr>
<tr>
<td><strong>Other indicators (growth rates, unless specified)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Potential GDP</strong></td>
<td>2.6</td>
<td>2.6</td>
<td>2.5</td>
<td>2.6</td>
<td>2.8</td>
<td></td>
</tr>
<tr>
<td><strong>Output gap²</strong></td>
<td>0.1</td>
<td>-0.1</td>
<td>1.3</td>
<td>2.1</td>
<td>2.2</td>
<td></td>
</tr>
<tr>
<td><strong>Employment</strong></td>
<td>1.2</td>
<td>2.0</td>
<td>-0.5</td>
<td>-0.4</td>
<td>-0.4</td>
<td></td>
</tr>
<tr>
<td><strong>Unemployment rate</strong></td>
<td>9.1</td>
<td>7.9</td>
<td>7.1</td>
<td>6.6</td>
<td>6.2</td>
<td></td>
</tr>
<tr>
<td><strong>GDP deflator</strong></td>
<td>0.3</td>
<td>1.0</td>
<td>4.2</td>
<td>3.1</td>
<td>2.8</td>
<td></td>
</tr>
<tr>
<td><strong>Harmonised consumer price index</strong></td>
<td>-0.7</td>
<td>0.7</td>
<td>3.7</td>
<td>2.8</td>
<td>2.6</td>
<td></td>
</tr>
<tr>
<td><strong>Harmonised core consumer price index</strong></td>
<td>1.9</td>
<td>1.7</td>
<td>2.6</td>
<td>2.0</td>
<td>2.5</td>
<td></td>
</tr>
<tr>
<td><strong>Current account balance³</strong></td>
<td>-2.9</td>
<td>-1.2</td>
<td>0.4</td>
<td>-0.2</td>
<td>-0.5</td>
<td></td>
</tr>
<tr>
<td><strong>General government financial balance³</strong></td>
<td>-0.2</td>
<td>0.3</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td><strong>Underlying government financial balance³</strong></td>
<td>-0.5</td>
<td>0.2</td>
<td>0.1</td>
<td>-0.1</td>
<td>-0.2</td>
<td></td>
</tr>
<tr>
<td><strong>Underlying government primary financial balance³</strong></td>
<td>1.0</td>
<td>1.5</td>
<td>1.2</td>
<td>0.9</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td><strong>General government gross debt³</strong></td>
<td>53.8</td>
<td>51.7</td>
<td>48.0</td>
<td>43.1</td>
<td>41.6</td>
<td></td>
</tr>
<tr>
<td><strong>General government gross debt, Maastricht definition³</strong></td>
<td>42.6</td>
<td>40.1</td>
<td>39.7</td>
<td>34.8</td>
<td>33.4</td>
<td></td>
</tr>
</tbody>
</table>

1. Contributions to change in real GDP.
2. As a percentage of potential GDP.
3. As a percentage of GDP.

*Source: OECD Economic Outlook 103 database and updates.*

[StatLink](https://doi.org/10.1787/888933789821)
Export performance is measured as actual growth in exports relative to the growth of the country’s export market, which represents the potential export growth for a country assuming that its market shares remain unchanged.

Data refer to annualised agreed rate on loans other than revolving loans and overdrafts, convenience and extended credit card debt to non-financial corporations of less or equal to 1 million euros.

Source: OECD Economic Outlook database; and Eurostat.

StatLink  
https://doi.org/10.1787/888933788263
Stronger activity has also helped reduce unemployment, which edged down to less than 7% of the labour force towards the end of 2017, more than 10 percentage points below its 2010-peak (Figure 7). Lower unemployment is due not only to the employment gains in sectors such as industry and services, but also reflects a shrinking labour force as a result of unfavourable demographics. At the same time, labour force participation, especially among older workers, rose potentially reflecting a rising retirement age and low pensions and social support.

External positions are sustainable with foreign debt at 83% of GDP in 2017 and the net international investment position on an improving trend (Figure 8). The deficit is financed essentially by a rise in foreign direct investment (FDI) and in portfolio investment. The inward FDI stock stood at around 37% in 2017, less than in other Baltic countries. Many projects in recent years concerned shared services centres, which require little capital expenditure and hence do not contribute much to the FDI stock. By this token more FDI would not only improve external sustainability but help boost productivity with transfer of know how (OECD, 2016a). Therefore, improving the business environment to attract FDI remains important.
Figure 7. Labour market and wage developments

A. Labour force, employment and unemployment rate

B. Population and labour force participation

C. Employment dynamics
Average annualised quarterly contribution 2011-2017

D. Real wages and productivity

E. Minimum wage to median wage of full time workers, 2016

F. Competitiveness indicator (unit labour costs)

Source: OECD Labour force statistics database; OECD Economic Outlook database; and Eurostat.

StatLink 2 https://doi.org/10.1787/888933788301
Productivity needs a boost to maintain competitiveness

Wage growth has outpaced productivity growth in recent years without bearing much on competitiveness as reflected in export performance (Figure 5, Panel D and Figure 7, Panel D). Minimum wages grew by 64% between 2009 and 2016, bringing the ratio of minimum to the median wages even above the OECD average (Figure 7, Panel E). While boosting inclusiveness, such hikes have added to wage pressures, pushing up relative unit labour costs (Figure 7, Panel F). Official estimates suggest that the rise in the monthly minimum wage by 17% in 2016 might have increased the growth of average monthly gross wages by approximately 2 percentage points (Ministry of Finance, 2017). Maintaining price competitiveness going forward could prove challenging as supply-side constraints will keep pressures on wages, unless productivity growth picks up substantially. Wage developments should be monitored closely. The recent pick up in labour productivity is encouraging, though growth remains well below its past highs.

Productivity can be boosted by deepening integration in global value chains (GVCs) which enables knowledge transfer and provides access to more differentiated and better quality inputs (OECD, 2013). Lithuania’s participation in GVCs is low in international comparison, although improving (Figure 9). Raising the export pattern towards higher value-added goods and services would help boost productivity. Exports are currently dominated by medium-low technology goods, such as resource-intensive goods, raw material and less-knowledge-intensive services (Figure 10). Transport accounted for around 60% of total export services in 2016 and keeps growing as the sector extended its activities towards Western markets (Bank of Lithuania, 2017a). Re-exporting activities constitute an important share of exports, making up around 40% of good revenues in 2013 (Notten, 2015).

At the end of 2017 Lithuania established the National Productivity Board (NPB). The Board monitors productivity developments, assesses the risks and works on the proposals for further reforms/actions. The first annual productivity report by the NPB will be published by the end of 2018.
Figure 8. External positions appear sustainable

A. Current account

![Graph of current account and net exports](image)

B. Stock of inward FDI, 2017

![Graph of stock of inward FDI](image)

C. Gross external debt, 2017

![Graph of gross external debt](image)

Source: IMF Balance of Payment database; OECD Economic Outlook database; and Eurostat.

[StatLink](https://doi.org/10.1787/888933788320)
1. Complexity is defined by the implied productivity of the product (PRODY) using the methodology of Hausmann et al. (2007), “What you export matters”, Journal of Economic Growth, Springer, Vol. 12(1). PRODY is calculated by taking a weighted average of the per capita GDPs of the countries that export the product. The weights are the revealed comparative advantage of each country in that product. The products are then ranked according to their PRODY level.

2. This indicator is calculated for the total value of source and exporting industries; it is estimated as being the VA contents of exports originated in the source country, and embodied in the exports of the exporting country, divided by the gross exports of the source country.

3. This indicator is calculated for the total value of source and exporting industries; it is estimated as the ratio between the VA of the source country embodied in the exports of the exporting country, and the gross exports of the exporting country.

Source: WITS database; UN Comtrade database; OECD TiVA database; and OECD calculations.

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Lithuania is an open economy but low-medium technology exports dominate.

1. The Basic industry sector includes the following sectors: Chemicals and chemical products; Basic pharmaceutical products and pharmaceutical preparations; Rubber and plastic products; Other non-metallic mineral products; Basic metals; and Fabricated metal products, except machinery and equipment.

