OECD Economic Surveys
LITHUANIA

NOVEMBER 2020

OECD

OECD Economic Surveys: Lithuania 2020

BETTER POLICIES FOR BETTER LIVES

Please cite this publication as:
OECD (2020), *OECD Economic Surveys: Lithuania 2020*, OECD Publishing, Paris, *https://doi.org/10.1787/62663b1d-en*.

ISBN 978-92-64-70180-9 (print)
ISBN 978-92-64-92435-2 (pdf)

OECD Economic Surveys
ISSN 0376-6438 (print)
ISSN 1609-7513 (online)

Photo credits: Cover © Dzmitrock/Shutterstock.com.

Corrigenda to publications may be found on line at: *www.oecd.org/about/publishing/corrigenda.htm*.

Table of contents

Tables

Figures

Boxes

Follow OECD Publications on:

http://twitter.com/OECD_Pubs

http://www.facebook.com/OECDPublications

http://www.linkedin.com/groups/OECD-Publications-4645871

http://www.youtube.com/oecdilibrary

OECD Alerts http://www.oecd.org/oecddirect/

This book has...

StatLinks

A service that delivers Excel® files from the printed page!

Look for the *StatLinks* at the bottom of the tables or graphs in this book. To download the matching Excel® spreadsheet, just type the link into your Internet browser, starting with the *http://dx.doi.org* prefix, or click on the link from the e-book edition.

This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.
The economic situation and policies of Lithuania were reviewed by the Committee on 24 September 2020. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 29 October 2020.
The Secretariat's draft report was prepared for the Committee by Hansjörg Blöchliger and Vassiliki Koutsogeorgopoulou under the supervision of Piritta Sorsa. Statistical research assistance was provided by Roland Tusz and editorial coordination by Carolina Gonzalez.
The previous Survey of Lithuania was issued in June 2018.
Information about the latest as well as previous Surveys and more information about how Surveys are prepared is available at http://www.oecd.org/eco/surveys.

Basic statistics of Lithuania, 2019

(Numbers in parentheses refer to the OECD average)[1]

LAND, PEOPLE AND ELECTORAL CYCLE					
Population (million)	2.8		Population density per km² (2018)	44.7	(38.0)
Under 15 (%)	15.1	(17.9)	Life expectancy at birth (years, 2018)	75.7	(80.1)
Over 65 (%)	20.2	(17.1)	Men (2018)	70.9	(77.5)
Foreign born (%, 2018)	4.7		Women (2018)	80.7	(82.8)
Latest 5-year average growth (%)	-1.0	(0.6)	Latest general election	October-2020	
ECONOMY					
Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	54.2		Agriculture, forestry and fishing	3.3	(2.6)
In current prices (billion CRC)	48.4		Industry including construction	28.1	(26.8)
Latest 5-year average real growth (%)	3.3	(2.2)	Services	68.6	(70.5)
Per capita (000 USD PPP)	38.2	(48.3)			
GENERAL GOVERNMENT					
Per cent of GDP					
Expenditure	34.9	(41.7)	Gross financial debt (OECD: 2017)	44.9	(108.9)
Revenue	35.2	(38.5)	Net financial debt (OECD: 2017)	13.8	(69.0)
EXTERNAL ACCOUNTS					
Exchange rate (EUR per USD)	0.89		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	0.45		Machinery and transport equipment	20.3	
In per cent of GDP			Miscellaneous manufactured articles	16.4	
Exports of goods and services	78.1	(54.2)	Chemicals and related products, n.e.s.	15.1	
Imports of goods and services	72.5	(50.5)	Main imports (% of total merchandise imports)		
Current account balance	4.3	(0.3)	Machinery and transport equipment	26.9	
Net international investment position	-21.6		Mineral fuels, lubricants and related materials	17.9	
			Chemicals and related products, n.e.s.	14.8	
LABOUR MARKET, SKILLS AND INNOVATION					
Employment rate (aged 15 and over, %)	58.2	(57.5)	Unemployment rate, Labour Force Survey (aged 15 and over, %)	6.3	(5.4)
Men	63.1	(65.6)	Youth (aged 15-24, %)	11.9	(11.7)
Women	54.1	(49.9)	Long-term unemployed (1 year and over, %)	1.9	(1.4)
Participation rate (aged 15 and over, %)	62.1	(61.1)	Tertiary educational attainment (aged 25-64, %, 2018)	41.7	(36.9)
Average hours worked per year)	1,635	(1,726)	Gross domestic expenditure on R&D (% of GDP, 2018)	0.9	(2.6)
ENVIRONMENT					
Total primary energy supply per capita (toe, 2018)	2.8	(4.0)	CO2 emissions from fuel combustion per capita (tonnes, 2018)	4.2	(8.6)
Renewables (%, 2018)	19.3	(10.5)	Water abstractions per capita (1 000 m³, 2018)	0.1	
Exposure to air pollution (more than 10 µg/m³ of PM 2.5, % of population, 2017)	96.6	(58.7)	Municipal waste per capita (tonnes, 2018)	0.5	(0.5)
SOCIETY					
Income inequality (Gini coefficient, 2017, OECD: 2016)	0.374	(0.310)	Education outcomes (PISA score, 2018)		
Relative poverty rate (%, 2017, OECD: 2016)	17.3	(11.5)	Reading	476	(487)
Median disposable household income (000 USD PPP, 2017, OECD: 2016)	15.4	(24.4)	Mathematics	481	(489)
Public and private spending (% of GDP)			Science	482	(489)
Health care	6.8	(8.8)	Share of women in parliament (%)	21.3	(30.7)
Pensions (2015)	6.9	(8.5)	Net official development assistance (% of GNI, 2017)	0.1	(0.4)
Education (% of GNI, 2018)	3.9	(4.5)			

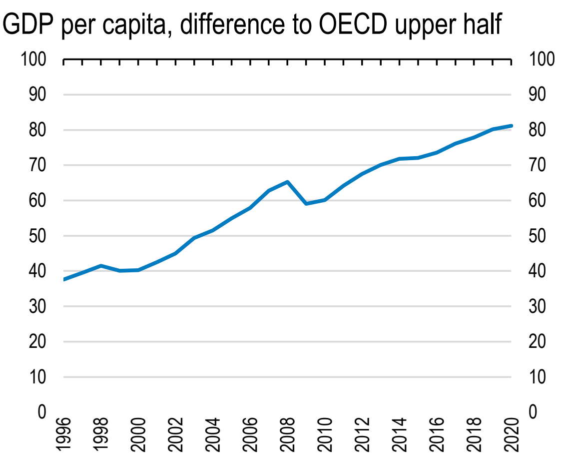
1. The year is indicated in parenthesis if it deviates from the year in the main title of this table. Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 80% of member countries.
Source: Calculations based on data extracted from databases of the following organisations: OECD, IEA, ILO, IMF, World Bank.

Executive summary

The covid crisis hit a buoyant economy

The strong pre-COVID-19 economy boosted rapid convergence towards the OECD average incomes. An investment-friendly business climate helped attract foreign direct investment and integration in global-value chains.

Figure 1. Lithuania is converging rapidly



Source: OECD Economic Outlook database.

StatLink https://doi.org/10.1787/888934184814

The recovery will be uncertain. The COVID-19 recession was comparatively mild, and the economy is recovering. The government swiftly set up a programme supporting households and firms, representing almost 10% of GDP, and plans new investments to support long-term growth. The economy is expected to contract by 2% in 2020 and to rebound by 2.7% in 2021, and unemployment will rise to around 9%, yet protracted disruptions in world trade would be harmful for the outlook.

Poverty is high, especially among the unemployed, less educated, single parents and older people. The tax-benefit system is not very redistributive and its size below the OECD average. The government should increase social support while keeping work incentives.

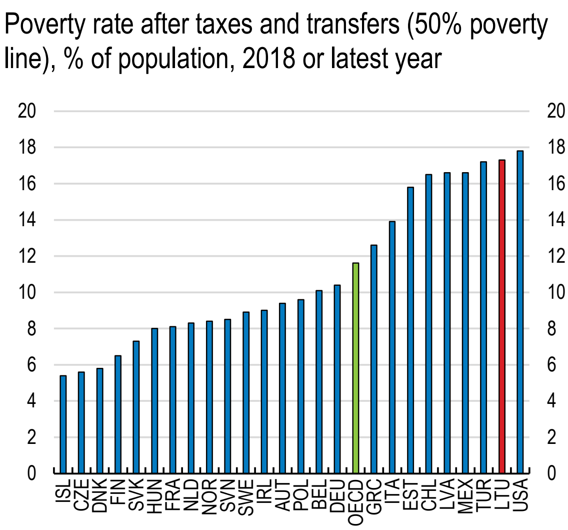
Regional disparities are increasing. Investment in peripheral regions is low and labour mobility towards economically strong areas insufficient. Productivity differences between core and peripheral regions are rising. The government should continue investing in rural areas while facilitating migration to more prosperous areas.

Table 1. The economy is projected to rebound

	2019	2020	2021
	Percentage changes, volume (2015 prices)		
GDP at market prices	4.3	-2.0	2.7
Private consumption	3.4	-3.2	2.8
Gross fixed capital formation	6.2	-6.6	3.8
Exports	9.5	-4.7	3.7
Imports	6.3	-6.9	5.5
Consumer price index	2.2	1.2	1.5
Unemployment rate	6.3	8.8	8.1
Government financial balance (% of GDP)	0.3	-8.9	-5.4
Current account (% of GDP)	3.5	5.2	3.9

Source: OECD Economic Outlook 108 database (provisional).

Figure 2. Poverty is high



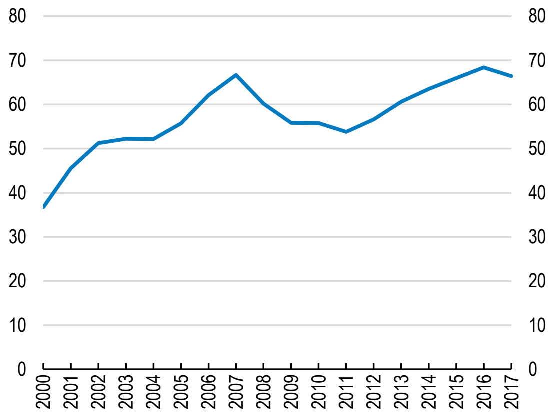
Source: OECD Income Distribution Database.

StatLink https://doi.org/10.1787/888934184833

Growth should be greener. CO2 emissions are below OECD average and declining, but mortality from exposure to fine particles is the highest in the OECD. Transport and energy are the main sources of emissions. Environmental taxation is low. The government set up a programme to co-fund private climate investment and wants to reach carbon neutrality by 2050. The government should also introduce a CO_2 tax.

Figure 3. Regional inequality is rising

Productivity gap between rural and urban areas, premium in GDP per capita, %



Source: OECD Regional database.

StatLink https://doi.org/10.1787/888934184852

Fiscal and financial policies are sound

Sound fiscal policy over the past years has created fiscal space to help the economy in the current crisis.

Fiscal policy is expansionary. The constitutional fiscal law of 2015 provides for tight surveillance. In 2019 the budget was in a small surplus. To help households and firms to weather the COVID-19 crisis, the government plans additional tax and spending measures totalling 10% of GDP. As a result, the balance is expected to turn sharply negative in 2020. Once fiscal positions have recovered, the government should simplify the fiscal framework and set a long-term debt target.

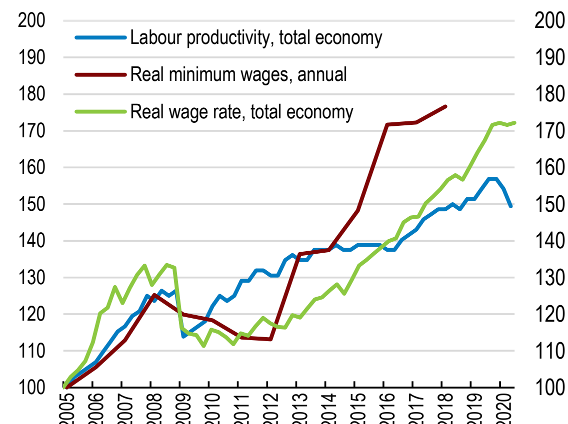
The COVID-19 crisis affects credit. About 40% of the corporate sector was affected by containment measures, exacerbating funding challenges especially for small firms. Non-performing loans in the banking sector declined markedly, and frequent use of macro-prudential regulation helped strengthen financial stability. The government eased financial conditions following the COVID-19 crisis and should continue to do so.

Reforming state-owned enterprises could boost the recovery

Wages grew faster than productivity over the past few years, reducing competitiveness while boosting lower incomes. Reforming state-owned enterprises could help raise productivity.

Figure 4. Competitiveness is declining

Index, 2005 = 100



Source: Economic Outlook database; and OECD Earnings database.

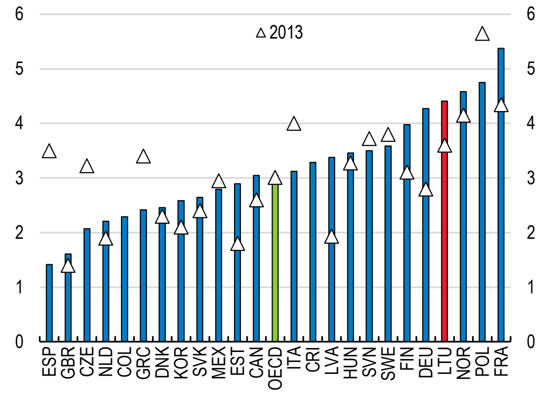
StatLink https://doi.org/10.1787/888934184871

State-owned enterprises are oversized. The scope of state-owned enterprise (SOE) belongs to the largest in the OECD. Governance has improved over the past two years following the adoption of the 2018 “SOE Reorganisation and Optimization Plan”, but remains weak against OECD standards. Only half of the SOEs reach their targets. A clearer strategy defining the rationale for public ownership is needed, and SOEs should be subject to same regulations and market constraints as private companies.

Municipal SOEs pose a particular challenge. Around 250 municipal enterprises are active across 40 sectors, ranging from energy supply, waste treatment to local public transport, with few limits set on their scope. Municipal SOEs often compete with private providers and cross-subsidise corporate activities with revenues from publicly supported ones, distorting competition. The government should strengthen the regulatory framework for municipal enterprises, by establishing a level playing field between public and private providers.

Figure 5. State-owned enterprises proliferate

Scope of public ownership, Index from 0 to 6 (greatest scope), 2018



Source: OECD Product Market Regulation database.

StatLink https://doi.org/10.1787/888934184890

Education should foster strong and relevant skills

Strong and relevant skills could help accelerate the recovery and reduce inequality across regions and income groups. The education infrastructure should better adapt to higher skill needs and shrinking student numbers.

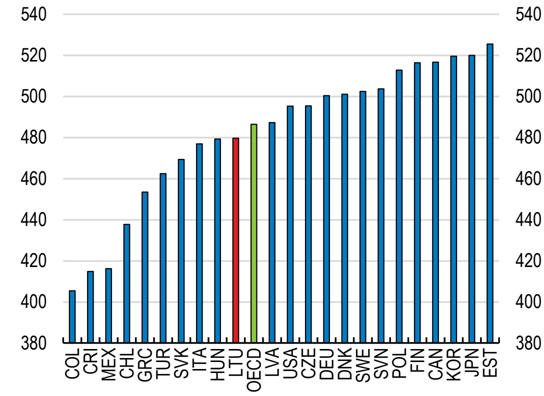
Performance of primary and lower secondary education is weak. Spending on infrastructure is excessive, reflecting high spending on overly small schools. School performance lacks systematic oversight. Recent reforms were rather shy, mainly involving an increase in teacher salaries. The government should merge small schools and strengthen quality oversight.

Vocational education fails to provide relevant skills. The school network often lacks scale and specialisation. Firm-based learning (apprenticeships), introduced in 2016, still attracts few students. Reform should improve VET, including apprenticeships, thereby strengthening links to the labour market.

Tertiary education is fragmented. Recent attempts to consolidate the university network failed or did not bring the expected results. Funding provides few incentives to improve quality. The government should encourage universities to specialise in fewer areas. More rigorous quality assessment and a funding reform could also help improve quality.

Figure 6. School outcomes are weak

PISA scores, average, 2018



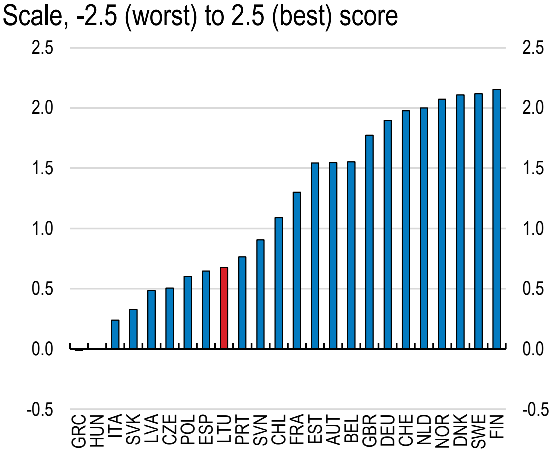
Source: PISA 2018 database.

StatLink https://doi.org/10.1787/888934184909

Reforms to increase public integrity should bear fruit. Indicators of control and perceived risks of corruption suggest performance below OECD averages. Sectors with corrupt practices include health care and public procurement. In 2019 the shadow economy shrank after rising during four consecutive years. Recent policy measures to prevent foreign bribery have been impressive. Public integrity should remain a guiding principle in the government's efforts to implement the 2015-2025 anti-corruption programme.

Figure 7. Control of corruption remains below OECD average

Scale, -2.5 (worst) to 2.5 (best) score



Source: World Bank Worldwide Governance Indicators.

StatLink https://doi.org/10.1787/888934184928

MAIN FINDINGS	KEY RECOMMENDATIONS
Policies to support the recovery	
The COVID-19 crisis has affected economic activity and household incomes, exacerbating funding challenges for the corporate sector.	Continue providing temporary support to households and firms, while helping to reallocate resources to viable firms.
Financial and fiscal policies	
The asymmetric fiscal rule (two-regime rule), relying on potential output, causes frequent revisions to fiscal planning.	Simplify the fiscal framework and establish a long-term debt target.
Public investment is low.	Increase public investment against rigorous cost-benefit analysis.
Structural policies	
The scope of state-owned enterprises is large and governance lags behind OECD standards.	Strengthen the governance of state-owned enterprises further. Sell to private investors if no compelling reasons for public ownership exist.
Green growth policies	
The economy's carbon imprint is considerable, while environmental taxation is below the OECD average.	Introduce a carbon tax in sectors not covered by the European emission trading system, and reimburse at least partially the proceeds to households and firms.
Fossil fuel subsidies belong to the highest in the OECD.	Remove environmentally damaging fuel subsidies.
Reducing poverty and social disparities	
Social spending is comparatively low and the provision of cash benefits and social services is not closely linked to the needs of vulnerable groups.	Further increase the level of minimum-income benefits, while maintaining work incentives. Increase gradually social assistance pensions, while strengthening means-testing. Better tailor the provision of social benefits and services to individuals' needs.
The long-term care services do not effectively reach the elderly population.	Move to an integrated model of long-term care provision, with a focus on home-care for the elderly.
Access to early childhood education and care is not ensured for all children.	Continue the expansion of early childhood education and care, with a special emphasis on children from disadvantaged background and rural areas.
Activation policies need to strengthen to facilitate labour market integration of those out of work with high poverty rates.	Increase spending in active labour market programmes, upon a close monitoring of their outcomes and a focus on training programmes.
Fostering regional growth	
PISA scores are weak, especially in small rural schools.	Improve educational outcomes by reforming the school network and by strengthening supervision.
Vocational education and training is little developed, contributing to skills mismatch especially in rural areas.	Foster and improve vocational education and training, and strengthen firm-based learning (apprenticeships).
The housing rental market is very small, discouraging mobility.	Revise rental legislation by clarifying the rights of tenants and landlords.
Policy coordination between municipalities is weak, driving cost and reducing public service quality.	Implement functional regions as planned and provide them with power to coordinate investment and public services across municipalities.

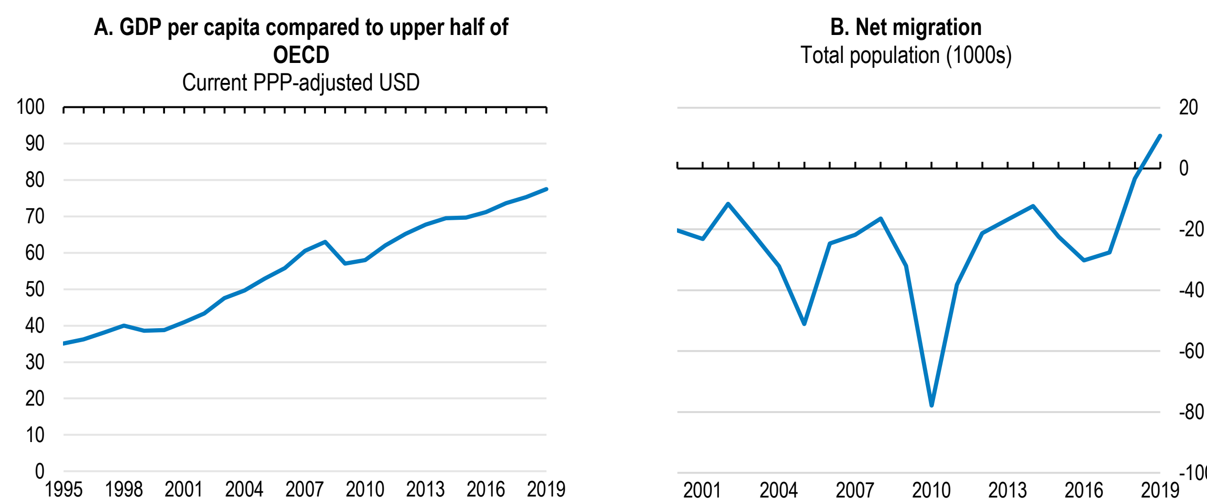
1 Key policy insights

Introduction

Lithuania has gone through a comparatively mild COVID-19 crisis so far. The number of victims remained low thanks to effective containment measures and a well-functioning health system. The lockdown was rather short and lenient. The economy dived less than in almost any other European country and seems to recover fast. Some sectors suffered more such as manufacturing and transport, given still weak export markets and the country's role as a transport hub between Eastern and Western Europe. A surge of new infections and the reintroduction of travel restrictions since end-August dents the outlook further. Before the pandemic, the economy showed a strong performance and was rapidly converging towards the OECD upper half, driven by rapid export and investment growth supported by several key policy initiatives. With income prospects brightening up further, net migration turned positive for the first time since renewed independence (Figure 1.1; Box 1.1).

