SGI Sustainable Governance Indicators

2014 Lithuania Report

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Executive Summary

Formal democracy is well developed in Lithuania. Participation rights, electoral competition and the rule of law are generally respected by the Lithuanian authorities. However, substantive democracy suffers from a few weaknesses. Party financing is not sufficiently monitored or audited, and campaign-financing fraud is not subject to adequate enforcement. In addition, discrimination continues to be evident in sometimes significant ways. Most importantly, corruption is not sufficiently contained in Lithuania. Although the country improved its position in the 2012 Corruption Perceptions Index, it still remains behind the European average. Anti-corruption legislation is well developed, but the public sector continues to offer opportunities for corruption, and the enforcement of anti-corruption laws remains insufficient.

Lithuanian policymakers have sought to establish and maintain social, economic and environmental conditions promoting their citizens' well-being. However, the country's policy performance remains mixed, with social-policy results lagging behind those of economic and environmental policies. Some observers attribute this to transition and EU integration processes that focused on political, economic and administrative matters. The country's formal governance arrangements are quite well-designed, with policymakers taking a long-term view of societal development and seeking to change unsuccessful policies. However, these arrangements do not always function to their full potential. There are significant gaps in policy implementation, and societal consultation remains underdeveloped.

There were several important developments in the 2011 – 2013 period. On the political front, the 2012 parliamentary election led to another change in government, producing a new coalition government led by the Social Democratic Party and Prime Minister Algirdas Butkevičius at the end of 2012. This fragmented four-party government was politically stable through the middle of 2013, but the 2014 presidential elections may bring some political changes to the cabinet composition.

In terms of economic developments, the Lithuanian economy returned to growth in 2010 as a result of successful fiscal consolidation efforts during the crisis period, as well as a recovery in the global economy. In addition, Lithuania is making efforts to improve its business environment (in 2013, the World Bank ranked Lithuania 27th worldwide in terms of ease of doing business) and innovation performance (the country was promoted to the country group called “moderate innovators” in the 2013 EU Innovation Scorecard). However, the country continues to face a number of significant challenges to its long-term competitiveness.

The country’s social developments were less positive. The number of people at risk of social exclusion continued to rise during the financial crisis, and unemployment rates remained relatively high (about 13% at the end of 2012, with rates among young people particularly high). In addition, Lithuania had the EU’s highest emigration rate during the period under review, with labor outflow becoming a potential serious problem. However, no comprehensive policies have been formulated that systematically address these challenges.

Despite the change of government in 2012, there was a good deal of continuity in the country’s governance arrangements, and number of clearly politically motivated decisions has been rather small. Thus, executive capacity and accountability were largely maintained. However, power and authority remained too concentrated at the central level. The involvement of citizens and various other external stakeholders in the structures and processes of government was rather limited, while staffing decisions at the senior levels of the civil service and other public-sector organizations remained rather politicized.

Key Challenges

Although the current four-party government enjoys a stable parliamentary majority, wider cross-party consensus should be established on major longer-term political projects, especially those in the energy field. As of the time of writing, current President Dalia Grybauskaitė appeared to be the candidate most likely to win the next presidential elections, due in May 2014, assuming she decides to run for re-election. A cabinet reshuffle is likely after the presidential elections.

Average annual growth is likely to slow in the following years (depending on conditions in the global economy and Lithuania’s export markets), but Lithuania should retain its position as one of the fastest-growing economies in the EU-27 through 2013 – 2014. The Lithuanian government has managed to stabilize the country's economy and public finances through a process of substantial fiscal consolidation, and its commitment to the adoption of euro, which is planned for 2015, is likely to ensure macroeconomic stability by controlling government expenditure in the short-term period. However, the long-term sustainability of public finances remains at risk in the absence of a comprehensive pension reform (especially given the unsustainability of the pay-as-you-go pillar, an issue that should be given more attention by Lithuanian decision-makers).

Lithuania faces the following primary challenges to its long-term competitiveness: unfavorable demographic developments; labor-market deficiencies and high emigration rates; rising levels of poverty and social exclusion; a lack of competition and interconnection in the country's infrastructure; low energy efficiency; a low level of R&D spending; and a poor performance in terms of innovation. Therefore, the country should continue implementing policy reforms, in particular regarding the labor market, social policies, energy efficiency and the energy sector. The European Union's planned 2014 – 2020 financial assistance for Lithuania, which is expected to total about €13 billion over the seven-year period, offers an opportunity to boost Lithuania's competitiveness. However, these funds should be rationally allocated, with particular focus on growth-enhancing sectors, while avoiding mismanagement and the addition of new administrative burdens.

The complex causes of high unemployment and emigration rates, as well as rising levels of poverty and social exclusion, should be urgently addressed by Lithuanian decision-makers. A mix of government interventions is needed in order to mitigate these social problems, including general improvements to the business environment, effective active-labor-market measures, an increase in the flexibility of labor-market regulation, improvements in education and training, and changes to social benefits and other social services targeted at vulnerable groups. Better policy implementation in line with strategic priorities set out in strategy documents such as Lithuania 2030 would improve the sustainability of policy reforms and the quality of governance.