2. The Machinery sector includes the following sectors: Computer, electronic and optical products; Electrical equipment; Machinery and equipment not elsewhere classified; Motor vehicles, trailers and semi-trailers; and Other transport equipment.

Source: OECD Economic Outlook database; OECD STAN Bilateral Trade Database in goods database; and Eurostat.

StatLink 2 https://doi.org/10.1787/888933788358
The macro-economic policy mix is appropriately supportive of growth. Interest rates are low as euro area monetary policy remains accommodative and credit to the private sector is growing. The fiscal stance was slightly expansionary in 2017. This was appropriate, despite strong activity, to finance important structural fiscal reforms. The increase in the non-taxable income threshold in the personal income tax system boosts work incentives and inclusiveness and structural measures under the “New Social Model” make labour relations more flexible. Reforms also make unemployment and social insurance benefits more generous and active labour market policies broader in scope. Fiscal policy is poised to remain slightly expansionary in 2018, aiming at boosting productivity and reducing inequality and poverty, and become broadly neutral in 2019. Going forward and given the strong economy, a tighter stance could be appropriate to avoid procyclicality.

Growth will remain robust

Supportive financial conditions and solid investment will keep growth brisk at around 3.2% in 2018-19 (Table 3). Firms are projected to increase their investments in advanced technologies to offset the impact of the declining labour force. Increased roll-out of EU-funded projects and solid exports will also spur investment, even though some easing in investment growth is expected in 2019 as the flows of the structural funds return to normal levels. Tightening labour market conditions will continue supporting private consumption but constraints on the supply side will weigh on growth. Unemployment is set to fall further, while core inflation will keep rising as wage and demand pressures persist.

Lithuania’s growth prospects depend on both external and domestic factors. A weaker than anticipated growth in the euro area would affect Lithuania’s exports and investment. Brexit may affect the Lithuanian economy since it increases uncertainty in the European Union and may also lower Lithuanian emigrants’ remittances. A shrinking labour force could limit employment growth more than projected, and wage increases could lead to a higher-than-foreseen increase in unit labour costs, impacting competitiveness. While good macro prudential measures are in place, housing market developments might destabilise the economy over the medium term. Finally, the economy may confront unforeseen shocks, whose effects are difficult to factor into the projections (Table 4).

<table>
<thead>
<tr>
<th>Shock</th>
<th>Possible impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in geopolitical tensions</td>
<td>Geopolitical events in and around Europe, especially relating to Russia, could jeopardise activity in Lithuania through the trade, confidence and investment channels.</td>
</tr>
<tr>
<td>Financial turbulence in the Nordic banking system</td>
<td>Imbalances in parent banks could cause financial sector duress in Lithuania through a sudden withdrawal of capital and credit squeeze.</td>
</tr>
<tr>
<td>Rising protectionism in trade and investment</td>
<td>Rising protectionism would affect the external demand of the main trading partners.</td>
</tr>
</tbody>
</table>

Maintaining financial stability

Credit to the private sector is firming up and housing activity is buoyant

Credit growth has gathered momentum since mid-2015, driven by a pick-up in loan demand and strong balance sheets among enterprises and households (IMF, 2016) (Figure 11). The debt overhang in many households and strong risk aversion on the part
of both potential borrowers and banks in the post-crisis years has kept credit growth sluggish, especially for small and medium-sized enterprises (SMEs). The ongoing expansion in credit also benefits SMEs, which bodes well for growth and job creation. Indeed, the total value of loans granted to enterprises rose by more than 5% in 2017, with the corresponding increase for SMEs reaching nearly 10% (Bank of Lithuania, 2017b).

Housing activity is buoyant amidst low interest rates, growing credit, and rising incomes (Figure 11). Housing affordability continued to improve, amid fast growing household income and low interest rates (Bank of Lithuania, 2017c). The number of housing transactions in 2016 came close to pre-crisis peaks, with the positive – though more sluggish – trend continuing in 2017. House prices have continued to trend upwards, with some slowing down since mid-2017. A significant share of funding for housing purchases comes from bank loans as approximately 40% of housing transactions involve mortgages. In the third quarter of 2017, loans for house purchases comprised 80% of the loan stock to households, or 40% of all loans to the private sector in 2016 (Bank of Lithuania, 2017c). Rental prices have also been rising but at a slower pace than sales prices. Developers have responded to the buoyancy in the real estate market by investing heavily in the expansion of the housing stock, which started to ease price pressures.

The financial system appears sound but vigilance is required

Lithuania’s banking sector is highly concentrated and dominated by foreign-owned banks. At the end of 2017 there were 6 banks and 7 foreign branches accounting, respectively, for 84% and 8% of the market (by both assets and loans). The three largest banks (SEB, Swedbank and Luminor) covered, respectively, 81% and 83% of the market by assets and loans. The market share of foreign branches is set to increase to about one-third by the beginning of 2019. The financial system is resilient according to the IMF assessment (IMF, 2017a). Performance indicators suggest that the banking sector’s solvency and liquidity indicators are above the required levels; capital adequacy is robust, and almost all bank capital consists of Common Equity Tier 1 (CET1) securities (Figure 12). The quality of loans has also improved. Net funding from parent banks, an important indicator for Lithuania’s largely foreign-owned banking system, is down to less than 4% of GDP.

Lithuania has been strengthening the legal and institutional foundations of financial stability since the global crisis. A Law on Financial Sustainability was enacted in 2009; the Bank of Lithuania was granted an explicit mandate to conduct macro-prudential policy in 2014; and a Strategy of Macroprudential Policy was adopted in 2015. The central bank’s macroprudential toolkit includes a countercyclical capital buffer and a buffer for systemically important institutions which are readjusted on a periodical basis, as well as requirements based on loan-to-value ratios (LTV), debt-service-to-income ratios (DSTI) and loan maturity indicators for borrowers (Box 3). It also includes a systemic risk buffer. This broad and flexible macroprudential policy toolkit is providing the Bank of Lithuania with the appropriate instruments needed to deal with the specific challenges of the financial system.
1. The housing affordability index is calculated by dividing the average annuity housing loan instalment by average net wage.

2. The private non-financial sector includes households and private non-financial corporations.

*Source*: European Central Bank; Bank of Lithuania; OECD Economic Outlook database; and OECD House price index database.
Nevertheless risks need to be monitored, including the relatively fast credit growth and buoyancy in the real estate market, which is approaching pre-crisis levels (Figure 11). With private sector indebtedness still modest and house prices well below their historical highs there are no immediate risks to financial stability. However, close attention is required as the financial cycle is gaining momentum, especially as credit growth is among the fastest in the European Union and many SMEs face a shortage of collateral (Bank of Lithuania, 2017c). The Bank of Lithuania reassesses the existing macroprudential policy stance periodically and is ready to take actions when needed. To increase the resilience of banks against a potential market downturn, in December 2017 the Bank raised the countercyclical buffer rate from 0% to 0.5%, effective from end-2018. This aims to build capital reserves during times of robust growth, when profitability of the banking sector is high, to cover potential losses and reduce credit cyclicality during bad times. If further actions were needed in light of rising house prices and strong demand for housing credit, the option of further raising the countercyclical buffer and/or reassessing Responsible Lending Regulations (RLR) could be considered.

Figure 12. Soundness indicators

A. Regulatory capital to risk-weighted assets

B. Loans to deposit ratio

C. Non-performing loans to total gross loans

D. Non-performing loans to total gross loans 2017 or latest year available

Source: IMF Financial Soundness Indicators database; and European Central Bank.

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The high presence of Nordic banks in the banking sector, which own the lion’s share of the sector, makes the Lithuanian economy particularly vulnerable to developments in the Nordic countries. Dealing with the spillovers from vulnerabilities in parent banks therefore calls for carefully monitoring those developments when assessing the resilience of Lithuanian banks to various types of stress. The Bank of Lithuania and the Ministry of Finance are part of the Baltic-Nordic co-operation agreement on cross-border financial stability and crisis management which foresees exchange of information, joint discussions on issues related to financial stability and regular joint financial crisis simulation exercises (Bank of Lithuania, 2018). The large concentration of the banking sector also makes the financial system highly dependent on a few large market players, which can massively disturb the financial system in case of imbalances. Indeed, the Bank of Lithuania identified four systemically important banks and set additional buffer requirements for them, effective from 31 December 2016 (Box 3).