The government swiftly provided emergency funds for the health care system as well as financial and fiscal support to households and firms with the aim to preserve incomes and jobs, representing around 10% of annual GDP. In May the government extended support, in particular short-term work schemes and additional unemployment benefits, until the end of the year. The central bank's liquidity assistance programme helped maintain financial stability. Support is now being gradually wound down, giving way to more targeted programmes. To stimulate supply and long-term growth after the crisis, the government is stepping up a multi-annual investment programme covering education, innovation and research, digital transformation, infrastructure and a climate and energy action plan, amounting to another 4.5% of GDP and with a focus on balanced development across Lithuania's regions. A sound macroeconomic framework and a business-friendly climate is supporting these policies.

Figure 1.1. Lithuania is converging rapidly, and migration flows have turned positive



Source: OECD Economic Outlook 107 database; and Statistics Lithuania.

StatLink https://doi.org/10.1787/888934184947

Box 1.1. The government's key policy initiatives

The government has followed up on the "new social model" reforms of 2016-18, which thoroughly revamped labour markets, pensions and taxation. Key new initiatives until summer 2020 include:

- The adoption of new insolvency legislation, which makes the framework from one of the most restrictive and burdensome to one of the most open and balanced of the OECD.
- An increase in income taxation for high-income earners and a reduction of social security contributions, bringing higher tax progressivity, and additional tax deductibility for payments into pension funds. A one-off tax amnesty and the introduction of tax deductibility of personal services aims at fighting tax evasion better.
- A reform of the innovation system to raise productivity and competitiveness, which strengthens the digital transformation of the industry, helps develop a start-up ecosystem, and provides additional support for selected sectoral activities. The support system was streamlined and additional R&D tax incentives are granted.
- A change in the funding of general education, giving more weight to class size, student needs and test scores. Salaries of teachers at all levels were increased, teacher education improved and the quality of vocational education and training schools strengthened.
- Gradual deregulation of electricity prices and the creation of a gas exchange market.

In the health sector, the salaries of medical staff were considerably increased and service quality – e.g. shorter waiting times – improved, although the planned reorganisation of small municipal hospitals, as recommended in the last Survey, continued only slowly.

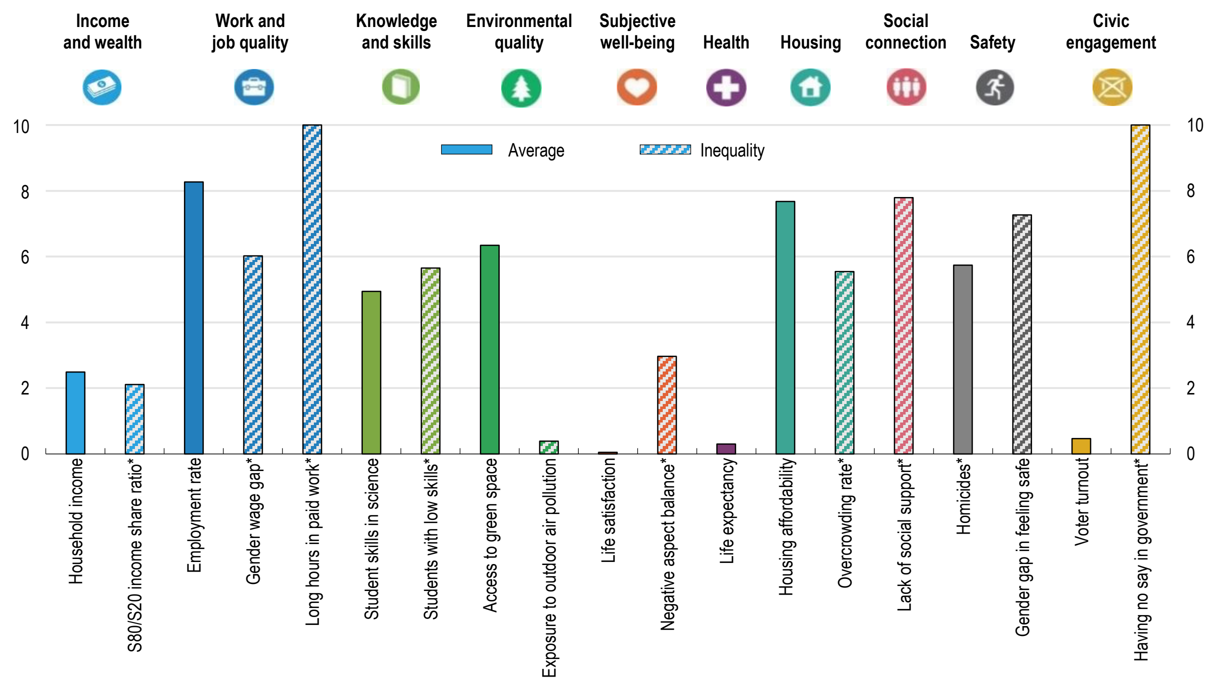
Source: (OECD, 2018[1]), (Government of Lithuania, 2019[2]), questionnaire responses.

However, the COVID-19 crisis laid bare some weaknesses of Lithuania's economy, in particular the uneven distribution of prosperity across people and places. Income inequality and poverty rates are among the highest in the OECD, although wealth inequality is comparatively low because of a high homeownership rate (Figure 1.2). Despite recent reforms that made the benefit system more effective especially for families and taxation more progressive, and despite a recent decline, the share of poor households remains elevated. The elderly, disabled, lone parents, the less educated and unemployed, are among the most vulnerable groups, facing poverty rates well above the overall population. Regional differences in income, productivity and unemployment are among the highest in the OECD despite the small size of the country, and they continue to rise. Growth is concentrated in a few urban agglomerations and resorts along the Baltic coast, while many rural and more peripheral areas stagnate, with emigration often the only way to escape poverty. Other areas where Lithuania fares below OECD average is general life satisfaction, housing quality, and the level of skills and education.

Against this background, the Survey sends the following key messages:

- Maintain resilient and sustainable growth, by improving skills, strengthening the regulatory framework, and moving towards a low-carbon economy.
- Reduce poverty, by ensuring adequate income support for the needy and high quality social services, while helping the transition out of poverty and into the labour market.
- Foster regional convergence, by strengthening regional institutions and fostering mobility of people towards economically stronger regions.

Figure 1.2. High inequality drives low well-being



Note: This chart shows Lithuania's relative strengths and weaknesses in well-being compared to other OECD countries. Longer bars always indicate better outcomes (i.e. higher well-being), including for negative indicators (marked with "*"), which have been reverse-scored. Inequalities (indicators plotting gaps between top and bottom, differences between groups, and people falling under a deprivation threshold) are shaded with stripes. Indicators are normalised using a min-max benchmarking method, with the three top and bottom performers held constant.
Source: OECD Better Life Index.

StatLink https://doi.org/10.1787/888934184966

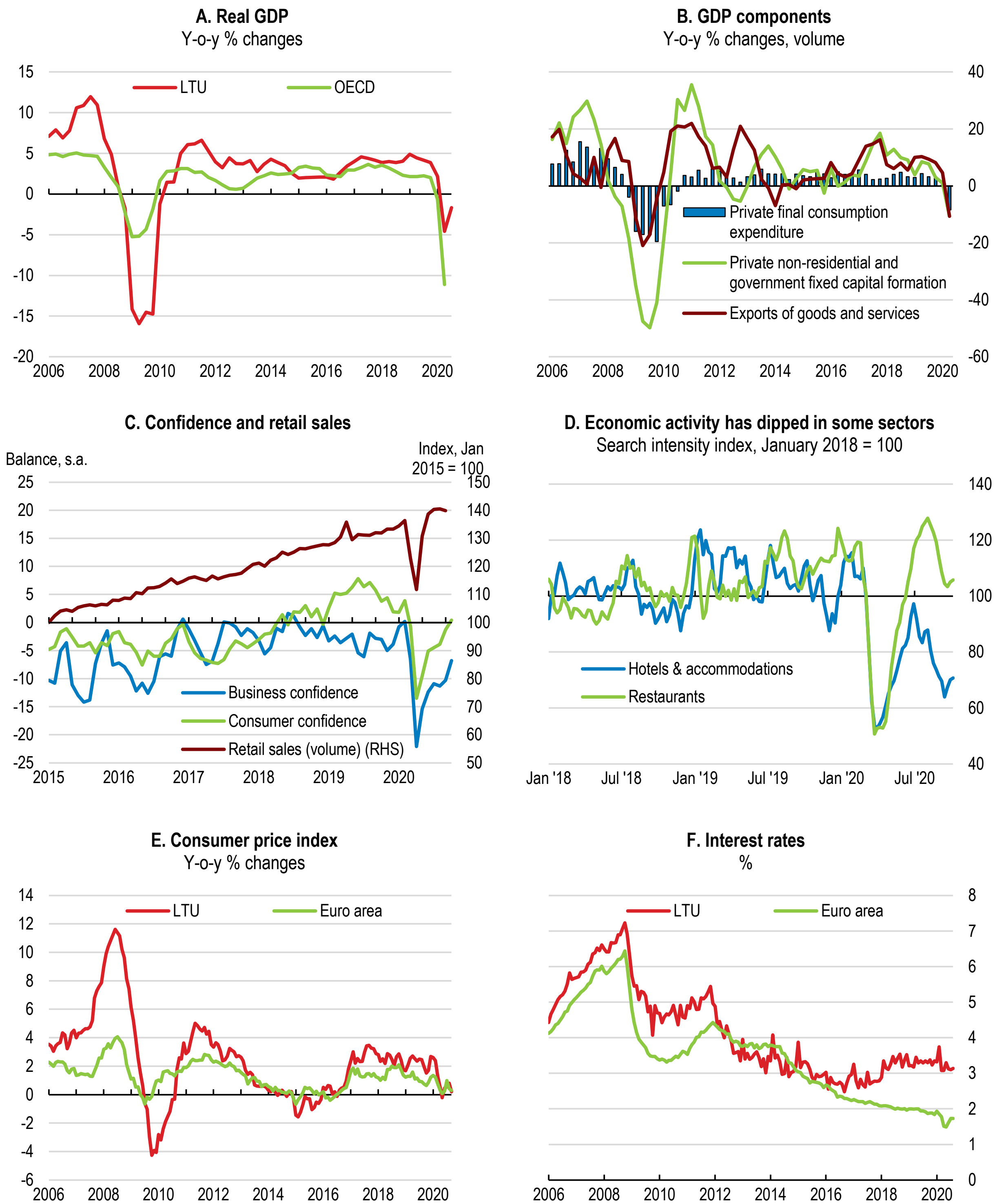
Recent developments and short-term prospects

The economy held up well during the pandemic-related crisis, yet risks to recovery remain

The outbreak of the COVID-19 pandemic has affected the course of the economy but the impact has been comparatively mild (Figure 1.3). Containment measures, heightened uncertainty and deteriorating external environment triggered a decline in activity in the second quarter of 2020. Service sectors, especially tourism, felt the impact of the crisis most. The dip was short-lived, however. Retail sales and consumer confidence rebounded fast once the confinement measures started to be eased in mid-April and industrial confidence has improved from the spring's slump. The deceleration in export growth has also slowed. The resurgence of the pandemic and the introduction of new measures appear to have an impact on economic activity according to some high frequency indicators, such as mobility data. Investment is supported by public spending but also faces headwinds from the still weak domestic and external demand. Headline inflation receded as oil prices fell.

After a comparatively mild contraction of 2% in 2020, economic activity is projected to return to a positive growth in 2021. While the economy seems to be on the path of recovery and confidence has rebounded from its lows in early 2020, uncertainty remains high and export markets weak. Policy measures (Box 1.2) and the implementation of EU-funded projects and the multi-annual public investment project will provide support to activity. GDP is expected to grow by 2.7% in 2021 (Table 1.1).

Figure 1.3. The pandemic had a relatively mild impact on the economy



Note: Panel D: most recent observations are for 20 October 2020. Online search categories encompass various keywords and are harmonised across languages. Results show a three-week moving average of search intensity indexed to January 2018. Panel F shows the annualised agreed rate on loans of less than, or equal to, 1 million euros to non-financial corporations (excluding revolving loans and overdrafts, convenience and extended credit card debt).

Source: OECD Economic Outlook 107 database; OECD Main Economic Indicators; and Google Trends data and OECD calculations.

StatLink https://doi.org/10.1787/888934184985

Box 1.2. The government introduced a broad stimulus package in response to the crisis

The government announced an overall package of EUR 5 billion (10% of GDP) on 16 March 2020, equally split between fiscal and financial support. The fiscal initiative entails funds for the health care system and emergency management, as well as measures to preserve jobs and incomes, maintain business liquidity and stimulate the economy. The initiative includes short-time work schemes and support for non-standard workers (Chapter 2). Other measures were loan and tax payment deferrals, soft loans to eligible small firms and temporary rental subsidies to businesses. To help the economy recover, special attention is given to the acceleration of investment programmes, including co-financing of private climate investment. Additional fiscal measures of around 2% of GDP were approved in May 2020 to support businesses and households after the end of confinement. The central bank lowered its counter cyclical capital buffer in March 2020 and is also taking a more flexible approach regarding some capital and liquidity requirements imposed on banks (discussed below), in addition to the ECB's accommodative monetary policies. To help the recovery and ensure robust growth over the longer-term, the government is stepping up a multi-annual investment programme (DNA Plan for the Future) that aims to create the conditions for a qualitative transformation of the economy. The investment package covers the areas education, innovation and research, digital transformation, infrastructure and climate and energy, with expenditure on new investment amounting to 4.5% of GDP.

Source: Ministry of Finance and Ministry of Labour and Social Security.

Projections are subject to substantial uncertainty and risks. Return to normal is closely related to economic developments in Lithuania's trading partners, given high export dependence, as well as to domestic demand which could be affected by high unemployment. The economy may further confront unforeseen events, including protracted disruptions in world trade that would be particularly harmful for the outlook (Table 1.2).

Table 1.1. Macroeconomic indicators and projections

	2016	2017	2018	2019	2020	2021
	Current prices (EUR billion)	Percentage changes, volume (2015 prices)				
GDP at market prices	38.9	4.3	3.9	4.3	-2.0	2.7
Private consumption	24.5	3.5	3.7	3.4	-3.2	2.8
Government consumption	6.6	-0.3	0.2	0.1	5.9	4.7
Gross fixed capital formation	7.7	8.9	10.0	6.2	-6.6	3.8
Final domestic demand	38.9	3.9	4.4	3.4	-2.4	3.4
Stockbuilding[1]	-0.3	-1.3	-1.1	-1.5	-0.9	0.2
Total domestic demand	38.6	2.6	3.3	2.0	-3.4	3.8
Exports of goods and services	26.3	13.5	6.8	9.5	-4.7	3.7
Imports of goods and services	26.0	11.1	6.0	6.3	-6.9	5.5
Net exports[1]	0.3	1.7	0.7	2.5	1.4	-0.9
Other indicators (growth rates, unless specified)						
Potential GDP	_	2.4	3.0	3.0	2.8	2.8
Output gap[2]	_	-0.6	0.4	1.6	-3.0	-3.1
Employment	_	-0.5	1.5	0.3	-2.1	0.4
Unemployment rate (% of labour force)	_	7.1	6.1	6.3	8.8	8.1
GDP deflator	_	4.2	3.5	2.8	1.1	1.5
Harmonised index of consumer price index	_	3.7	2.5	2.2	1.2	1.5
Harmonised index of core inflation[3]	_	2.6	1.9	2.3	2.7	1.6
Household saving ratio, net (% of disposable income)	_	-3.7	-3.6	0.6	6.9	5.6
Current account balance (% of GDP)	_	0.6	0.2	3.5	5.2	3.9
General government financial balance (% of GDP)	_	0.5	0.6	0.3	-8.9	-5.4
Underlying government financial balance[2]	_	0.6	0.5	-0.3	-7.7	-4.2
Underlying government primary financial balance[2]	_	1.7	1.3	0.5	-6.8	-3.4
General government gross debt (% of GDP)	_	47.0	40.7	44.5	53.6	58.1
General government debt, Maastricht definition (% of GDP)	_	39.1	33.7	35.9	45.0	49.5
Three-month money market rate, average	_	-0.3	-0.3	-0.4	-0.4	-0.5
Ten-year government bond yield, average	_	0.3	0.3	0.3	0.2	0.2

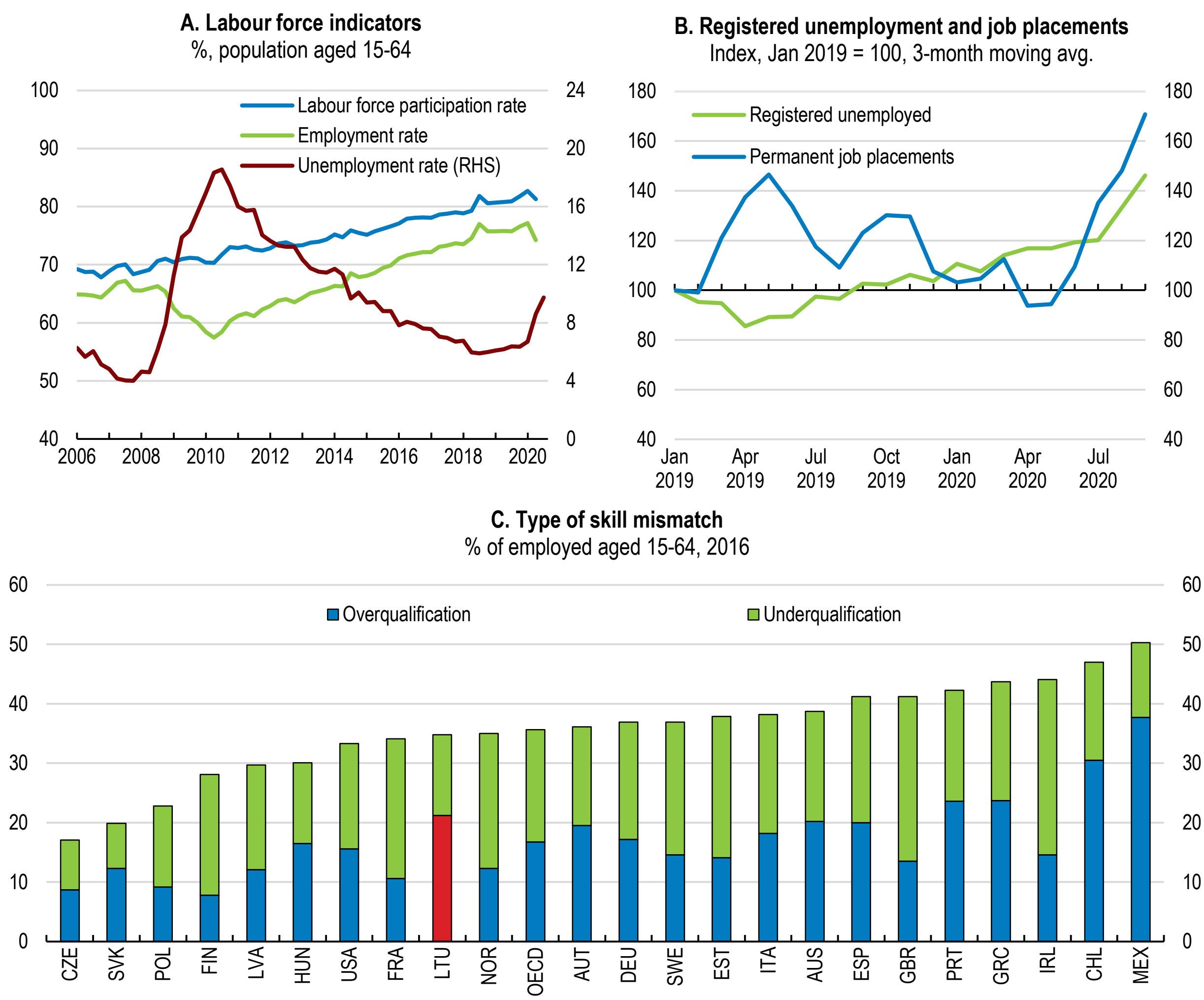
1. Contributions to changes in real GDP, actual amount in the first column.
2. As a percentage of potential GDP.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 108 database (provisional).

Table 1.2. Events that could entail major changes to the outlook

Shock	Potential impact
Protracted disruptions in world trade	Prolonged weakness in external demand and disruptions in supply chain, and geopolitical events in and around Europe, especially related to Russia and Belarus, would curb exports and weaken confidence and investment
Financial market turbulence	An increase in non-performing loans and a sharp correction in housing markets could cause financial duress. Turbulences in the Nordic banking system could put Lithuania's banking sector under pressure.
Prolonged period of pandemic	A more protracted pandemic period would compound health and economic risks, given the interconnectedness of economies.