Improvements in the functioning of Lithuania's substantive democracy and governance arrangements are also necessary. Some standards such as media-ownership transparency should be enhanced, while others such as non-discrimination rules should be better enforced. Other potentially useful reforms might include a decentralization of governance (accompanied by sufficient local-government task funding); the improvement of partnerships between the central government, local self-governments and other social actors; and the creation of processes that enhance citizen participation. Lithuania should target its anti-corruption efforts toward the most corrupt institutions, including the health care sector, the parliament, the courts, the police and local authorities, by eliminating or otherwise ameliorating conditions that facilitate corruption as well as by more effectively enforcing anti-corruption regulations. The country should maintain the professionalism of its civil service, retain or implement modern policymaking practices (such as strategic steering, evidence-based decision-making and interinstitutional coordination), improve policy execution, and ensure that top managerial staffing decisions and public-finance policies are not politicized.

Policy Performance

I. Economic Policies

Economy

Economic Policy
Score: 8

Lithuania's economic policies have created a reliable economic environment, fostering the country's competitive capabilities and improving its attractiveness as an economic location. In 2013, the World Bank ranked Lithuania 27th worldwide in terms of ease of doing business. The individual attributes of registering property (5th place), enforcing contracts (14th place), trading across borders (24th place), resolving insolvency (40th), dealing with construction permits (48th place), getting credit (53th place), paying taxes (60th place), and protecting investors (70th place) were rated above the Eastern Europe and Central Asia regional average (73rd place), whereas those of getting electricity (75th place) and starting a business (107th place) fell below that average. It was ranked 45th in the World Economic Forum's 2012 – 2013 Global Competitiveness Report, with some factors such as higher education and training ranked 26th worldwide) scoring above its overall average, and some factors such as financial-market development (87th place worldwide) falling significantly below.

In a 2012 assessment, the European Commission identified the following challenges to Lithuania's long-term competitiveness: unfavorable demographic developments, labor market deficiencies and high emigration rates, growing levels of poverty and social exclusion, a lack of competition and interconnections in the country's infrastructure (particularly its energy system), low energy efficiency (especially in the case of buildings), a low level of R&D spending, and poor performance with respect to innovation. Lithuanian authorities have sought to address these concerns through the national reform and convergence programs, as well as through other reform measures, with only mixed success.

Although the 2008 – 2012 Lithuanian government stabilized Lithuania's economy and public finances through substantial fiscal consolidation, other reform efforts have been more limited, in particular those relating to the labor market, social policies, energy efficiency and the energy sector. Considerable political emphasis has been placed on structural reforms, especially in the previous government's program, but a significant number of these have been left unimplemented. Although the economic crisis of 2008 – 2009 provided a window of opportunity to reform inefficient sectors, no consistent reform program was undertaken. As the economy recovered, in recent years becoming one of the fastest-growing economies in the European Union, the political will to reform has decreased, especially in fields such as the pension system or health care. Streamlining the regulatory environment for businesses is one of the few areas where progress has been achieved.

Citation:
COMMISSION STAFF WORKING DOCUMENT on the assessment of the 2012 national reform program and convergence program for Lithuania: http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2012/02_staff_working_document/lt_2012-05-30_swd_en.pdf.
Also, see the Doing Business Report and the Global Competitiveness Report.

Labor Markets

Labor Market Policy
Score: 6

Although Lithuania's labor market proved to be highly flexible during the financial crisis, ongoing labor-market difficulties present some of the primary challenges to Lithuania's competitiveness. Unemployment rates remain high, especially among youth (with this rate among Europe's highest), the low-skilled, and the long-term unemployed. In its 2012 report, the European Commission assessed Lithuania's labor-market policies as lacking ambition, and as only partially addressing the most pressing concerns. In particular, the report said that additional measures are necessary to enhance labor-market participation and improve labor-market flexibility. The country's active labor-market policies have struggled to cope with the increased number of unemployed, with Lithuania's activation rate among the EU's lowest (only 4.7 % in 2009).

Despite the flexibility provided in determining wages, for which the country earned its highest rating in the area of labor market efficiency in the Global Competitiveness Report, hiring and firing practices are considered to be too restrictive (earning the country's lowest rating in the same index). In 2013, the current Lithuanian government increased the minimum wage by about 20%, to about €290, in order to fulfill pre-election promises. It is too soon to judge the overall effects of this decision on employment trends; while it caused no massive new wave of unemployment, rates stabilized at the beginning of 2013 after series of improvements in the latter months of 2012. Relatively high rates of emigration to other EU member states have partially compensated for the inflexibility of hiring and firing rules and the country's rigid labor code.

Citation:
COMMISSION STAFF WORKING DOCUMENT on the assessment of the 2012 national reform programme and convergence programme for LITHUANIA, http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2012/02_staff_working_document/lt_2012-05-30_swd_en.pdf.

Taxes

Tax Policy
Score: 8

In Lithuania's tax system, a significant share of government revenue is generated from indirect taxes, while environmental and property taxes are relatively low. However, there is significant tax evasion. In terms of horizontal equity, there are mismatches between various groups of economic actors with similar tax-paying abilities. The labor force is taxed somewhat more heavily than is capital (although the tax burdens faced by both labor and capital are below the EU average), while specific societal groups such as farmers benefit from tax exemptions. Previous governments have reduced the number of exemptions given to various professions and economic activities with regard to personal income tax, social security contributions and VAT. Social-security contributions are high, exceeding 30% of wages, and while there are ceilings on payments from the social-security fund (pensions), there are no ceilings on contributions to it.

In terms of vertical equity, the Lithuanian tax system to a certain extent imposes a higher tax burden on those with a greater ability to pay taxes, insofar