**Box 3. Prudential regulations in Lithuania**

In line with the EU’s Capital Requirements Regulation and Directive (CRD IV), new capital buffer requirements have been introduced for banks to reduce structural and cyclical risks. A 2.5% capital conservation buffer is now in place and the countercyclical capital buffer rate, currently at 0%, is set to increase to 0.5% end-2018. This level can be raised, if necessary, to bolster the resilience of the banking sector, as well as containing excessive credit growth and financial leverage (Bank of Lithuania, 2017c).

In addition, domestic systemically important institutions were identified at end-2015 and are now subject to additional capital buffer requirements. The O-SII buffers have been applied to the four systemically important banks since end-2016: an additional capital buffer of 5% has been applied to AB Šiaulių Bankas, and 2% buffer to the three largest banks – AB SEB Bankas, Swedbank AB and Luminor Bank AB.

Several measures have also been put in place to safeguard borrowers from excessive debt accumulation in the current low-interest, high growth environment. The Responsible Lending Regulations were amended in 2015, the maximum loan maturity was shortened from 40 to 30 years, and the interest rate sensitivity of the debt service to income (DSTI) requirement has been reduced, while providing limited flexibility to apply a higher DSTI ratio under specific circumstances without compromising the macro-prudential objectives.

The presence of foreign bank branches highlights the role of cross-border coordination of macroprudential policy. The Bank of Lithuania has a number of instruments at its disposal that could be activated and applied to bank exposures in Lithuania if cyclical or structural systemic risks increased. For some of them (such as the countercyclical capital buffer), reciprocity is mandatory, while for others (such as the systemic risk buffer) reciprocity by other EU members would be sought through the voluntary reciprocity framework promoted by the European Systemic Risk Board. The borrower-based requirements (LTV, DSTI, loan maturity) in Lithuania already apply to all lenders that provide housing loans in the country and hence no reciprocity arrangements are required.

As in other countries, Lithuanian banks are facing the challenges associated with technological change in the financial industry, with the emergence of cyber security threats, for example, as well as the need to adjust to disruption in their business models
due to the emergence of new products and market participants, such as FinTech, and their financial technologies (Bank of Lithuania, 2017c).

**Fiscal policy for inclusive growth**

*Fiscal policy has become more sustainable*

Lithuania’s fiscal position is sound. After revenues fell sharply in the wake of the 2008 crisis, the government started consolidating public finances on the spending side by reducing the wage bill, lowering social spending and cutting infrastructure investment. The 2016 budget resulted in a 0.3% surplus, the first for more than a decade (Figure 13). As a result, gross debt is now stabilising at around 50% of GDP (OECD National Accounts definition), which is sustainable under various simulations (Fournier and Bétin, forthcoming). The budget remained positive in 2017 and is expected so in 2018. The New Social Model is expected to make the budget more sustainable and more inclusive, improving the budget balance by around 3% of GDP in the long term, while higher social benefits will increase spending by around 0.5% in the short-term.

**Figure 13. Fiscal policy is relatively sound**

A. Fiscal balance (actual, structural and underlying)

B. Public debt, 2017 or latest year available

*Note:* Debt follows OECD National Accounts definitions.  
*Source:* OECD Economic Outlook database.
Lithuania’s fiscal framework has been strengthened by adopting the EU fiscal compact at the constitutional level and establishing an independent fiscal council, in operation since 2016.

- **Fiscal rules.** The fiscal rules framework comprises a budget and a spending rule. The budget rule requires the balance to reach the medium term objective – currently set at minus 1% of GDP – when GDP growth is below potential, and to improve until a structural surplus is reached when GDP growth is above potential. The spending rule limits expenditure growth to half of a multiannual average of the potential GDP growth, if a deficit is recorded for five years on average. The rules are considered rather tight and rely on potential growth, which is often hard to measure (European Commission, 2015). However, the multiannual budget framework is not fully binding, and with a three years planning period, is at the lower end of what is common today (OECD, 2014).

- **Fiscal council.** The fiscal council started to monitor compliance with the fiscal rules and the preparation of opinions and their submission to the Parliament. The remit of the Council is large, in line with OECD recommendations (OECD 2015a). However, alignment with the OECD principles for independent fiscal institutions has just started, and internal management and procedures have yet to be established (European Commission, 2017a). The council remains under the authority of the National Audit Office whose reputation is high, but tensions could arise should the objectives of the two institutions diverge.

**The fiscal framework could be strengthened further**

As a small open economy, Lithuania is vulnerable to external shocks and hence should keep debt low to have room for counter-cyclical fiscal policy. The authorities estimate fiscal buffers needed to cushion adverse shocks at 5% to 10% of GDP. The current deficit rule would reduce debt to around 40% of GDP in 2040 (OECD National Accounts definition), which is prudent in view of a declining population (Fall et al, 2015). However, this is only little below the debt level reached in 2017, and debt could rise quickly towards thresholds set by the European Union if the economy was hit by a recession (Figure 14). To reduce debt further and to strengthen counter-cyclical fiscal buffers, the long-term budget deficit should not exceed 0.5% per year.

The fiscal framework could be strengthened further by anchoring a long-term numerical debt target and establishing a credible frontloaded debt reduction path (Fall et al., 2015). Medium-term budgeting underpinning long-term plans should be extended to four or five years. The budgeting process should be well-coordinated and transparent. Finally, the fiscal council could be strengthened, by raising its institutional independence, and it could use its mandate more actively in the preparation of the budget.

**The spending mix fosters inclusive growth, but spending could be more efficient**

The composition of public spending – i.e. the allocation of spending across the various policy areas and functions – is conducive to inclusive growth (Table 5). The above-average quality of public spending relies on relatively high public investment, education, research and health spending, which tend to underpin both growth and equality, while subsidies are low (Figure 15). Spending quality fluctuates mainly in line with the rise and fall of public infrastructure investment. Social spending is still below par, but family and child benefits are increasing rapidly.
Figure 14. The debt sustainability path under different structural deficit assumptions

Note: The "No deficit" scenario consists of projections for the Economic Outlook No. 103 until 2019. Thereafter, assumptions are: real GDP growth progressively closing the output gap and from 2020 growing by 2.5%; a budget balanced from 2025; inflation declining progressively to 2% by 2030 and an average effective interest rate converging to 3% by 2030. Surpluses arising in the pension system (Figure 3.3.) are not taken into account. The debt and deficit to GDP ratio is calculated using the national account method.

Source: OECD calculation.

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Figure 15. The spending mix favours inclusive growth

Note: The quality of public spending indicator is derived from a set of multivariate regressions linking the spending mix to average growth and income inequality in around 30 OECD countries and normalised to zero. An indicator value of greater than 0 means that Lithuania’s spending mix was more growth-enhancing than those of an average OECD country in that year.


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Public spending efficiency is more of a concern. Education performance as measured by PISA is below peer countries, and gaps between students from rural and urban areas persist. Schools are often too small, and particular attention should be given to the quality of teachers (OECD, 2017c). Research output is below OECD average, although the number of researchers per capita is slightly above (OECD, 2016a). Health status is
relatively low compared to OECD averages. Public investment projects are frequently delayed, though cost overruns are small. While the underlying reasons for low public spending efficiency vary across spending area, a common cause seems to be the lack of public sector performance targeting and surveillance. Developing a culture of performance, e.g. by setting and enforcing targets for publicly-financed goods, and by carrying out regular spending reviews, could help provide better public services at lower cost. Establishing uniform cost-benefit analysis to assess public investment projects would also foster public sector outcomes.