The labour market, which showed signs of overheating before the crisis, was severely hit (Figure 1.4). Registered unemployment increased by 2.4 percentage points between mid-March (beginning of the quarantine) and end-April. The rise might have been sharper without short-time work schemes (Box 1.2). Net international migration became positive in 2019 due to the favourable situation in Lithuania, changes in migration policy, and probably Brexit (Bank of Lithuania, 2019[3]) (Figure 1.1). It slowed in April, however, affected by mobility restrictions and a decline in labour demand. Unemployment is projected to decline but remain above the pre-crisis level in 2021, given hysteresis effects. Large skills mismatch and labour shortages, especially of highly qualified workers, may also slow the adjustment of the labour market, even though improving migration trends and larger labour market slack reduce pressures.

Figure 1.4. The labour market was strong before the crisis

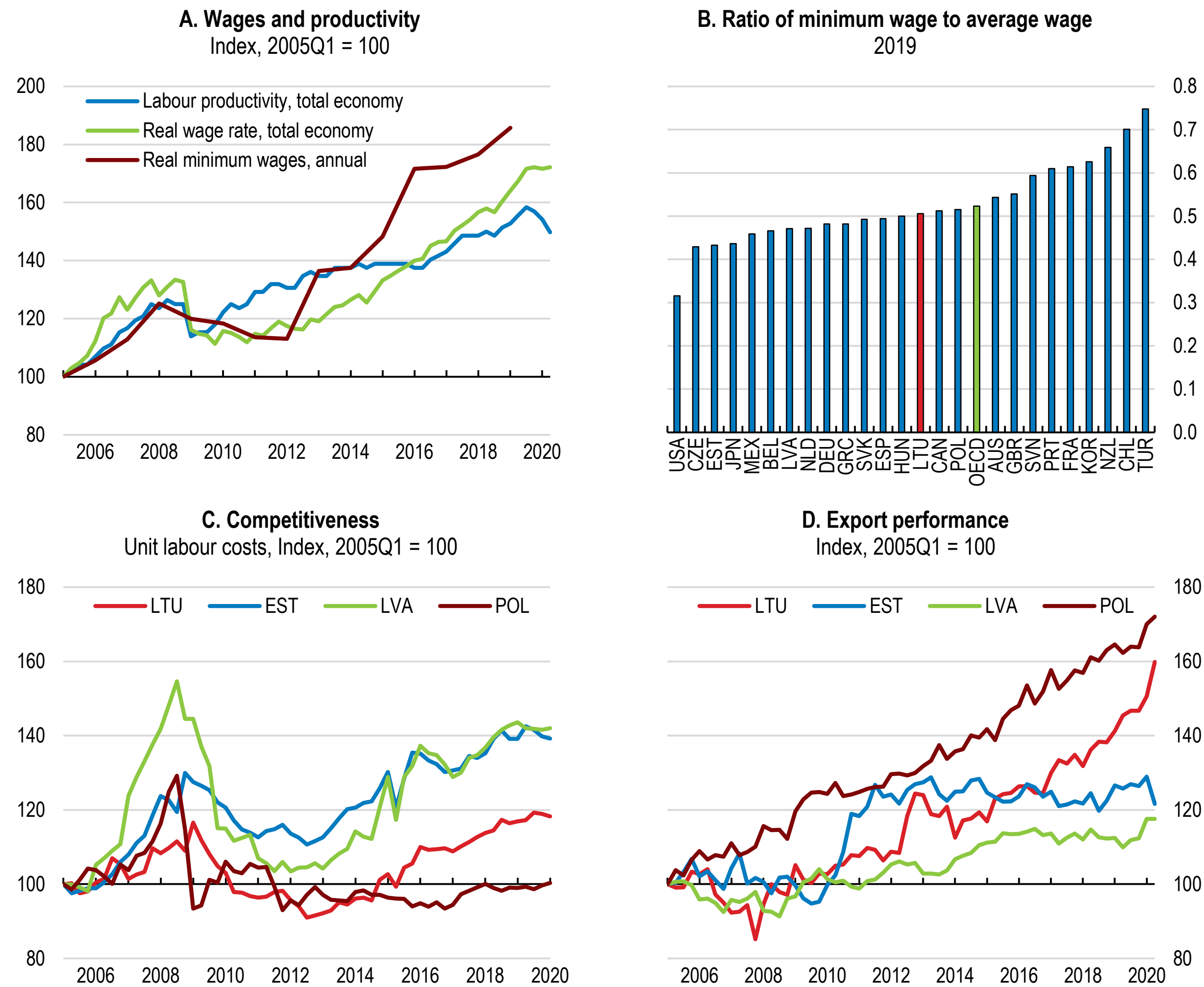


Source: OECD Labour Force Statistics; Ministry of Social Security and Labour; and OECD Skills for Jobs database.

StatLink https://doi.org/10.1787/888934185004

Wages were growing rapidly before the pandemic (Figure 1.5). Minimum wages increased by almost 2.5 times between 2009 and 2019, bringing the ratio of the minimum to the median wage close to OECD average. The COVID-19 crisis is expected to reduce wage pressure due to increased unemployment and weak consumer demand. Recent wage data for the accommodation sector and food service activities and real estate sectors show a considerable slowdown in wage growth in the first quarter 2020 (Ministry of Finance, 2020[4]). Wage developments need to be closely watched to ensure that vulnerable groups are not affected disproportionally by the crisis. At the same time, competitiveness needs to be maintained. High wage growth did not bear, so far, on export performance, but relative unit labour costs have been trending up. Against this background, in-work benefits would be a more appropriate tool than increases in minimum wages, to tackle poverty issues (Chapter 2).

Figure 1.5. Wages grew fast in recent years



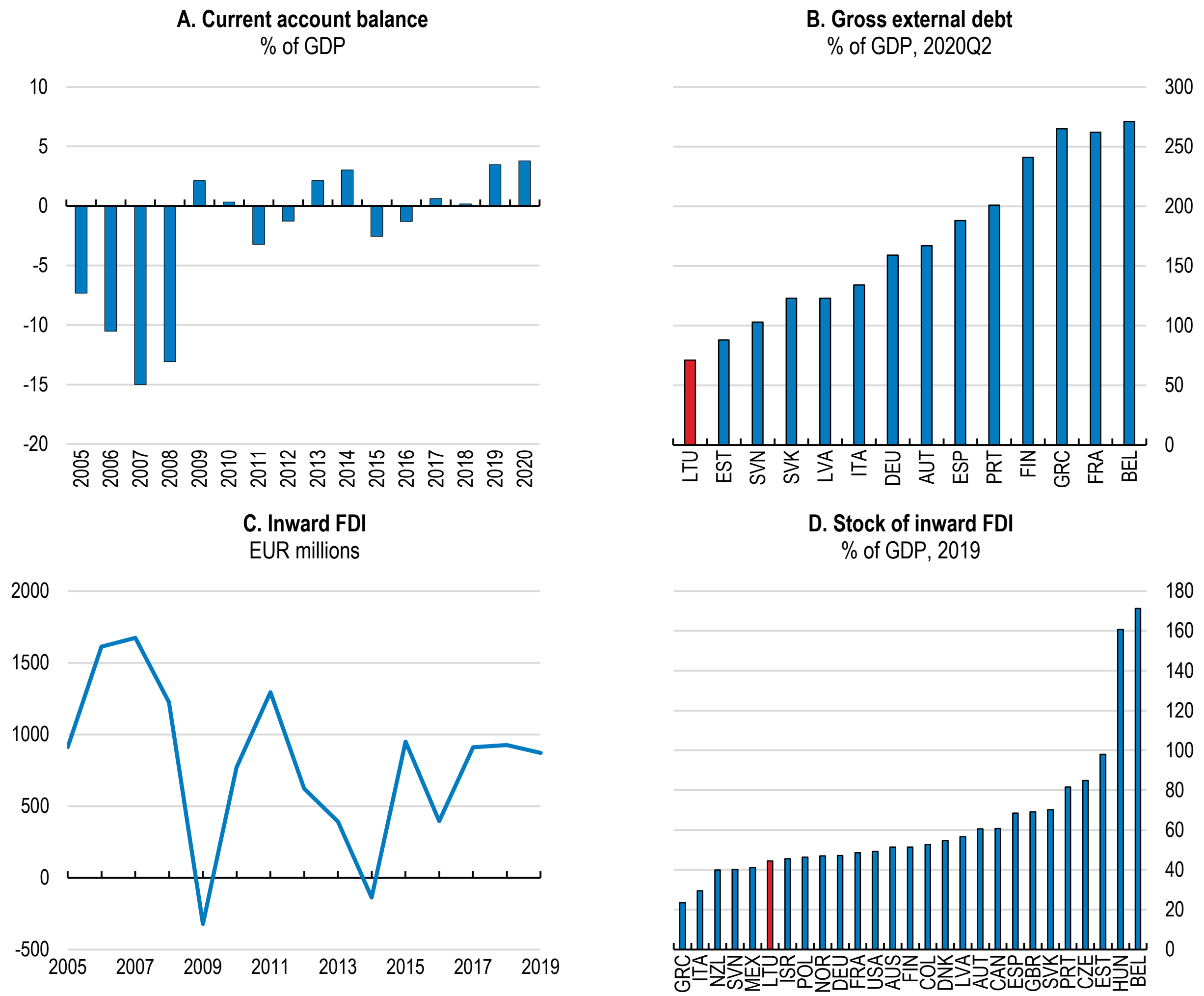
Note: Panel A: real minimum wage data are PPP-adjusted.
Source: OECD Earnings database; OECD Economic Outlook 107 database; and Eurostat.

StatLink https://doi.org/10.1787/888934185023

External positions appear sustainable with total foreign debt less than 70% of GDP at end-2019 and the net international investment position on an improving trend (IMF, 2019[5]) (Figure 1.6). The current account became positive in 2017, with the surplus increasing to over 4% of GDP in 2019 driven by strong exports of services, particularly transport. The balance remained in surplus in the first half of 2020. Before the COVID-19 crisis foreign direct investment (FDI) trends were encouraging, with the number of greenfield projects increasing by 25% in 2018 compared to the previous year. The inward FDI stock, however, remains low in international comparison given that many projects in recent years concerned shared services centres, which require little capital expenditure and hence do not contribute much to FDI stock. The crisis raises additional risks, as business confidence and appetite for investment have weakened.

Improving the business environment to attract FDI remains important. More FDI would help foster knowledge transfer and increase productivity which is essential for fast convergence.

Figure 1.6. External positions appear sound

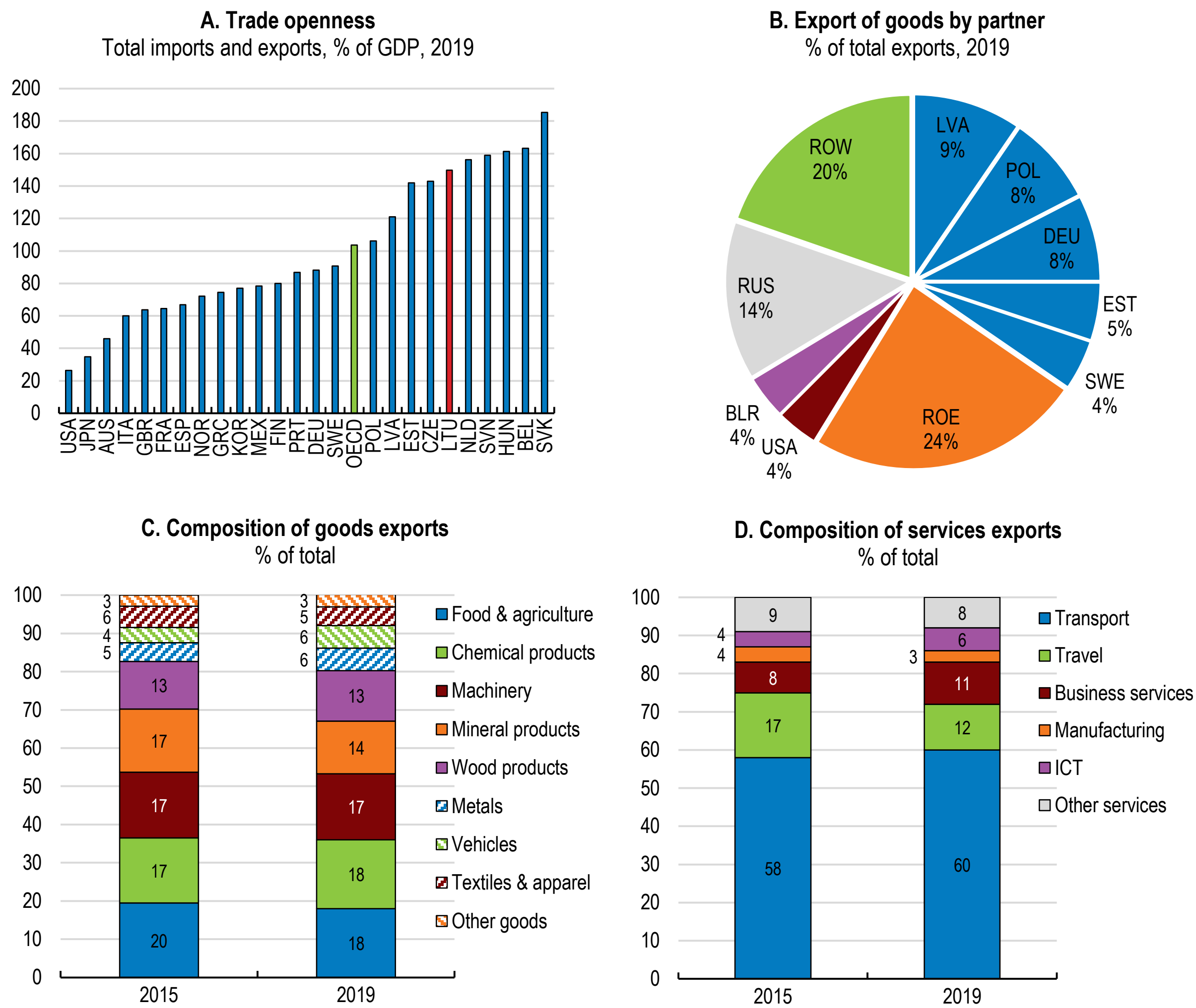


Source: OECD Economic Outlook 107 database; European Central Bank; Bank of Lithuania; and IMF Balance of Payments database.

StatLink https://doi.org/10.1787/888934185042

Trade openness is high, but exports have relied on low-medium technology and resource-intensive goods, and on less-knowledge-intensive services such as transportation (Figure 1.7). The export structure has not changed much over the last decade, with the domestic value-added content of total exports having stabilised at around 60%, according to official estimates. Lithuanian exports have been mostly low-complexity goods. The share of exports of more complex goods (mostly machinery, equipment and vehicles) remains relative small, with low and medium complexity goods accounting for the largest share (Bank of Lithuania, 2019[3]), and some recent export indicators point to new dynamism in integration to global value chains. Progress towards rising complexity of exports could help deepen integration in global value chains, boosting productivity. The National Progress Plan for 2021-2030 aims to promote exports of higher added value products, including high-tech goods and knowledge-intensive services.

Figure 1.7. The export structure has changed little over the past decade



Source: OECD Economic Outlook 107 database; OECD STAN database; Eurostat; Statistics Lithuania; and Bank of Lithuania.

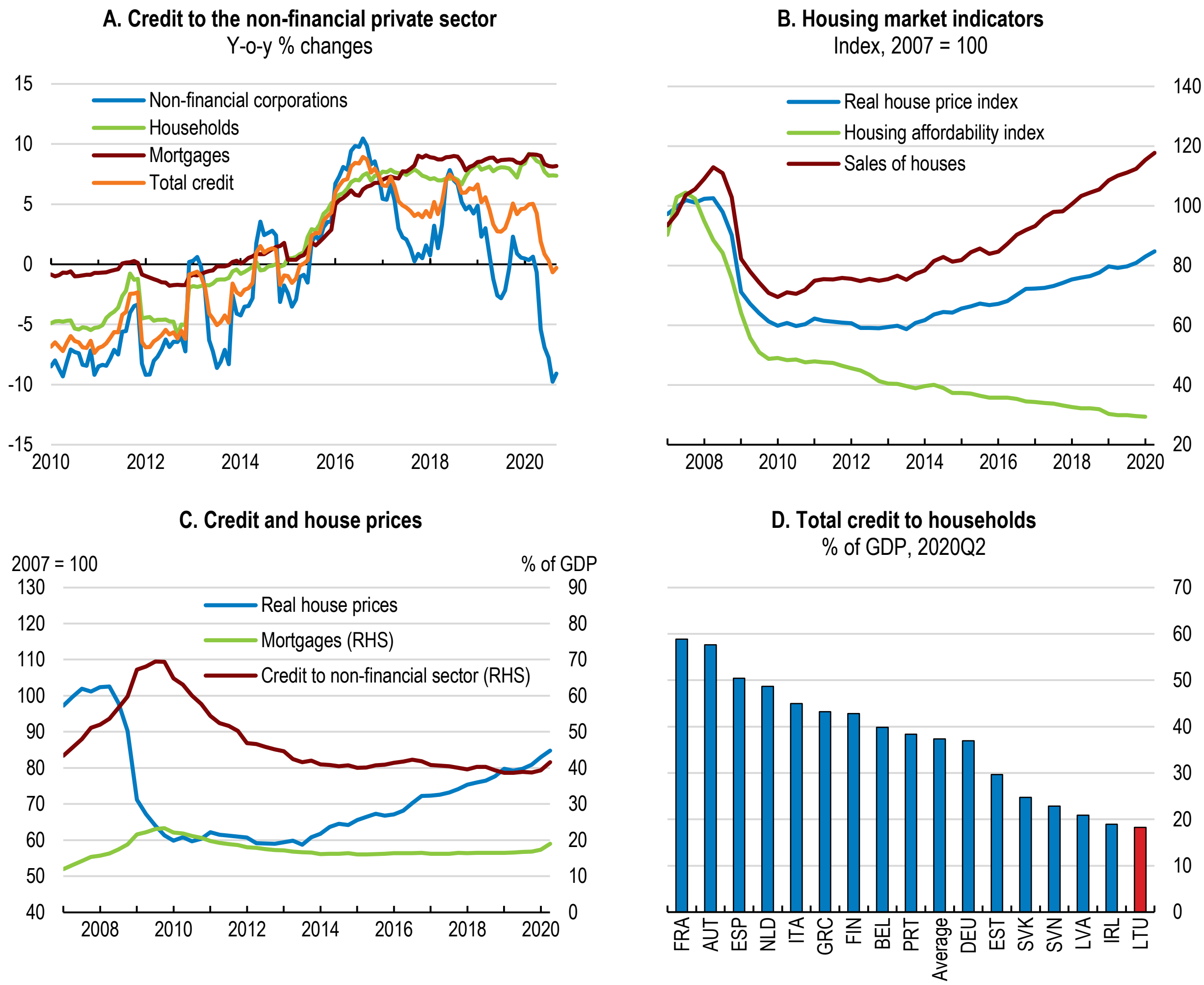
StatLink https://doi.org/10.1787/888934185061

The financial system appears solid, but the COVID-19 crisis poses challenges

The crisis affects credit developments

The COVID-19 outbreak is exposing vulnerabilities mostly in the corporate sector. Credit to households has been expanding robustly before the crisis, reflecting a rapid growth in housing loans, while business lending continued to contract (Figure 1.8). The financial leverage of domestic businesses increased, however, driven by funding from alternative sources such as trade credits and loans extended by other firms (Bank of Lithuania, 2020[6]). Corporate debt amounted to around 40% of GDP in 2019. The containment measures put in place at the onset of the crisis have affected firms through losses in revenue. Approximately 40% of the corporate sector have been directly affected by the lockdown, according to official estimates (Bank of Lithuania, 2020[6]). This, coupled with considerable uncertainty about the economic outlook, has resulted in a slower pace of expansion of credit to the non-financial corporate sector, especially for small firms, and exacerbated pre-existing funding challenges. The close financial links among firms in Lithuania, following increased non-bank funding by the corporate sector, aggravate the pressures. Although the housing market froze after the onset of the crisis in late March, the growth of household lending remains solid (Figure 1.8). Still house prices remained stable.

Figure 1.8. Credit and housing indicators were robust before the crisis



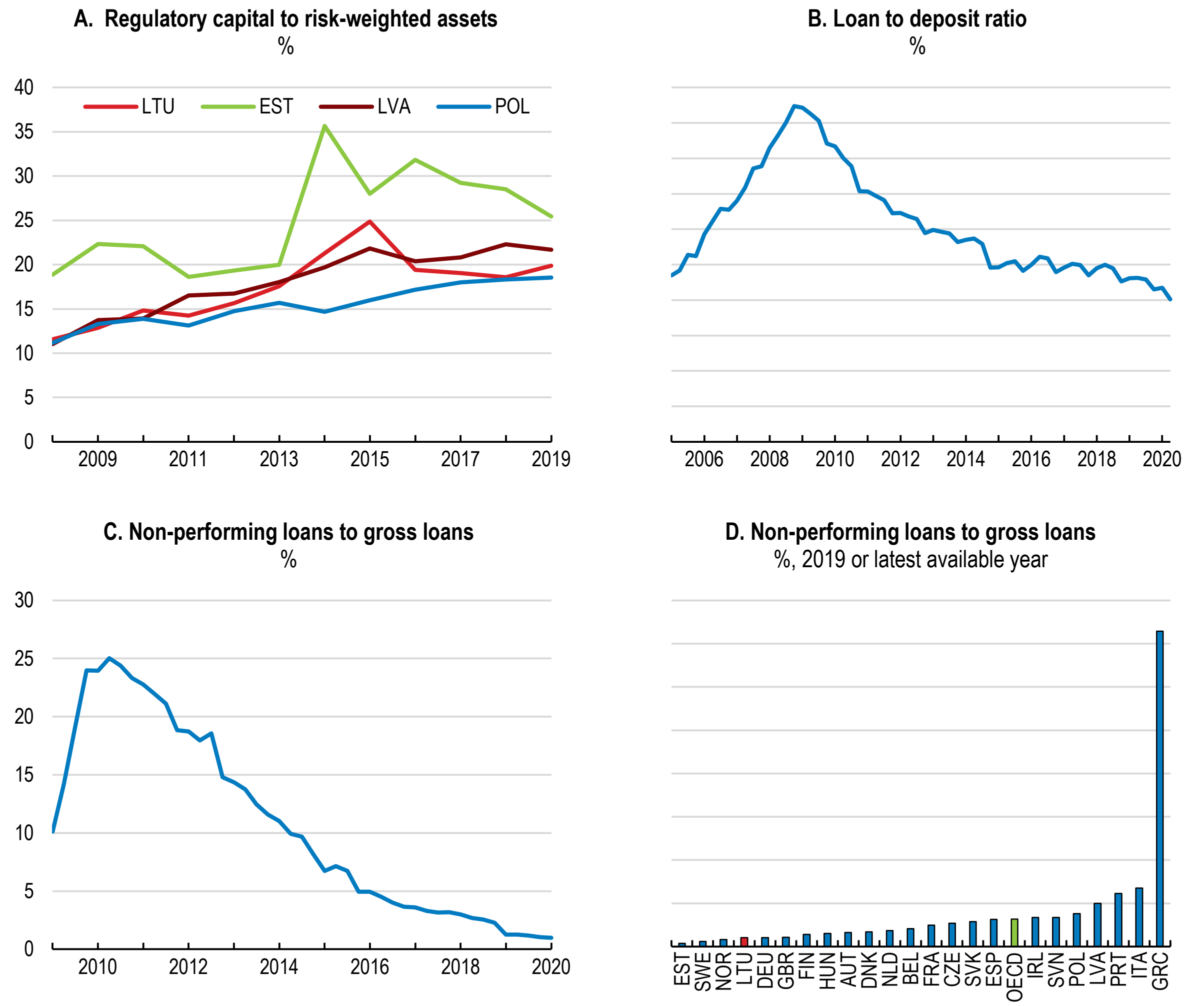
Note: Panel B: the housing affordability index is calculated by dividing the average annuity housing loan instalment by average net wage.
Source: OECD Housing Price database; European Central Bank; and Bank of Lithuania.

StatLink https://doi.org/10.1787/888934185080

The banking sector appears well prepared to cope with the crisis but vigilance is needed

Over the years, Lithuanian banks have increasingly relied on deposits for funding, and asset quality has been improving (IMF, 2019[5]) (Figure 1.9). The marked decline in NPLs over the past decade or so mirrors the improvements in credit quality and buoyant economic conditions. Financial stability has been strengthened since the 2009 global crisis through greater use of macro-prudential regulations, including through the establishment of buffers for countercyclical capital requirements and important domestic institutions which are readjusted on a periodical basis, as well as requirements based on loan-to-value ratios, debt-service-to-income ratios, loan maturity indicators for borrowers (OECD, 2018[7]).

Figure 1.9. Performance indicators suggest that the financial system is resilient



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

StatLink https://doi.org/10.1787/888934185099

Since the onset of the crisis several measures have been taken to shore up the credit market. The central bank lowered its counter-cyclical capital buffer from 1% to 0% in March 2020 and is also taking a more flexible approach regarding some capital and liquidity requirements imposed on banks (Box 1.3). Solvent financial institutions facing temporary liquidity problems can apply to the Bank of Lithuania for emergency liquidity assistance. These initiatives add to the ECB’s accommodative monetary policies. As in other countries, support measures have included a variety of loan and mortgage payment forbearance (OECD, 2020[8]). Going forward, financial conditions should remain accommodative and support the recovery, continuing to provide temporary liquidity support to viable firms.

Box 1.3. Financial measures to counter the effects of the crisis

The key measures taken by the Bank of Lithuania to shore up credit in response to the crisis include:

- Macro-prudential measures: The countercyclical capital buffer was lowered from 1% to 0% as of 1 April 2020, and the end-date of the phase-in period for O-SII capital buffers was postponed by one year.
- Micro-prudential measures: Credit institutions are encouraged to review dividend polices and abstain from paying dividends in 2020, and a more flexible approach is taken in terms of some capital (e.g. Pillar 2 guidance, combined buffer requirement, composition of Pillar 2 requirement) and liquidity requirements, as well as requirements for NPL strategies imposed on directly supervised credit institutions.
- Monetary policy measures: A number of policy measures adopted by the Eurosystem have been implemented, including an increase in government bond purchases and some easing of collateral eligibility for use in monetary policy operations. In addition, on 30 March 2020 Parliament amended the Law on the Bank of Lithuania, enabling the central bank to grant emergency liquidity loans not only to credit institutions but also to other financial institutions experiencing liquidity problems.
- Other measures include deferrals of mortgage loan payments for up to one year, and leasing and consumer loans for up to half a year (deferrals apply to the principal only, not interest payments). In addition, voluntary agreements were reached on deferrals of corporate loans repayments for up to 6 months, without changing contract terms and interest rates.

Source: Bank of Lithuania.

The COVID-19 crisis can affect financial stability. Non-financial corporations facing liquidity problems may become insolvent, putting pressure on banks through an increase in non-performing loans. Households also may find it difficult to honour their obligations due to income losses, with consumer loans raising particular risks for creditors. The Bank of Lithuania estimates that, under a baseline scenario, around 80 000 households would lose their regular income source due to the COVID-19 shock, undermining the value of around 19% of consumer and other non-housing loans (Bank of Lithuania, 2020[6]). A sharp adjustment in the housing market could put borrowers and lenders under duress. Housing markets are holding up, but the commercial real estate segment is facing the strains caused by the crisis. Should these pressures continue, real estate developers will be under strain, posing risks for banks, given that commercial property loans accounted for around 60% of the total portfolio of bank loans to non-financial corporations (Bank of Lithuania, 2020[6]).

The banking sector is highly concentrated and dominated by foreign-owned banks. The three largest banks operating in Lithuania account for over 80% of the market and are controlled by foreign-owned institutions. The authorities assess that a possible correction of imbalances in the Nordic countries, which may accelerate due to the COVID-19 crisis, can pose risks to the Lithuanian banking sector, even though the significance of the direct exposure channel (net funding from parent banks) has decreased (Bank of Lithuania, 2020[6]). Steps to strengthen the Baltic-Nordic co-operation agreement on cross-border financial stability and crisis management, including the joint financial crisis management exercise conducted in 2019, have enhanced resilience (IMF, 2019[5]). Moreover, as highlighted in the previous Survey (OECD, 2018[7]), the concentration in the banking sector makes the financial system dependent on a few large market players. In its 2019 assessment, the Bank of Lithuania identified three systemically important institutions and set additional capital buffers to them.

The Fintech industry is rapidly developing due in part to regulatory reform, including remote Fintech licensing with a fast-track process and the introduction of a regulatory sandbox in 2018. The latter allows market participants to test financial innovations in a real environment for a limited time. Participants must submit a testing plan to the central bank that needs to meet specific requirements. Lithuania has currently 210 Fintech companies, making it a regional Fintech hub, with the sector employing more than 3 400 specialists (Invest Lithuania, 2020[9]). The development of Fintech can promote financial deepening and competition among financial service providers in areas such as payments and loans, especially among the underserved population. It also poses challenges, however, particularly related to money laundering, financing of terrorism and cyber-security risk. These challenges are addressed through enhanced cooperation and exchange of information in risk management between the government and financial institutions, and capacity building.

Anti-money laundering and counter-terrorist financing (AML/CTF) efforts were also stepped up. Lithuania has improved its framework for anti-money laundering and counter-terrorist financing in recent years, including by explicitly criminalising the financing and support of terrorism and extending the list of activities punishable as money laundering. The 2018 mutual evaluation report by the committee of experts (MONEYVAL) stressed the need for further policy action recommending that Lithuania strengthen existing law enforcement strategies, continue targeting more complex and sophisticated types of money laundering, and extend financial investigations. A comprehensive action plan to address the identified deficiencies approved in 2019, with the central bank already enhancing its AML/CFT supervision. Moreover, the National AML/CFT Risk Assessment has recently been updated, in response to the 2018 MONEYVAL review. Ensuring sufficient resourcing and expertise across all involved agencies is crucial.

In June 2020, the Parliament authorised the government to launch the procedures for the establishment of a National Development Institution that will rely on the pooled competence of three existing institutions: the state-owned credit guarantee agency (INVEGA), the Public Investment Development Agency and the Agricultural Loan Guarantee Fund. A rationale for the National Development Institution is to ensure credit for SMEs. In 2019, 60% of loan applications submitted by small enterprises were rejected, compared to 12% in the EU on average (Bank of Lithuania, 2020[6]). This may be explained by a number of factors including increasing expectations for a price correction in the Lithuanian real estate markets that made banks more cautious to lending to SMEs, the rise in banking sector's concentration in the recent years constraining credit supply to the corporate sector and the relatively high degree of banks' risk aversion.

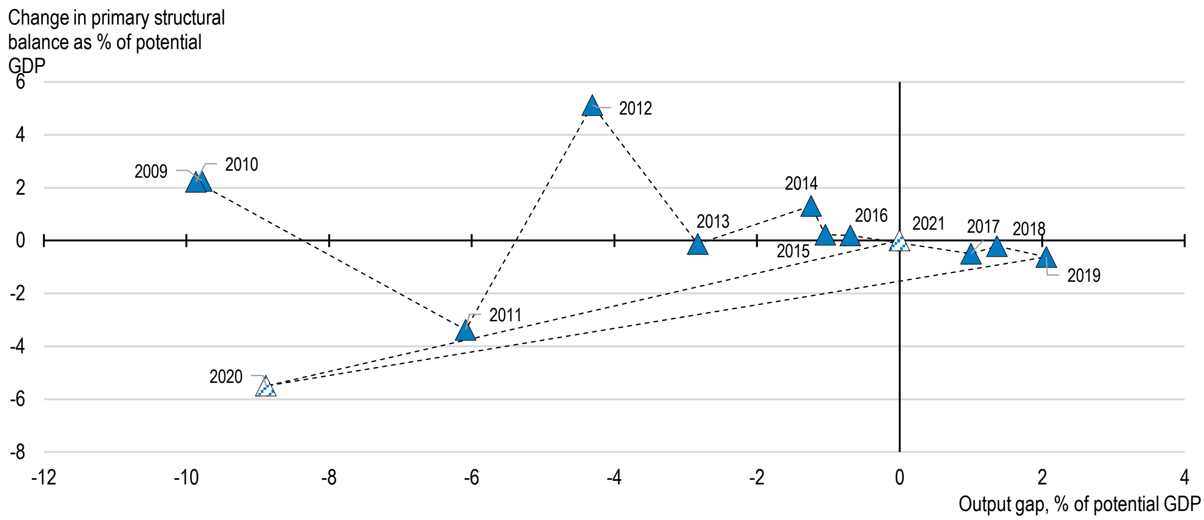
Beyond supporting small innovative companies, the new institution aims to ensure financing for long-term investments that benefit the wider economy and provide sufficient credit during economic slowdowns. Cross-country experience suggests that national development banks can play an active role in crises (IMF, 2020[10]), while also contributing to the development of key new sectors, such as sustainable energy (Ocampo and Griffith-Jones, 2019[11]). Public banks entail risks, however, including from explicit or implicit government guarantees, from taking up bad loans, and from slowing the development of private finance. Appropriate design is essential, especially strong governance, rigorous assessment of projects, and close monitoring of outcomes.

Sound fiscal policy created fiscal space to deal with the crisis

Lithuania has sufficient fiscal space to deal with the COVID-19 crisis. Fiscal positions were sound after a bumpy consolidation period following the economic crisis of 2009 and the implementation of the constitutional fiscal law in 2015 (Figure 1.10). At the end of 2019 the budget was in a small surplus. The fiscal stance was slightly expansionary, partly due to an unexpected change in accounting in the pension system. The government had initially planned further consolidation, yet given additional spending and lower tax revenue following the COVID-19 pandemic, the balance is expected to turn sharply negative in 2020 (-11% of GDP) and then improve to around -6% in 2021 (Box 1.2).

Figure 1.10. Fiscal policy was pro-cyclical until recently

Output gap and structural fiscal balance, percent of potential GDP, 2009-2021



Note: Data for 2020 and 2021 are projections.
Source: OECD Economic Outlook 107 database.

StatLink https://doi.org/10.1787/888934185118

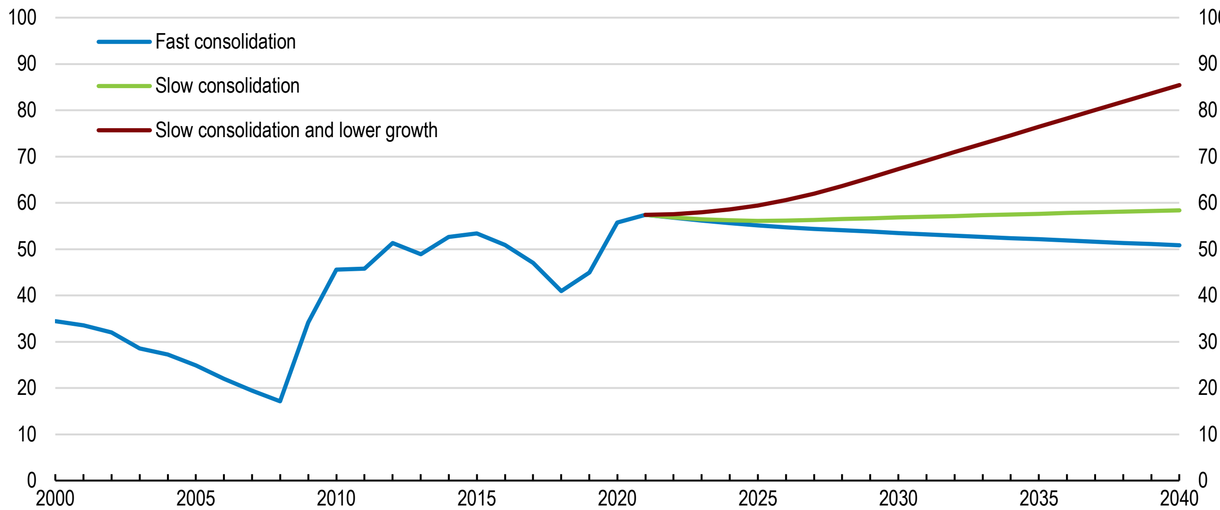
Gross public debt, which stood at 41% of GDP at the end of 2019, is expected to rise sharply. Bold policy steps will be required to maintain fiscal space (Figure 1.11). For debt to stabilise, the structural balance has to decline from -5.5% in 2020 to -0.5% in 2022, which is a sharp consolidation. In addition to overcome the current shock, policy should help address future crises. As a small open economy, Lithuania is highly vulnerable to external shocks and the authorities estimate fiscal buffers needed to cushion them at 5% to 10% of GDP. For that reason, the government should agree on a long-term numerical debt target and establish a credible debt reduction path once the recovery is well on its way, by prioritising reforms that help both reduce deficits and increase effectiveness of spending and taxation.

The fiscal framework has proved flexible during the covid-19 crisis, yet some simplification could make it more predictable and easier to follow going forward. Frequent revisions to potential output and the output gap, which underlie the fiscal rule, make the budget a moving target. The asymmetry of the rule compounds uncertainty. The rule requires the budget to move towards a 0% structural balance when the output gap is positive while not exceeding the medium term objective (currently minus 1% of GDP) if the output gap is negative. Against this background, small changes to potential output when it is close to actual output could imply budget revisions of up to 1% of GDP. The government should simplify the fiscal framework and establish the same numerical rule for both negative and positive output gaps. Iceland established such a rule in 2016, including correction paths if outcomes deviate from the rule.

The Fiscal Council or Budget Policy Monitoring Department, established in 2015 jointly with the constitutional budget law, continues to monitor compliance with fiscal rules, prepares opinions and submits them to Parliament following a "comply or explain" principle. The Council also started to assess medium and long-term fiscal forecasts and sustainability. Somewhat unusual, the Council is one of three independent institutions within the National Audit Office. The OECD published an assessment of the Council, concluding that it benefitted from the strong leadership and support of the Auditor General, yet lacks a clear public identity and visibility, and operational independence (OECD, 2019[12]). Improving operational independence could strengthen visibility and impact of the Council. The Council has started to publish macroeconomic forecasts and other fiscal data, as recommended by the OECD, but should also publish methodological details in technical notes and working papers.

Figure 1.11. Debt would rise to unsustainable levels if growth slows and deficits remain high

Debt scenarios under different assumptions



Note: The projections are based on the OECD Economic Outlook No. 107 until 2021, single-hit scenario. From then on, long-term GDP growth is assumed 2.5% for scenarios 1 and 2 and 1.25% for scenario 3. The implicit interest rate on public debt is assumed at 1%. Inflation will remain at the target (2.5%). The scenarios assume a gradual improvement of the structural balance until the structural deficit reaches respectively -0.5%, -1% and -2%. Declining pension spending from around 6% in 2020 to less than 5% of GDP in 2060, as assumed by government following the 2017 pension reforms, is not reflected. Other ageing costs are not taken into account.
Source: OECD Economic Outlook 107 database.

StatLink https://doi.org/10.1787/888934185137

Table 1.3. Fiscal overview

Main fiscal aggregates 2009 and 2018 percent of GDP

	2009	2018
Gross financial liabilities	34.1	41.8
Net financial liabilities	2.9	14.8
Budget balance	-9.1	0.6
Total revenue	35.8	34.6
Tax on individual income	4.1	4.1
Tax on corporate income	1.8	1.5
Taxes on property	0.3	0.3
Taxes on sales and services	11.3	11.3
Other Taxes	0.4	0.3
Social contributions	12.6	12.7
Other revenue	5.2	4.4
Total expenditure	44.9	34.0
Social protection	16.4	12.1
General public services	4.4	3.5
Health	6.7	5.9
Education	7.2	4.6
Economic affairs	3.9	3.0
Other expenditure	6.2	5.0

Source: OECD National Accounts database; and OECD Global Revenue Statistics.

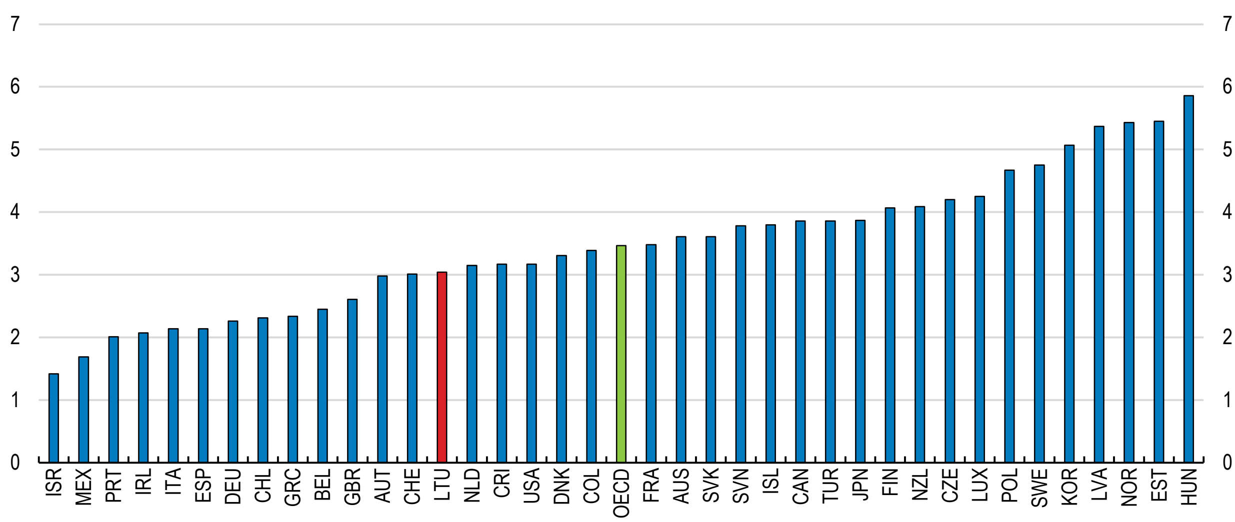
Public investment should be maintained

Government spending accounts for around 33% of GDP, which is below the OECD average (Table 1.3). Spending increased considerably over the past two years, particularly following wage increases in the education and health sectors. Spending quality – i.e. the composition of spending across policy areas - remains favourable for inclusive growth, with the share of spending on education slightly above OECD averages, spending on pensions and subsidies below average, and social spending raising rapidly, especially on child and family benefits.

Public investment remains relatively low however, running counter to the needs of a catching-up economy (Figure 1.12). Investment concerns mainly transport, digital infrastructure, education and health care. Most investment projects benefit from European Union cohesion funds with a matching rate of 85%. The European Union plans to reduce the matching rate to 40% for wealthier regions, although several new instruments (Recovery and Resilience Facility, REACT-EU and others) could partially make up for lower co-funding. Given the importance of modernising the infrastructure, of increasing long-term growth and stimulating crisis-hit demand in the short term, the government should at least maintain the level of investment and improve investment quality by carrying out rigorous cost-benefit analysis for individual projects.