Table 5. Lithuania’s spending and revenue mix, 2016

<table>
<thead>
<tr>
<th>General government expenditure</th>
<th>34.2</th>
<th>Total revenue</th>
<th>34.6</th>
</tr>
</thead>
<tbody>
<tr>
<td>General public services</td>
<td>4.1</td>
<td>Taxes on production and imports</td>
<td>11.6</td>
</tr>
<tr>
<td>Public order and safety</td>
<td>1.5</td>
<td>Current taxes on income, wealth, etc.</td>
<td>5.4</td>
</tr>
<tr>
<td>Economic affairs</td>
<td>3.0</td>
<td>Capital taxes</td>
<td>0</td>
</tr>
<tr>
<td>Health</td>
<td>5.8</td>
<td>Social contributions</td>
<td>11.9</td>
</tr>
<tr>
<td>Education</td>
<td>5.2</td>
<td>Property income</td>
<td>0.4</td>
</tr>
<tr>
<td>Social protection</td>
<td>11.2</td>
<td>Other</td>
<td>5.3</td>
</tr>
<tr>
<td>Others</td>
<td>3.4</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Eurostat and Ministry of Finance of Lithuania. StatLink: https://doi.org/10.1787/888933789840

The tax system should become more inclusive

The tax system leans strongly towards taxation of labour and consumption, while income and property are taxed rather lightly, although with less than 30% of GDP, the country’s overall tax burden is below the OECD average of 34% (Table 5). The tax mix could be made more inclusive by moving away from labour taxes and by reducing the tax burden for low-income groups:

- The social security contribution rate – funding pensions, health and unemployment benefits – account for a high 40% of gross wages, mostly paid by employers. Such a high rate could reduce labour demand and induce informality, especially for low-income earners. In 2017 the government started to shift the funding of benefits from social security to the general budget, thereby broadening the tax base, but contribution rates were not lowered. The government should continue diminishing the contribution burden, while ensuring benefits and deficit targets are maintained.

- Personal income is taxed at a flat rate of 15%. When implementing the new social model the governmental more than doubled tax exemptions for low-income households from EUR 165 monthly in 2014 to EUR 310 in 2017 and EUR 380 in 2018, but they remain below the OECD average. In 2017 the government further strengthened progressivity of income taxation by tapering tax exemptions, i.e. providing lower tax allowances for higher incomes. A child tax allowance was replaced by a child benefit in 2018, thereby favouring low-income earners.

- Recurrent taxes on immovable property account for 0.4% of GDP, less than the OECD average (Figure 16). Property values are assessed by market appraisal, but the threshold value when property taxes kick in is high at EUR 220 000. Since property tax is considered the least detrimental to growth, the government should aim at a higher property tax share, by broadening the tax base rather than setting
higher rates and providing exemptions for low-income households (Blöchliger, 2015).

- Taxation of capital gains is low. Exemptions favour high-income earners and reduce the progressivity of the tax system. In 2016, the tax exemption for capital gains on the sale of a non-principal residence was restricted to property held for at least 10 years. A longer period could depress market transactions and reduce geographical mobility (Caldera-Sanchez et al, 2011). Going forward, the authorities should consider phasing out such exemptions.

Tax compliance has increased but remains an issue. The value-added tax gap – the difference between actual collection and what could be theoretically collected – is one of the highest in the European Union (CASE, 2017). Several measures to improve VAT and personal income tax collection are supposed to bring in additional revenues equal to 0.4% of GDP, which is considered ambitious (EU Commission, 2017). In 2016, the State Tax Inspectorate continued to implement its Tax Compliance Strategy, by introducing an electronic invoicing system and an electronic waybill system, which should improve tax collection considerably in the coming years. Efforts to tackle tax avoidance should continue, strengthening the fairness of the tax system and improving the competitiveness of the economy. Particular attention should be paid to whether the measures already implemented were successful.

The recommendations of this Survey would have an overall positive impact on the budget balance over time (Box 4).

**Figure 16. Recurrent taxes on immovable property are low**

![Property tax revenues graph](https://doi.org/10.1787/888933788472)

*Note*: For the OECD countries the aggregate "4100 Recurrent taxes on immovable property" is used. For Lithuania instead the revenues from taxes different than Taxes on income, profits and Taxes on goods and services were used. Therefore the figure for Lithuania overestimates the revenues from taxation on property.

*Source*: OECD Revenue statistics database; and Ministry of finance of Lithuania.

Greening the economy

Lithuania's economy is relatively energy intensive. Since closing its nuclear reactor at the end of 2009 Lithuania has been dependent on imports, mainly from Russia. Interconnectors with Sweden and Poland brought into service in late 2015 have reduced this dependence, but further interconnectors and the planned synchronisation with central
and western Europe are needed for Lithuania to benefit from the integrated European electricity market.

### Box 4. The long-term fiscal effects of some key OECD recommendations

Table 6 presents an order of magnitude of the long-term fiscal effects of some OECD recommendations presented in this Survey. These estimates are based on illustrative scenarios for specific spending and tax items and existing estimates for the elasticity of taxes to GDP. The effects of the structural reforms quantified in Box 2 are decomposed into their impact on GDP, including estimated behavioural responses (“budget effects”), and their direct fiscal costs (“accounting effects”). The estimates assume budget effects to accrue immediately after implementation of reforms. All results should be interpreted with care, in particular as they do not take dynamic and country specific effects into account.

<table>
<thead>
<tr>
<th>Measure</th>
<th>Change in fiscal balance (% GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase property tax, notably recurrent taxes on housing, from 0.4% of GDP to the OECD average (1.1%).</td>
<td>+0.7</td>
</tr>
<tr>
<td>Reduce social security contributions from 40% to 35% of gross wages</td>
<td>-1.5</td>
</tr>
<tr>
<td>Increase spending on activation policies from 0.3% to 0.5% of GDP</td>
<td>-0.2</td>
</tr>
<tr>
<td>Increase spending on childcare from 0.3% of GDP to 0.6% (OECD average)</td>
<td>-0.3</td>
</tr>
<tr>
<td><strong>Accounting effects of the structural reforms proposed in Box 2</strong></td>
<td></td>
</tr>
<tr>
<td>Budget effects of the structural reforms proposed in Box 2</td>
<td>+1.0</td>
</tr>
<tr>
<td>The estimated impact of structural reforms on GDP per capita (Box 2) would lead to higher GDP by 2.8%, abstracting from population growth. The public-spending-to-GDP ratio of 36.8% of GDP in 2016 would be lowered to 36.8/1.028 ≈ 35.8% of GDP. Assuming a long-run tax revenue to GDP elasticity of one, the estimated effect on the fiscal balance would be 1.0% of GDP (36.8% minus 35.8%).</td>
<td></td>
</tr>
</tbody>
</table>

Source: OECD calculations.

The energy supply structure has changed, and the economy has reduced its impact on the environment over the past 10 years (Figure 17):

- The use of biomass partly explains why Lithuania's per capita CO₂ emissions are much lower than the OECD average (Panel A). Lithuania estimates absorption of CO₂ by new forest growth offsets as much as half of its greenhouse gas emissions (Ministry of Environment, 2015). Per capita emissions continue falling in line with the average OECD country.

- The use of renewables has climbed rapidly over the past 10 years as wind power and biomass burning for heat and electricity have expanded (Panel B). Most domestic heating is supplied by district heating plants (CHP). In over 30% of CHP fuel was from biomass, investment in waste- and biomass-fired CHP plants is planned to replace additional fossil-fuel capacity.

- Biomass burning is an important contribution to energy independence but also contributes to air pollution. Most emissions of fine particles (PM2.5) in Lithuania are due to combustion in the energy sector, while transport accounts for the rest (EPA, 2014). Air quality, which is affected by domestic emissions as well as those from neighbouring countries, is around the OECD average, though the share of population exposed to high annual levels is small (Panel C).
- Waste disposal is still reliant on landfill (Panel D). A landfill tax was introduced in 2016 but set very low, and it should be increased. Waste disposal is subject to a volumetric charge, and a tax applies to a number of products whose disposal is likely to pollute (e.g. batteries). Treatment of household wastewater has improved radically since 2000, moving from only half wastewater receiving adequate treatment to almost 100% coverage. Nevertheless, 10% of surface water bodies are classified as "bad" (Environmental Protection Agency, 2016). Lithuania has recently moved to establish river basin management systems to better manage risks, including flooding.