Figure 1.12. Public investment is relatively low

Public investment, % of GDP, 2018 or latest year



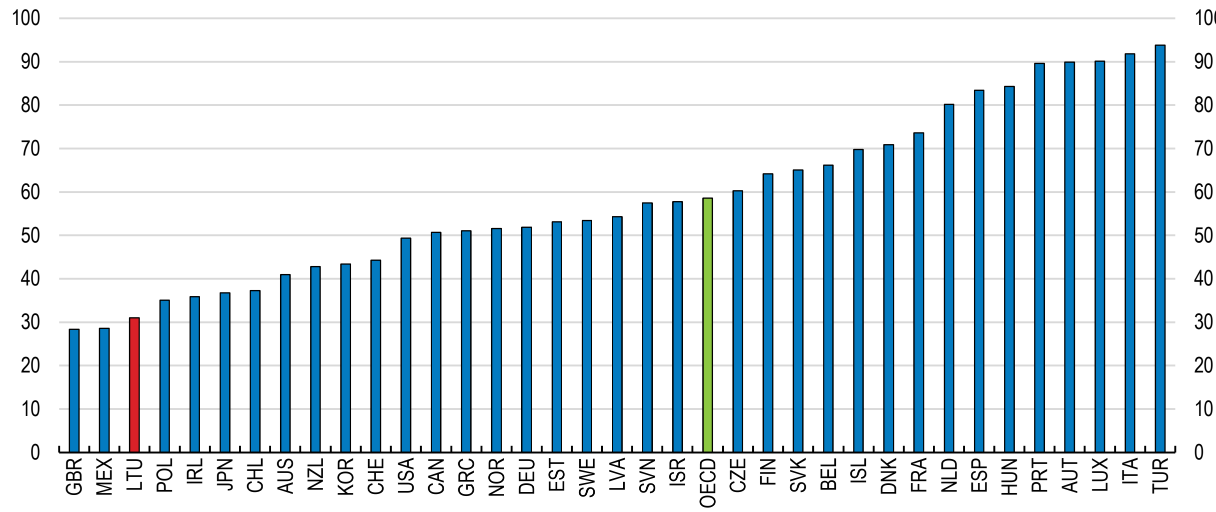
Source: OECD Government at a Glance database.

StatLink https://doi.org/10.1787/888934185156

The pension system has undergone significant amendments (Box 1.1). A thorough pension reform in the wake of the “New Social Model” strengthened capital-based pension funds, linked benefits to economy-wide wage growth and increased minimum pensions. The retirement age, currently increasing by 2 months every year, helps weather the fiscal implications of ageing for the coming years. Funding of the basic pension shifted from the social security fund towards the general budget, broadening the funding base. Minimum pensions remain low however (Figure 1.13). The government plans to raise minimum pension entitlements above nominal GDP growth, in line with a newly defined basket of minimum consumptions needs, which is welcome. To maintain sustainability and adequacy, the government should establish an automatic link between the retirement age and life expectancy, once retirement age has reached 65 years for both men and women.

Figure 1.13. Pension adequacy could improve

Net pension replacement rate, male, average wage, 2018



Note: The net replacement rate is defined as the individual net pension entitlement divided by net pre-retirement earnings, taking account of personal income taxes and social security contributions paid by workers and pensioners.
Source: OECD Pensions at a Glance database.

StatLink https://doi.org/10.1787/888934185175

Taxation relies too much on labour

Rebalancing taxation could help the economy recover from the covid-19 shock and make it more inclusive and resilient. With less than 30% of GDP, the overall tax burden is below the OECD average of 34% (Table 1.3). Consumption taxes and social security contributions are high, while income and property are taxed rather lightly. Moreover, frequent piecemeal revisions to the tax code reduce confidence of firms and households in tax policy. Against this background, the government should put taxation on a sustainable and inclusive basis.

- *Income tax and social security contributions*: The authorities continued to shift taxation from social security contributions (SSC) to the personal income tax, in a welcome attempt to broaden the tax base and to make taxation more progressive. Two brackets of 20% and 32% replaced the flat income tax rate of 15%, while SSC were lowered. As a result, overall labour taxation declined by 1.55%. Employer and employee SSC were merged to be borne by employees alone, with a corresponding increase in gross salaries.
- *Business taxes*: the government broadened tax incentives to make corporate income taxation more innovation-friendly, including a patent box – i.e. tax-favouring income from commercialising patents - and alternative business financing models such as collective investment undertakings. Moreover, agriculture no longer benefits from reduced business tax rates, making taxation less distorting.
- *Property taxes*: Lithuania remains among the OECD countries with the lowest share of property tax revenue in GDP at around 0.4%, despite separate land and building taxes and despite a progressive scale for the buildings tax. In 2020, the threshold when the building tax kicks in was reduced from EUR 220 000 to 150 000, which is still high. Moreover, municipalities often set low land tax rates and partially or fully exempt the building tax, further reducing tax revenues. Against this background, the government should broaden the land tax base and incentivise municipalities to raise more property tax revenue (see also chapter 3).

Environmental and "sin" taxes remain low. Lithuania has no carbon tax, which should be levied at around 30 EUR/ton at least to reflect damage of emissions (OECD, 2019[13]). Gasoline taxes were increased in 2020 but remain low in international comparison, and Lithuania was one of the last countries to introduce a car tax in 2020. Environmental taxes, including the landfill tax, will increase significantly in 2021 following an amendment of the pollution tax law. All environmental taxes are earmarked to fund environmental projects. Excise taxes on tobacco were increased in 2019 and further increases are planned.

The fiscal recommendations of this Survey would have an overall negative impact on the budget balance (Box 1.4).

Box 1.4. Quantifying fiscal policy recommendations

The following estimates roughly quantify the fiscal impact of selected recommendations within a 5-10 year horizon, using simple and illustrative policy changes. The reported effects do not include behavioral responses.

Table 1.4. Illustrative fiscal impact of recommended reforms

Policy Measure		Impact on the fiscal balance, % of GDP
Deficit-increasing recommendations		
Maintain public investment	Maintain the share of public investment in GDP despite a potential decline in EU funds	-1.0
Increase minimum-income benefits	Raise the level of state-supported income from 50% to 57% of the amount of minimum consumption needs	-0.1
Increase spending on childcare	Increase public spending on childcare from 0.1% of GDP to 0.3% of GDP (OECD average)	-0.2
Increase spending on activation policies	Increase expenditure per unemployed from 7% to 10.2% of GDP per capita	-0.2
Deficit-reducing recommendations		
Increase property taxation	Increase property taxation from 0.4% of GDP to the OECD average of 1.2%	+0.8
Levy a CO_2 tax	Increase carbon taxes to 30 Euro/ton, corresponding to the lower bound of estimated damage of emissions	+1.0
Consolidate the school network	Merge schools until each has at least 200 pupils	0.1
Total fiscal impact		0.4

Note: Activation spending calculation based on OECD public spending on labour markets indicators.

The fiscal framework is centralised

Lithuania's fiscal framework is highly centralised and local governments face tight fiscal rules, limiting local incentives and capacity to invest. Municipalities have little own tax revenue and rely on transfers from the central government to cover responsibilities in education, health care and social welfare. The local fiscal rule requires municipal budgets to be nominally balanced every year, except for the largest cities with a structural balance rule. European co-funding might decline over the next few years. Against this background access to own-source revenue, such as property taxation and development fees, should be strengthened. A multi-annual municipal fiscal rule or a rule that exempts investment (“Golden Rule”) might also help increase investment while maintaining the sustainability of the public finances.

Table 1.5. Past OECD recommendations on financial and fiscal stability for inclusive growth

Recommendation	Action taken
Reduce social security contributions, especially for low-income workers, while ensuring benefits and deficit targets, including through broadening the tax base.	Two new income tax brackets of 20% and 32% replace the former flat tax rate of 15%. Social security contribution rates were reduced and capped for high-income earners.
Assess spending efficiency by carrying out regular spending reviews.	Spending review has started in the education and health care ministries.
Set a debt target and establish a credible frontloaded path to reach it.	Preparatory work ongoing.
Actively use macro-prudential measures once imbalances threaten to emerge.	Rules have been made more flexible following the covid-19 pandemic.

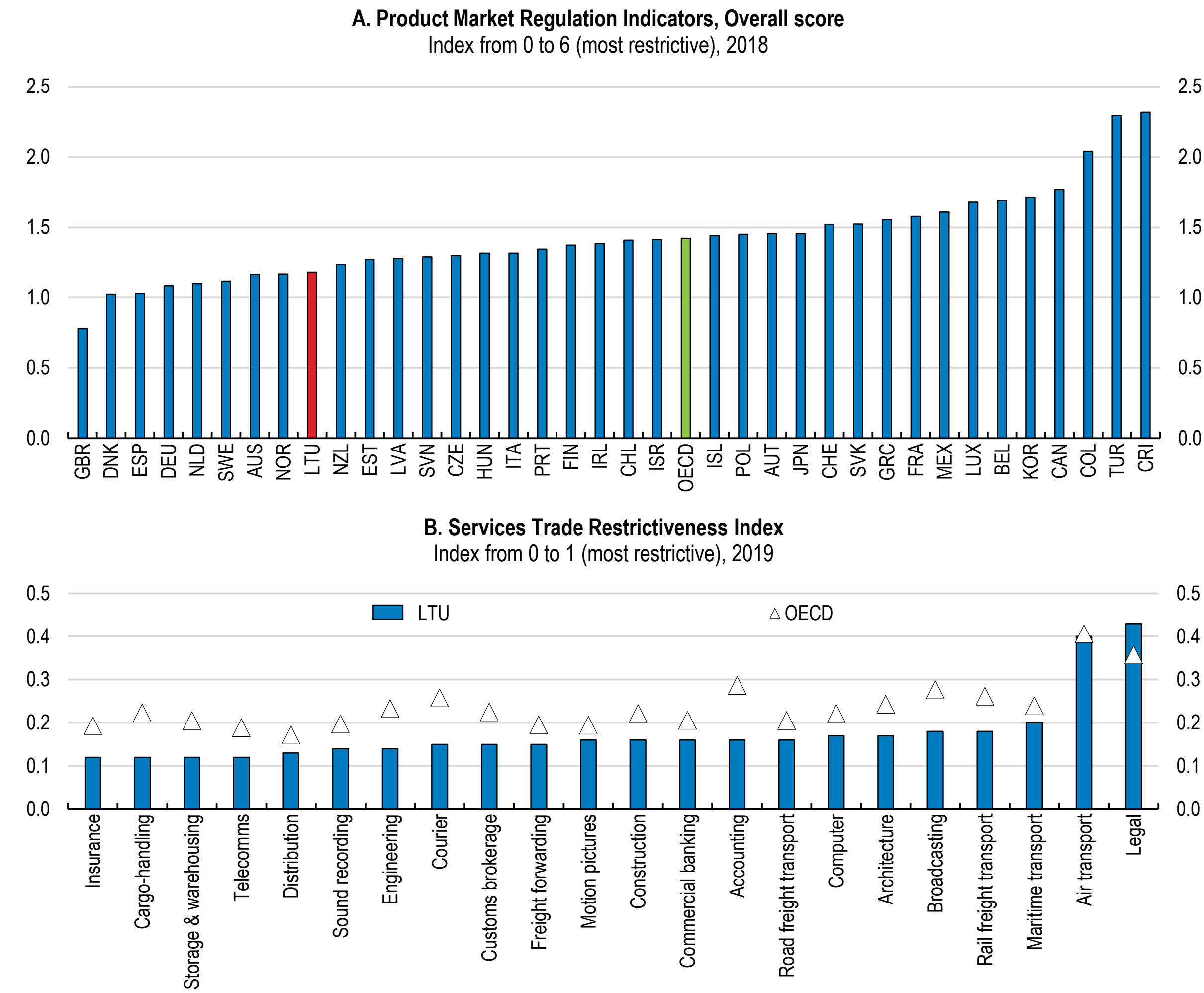
Structural reform could accelerate the recovery and boost productivity

The regulatory framework is well-prepared for post-covid-19 challenges

The regulatory framework is business-friendly and the regulatory burden below OECD averages (Figure 1.14). Trade in services is less restricted than in most other OECD countries, although restrictions remain in legal services, air transport services and motion pictures. Reforms over the past two years – in addition to those mentioned in Table 1.6 - include a gradual deregulation of electricity prices; the creation of a gas exchange market; simplifications in the tax and social security system; as well as stricter disclosure requirements to protect minority investors. Regulatory impact analysis has become compulsory for all new legislation with an economic impact. The regulatory framework provides firms with the necessary flexibility to adapt to post-COVID-19 challenges, such as to help them reposition workers, change production patterns or move to new sectors.

The competition framework has improved, especially in the network industries. A change to the competition law in 2019 allows the authorities to remunerate whistle-blowers who provide information about anti-competitive behaviour. The government created an electricity and gas exchange to foster multilateral trading. In 2019 the state railway company was split into three separate companies responsible for infrastructure, freight and passenger transport, although the reform remains relatively modest as all three entities remain state-owned. Unlike in most other Northern, Central and Eastern European countries, there are no private providers in the rail market, and the regulatory body is considered weak (European Commission, 2019[14]). Against this background, access of private providers, especially in the rail sector, should be facilitated further.

Figure 1.14. Lithuania's regulatory environment is open and business-friendly



Source: OECD Product Market Regulation Indicators; and OECD Services Trade Restrictiveness Index database.

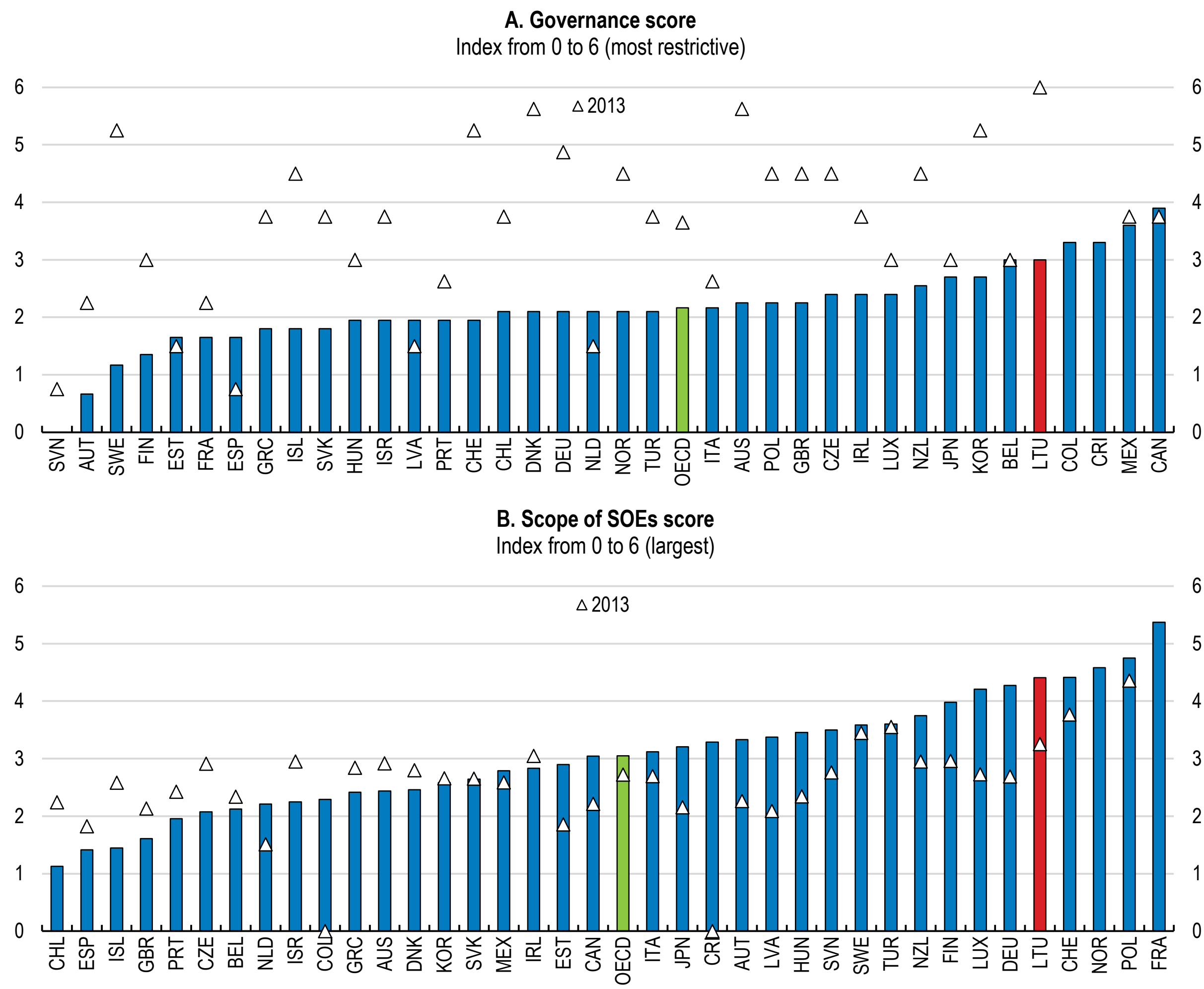
StatLink https://doi.org/10.1787/888934185194

State-owned enterprises could be a drag on the economy

State owned enterprises (SOE) are widespread, and their governance remains weak against OECD standards despite recent improvements (Figure 1.15). The strength of SOE governance is positively associated with efficiency of the firm and the economy (Égert and Wanner, 2016[15]; Bourlès et al., 2010[16]). The "SOE Reorganisation and Optimization Plan" from end 2018 clarifies the ownership strategy and sets out goals and timelines for streamlining SOEs' legal and corporate forms and for reducing the number of SOEs. The government privatised five (5) SOEs in 2018-2019. The corporate function of SOEs was strengthened, with more than 60% of board members now being professionals rather than public servants. However, only half of SOEs reached their financial objectives in 2018. A clear strategy that defines the rationale for public ownership is lacking. Against this background, the government should continue to subject SOEs to the same laws, regulations and market constraints as private companies, and if no compelling reasons persist to maintain public ownership, sell them (OECD, 2015[17]).

SOEs owned by municipalities also pose a challenge. Around 250 municipal enterprises are active across 40 sectors, from energy supply to waste treatment and local public transport (Lithuanian Free Market Institute, 2019[18]). While a few rules limit the power of municipalities to set up a local SOE, including prior agreement of the Competition Council, existing undertakings are not assessed even if they violate the rules (National Audit Office, 2017[19]). Against this background, municipal SOEs have proliferated, often competing with private providers. Some SOEs cross-subsidise corporate activities with revenues from publicly supported activities, distorting competition (Lithuania Free Market Institute, 2018[20]). While services heavy in infrastructure such as water or heat supply or sewage may be appropriately provided by a public monopoly, private providers can - and do - compete for public transport, waste management or catering services. The government should establish a level playing field between municipal and private providers, and submit all municipal SOEs to a ruling of the Competition Council.

Figure 1.15. State-owned enterprises weave through the economy



Note: 2013 and 2018 PMR vintages are not directly comparable: the 2013 figure should be interpreted for countries' relative standing to each other and not to their 2018 score.
Source: OECD Product Market Regulation Indicators.

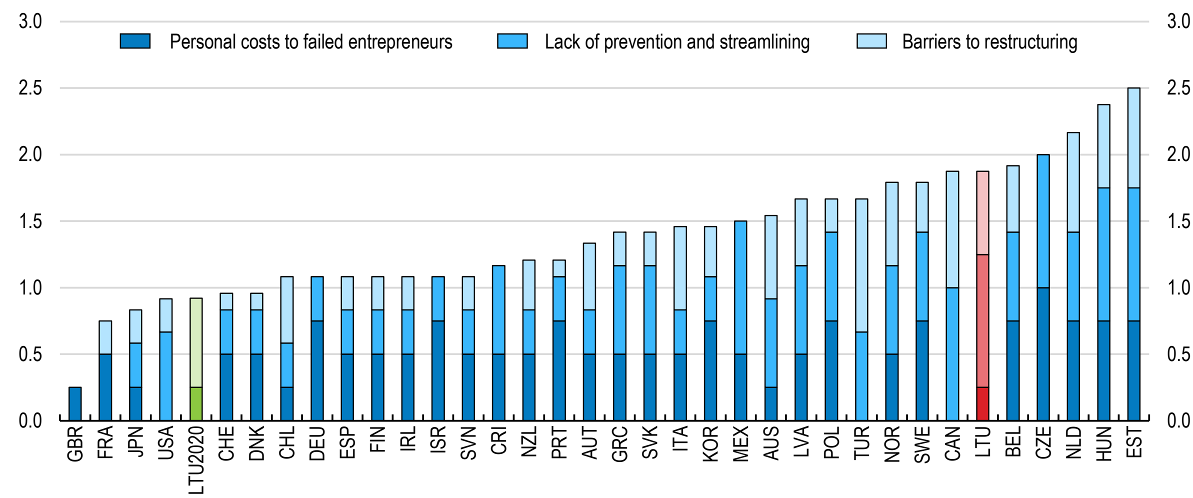
StatLink https://doi.org/10.1787/888934185213

The new insolvency framework will help address covid-19 challenges

The government thoroughly overhauled the insolvency regime in 2020, accelerating timely initiation and resolution of personal and corporate insolvency proceedings and increasing returns for creditors. The new regime is well designed to address the challenges of economic change after the covid-19 crisis, namely to restructure viable firms, unwind non-viable ones, move capital to their most productive use and foster continued technological diffusion (Figure 1.16). In particular, the new regime encourages the parties to look for dialogue and out-of-court solutions; provides business with more options for restructuring rather than exit; speeds up court procedures; improves accountability of insolvency administrators; and establishes new supervision rules implying stronger self-regulation. The reform changed Lithuania's insolvency framework to become one of the potentially most effective of the OECD (Adalet McGowan and Andrews, 2018[21]).

Figure 1.16. After thorough reform, Lithuania boasts an effective insolvency framework

Restrictiveness of insolvency frameworks, Index from 0 (less stringent) to 6 (more stringent), 2016



Note: The figure shows values for 2016, except Lithuania for which the pre-reform 2016 and post-reform 2020 values are shown.
Source: "The design of insolvency regimes across countries", OECD Economics Department Working Paper, No. 1504, 2018.

StatLink https://doi.org/10.1787/888934185232

Performance of education is weak

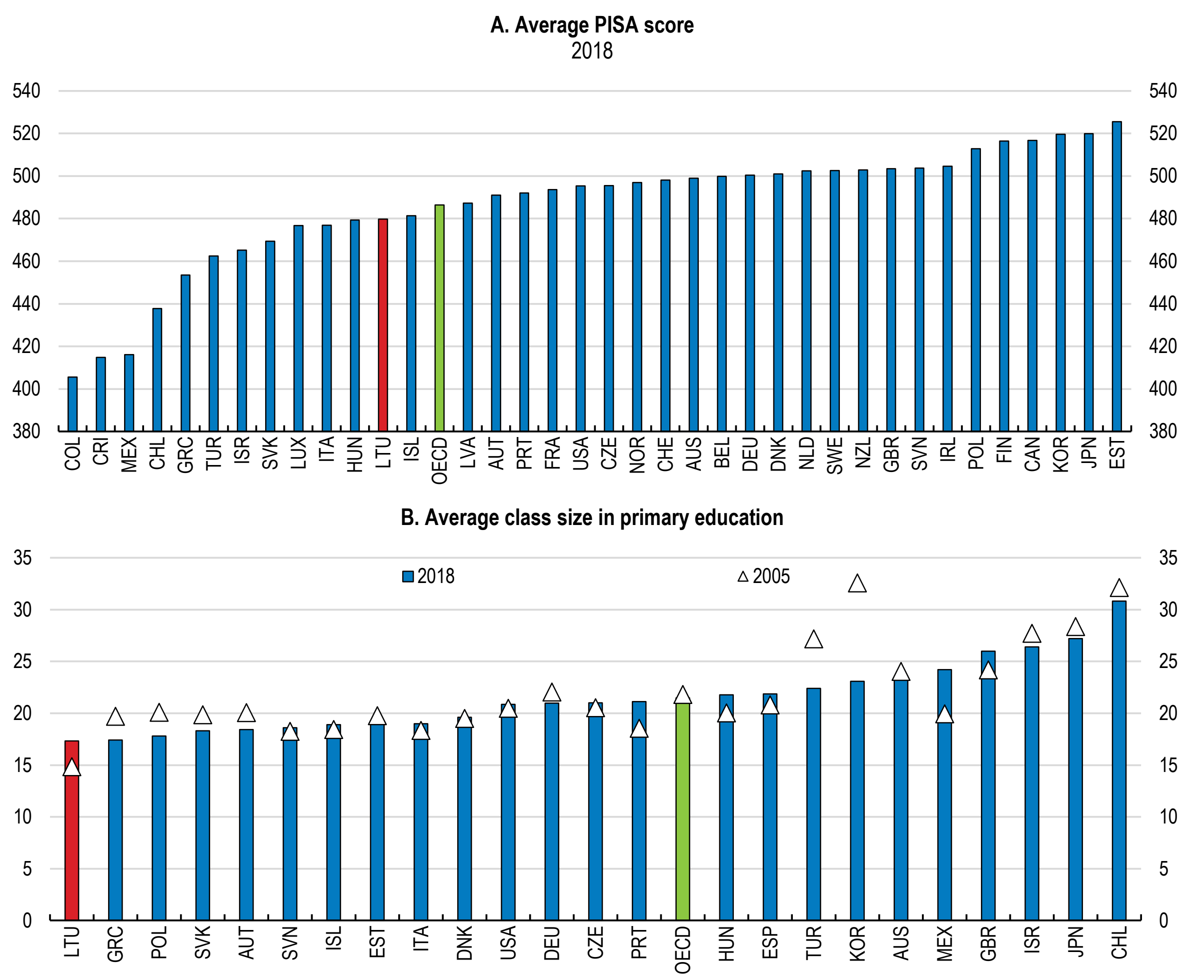
A lack of strong and relevant skills slows Lithuania's growth potential. While the government tried to minimise the impact of the covid-19 crisis on education and training to avoid hysteresis, e.g. by ordering a relatively mild school lockdown, long-term challenges persist. These include high skills mismatch, a lack of digital skills, and large urban-rural disparities in access to quality education and in student performance. The education infrastructure adapts only slowly to shrinking student numbers and higher skill needs.

Performance of primary and lower secondary education is weak, with Lithuania having one of the lowest PISA scores of the region (Figure 1.17 Panel A). While spending on education is comparatively low, spending on infrastructure is excessive, reflecting high spending on an extensive network of small schools, failing to reach scale and network effects (see also chapter 3). (Figure 1.17 Panel B). Salaries hardly rise with teachers' skills or performance, and school performance lacks systematic oversight (Shewbridge et al., 2016[22]). Recent reforms were rather shy, essentially involving an increase in teacher salaries.

Upper-secondary education leans strongly towards the general curriculum, while students shun vocational education and training (VET) as it often fails to provide relevant skills (National Audit Office, 2016[23]). The school network often lacks scale and specialisation. Collaboration between VET schools and firms is scarce, weakening the link between education and labour market needs. The 2017 reform, aimed at rising quality of VET, helped modernise infrastructure and brought more modular and flexible training opportunities to the curriculum. Apprenticeships, introduced in 2016, still attract few students. Reform should focus on raising the share of VET in upper secondary education, especially by raising the number of apprenticeships, and strengthen links to the labour market.

Tertiary education again is fragmented, and studies are not always in line with labour market needs, although quality is improving (IMD, 2019[24]). With 19 public universities and 22 colleges, Lithuania's tertiary institutions struggle to reach scale, and overlap and duplication of study areas is rife (OECD, 2017[25]). Recent attempts to consolidate the university network failed or did not bring the expected results. Universities are largely funded on per-student basis (student voucher), providing few incentives to improve quality. To reach critical mass, the government should close some universities and encourage others to specialise in fewer curriculae. Relating funds to graduates' success on the labour market, as in some Nordic countries, and rigorous quality assessment, could also help improve relevance of tertiary education.

Figure 1.17. Education performance is weak, although the system is well endowed with teachers



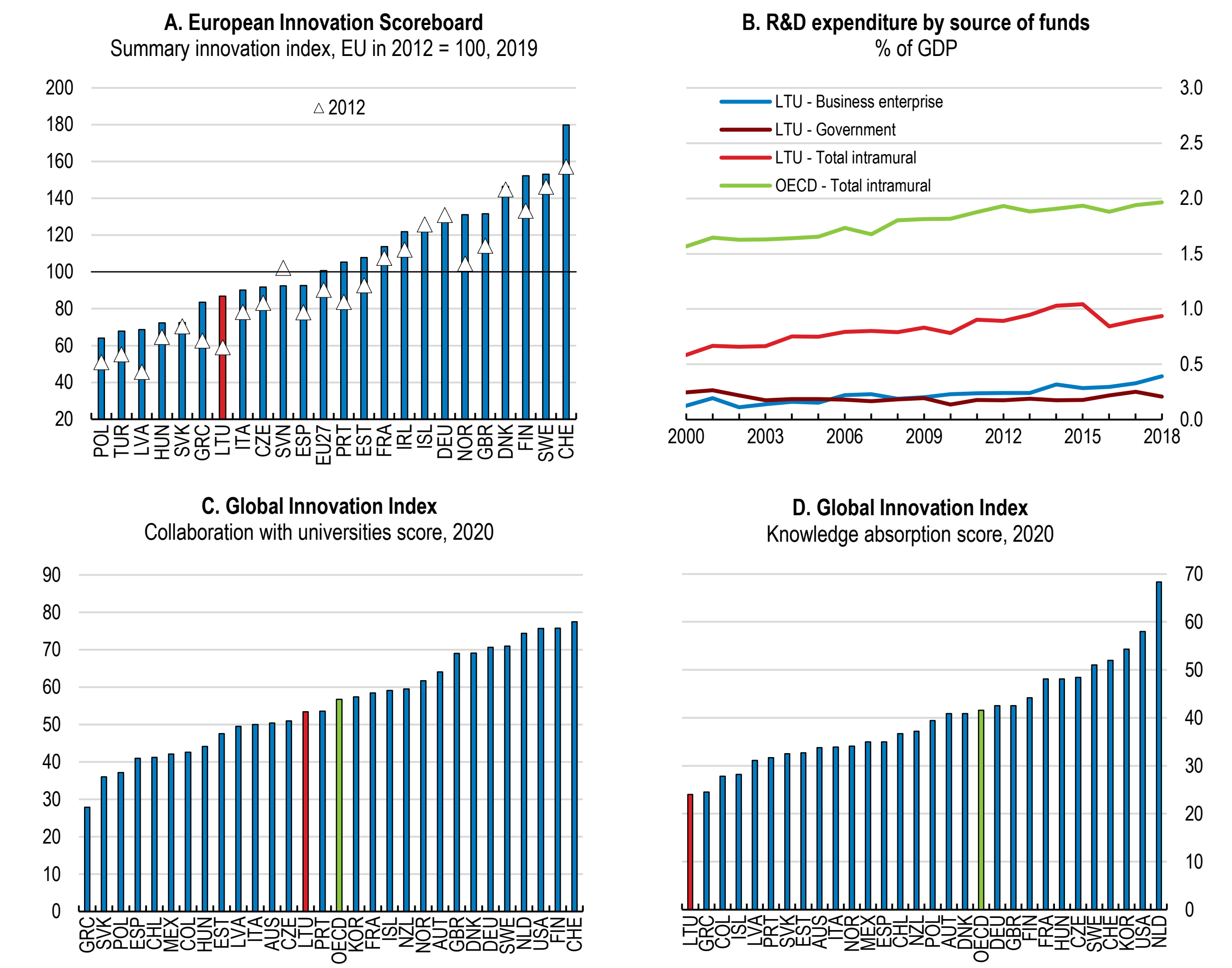
Source: PISA 2018 database; and OECD Education at a Glance database.

StatLink https://doi.org/10.1787/888934185251

Enhancing innovation performance

Lithuania has strengthened its international innovation position over the past decade but has not yet caught up with the EU average (Figure 1.18). Recent efforts aim to improve the funding and governance of the innovation system, as part of a comprehensive reform of the system aiming to boost productivity and competitiveness (Box 1.1). A new law in 2018 defines the areas of technology and innovation and establishes the principles and mechanisms for supporting such activities. Moreover, the government plans to establish in 2021 the Innovation Promotion Fund, aiming to ensure effective financing of R&D and innovation activities and contribute to their development. The Fund will also make it easier for innovative businesses to obtain funds. This is appropriate, given that public funding for R&D is low in international comparison. Measures to improve the co-ordination and effectiveness of innovation policy, are also in the right direction. These include, in particular, the creation of the Science, Technology and Innovation Council in 2019, chaired by the Prime Minister with broad representation of stakeholders. Moreover, business and innovation support agencies are to be consolidated under a unified agency by end- 2021 that will provide financial services for small firms, including for innovation. This should help to reduce fragmentation and overlap.

Figure 1.18. Innovation performance can be strengthened further



Note: Panel C: Results show the average answer to the survey question: 'In your country, to what extent do people collaborate and share ideas in between companies and universities/research institutions?' Panel D: The knowledge absorption index is a composite indicator that measures how good economies are at absorbing and diffusing knowledge. It is based on the following indicators: intellectual property payments as a percentage of total trade; high-tech net imports as a percentage of total imports; imports of communication, computer and information services as a percentage of total trade; net inflows of foreign direct investment as a percentage of GDP and the percentage of research talent in business.
Source: European Commission European Innovation Scoreboard 2020; OECD Research and Development Statistics database; Eurostat; and Global Innovation Index 2020.

StatLink https://doi.org/10.1787/888934185270

Reforms since 2018 further aimed to strengthen the collaboration between research and businesses on innovation, to foster knowledge transfer (OECD, 2015[26]). Business-research collaboration remains limited, with low mobility between the two sectors, that can explain to a large extent the low absorption capacity of firms in Lithuania (Figure 1.18) (Maggs and Hathawa, 2016[27]). Measures include innovation vouchers, support of technical feasibility studies at early stages of R&D projects, support to SMEs for the recruitment of researchers, and the establishment of science and technology parks for start-ups attached to a university. In addition, a new funding formula for universities and research institutions was introduced taking into account science-business collaboration, as well as the activities related to international R&D programmes. This is a positive step, and in line with international experience (OECD, 2018[7]). The effectiveness of the new measures needs to be monitored regularly.

Box 1.5. Quantification of structural reforms

Selected reforms proposed in the Survey are quantified in the table below, using simple and illustrative policy changes. Other reforms, including in the area of skills or public spending, are not quantifiable under available information or the complexity of the policy design. Some estimates rely on empirical relationships between past structural reforms and productivity, employment and investment, assuming swift and full implementation, and they do not reflect particular institutional settings in Lithuania. The estimates are hence illustrative, and results should be taken with caution.

Table 1.6. Potential impact of structural reforms on per capita GDP

Policy	Measure	10 year effect, %	Long-run effect, %
Public ownership	Privatise state-owned enterprises to reach the average OECD public ownership level	1.4	3.6
Public integrity	Improve control of corruption by 0.5 indicator points to reach EU average	1.3	3.3
Retirement age	Link retirement age to life expectancy or	1.2	2.6
Property taxes	Raise property taxes from 0.5% to 0.7% of GDP, keeping overall taxation stable	1.8	3.7
Business R&D spending	Increase R&D business spending from 0.3% to 0.7% of GDP (half of OECD ratio)	0.6	1.5
Increase spending on activation	Increase expenditure per unemployed from 7 % to 10.2 % of GDP per capita	0.8	1.6

Note: The following recommendations are included in the fiscal quantification (Box 2), but their impact on GDP cannot be quantified: maintain public investment, levy a CO2 tax, consolidate the school network, spending on activation.
Source: OECD calculations based on (Égert and Gal, 2017[28]) and (Cournède et al., 2018[29]).

Public integrity should be improved

Indicators of control and perceived risks of corruption suggest Lithuania performs below the OECD average, and some scores worsened recently (Figure 1.19). Sectors where corruption practices seem to endure include health care - especially illicit payments to physicians, insufficient control of lobbying and close ties between public institutions and private companies -, and public procurement. 15% of Lithuanian firms consider corruption in the country a problem, less than in 2015 (28%) and the EU28 average but more than some Nordic countries (Eurobarometer, 2019[30]).

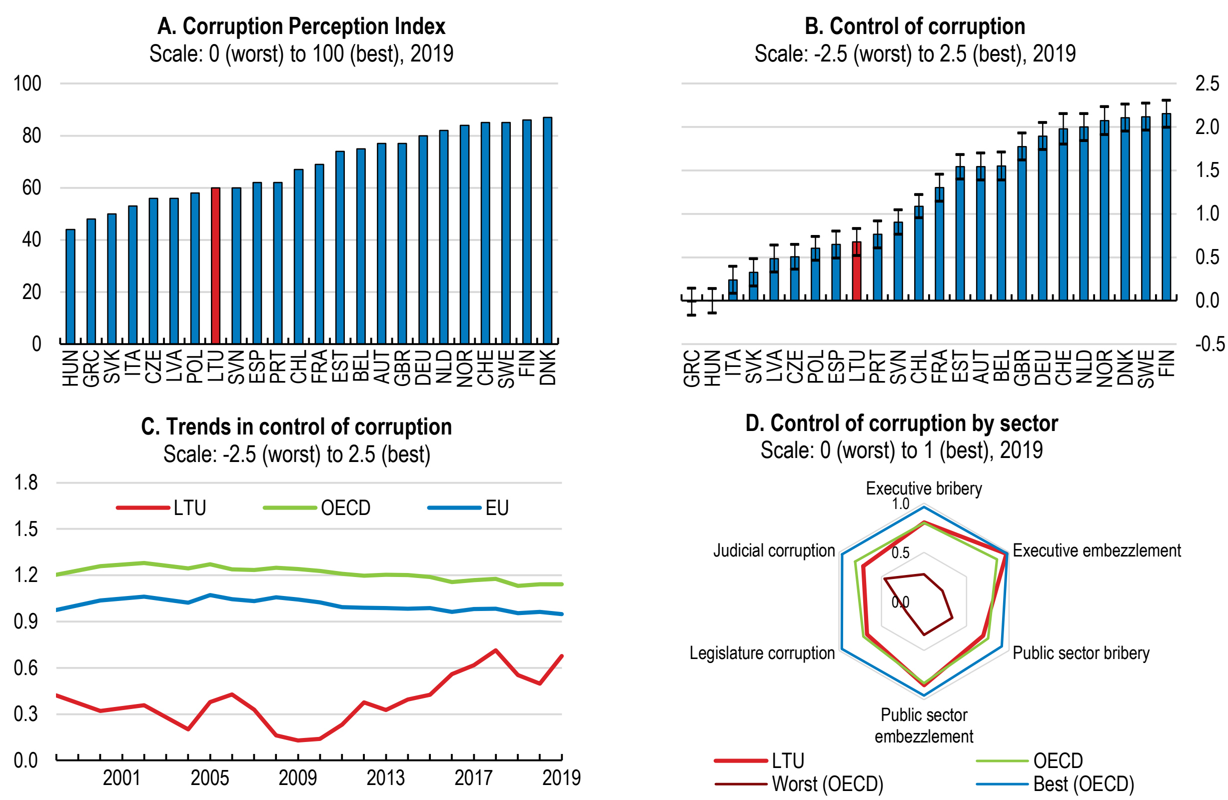
Policy measures to prevent, detect and report foreign bribery have been impressive though. The OECD Working Group on Bribery concluded that Lithuania implemented fully or partially 26 out of 27 recommendations (OECD, 2019[31]). In particular, the country amended the law on Money Laundering and

Terrorist Financing to include all types of monetary transactions, and the Financial Crime Investigation Service updated the list of suspicious monetary transactions and operations. An amendment to the Law on Financial Statement planned for spring 2021 will require large public and private entities to provide information on anti-corruption and bribery matters. The credit support agency "Invega" requests that credit beneficiaries agree to a set of integrity measures and the repayment of guarantees if it discovers bribes or other forms of corruption. There were no new foreign bribery cases in 2019.

Some unfinished business remains. The Anti-Bribery Working Group concluded that procurement agencies do not have sufficient access to the list of firms and people convicted for corruption. More generally, the informal sector in Lithuania is a source of corruption and anti-integrity behavior. The shadow economy shrank in 2019 after four consecutive years of expansion, mainly because of declining "envelope wages", yet remains above 18% of GDP (Stockholm School of Economics in Riga, 2020[32]). Lithuania's National Anti-Corruption Programme 2015-2025 addresses public integrity in eight critical areas; among them public procurement; political finance; public construction supervision and waste management. Public integrity should remain a guiding principle in the government's anti-corruption efforts.

Over the past two years, the government implemented several reforms in the area of state-owned enterprises, innovation, education and active labour market support, in line with recommendations in the last *Survey* (Table 1.7).

Figure 1.19. Some perceive corruption to be considerable



Note: "Control of corruption" is an indicator developed by the Varieties of Democracy Project. Panel B shows a point estimate and the margin of error. In Panel D, Best (OECD) and Worst (OECD) refer to the scores of the best and worst performing OECD member countries.
Source: Panel A: Transparency International; Panels B & C: World Bank Worldwide Governance Indicators; Panel D: Varieties of Democracy Institute; University of Gothenburg; and University of Notre Dame.

StatLink https://doi.org/10.1787/888934185289

Table 1.7. Past OECD recommendations on fostering productivity and inclusiveness

Recommendations	Action taken
Strengthen the monitoring capacity of the Governance Coordination Centre (GCC), building on the recent increase in its budget.	GCC's functions were expanded in 2018 and the obligation to prepare annual aggregated reports on the activities of municipally owned enterprises was established. Moreover, ownership entities are obliged to coordinate the Letters of Expectations of the SOE (entailing state's expectations) with the GCC.
Simplify criteria for starting bankruptcy procedures and establish more favourable conditions for restructuring.	The new insolvency framework of 2019 accelerates initiation and resolution of insolvency proceedings and facilitates restructuring.
Continue the implementation of the institutional reform of innovation policy by improving co-ordination, and consolidate agencies and support programmes where overlaps exist.	The Science, Technology and Innovation Council) was launched in 2019. Business and innovation support agencies will be consolidated under a unified agency by end-2021.
Give more weight on collaborative research when allocating funds to public research institutions.	A new funding formula for research institutions was introduced taking into account science-business collaboration and international R&D programmes`.
Strengthen work-based learning, including by linking the length of apprenticeships to the level of acquired competencies.	No action taken.
Provide differentiated awards for tertiary courses with skills closely linked to labour market needs.	Since 2020, special grants are provided for students who choose programs that provide skills in demand, such as teacher training programmes.
Continue with overall reform of education at all levels system addressing skill mismatch.	Vocation education and training curricula have been made more flexible.
Further increase the level of social assistance, while ensuring strong work incentives.	The state-supported income was considerably increased and indexed. A universal-child benefit was introduced in 2018 and the income disregard raised. In-work benefits were strengthened.
Increase investment in active labour market programmes upon a close monitoring of their outcomes.	No action taken.