Taxes on petrol and diesel fuels are at OECD average levels. However, Lithuania remains among the few European countries without car taxation or a road-use tax for private passenger vehicles. The government should introduce car taxation, possibly based on emissions or mileage.

**Figure 17. Green growth indicators**

Promoting productivity and inclusive growth

Strengthening productivity growth would help to speed up the income convergence process, yielding gains in terms of inclusiveness (Figure 18). Coherence between policies is important to ensuring that they work together to address these interrelated challenges. Well-designed active labour market programmes, for example, could facilitate the reallocation of workers towards more productive sectors by helping displaced individuals to transition to new, good jobs (OECD, 2016d). Education reforms yield a double dividend in terms of boosting productivity and fostering inclusiveness.

**Figure 18. GDP per capita convergence according to different scenarios**

![Graph showing GDP per capita convergence with three scenarios: Scenario 3: doubled LP growth 3.9%, Scenario 2: LP growth 2.9%, Base line scenario: LP growth of 2007-2017 1.9%.]

Source: OECD calculation.

*StatLink*  [https://doi.org/10.1787/888933788510](https://doi.org/10.1787/888933788510)

Boosting productivity by removing remaining barriers to investment

Lithuania’s regulatory environment is overall business-friendly and open to foreign investment. This is echoed in the OECD’s Product Market Regulation (PMR) indicator (Figure 19) and the *World Bank Doing Business* index, where Lithuania is placed among the top 20 countries (World Bank, 2018). Moreover, Lithuania ranks among the top 10 countries with the most open markets for services trade (OECD, 2018a). However, some barriers to investment, including relatively tight regulations for the employment of non-EU workers and for entering legal services (Figure 19 and Figure 20), can reduce the country’s attractiveness for foreign investors with current efforts to address such barriers going in the right direction.

More specifically, a recent law has eased restrictions on the employment of workers from non-EU countries for selected professions. It also improved the employment possibilities for non-EU students (part-time) and graduates, while introducing a simplified start-up visa scheme for non-EU entrepreneurs planning to establish a high-tech business in Lithuania. Further steps towards relaxing employment regulations for non-EU workers are in the pipeline. Recent reforms, including a change to the constitution, also eased restrictions to non-residents in areas such as legal services and land acquisition, but some limited barriers in these areas remain. Greater competition is also key to higher productivity. Competition in some key sectors should be increased, such as railways, where there is only one main undertaking offering freight transportation services. The
government plans to reorganise the state-owned enterprise Lithuanian Railways ("Lietuvos geležinkeliai"), separating it into different companies for passengers, cargo and infrastructure management, which would be welcome. Devising packages of reforms can help reduce resistances to change from stakeholders.

\[\text{Figure 19. Product market regulations, 2013}\]

The licencing reform underway would also stimulate investment by reducing further the administrative burden on businesses. The widespread informal economy in Lithuania, estimated by various studies (e.g. Schneider, 2016, Figure 21) at around 17% to 25% of GDP, can be another obstacle to investment by creating an uneven playing field for firms, while it also reduces labour market inclusiveness. Firms tend to operate in the shadow sector for a number of reasons including high social security contributions and uncertainty about regulatory policies, tax rates and tax administration (Putnis and Sauka, 2017). Difficulties faced by firms in finding adequately-skilled workers (discussed below) also weigh on investment decisions.
Enhancing the performance of state-owned enterprises

State-owned enterprises (SOEs) account for approximately 3.2% of total employment, above the 2.4% OECD average. Around two-thirds of Lithuanian SOEs engage in commercial activities, either exclusively or in combination with public policy objectives (Bank of Property, 2017). SOEs’ average financial performance has improved in recent years, but many still do not achieve the annual return on equity target set by the government (Bank of Property, 2016; 2017). Some SOEs are unprofitable, creating a strain on the public budget and potentially crowding out more efficient private enterprises.

Lithuania has made considerable progress in recent years to bring SOE governance practices closer to the standards set forth in the OECD Guidelines on Corporate Governance of State-Owned Enterprises. However, the 2015 OECD Review of the Corporate Governance of State-Owned Enterprises: Lithuania identified some crucial shortcomings in SOEs’ governance. These include insufficient separation of the government’s role as owner and regulator of SOEs, the absence of a centralised ownership entity, limited operational independence of SOE boards, weak corporatisation and concerns about the quality and credibility of SOEs’ financial reports (OECD, 2015b).

A number of recent reforms aim to address such shortcomings. These include notably the elaboration of a state ownership policy and SOE disclosure requirements, strengthening the ownership coordination function to monitor SOEs’ compliance with these requirements, and efforts to remove politicians and place more independent directors on SOE boards. These reforms, along with the restructuring underway in the state-owned forestry and road maintenance sectors, are proceeding as planned and should go hand-in-hand with increased accountability for boards of directors and managers for achieving results. Plans are also underway to fully corporatise a number of commercially-oriented SOEs that are currently subject to statutory legislation rather than company law. Only a small number of SOEs is to remain as statutory enterprises under the planned changes. Ensuring that SOEs are subject to the same laws and regulations as private companies is essential for safeguarding competition and productivity (OECD, 2015b).
Figure 21. A large informal economy

A. Size of the shadow economy, 2016

B. Extent of income underreporting, 2016

C. Type of own shadow economy, 2016

**Improving the efficiency of insolvency procedures**

Lithuania needs to make the insolvency framework more efficient, facilitating the exit of less productive firms (Figure 22) (Adalet McGowan et al., 2017). Despite progress in recent years, bankruptcy processes remain costly and time-consuming (World Bank, 2017). Rules regarding manager’s liability of insolvent companies should become clearer and stricter, so as to increase incentives for early filings for bankruptcy (NAO, 2014). The government is currently drafting a comprehensive law on corporate insolvency, which changes the criteria for starting bankruptcy procedures and establishes clearer deadlines for filings. Amendments also aim to establish more favourable conditions for enterprise restructuring, offering the opportunity to debtors in financial difficulties to restructure early (Adalet McGowan and Andrews, 2016). Strengthening the use of expertise is key for raising efficiency, given that winding down or rehabilitating a company can be complex. Specialised judges and administrators are important in this regard.

**Figure 22. Insolvency framework needs to be improved**

![Graph showing the strength of insolvency framework index (0-16), 2017](image)


**Boosting innovation capacity**

Lithuania has improved its international innovation position, but its performance remains below EU average (European Commission, 2017b) (Figure 23, Panel A). Despite progress, innovation inputs and outputs fall below the OECD median, with scope for greater efficiency. There are many institutions with advisory and implementation functions under various ministries and a plethora of support programmes and instruments which lead to policy fragmentation and overlap (OECD, 2016a; IMF, 2017b). A more coordinated governance of the innovative system is essential. The government should continue the implementation of the institutional reform of innovation policy by improving coordination, and consolidate agencies and support programmes where overlaps exist, based on a careful and well-evidenced assessment (OECD, 2016a).

Promoting business-firm collaboration - an increasingly recognised channel of knowledge transfer and commercialisation - remains another key challenge (OECD, 2016a). The
collaborative activity by SMEs has picked up significantly in recent years, surpassing the EU average. However, collaboration of firms with universities and research institutions remains limited, especially in the case of larger firms, with little mobility between the business and research sectors (Figure 23, Panels B and C). The share of researchers working in the business sector in Lithuania stands at around 16%, well below the EU28 average close to 40%. Increasing government contribution for collaborative research conducted by public research institutions could be a policy option on the basis of international experience (OECD, 2017a).

Fostering digitalisation can boost productivity growth and improve wellbeing as information and knowledge become more widely available (OECD, 2017b). It is particularly important in a context of a shrinking working-age population. However, reaping the opportunities of digitalisation requires that individuals are equipped with the right skills to use the new technologies and re-integrate swiftly in the labour market, if displaced by the digital transformation. Lithuania performs well internationally in terms of broadband coverage (fixed and mobile). Effective use of digital networks however remains a challenge: only 63% of households had subscribed to a broadband connection in 2016, around 10 percentage points below the EU28 average. The use of ICT by firms is also low. The “human capital” component of the EU Digital Economy and Society Index is below the EU average, reflecting a relative low share of internet users in population and of ICT specialists in total employment (Figure 23 D). Addressing skills mismatch and ensuring solid basic skills are important for strengthening the digital skill base (OECD, 2017b).