Greening the economy

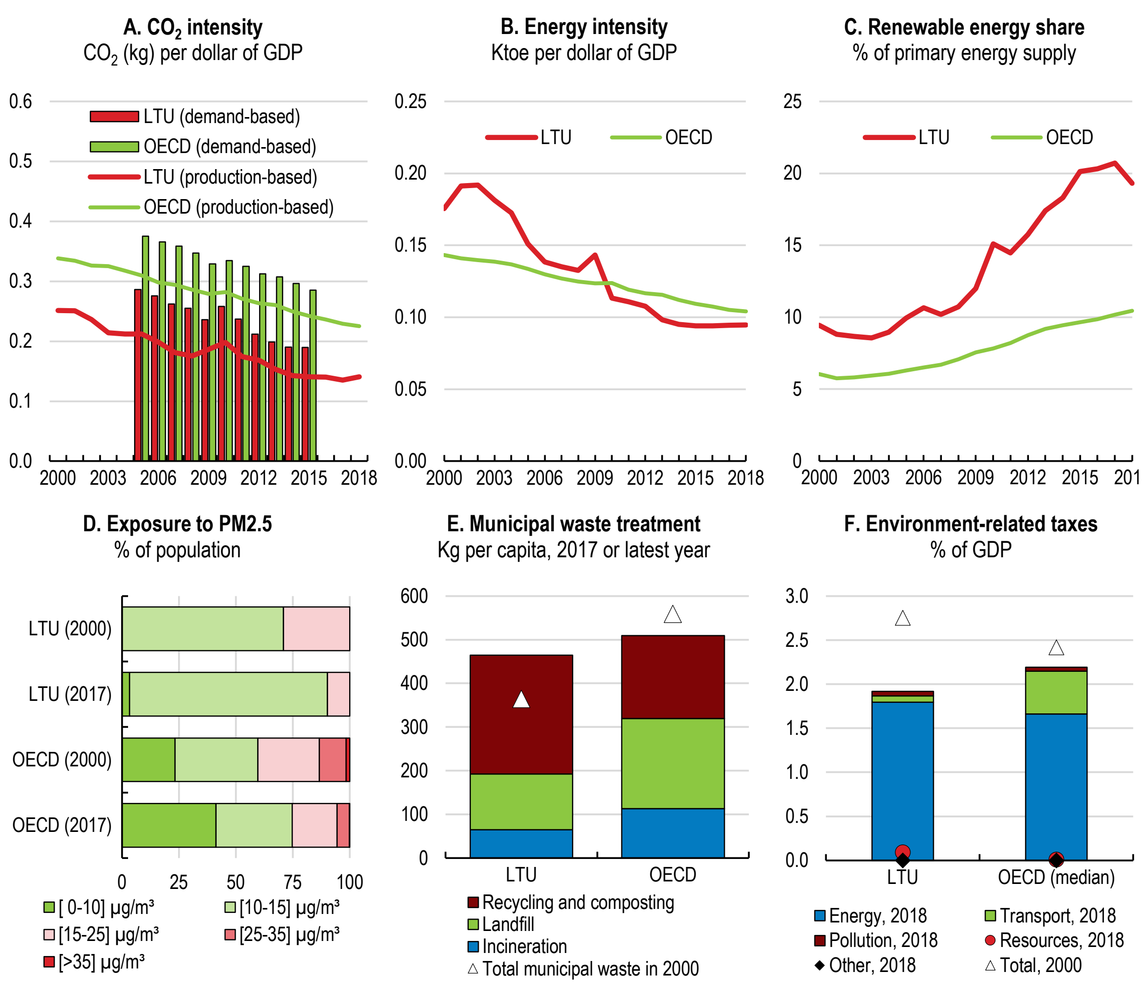
Lithuania's environmental performance has improved since the mid-2000s, but more needs to be done to improve sustainability and reach the government's ambitious targets (Figure 1.20). Greenhouse gas emissions (GHG) declined over the past decade, reflecting some decoupling of emissions from economic growth, yet per capita emission increased due to population decline. Lithuania has the highest welfare cost from exposure to fine particles (PM2.5) in the OECD. Transport and energy are the main sources of emissions with 28% and 27% respectively, followed by agriculture with 22% and industry with 18% of total emissions. The large share of transport emissions will require a deep restructuring if the 2030 targets are to be met.

The use of renewables has climbed rapidly over the past 10 years, led by wind power and biomass burning for heat and electricity. Though biomass burning has contributed to energy independence and diversification, it is also a major contributor to GHGs and air pollution. The National Energy Independence Strategy sets ambitious renewable energy development goals such as at least 80% renewable energy in final consumption and 100% renewable electricity by 2050. As such, the strategy should focus on the development of cleaner renewable energy, such as wind, solar and geothermal, despite headwinds from low fossil fuel prices. Lithuania has continued to reduce energy intensity in recent years and is currently slightly below the OECD average, yet energy efficiency is a concern, particularly in the housing sector where almost 30% of owners report difficulties to keep their house warm. On the other hand, there was much improvement in waste management practices, with a significant reduction of landfills.

Pricing of environmentally damaging activities is low. Carbon is not taxed, except in sectors subject to the European Union emission trading system. Lithuania has one of the lowest excise duties on motor fuel, petrol and diesel in the OECD, and has one of the largest 'diesel differentials', the gap in the price of diesel versus gasoline. It also provides among the highest subsidies to fossil fuels. Against this background, there is scope for increasing fossil fuel taxes and removing subsidies, in particular as energy prices have declined recently. Such a policy shift would achieve both reductions in emissions and pollution and generate additional revenues that could help reduce social security contributions or fund green jobs and innovation. Recent policy actions have moved in this direction. In July 2020 Lithuania joined most other OECD countries in introducing a tax for private passenger vehicles which, moreover, is differentiated along emissions. In 2021 tax rates for most taxes on pollutants will increase considerably. In addition, the parliament is currently debating the long-term National Climate Change Management strategy, which sets a net-zero carbon emission target by 2050.

The COVID-19 crisis presents both challenges and opportunities for environmental policy reform. Efforts to strengthen the recovery should be aligned with necessary action to limit the risks faced from climate change, pollution and biodiversity loss. The Lithuanian fiscal stimulus package approved in March has accelerated some investment programmes with an environmental goal, such as the Climate Change Programme and the multi-apartment building renovation programme to improve energy efficiency.

Figure 1.20. Lithuania needs to become greener



Note: Gross Domestic Product (GDP) in constant PPP-adjusted 2010 USD. Panel A: Included are CO2 emissions from combustion of coal, oil, natural gas and other fuels.
Source: OECD Green Growth Indicators.

StatLink https://doi.org/10.1787/888934185308

MAIN FINDINGS	RECOMMENDATIONS
Policies to support the recovery	
The COVID-19 crisis has affected economic activity and household incomes, exacerbating funding challenges for the corporate sector.	**Continue providing temporary support to households and firms, while helping to reallocate resources to viable firms.**
Financial and fiscal policies	
The asymmetric fiscal rule (two-regime rule), relying on potential output, causes frequent revisions to fiscal planning .	**Simplify the fiscal framework and establish a long-term debt target.**
Public investment is low.	**Increase public investment against rigorous cost-benefit analysis.**
The fiscal council lacks public identity and visibility.	Increase operational independence of the fiscal council.
The government plans to set up a National Development Institution, to ensure sufficient financing of small innovative firms.	Ensure appropriate design for the planned public National Development Institution.
Structural policies	
The scope of state-owned enterprises is large and governance lags behind OECD standards.	**Strengthen the governance of state-owned enterprises further. Sell to private investors if no compelling reasons for public ownership exist.**
There are no private providers in the rail transport market.	Facilitate access of private providers to the rail network.
Innovation performance remains comparatively low.	Improve the governance of the innovation system by strengthening co-ordination and by consolidating agencies.
Green growth policies	
The economy's carbon imprint is considerable, while environmental taxation is below the OECD average.	**Introduce a carbon tax in sectors not covered by the European emission trading system, and reimburse at least partially the proceeds to households and firms.**
Fossil fuel subsidies belong to the highest in the OECD.	**Remove environmentally damaging fuel subsidies.**

Note: Key recommendations are in bold and can be found again at the end of the executive summary.

References

Adalet McGowan, M. and D. Andrews (2018), "Design of insolvency regimes across countries", *OECD Economics Department Working Papers*, No. 1504, OECD Publishing, Paris, https://dx.doi.org/10.1787/d44dc56f-en. [21]

Bank of Lithuania (2020), *Finacial Stability Review, May*. [6]

Bank of Lithuania (2019), *Lithuanian Economic Review 2019, September*. [3]

Bourlès, R. et al. (2010), "Do Product Market Regulations in Upstream Sectors Curb Productivity Growth?: Panel Data Evidence for OECD Countries", *OECD Economics Department Working Papers*, No. 791, OECD Publishing, Paris, https://dx.doi.org/10.1787/5kmbm6s9kbkf-en. [16]

Cournède, B. et al. (2018), "Public Finance Structure and Inclusive Growth", *OECD Policy paper 25*. [29]

Égert, B. and P. Gal (2017), "The Quantification of Structural Reforms in OECD Countries: A New Framework", *OECD Economics Department Working Papers, No. 1354*, http://dx.doi.org/10.1787/2d887027-en. [28]

Égert, B. and I. Wanner (2016), "Regulations in services sectors and their impact on downstream industries: The OECD 2013 Regimpact Indicator", *OECD Economics Department Working Papers*, No. 1303, OECD Publishing, Paris, https://dx.doi.org/10.1787/5jlwz7kz39q8-en. [15]

Eurobarometer (2019), *Businesses' attitutes towards corruption in the EU*. [30]

European Commission (2019), *Country Report Lithuania*. [14]

Government of Lithuania (2019), *6Structurinesreformos (6 structural reforms)*. [2]

IMD (2019), *IMD World Talent Ranking*. [24]

IMF (2020), *National Development Bank in Lithuania: Aims and Effective Governance, MD's Keynote Speech, July 2*. [10]

IMF (2019), *Lithuania: 2019 Article IV, July*. [5]

Invest Lithuania (2020), *The Fintech Landscape in Lithuania 2019-2020 Report*. [9]

Lithuania Free Market Institute (2018), *Kryzminis Subsidijavimas Valstybes Valdomose Imonese: Itaka Konkurencijai (Cross-Subsidies in State-Owned Enterprises: Impact on Competition)*. [20]

Lithuanian Free Market Institute (2019), *Kiek Savivaldybiu Valdomu Imoniu Veikia Pagristai (How Many Municipally Managed Companies Are Reasonable?)*. [18]

Maggs, P. and I. Hathawa (2016), *Absorptive Capacity: Boosting Productivity in the Creative Industries", Frontier Economics, July.*. [27]

Ministry of Finance (2020), *Overview of the Lithuanian Economy, June (in Lithuanian)*. [4]

National Audit Office (2017), *Does the involvement of the state and municipalities in the management of public institutions ensure the benefit to the society?*, https://www.vkontrole.lt/failas.aspx?id=3703. [19]

National Audit Office (2016), *Taking Advantage of Vocational Training Possibilities*, http://dx.doi.org/www.vkontrole.lt. [23]

Ocampo, J. and S. Griffith-Jones (2019), *National Development Banks: What They Are, Why They Matter, World Economic Forum, 16 May*. [11]

OECD (2020), *OECD Economic Outlook, Volume 2020 Issue 1*, OECD Publishing, Paris, https://dx.doi.org/10.1787/0d1d1e2e-en. [8]

OECD (2019), *Implementing the OECD Anti-Bribery Convention. Phase 2 Two-Year Follow-Up Report: Lithuania*, OECD Publishing, Paris. [31]

OECD (2019), *Lithuania's Independent Fiscal Institution*, OECD Publishing, Paris. [12]

OECD (2019), *Taxing Energy Use. Using taxes for climate action*, OECD Publishing, Paris, http://dx.doi.org/doi.org/10.1787/058ca239-en. [13]

OECD (2018), *OECD Economic Surveys: Lithuania 2018*, OECD Publishing, Paris, https://dx.doi.org/10.1787/eco_surveys-ltu-2018-en. [1]

OECD (2018), *OECD Economic Surveys: Lithuania 2018*, OECD Publishing, Paris, https://dx.doi.org/10.1787/eco_surveys-ltu-2018-en. [7]

OECD (2017), *Education in Lithuania*, Reviews of National Policies for Education, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264281486-en. [25]

OECD (2015), *OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264244160-en. [17]

OECD (2015), *The Innovation Imperative: Contributing to Productivity, Growth and Well-Being*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264239814-en. [26]

Shewbridge, C. et al. (2016), *OECD Reviews of School Resources: Lithuania 2016*, OECD Reviews of School Resources, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264252547-en. [22]

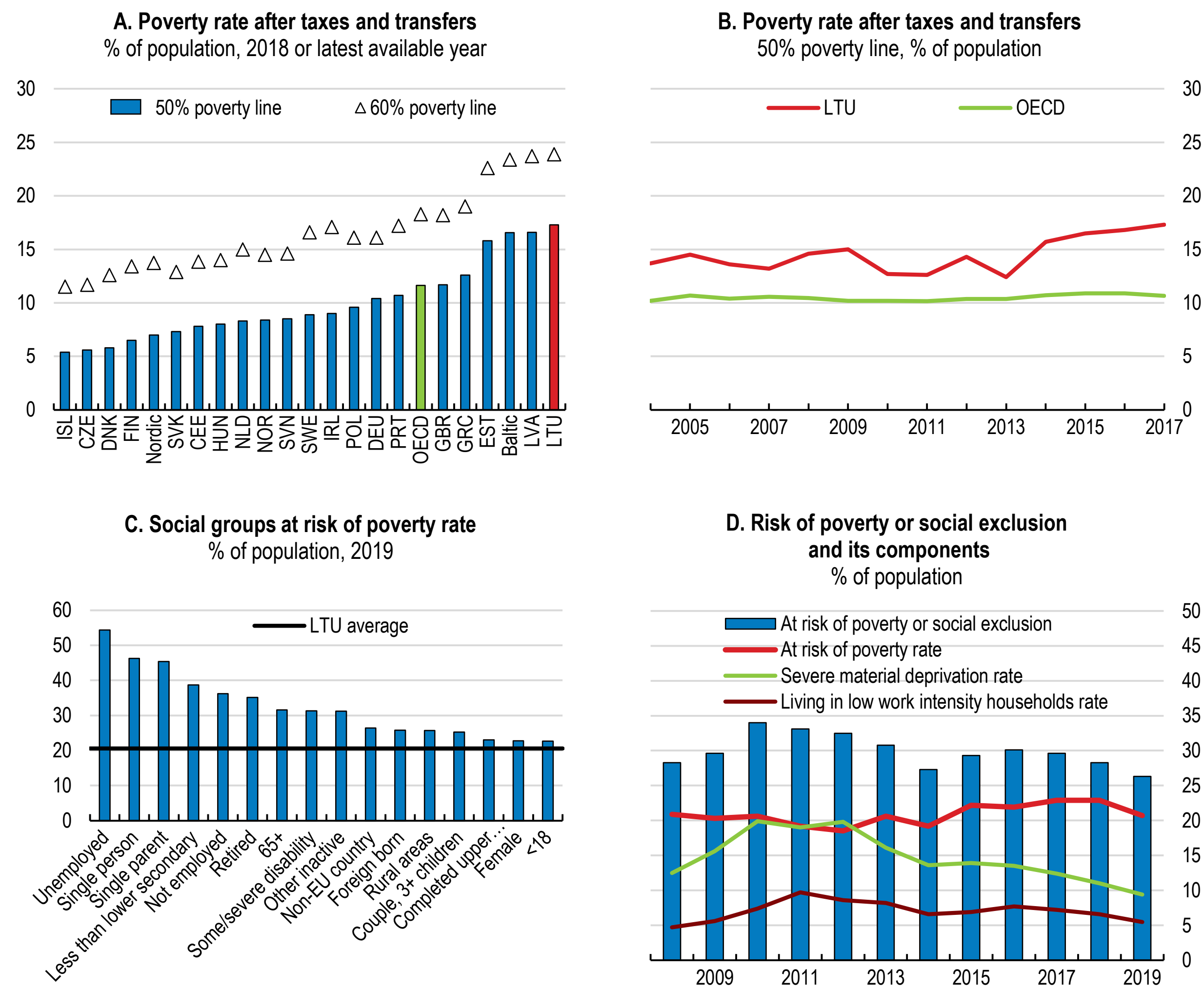
Stockholm School of Economics in Riga (2020), *Shadow Economy Index for the Baltic Countries*, https://www.sseriga.edu/shadow-economy-index-baltic-countries. [32]

2 Reducing poverty and social disparities

Reducing poverty remains an important challenge, and the COVID-19-crisis may further reinforce social vulnerabilities. Although it has declined lately, relative poverty remains high in international comparison and is distributed unevenly across population groups with the elderly, people with disabilities, lone parents, the low-educated and the unemployed being particularly affected. A comprehensive approach is required to ensure an effective transition out of poverty and social exclusion. Reforms should strengthen income protection by ensuring that cash benefits provide adequate and tailored support to those in need. An individual-based approach is also essential for the provision of social services to reduce deficits in important areas such as social housing and long-term care for the elderly. Equity in educational opportunity and outcomes could be strengthened further, starting at the early school years, as not all children benefit from early childhood education and care services. Progress in this domain is also crucial for striking a better work-family balance and improving work incentives. More and better quality jobs in the formal sector, especially for the low-skilled, are crucial for reducing poverty. Enlarged participation in life-long learning programmes can help re-skilling and up-skilling towards higher incomes. Increased spending on well-designed labour market activation policies is also important for tackling poverty effectively.

Rapid growth over the past two decades brought Lithuania's per-capita income closer to the OECD average, but relative poverty has increased in recent years and remains high, even though there have been some encouraging signs lately (Figure 2.1). The elderly, people with disabilities, lone parents, the less educated and unemployed are among the most vulnerable groups, facing poverty rates well above the overall population.

Figure 2.1. Poverty rates remain high



Note: Poverty rate is defined as the share of the population whose income falls below the poverty line, set at 50% of median equivalised disposable income of the entire population (OECD definition). The at-risk-of-poverty rate is the share of persons with an equivalised disposable income below the at-risk-of-poverty threshold, set at 60% of the national median equivalised disposable income (after social transfers) (Eurostat definition). Averages are calculated for the most recent value of all countries with available data (unweighted). Panel A: data for Lithuania are for 2017.
Source: OECD Income Distribution database; Statistics Lithuania; and EU-SILC.

StatLink https://doi.org/10.1787/888934185327

Denting poverty is a key policy priority not only for minimising the undesirable consequences of social exclusion, but also for increasing the opportunities and productive potential of the affected groups. The need to address poverty effectively is even more urgent in the current juncture as the COVID-19 crisis puts recent labour market improvements at risk, including by increasing informality, with an unequal burden on the poorer households. Low-skilled jobs tend to be concentrated in the sectors affected mostly by confinement, such as catering and accommodation.

The government has responded swiftly to the crisis through a number of measures to safeguard incomes and jobs and protect the needy (See Box 1.2, in Chapter 1). These include short-time working schemes, support for non-standard workers, more funds for activation policies, as well as increases in social benefits.

While the crisis-related measures can help to turn the poverty clock back, Lithuania continues to face important longer-term poverty challenges that need to be addressed. Comprehensive policy action was taken in the past few years to this end. Reforms increased the adequacy of key cash benefits, especially for families, while strengthening incentives to work and making labour market more flexible. However, social benefits remain comparatively low and the provision of support is not yet individual-based. Social services also need to address better the needs of vulnerable groups through more tailored and comprehensive support. Reducing deficits in important areas such as child care, long-term care and social housing are crucial to poverty reduction. Persisting informality in the labour market also affects poverty, weakening the social protection of the less skilled. At the same time, activation programmes need to strengthen further. The government's social agenda, currently under implementation, addresses many of these shortcomings, making strides in the fight against poverty and social exclusion. Reform efforts need to continue.