**Enhancing inclusiveness and productivity by addressing skills mismatch**

The share of workers with skill mismatch in Lithuania is above the OECD average (Figure 24, Panel A). This is exacerbated by the insufficient quality of the domestic education system. Lithuania has a highly educated workforce in terms of tertiary graduates; yet finding workers with the right skills appears to be a significant constraint for over 40% of firms (Figure 25). High emigration and certain restrictions on non-EU workers, as well as limited participation in lifelong learning, also explain the lack of suitable labour in Lithuania. More work-based training is necessary to meet the skill needs. Comprehensive efforts are underway to improve the attractiveness of vocational education and training (VET), which records low enrolments rates, and increase its labour market relevance. As an additional positive step, the new Labour Code, in force since July 2017, clarifies the legal status of apprenticeships, which are very little developed in Lithuania. Consideration should be given for moving from time-based to competence-based apprenticeship as is the case, for example, in Australia and the United Kingdom (OECD, 2018b). Developing incentives for employer-based training is important. Ongoing reforms aimed at improving basic skills development in general education and better alignment between general, VET and tertiary education should continue.

Field-of-study mismatch is relatively high (Figure 24 B). Plans for a more direct link between tertiary education funding mechanisms and labour market demands, including through differentiated awards to institutions for courses that provide skills closely linked to the labour market needs, are welcome.
Figure 23. Innovation and digitalisation indicators

A. EU Summary Innovation Index

Source: European Innovation Scoreboard 2017.

StatLink https://doi.org/10.1787/888933788605
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Figure 24. Skill mismatch is high

A. Components of skill mismatch, 2015

<table>
<thead>
<tr>
<th>Country</th>
<th>Underqualification</th>
<th>Overqualification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Switzerland</td>
<td>40</td>
<td>30</td>
</tr>
<tr>
<td>Germany</td>
<td>35</td>
<td>25</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>30</td>
<td>20</td>
</tr>
<tr>
<td>Finland</td>
<td>25</td>
<td>15</td>
</tr>
<tr>
<td>Austria</td>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>Belgium</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>Norway</td>
<td>10</td>
<td>0</td>
</tr>
<tr>
<td>Iceland</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>OECD</td>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>Czech Rep.</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>Slovakia</td>
<td>10</td>
<td>0</td>
</tr>
<tr>
<td>Poland</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Slovenia</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

B. Field-of-study mismatch¹, 2015

<table>
<thead>
<tr>
<th>Country</th>
<th>% employed aged 15-64</th>
</tr>
</thead>
<tbody>
<tr>
<td>Switzerland</td>
<td>40%</td>
</tr>
<tr>
<td>Germany</td>
<td>35%</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>30%</td>
</tr>
<tr>
<td>Finland</td>
<td>25%</td>
</tr>
<tr>
<td>Austria</td>
<td>20%</td>
</tr>
<tr>
<td>Belgium</td>
<td>15%</td>
</tr>
<tr>
<td>Norway</td>
<td>10%</td>
</tr>
<tr>
<td>Iceland</td>
<td>5%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0%</td>
</tr>
<tr>
<td>OECD</td>
<td>20%</td>
</tr>
<tr>
<td>Czech Rep.</td>
<td>15%</td>
</tr>
<tr>
<td>Slovakia</td>
<td>10%</td>
</tr>
<tr>
<td>Poland</td>
<td>5%</td>
</tr>
<tr>
<td>Slovenia</td>
<td>0%</td>
</tr>
<tr>
<td>Lithuania</td>
<td>5%</td>
</tr>
</tbody>
</table>

Note: The OECD average is calculated on the 25 available countries only.

1. Field-of-study mismatch arises when workers are employed in a different field from what they have specialised in.

Source: Adalet and Andrews, 2017 and OECD Skills for Jobs Database.

StatLink 2 https://doi.org/10.1787/888933788624

Figure 25. Finding the right skills is an obstacle to firms

<table>
<thead>
<tr>
<th>Obstacle</th>
<th>Lithuania</th>
<th>EU</th>
<th>Estonia</th>
<th>Latvia</th>
<th>Poland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Availability of finance</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Labour market regulations</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>Business regulations and taxation</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Demand for product or service</td>
<td>15%</td>
<td>15%</td>
<td>15%</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>Availability of staff with the right skills</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Uncertainty about the future</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
</tbody>
</table>

1. Firm responses to the question: “Thinking about your investment activities in your country, to what extent is each of the following an obstacle? Is it a major obstacle, a minor obstacle or not an obstacle at all?”

Source: European Investment Bank – EIBIS, EIB Investment Survey.

StatLink 2 https://doi.org/10.1787/888933788643

Making the labour market more inclusive through more and better jobs

Lithuania’s labour market performed strongly since the start of the recovery but some groups, notably the low-skilled, fare worse than others (Figure 26). At the same time, extensive undeclared work, high wage inequality and often poor working conditions impact job quality for many Lithuanians (Figure 27).
1. Calculated on the labour force aged 25-64.
2. Data refer to 2016.

*Source*: OECD Gender employment database; and OECD Education attainment and outcomes database.

StatLink 2 https://doi.org/10.1787/888933788662

**Figure 26. The labour market could become more inclusive**

*Group-specific unemployment rates, 2017*

The high tax wedge makes low-skilled workers less attractive to employers (Figure 28). Recent increases in the personal income tax threshold are welcome in this regard, but a reduction in social security contribution rates should lower the labour tax burden further. Reliable information on wages is critical for targeting effectively the low-skilled and containing budgetary costs. As a welcome step, the State Social Insurance Fund Board has started since early 2017 to publish the data on average wages in enterprises and institutions.

StatLink 2 https://doi.org/10.1787/888933788681

**Figure 27. Wage inequality is high**

*Ratio of 9th to 1th deciles of earning distributions, 2016 or latest year available*
Effective income support for those out-of-work

In tandem with increased flexibility, reforms under the New Social Model provide for more income security through better access to unemployment benefits and a rise in the payment rates (flexicurity). The changes are expected to increase the coverage of the registered jobseekers to around 45% and bring the net replacement rate (i.e. the unemployment benefits to earnings ratio) above the OECD average (OECD, 2018b) (Figure 29). Indicatively, the share of unemployment insurance benefit recipients in total registered unemployed increased from 29% in January 2017 (before the reform) to more than 33% a year after, while the average amount of unemployment insurance benefit increased by almost 1.5 times. The reforms will also strengthen job-search assistance. The maximum duration period of unemployment benefit, currently at nine months, could be further extended, making savings elsewhere. Most OECD countries pay unemployment benefits for at least twelve months (OECD, 2018b). This would strengthen the support for long term-unemployed, accounting for close to 40% of all unemployed in 2016, while effective polices to help them re-integrate in the labour market remain crucial.
Figure 29. Unemployment benefits became more generous

Net Replacement Rates for a single person in unemployment, 2015

Note: Net replacement rates (NRRs) give the case of a 40-years-old who has been continuously employed since the age of 18. For Lithuania, the results for January and July 2017 represent the situation before and after introduction of the New Social Model, respectively.


Social benefits – currently below OECD levels – should better combat poverty. Child poverty remains an important issue, with a risk of a vicious cycle between socio-economic background and economic opportunities (OECD, 2017c). Around 19% of children live in relative poverty with an income below 50% of the median, above the OECD the average and other Baltic countries and Poland (Figure 30). Children in Lithuania are more likely to live in income poverty than the general population, with the likelihood of being poor linked closely to the employment status of an adult in the household. To address child poverty better, the government introduced a universal child benefit replacing the former child tax allowance from 2018. Moreover, the child benefit will not be included in the income establishing a family's eligibility for social assistance. The government expects that at risk-of-poverty rate of children will decrease by about 2.7 percentage points as a result of these measures. These reforms are accompanied by efforts to improve the quality of services by social workers.
Increases in the level of income support to better protect those in need should not discourage work. The gap between minimum wages and social benefits implies that the financial incentives to take up a job are relatively large, depending on family size (Figure 31). Yet, as with other countries, the withdrawal of benefits when the recipient takes up a job makes employment less attractive. As a positive step, Lithuania has recently strengthened financial incentives for benefit recipients by extending the coverage of “in-work benefits”; those registered as unemployed for at least six months (rather than 12 months under the previous regime) and find a job can temporarily keep half of their benefits. Moreover, an income disregard was introduced in 2018, in line with practice in other countries, increasing social assistance without taking into account a part of the recipient’s work income. The impact of the new measure in boosting financial incentives to work and reducing poverty needs to be regularly evaluated.

Note: The child income poverty rate is defined as the proportion of children (0-17 year-olds) with an equivalised post-tax-and-transfer income of less than 50% of the national annual median equivalised post-tax-and-transfer income

Source: OECD Income Distribution and Poverty database.

StatLink: http://dx.doi.org/10.1787/888933788738
Figure 31. Financial incentives to take up a job are weaker for large households

Participation tax rates for a person taking up employment at the 20th percentile of the gross earnings distribution

A. Single without children

B. Couple with 2 children

Note: The participation tax rate is calculated as the income gain from taking up work net of taxes, contributions and losses in benefit payments as a share of the gross earnings from work. For Lithuania, the values refer to those for households receiving Social Benefits only (LTU) and social benefits plus heating compensation (LTU + HC). In the latter case, the calculations assume that the heating compensation is lost when a person takes up work. The data refer to 2015 except for Lithuania (July 2017). The 20th percentile of the gross earnings distribution corresponds to about EUR 440 per month.


StatLink https://doi.org/10.1787/888933788757

Helping jobseekers to get back to work through well-designed active measures

Participation in active labour market policies (ALMPs), and spending on them, is relatively low (Figure 32, Panels A and B). Moreover, Lithuania’s public employment services (PES, Lithuanian Labour Exchange) are understaffed (Figure 32, Panel C). Recent reforms have changed the structure of public employment services by centralising the management processes of activities planning and of financial and human resources.
This is expected to release some resources, increasing in turn the provision of direct services to jobseekers. However, intensive personalised PES services hinge upon a sufficient number of suitably trained officers. In addition, a new Law on Employment in July 2017 expands the range of ALMPs and attempts to increase efficiency by reallocating spending among programmes. Public works have been abolished and employment subsidies are now the main ALMP measure (Figure 32, Panel D). While employment subsidies can be an efficient tool for improving the employability of low skilled quickly, the spending on ALMPs appears too skewed at the expense of programmes that boost long-term employability, such as training. Increasing investment in active labour market programmes should be subject to a close monitoring of the achieved outcomes.

1. Activation programmes refer to the active labour market programmes (categories 2-7); cover training, employment incentives, supported employment and rehabilitation, direct job creation and start-up incentives. 
Source: OECD Labour database.
Ageing together

Growing life expectancy, continuing emigration and low fertility – albeit above the OECD average and raising again – are changing Lithuania’s demographic structure. The old-age dependency ratio is projected to rise from 25% in 2013 to 42% by 2060 (Figure 32). Population ageing has economic implications for various policy areas.

**Figure 33.** Old-age dependency ratio, 2010 and 2060

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Pensions have become more sustainable

Spending on pensions is relatively small at around 6.8% of GDP. The net replacement or wage to pension rate is close to the OECD average, and the large difference between low- and median earnings points at considerable redistribution as the wage-independent “basic pension” makes up more than half of pension spending (Figure 34). The New Social Model that entered into force in 2018 brought the pay-as-you-go first pillar on a more sustainable path, essentially by applying a new pension indexing formula and by gradually increasing the required length of pensionable service. According to national projections, based on demographic assumptions of the European Union, these reforms are thought to reduce the size of the pension system by more than 3 percentage points of GDP in the long run (Figure 35). The reform stopped short of introducing an automatic link from life expectancy to the retirement age, which would make the system even more sustainable.

Pensions are mostly financed through social security contributions, which at around 30% put a high wedge on labour. The government plans to shift the funding of the “basic pension” to the general government budget, thereby broadening the tax base (OECD, 2016b). The government also wants to strengthen the second pillar (funded pensions) and third pillar (individual savings) of the pension system, which tend to be more sustainable and provide a closer link between contributions and benefits. Second pillar pension savings, which are voluntary, should become compulsory to achieve the planned shift towards a funded pension system more rapidly. Third pillar private savings are tax-favoured, limited to a maximum 25% income-to-savings ratio and a ceiling of EUR 2 000 per year. Only 3% of the working-age population have private pension savings accounts.

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*StatLink* [https://doi.org/10.1787/888933788795](https://doi.org/10.1787/888933788795)
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Figure 34. Replacement rate is average

Note: The net replacement rate is defined as the individual net pension entitlement divided by net pre-retirement earnings, taking into account personal income taxes and social security contributions paid by workers and pensioners. For Lithuania a 2% contribution to the private funded pension was assumed.
StatLink https://doi.org/10.1787/888933788814

Figure 35. The recent reform is set to increase sustainability of the pension system

Source: Lithuanian Ministry of Social Security and Labour.
StatLink https://doi.org/10.1787/888933788833

Despite being redistributive, the system is not well-targeted at the poor. More than 25% of old Lithuanians are at risk of poverty (Figure 36). The social assistance pension, paid to those with insufficient or no acquired pension rights, is low at less than 30% of the minimum wage. Still, home ownership is widespread among older Lithuanians, raising their disposable income (Eurostat 2017). Moreover, pensions are not taxed. The government may consider raising minimum pensions and means-testing them, while streamlining the variety of other social benefits. Also, at 15 years the minimum service period to obtain a pension at all is high, potentially discouraging return emigrants to take up work.
Health care is improving

Health ranks low in well-being indicators. Life expectancy in Lithuania is among the lowest across the OECD, and the gap between men and women one of the largest (Figure 37), partly owing to lifestyle such as high alcohol and tobacco consumption. Policies to improve the health status of the population should therefore include prevention and the promotion of healthier lifestyles. The Lithuanian health strategy 2014-2025 rightly builds on a whole-of-life approach which emphasises the importance of tackling the main health determinants. Access to health care is satisfactory for all income groups and in all parts of the country, although private outlays for medicines are comparatively high (OECD, 2018b). Informal payments are still a problem, yet the government makes it a priority to reduce them, by raising wages for doctors and nurses and by improving monitoring. Health care spending is low at 6.5% of GDP and the system is considered sustainable, although population ageing is assumed to contribute up to 4% points of GDP to the health care bill by 2030 in some scenarios (European Commission 2015).

The health spending mix is more of an issue. Lithuania still favours hospital-centred over outpatient and primary care, despite having rebalanced health services since long (Figure 38). Hospitals are often small and underused, driving costs and carrying risks for patients requiring special treatments (OECD, 2018b). Lithuania should continue to reorganise the hospital sector and move towards outpatient care. More resources should also be devoted to long-term care. In 2013 a programme for integrated nursing and social care at home for disabled and elderly persons was started. Stronger reliance on nurses has proven very efficient in providing health services in Finland and Sweden, and their role should be strengthened further (OECD, 2016c). Finally, a network of around 55 palliative care centres has been established, often in former hospitals. Given its role for patient-centred care towards the end of life, palliative care should be extended.
Figure 37. Life expectancy of men is low

Healthy life years at birth, 2016

Source: Eurostat Health statistics database.
StatLink 2 https://doi.org/10.1787/888933788871

Figure 38. Lithuania’s health care system has undergone deep reforms but is still hospital-centred

StatLink 2 http://dx.doi.org/10.1787/888933788890

Life-long learning is limited

Life-long learning is key to maintain productivity and employment in an ageing society, yet it is low in Lithuania (Figure 39). Employers invest little in upskilling, and few collaborate with educational and research organisations. Participation of the unemployed in training programmes remains very weak, although about 40% of the Lithuanian unemployed have no professional qualification (OECD, 2018b). Financial incentives are modest: firms may deduct training expenses from social security contributions, and employees get a commuter allowance to attend training in distant places. The new Labour Code introduced a study leave of up to five days for non-formal training, partially covered by the employer if the employee was employed for more than five years.
Figure 39. Life-long-learning propensity in Lithuania is low

Participation rate in lifelong education or training, 25-64 year-olds, 2016

Note: Data refer to the share of 25 to 64 year-olds who participated in education or training in the 4 weeks prior to the survey.

Lithuania should elaborate a broad and flexible system of lifelong learning. Lifelong learning could be modelled on Estonia’s programme established in 2016, with targets for participation rates and regular monitoring (OECD, 2017d). Firms should be encouraged to offer training opportunities, maybe by a levy-based fund reimbursing firms based on the amount of training provided (OECD, 2018b). Tax allowances should be granted to employees for training expenses. Since upskilling needs rely partly on basic skills acquired through professional education, life-long learning programmes should be well linked to secondary and tertiary education, vocational training and the apprenticeship system.

Emigration remains high

Emigration is largely driven by wage differences with the destination countries and free movement within the European Union (Kumpikaitė Valiūnienė et al, 2017). The young are particularly inclined to leave, accelerating the ageing of the society and contributing to skills shortages (Figure 40). Remittances cushion the economic effect of emigration as they make up around 3% of GDP, but their role has declined recently, partly reflecting loosening ties between emigrants and their home country and weaker purchasing power in the destination countries. As part of broader strategy to reach out to emigrants, the government has set up the “Global Lithuania Programme”, a policy programme that aims at strengthening links with the diaspora, but it is scattered across 14 public agencies, and the sums spent on each activity are usually small. The government is currently drafting a new demography, migration and integration strategy, which aims at reducing emigration, higher return migration and reforms to immigration.
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Figure 40. Emigration is high and volatile

Emigration and immigration, absolute numbers

Source: Statistics Lithuania. StatLink https://doi.org/10.1787/888933788928

Migration policy should rest on three pillars: 1) taking care of those living in the country, 2) reaching out to those living abroad; and 3) attracting skilled immigrants. As such, immigration and returning emigrants could partly offset population ageing and a shrinking labour force, especially of the high-skilled. However, Lithuania’s immigration policy for non-EU workers is tight, with permit-free occupations having been scaled down gradually (OECD, 2017). Most immigrants are posted to freight companies, contributing little to economic activity in Lithuania. A reform to the immigration law lowered the administrative burden for high-skilled immigrants and those investing in the country in 2017, but the rules should be relaxed further. Finally, enrolment of foreign students is slowly increasing, although only around 5% remain in the country after graduation, fewer than in Estonia with around 20% (OECD, 2018b).

Family policy

Both fertility rates and female labour market participation are above OECD averages (Figure 41), pointing at good integration of working mothers. Yet tensions could arise between supporting families and providing incentives to work. Parental and home care leave is relatively generous as it is paid for up to two years. Child benefits for one or two children are means-tested, while those for three or four children are not. An additional universal child benefit of around EUR 30 per child was introduced beginning of 2018, probably lifting overall child support above the OECD average. Spending on support for childcare remains below the OECD and other Baltic countries, but enrolment has rapidly increased over the last ten years and is now close to the OECD average of around 30%.
Figure 41. Both birth rates and female employment are above OECD averages

A. Fertility rates¹, 2015 or latest year available

B. Share of working mothers², 2015 or latest year available

1. The Total Fertility Rate (TFR) is defined as the average number of children born per woman over a lifetime given current age-specific fertility rates and assuming no female mortality during reproductive years.

2. Employment rates for women (15-64 years old with children by age of the youngest child. Source: OECD Family Database.

StatLink [http://dx.doi.org/10.1787/888933788947](http://dx.doi.org/10.1787/888933788947)

The government programme establishes that reconciling work and family life is crucial to meet demographic challenges, raise birth rates and foster well-being of families (Government of Lithuania, 2016). To reach these objectives and to minimise the trade-off between higher fertility rates and the labour market participation of women, Lithuania’s family policy should focus on extending support for childcare and commit to the planned investment in childcare facilities.
References


NAO (National Audit Office of Lithuania) (2016), Management of the Programme for Investment in 2015, No. VA-P-60-9-16, October (Executive summary of the public audit report in English)


# Annex. Progress in structural reforms

This table reviews recent actions taken on recommendations from the previous Surveys. Recommendations that are new to the present Survey are listed in the relevant chapters.

<table>
<thead>
<tr>
<th>KEY RECOMMENDATIONS</th>
<th>ACTIONS TAKEN</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FISCAL AND FINANCIAL POLICIES TO SUPPORT THE ECONOMY</strong></td>
<td></td>
</tr>
<tr>
<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>
<td>“Smart tax administration” has been introduced, and the VAT tax gap reduced from 31% to 26%.</td>
</tr>
<tr>
<td>Further shift the tax burden away from labour, especially from employer social security contributions, and raise recurrent taxes on personal immovable property.</td>
<td>Property is now assessed close at market value, and the threshold value for property tax exemption was reduced. Property tax rates were reduced.</td>
</tr>
<tr>
<td>Increase taxes on activities that damage the environment</td>
<td>A landfill tax was introduced in 2016 but the rate is low</td>
</tr>
<tr>
<td><strong>BOOSTING PRODUCTIVITY</strong></td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td>The new Labour Code, in effect from July 2017, introduces apprenticeship contracts. These can either entail a training contract with a VET institution; or, include no such a contract. In the latter case the employer has to create the training programme for the whole period of apprenticeship contract. Sectoral professional committees are being renewed in order to ensure better cooperation with employers in the education system and life-long learning; this is facilitated by the revision of professional standards.</td>
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<td>Attract higher performing graduates to the teaching profession by paying higher wages and investing in teacher development. Promote participation in pre-primary education.</td>
<td>Attractiveness of the teaching profession is being addressed by reforming teachers’ remuneration and workload calculation system, raising the salary level, and restructuring teachers’ training institutions. The number of childcare facilities has been increased, now reaching OECD averages.</td>
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<td>Promote new forms of business financing and ensure that innovation policies support young innovative firms. Reform bankruptcy procedures.</td>
<td>A law on crowd-funding was adopted in November 2016. The government established three new venture capital instruments in 2017, with six more funds to be established by 2019. Three new financial instruments for SMEs are to be launched in 2018; short-term export credit guarantees to SMEs exporting their goods to non-EU and non-OECD countries; portfolio guarantees for factoring transactions to provide short-term financing for SMEs; and, crowd-funding loans, which would allow to finance SMEs through crowd-funding platforms. A measure specifically targeted at promotion of commercialization R&amp;D results has been worked out and the first call for proposals announced in June 2017.</td>
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<td><strong>PROMOTING INCLUSIVE GROWTH</strong></td>
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<td>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.</td>
<td>Recent reforms allow those who find employment to temporarily keep half of their benefits after taking up work in the form of in-work benefits.</td>
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<td>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</td>
<td>Almost all laws of the New Social Model were already in force or went into force on 1 July 2017. The coverage and generosity of unemployment benefits have increased by easing eligibility conditions and rising payment rates. The management of Public Employment Services has been centralised. In addition, a new Law on Employment in July 2017 expands the range of ALMPs and reallocates spending among programmes. The new Law on Employment provides more opportunities to employ the recipients of cash social assistance through programmes for increasing employment. The work incentives for social benefit recipients were strengthened by permitting</td>
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those who find employment to keep part of the work income that is not included in a
family income establishing person’s (family) right to assistance.

The government has initiated the evaluation of ALMP measures, social support and
social service compatibility when integrating unemployed into labour market. Its aim
is to evaluate ALMP measures, social assistance and social services impact of social
assistance recipients and its impact on their motivation to work.

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.

The number of staff who provides social services and nursing, including long term
care, has doubled within a few years. The number of nursing homes also increased.
Merging and restructuring of hospitals is continuing.