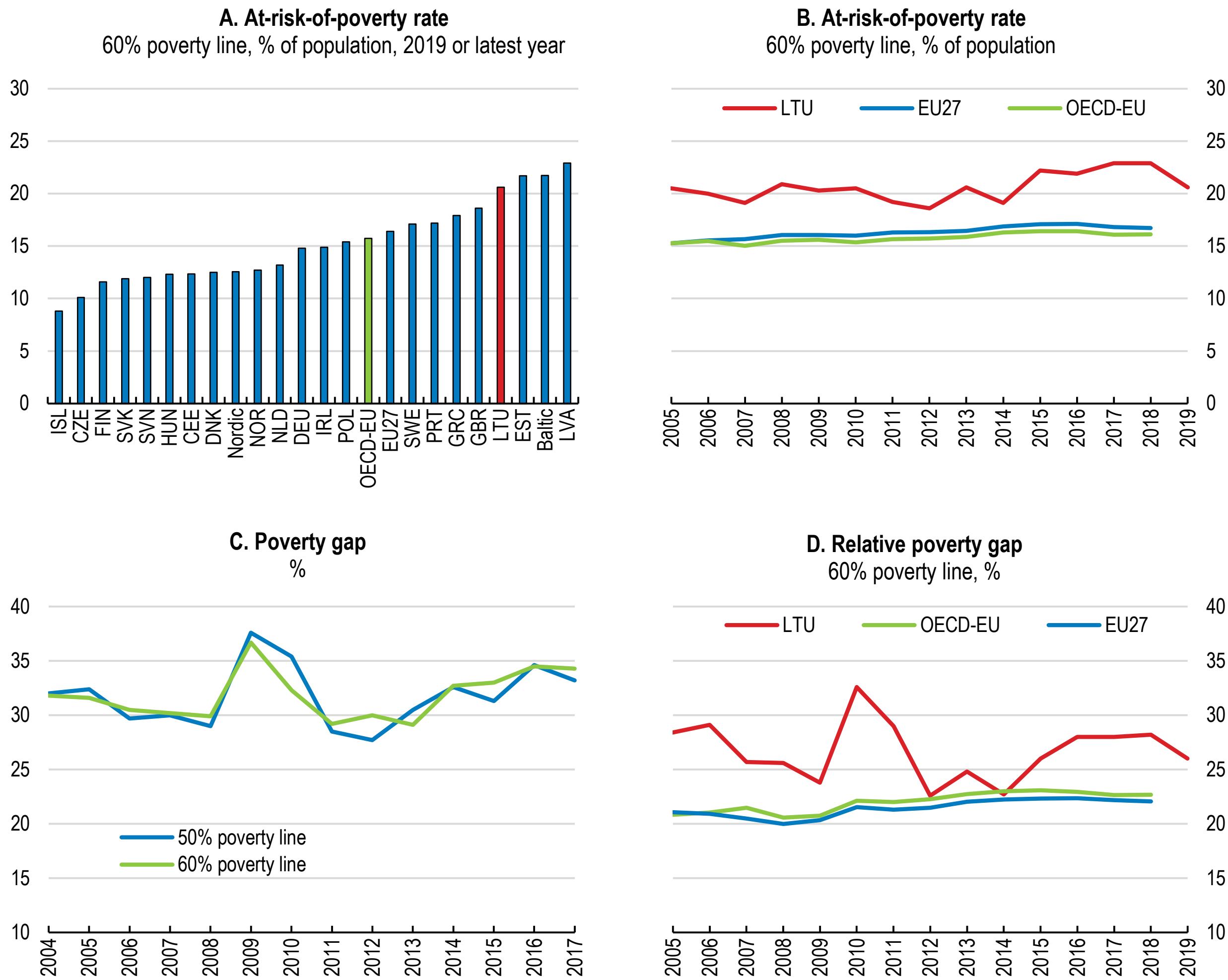
The chapter discusses poverty-related challenges and potential areas of further reforms, covering a wide range of policies as poverty is a multidimensional phenomenon. The next section describes the characteristics of the most affected population groups. Section two then discusses the transfer system and ways to make it a more effective anti-poverty tool for the working-age population and the elderly. Section three focuses on the provision of social services, particularly in the areas of health, long term care and housing. This is followed by an assessment of educational inequalities and reforms to reduce them. The final section examines policies that could help labour market integration of vulnerable groups, including measures to make family-work responsibilities more balanced and activation policies. The analysis focuses on relative poverty, which is the standard measure used in international comparisons of OECD countries. This depicts the proportion of individuals living in households with an income below a pre-defined poverty line. As in other advanced countries, relative poverty is the most prevailing form of poverty in Lithuania (Figure 2.1, Panel D). However, issues related to other forms of poverty, such as severe material deprivation (not being able to afford some necessities of daily life), homelessness, poor quality of housing and energy poverty are also discussed.

Poverty is high and unevenly distributed

Some groups are more at risk of poverty than others

A high share of population in Lithuania lives below the relative poverty threshold. This is consistent across different data sets and poverty metrics. OECD data reveal, in particular, that around 17% of the population had an income below 50% of the median in 2017 (latest year available), a proportion that rises to 24% when the threshold is set at 60% (Figure 2.1, Panel A). In both cases, the poverty rates are above the OECD average. EU data on income and living conditions confirm the need to strengthen inclusiveness: while declined by over 2 percentage between 2018 and 2019, at approximately 21% the at-risk-of poverty rate (i.e. the share of people with an income below 60 % of the national median equivalised disposable income) is still high in international comparison (Figure 2.2). The "poverty gap" has increased in recent years, indicating that the poor households fell further below the poverty line, and despite the recent decline, it remains comparatively large.

Figure 2.2. A large share of population is at risk of poverty and the poverty gap remains large



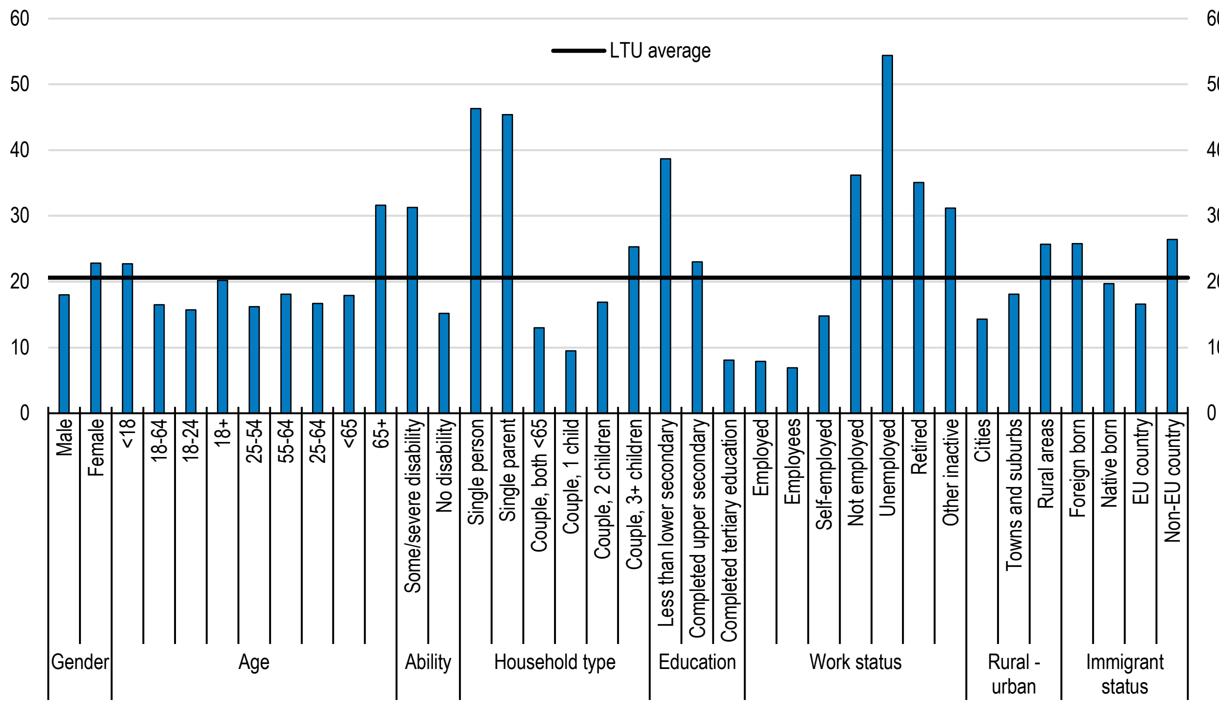
Note: Panels A and B: the at-risk-of-poverty rate is the share of persons with an equivalised disposable income below the at-risk-of-poverty threshold, set at 60% of the national median equivalised disposable income (after social transfers) (Eurostat definition). Panel C: the poverty gap is the ratio by which the mean income falls below the poverty line, defined as 50% or 60% of median equivalised disposable income of the entire population (OECD definition). Panel D: the relative at-risk-of-poverty gap is the relative difference between the median equivalised total net income of persons below the at-risk-of-poverty threshold and the at-risk-of-poverty threshold itself, expressed as a percentage of the at-risk-of-poverty threshold (cut-off point: 60% of median equivalised disposable income after transfers) (Eurostat definition). EU-SILC data refer to the year of reporting. Averages are calculated for the most recent value of all countries with available data (unweighted). Average groups are as follows: EU27: European Union members; OECD-EU: EU countries who are OECD members; Baltic: Estonia, Latvia, and Lithuania; Nordic: Denmark, Finland, Iceland, Norway, and Sweden; CEE (Central European Economies): Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia.
Source: OECD Income Distribution database; Statistics Lithuania; and EU-SILC.

StatLink https://doi.org/10.1787/888934185346

The risk of poverty is far from evenly distributed across population, varying with individual and household characteristics such as gender, age, employment status and family composition (Figure 2.3). Even though the poverty indicators have improved lately, certain groups, namely women, the elderly, people with disabilities, single-parents, the less educated and those living in rural areas face higher poverty rates than the overall population, with the unemployed being the hardest hit.

Figure 2.3. Some groups face especially high rates of poverty

At-risk-of-poverty rate, % of population, 2019



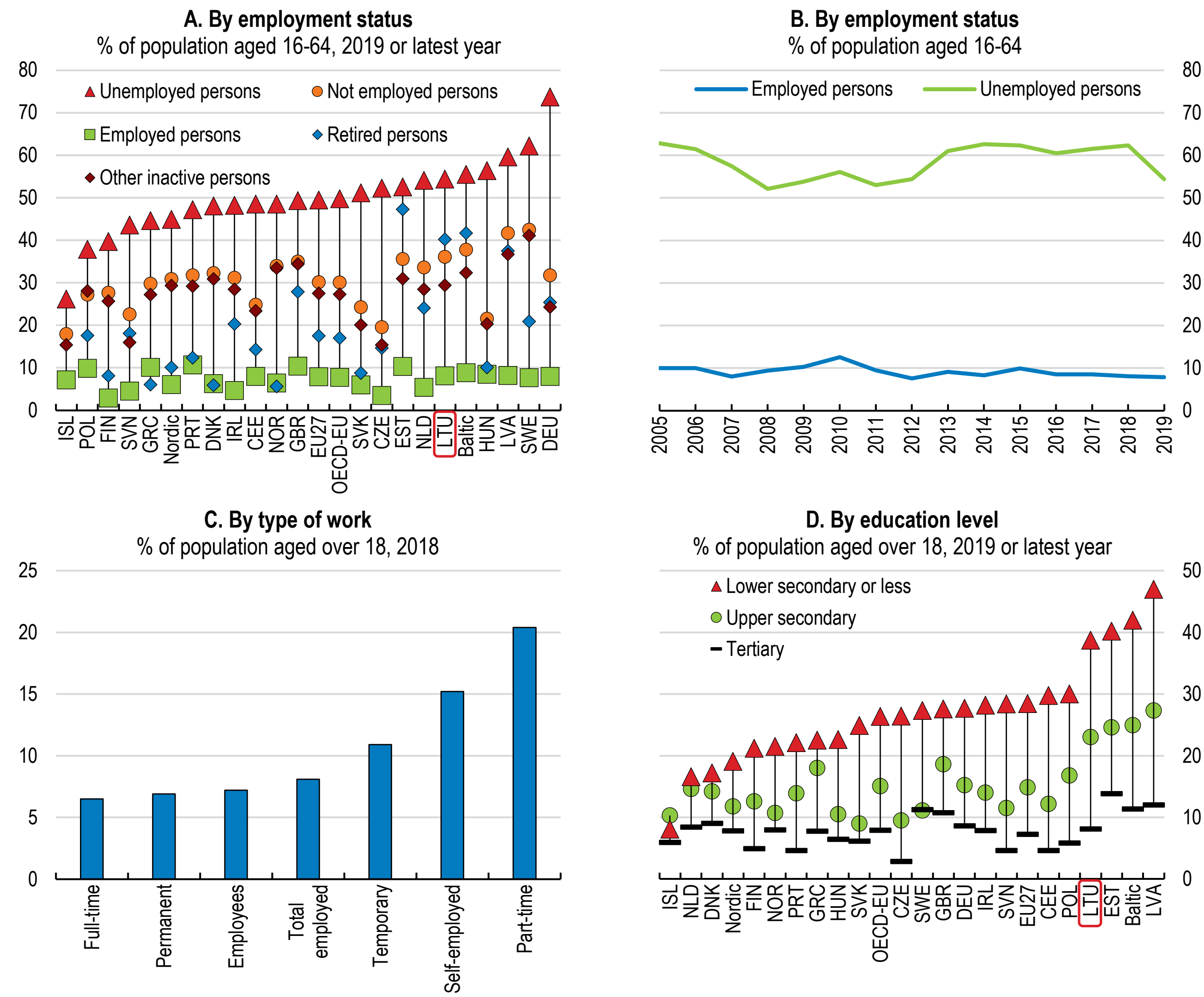
Note: The cut off for the at risk of poverty rate is 60% of median equivalised income after social transfers.
Source: EU-SILC; and Statistics Lithuania.

StatLink https://doi.org/10.1787/888934185365

More than half of the unemployed were at risk-of-poverty in 2019, above the average of the OECD members of EU and around 7 times higher than those in employment (Figure 2.3 and Figure 2.4). Poverty rates among the unemployed increased by approximately 5 percentage points between 2007 and 2018, as wages increased much faster than unemployment benefits, before falling back in 2019 as a result of recent reforms (discussed below). Those who have dropped out of the workforce (aged 16 to 64) also face comparatively high poverty rates. The difference is particularly pronounced when comparing these groups with their peers in full-time and permanent jobs, corroborating the view that good quality jobs is the best antidote to poverty (Causa, Hermansen and Ruiz, 2016[1]). At the same time, poverty at work could be reduced further. While the overall in-work poverty rate does not stand out in international comparison, part-time and temporary workers face disproportionally high rates. The slowing of wages due to the COVID-19 crisis may aggravate the situation (see, Chapter 1).

Figure 2.4. The unemployed and low-educated are at high risk of poverty

At-risk-of-poverty rate by employment type and education level



Note: The at-risk-of-poverty rate is the share of persons with an equivalised disposable income below the at-risk-of-poverty threshold, set at 60% of the national median equivalised disposable income (after social transfers) (Eurostat definition). Averages are calculated for the most recent value of all countries with available data (unweighted). Average groups are as follows: OECD-EU: EU countries who are OECD members; EU27: European Union members; Baltic: Estonia, Latvia, and Lithuania; Nordic: Denmark, Finland, Iceland, Norway, and Sweden; CEE (Central European Economies): Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia.
Source: Statistics Lithuania; and EU-SILC.

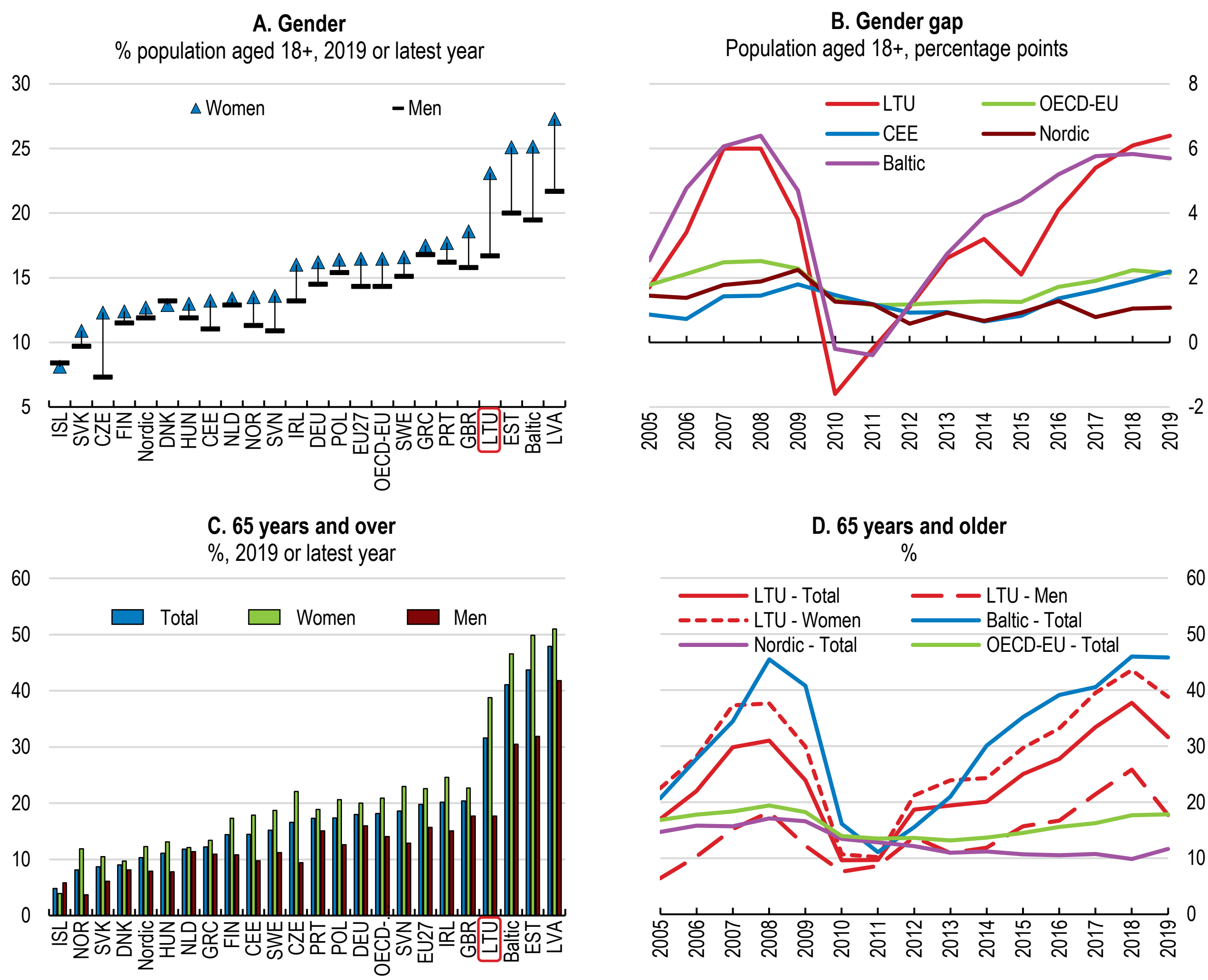
StatLink https://doi.org/10.1787/888934185384

As elsewhere, relative poverty tends to fall with the level of education (Figure 2.3 and Figure 2.4). This is not surprising, given the close relation between educational achievement and labour market outcomes. Recent data reveal, in particular, that the least-educated are around five times more likely to be at-risk-of-poverty than those with the highest education level, above the EU average. The transmission of disadvantage across generations is an important issue to address (Eurostat, 2019[2]). As discussed below, poverty rates are especially high among children (aged less than 18) with low-educated parents, with a risk of a vicious cycle between socio-economic background and economic opportunities (OECD, 2018[3]).

Lithuania also records large differences in poverty rates among genders, with women facing a higher risk than men (Figure 2.3 and Figure 2.5). The gap in poverty rates was close to 6 ½ percentage points in 2019, well above the average of the OECD members of EU, and has increased in recent years. These gender differences seem to mirror to a large extent the poverty patterns among the elderly. Other factors, such as household composition, can also be part of the explanation.

Figure 2.5. Elderly women are affected most by poverty, explaining much of the gender gap

At-risk-of-poverty rate by demographic group



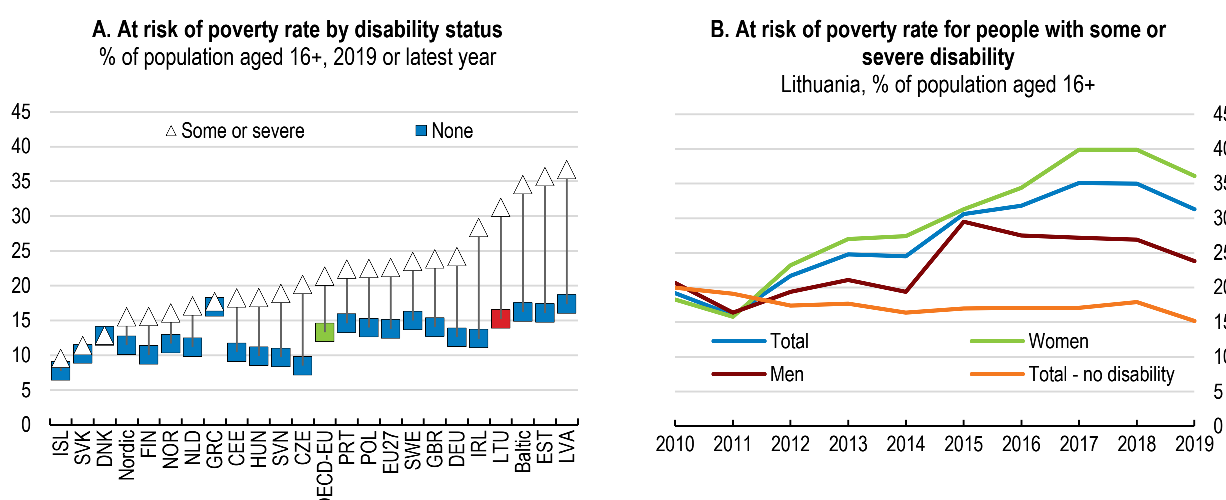
Note: The at-risk-of-poverty rate is the share of persons with an equivalised disposable income below the at-risk-of-poverty threshold, set at 60% of the national median equivalised disposable income (after social transfers) (Eurostat definition). The gender gap in poverty rate is calculated as the male adult poverty rate less the female poverty rate. In Panel D, "total" refer to men and women. Averages are calculated for the most recent value of all countries with available data (unweighted). Average groups are as follows: OECD-EU: EU countries who are OECD members; EU27: European Union members; Baltic: Estonia, Latvia, and Lithuania; Nordic: Denmark, Finland, Iceland, Norway, and Sweden; CEE (Central European Economies): Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia. The gender gap in poverty rate is calculated as the male adult poverty rate less the female poverty rate.
Source: Statistics Lithuania; and EU-SILC.

StatLink https://doi.org/10.1787/888934185403

The elderly face the highest risk of poverty among the age groups (Figure 2.3). Lithuania has one of the highest old-age poverty rates among the European OECD countries, although it ranks below the other Baltic countries (Figure 2.5). Despite a drop in the elderly poverty rate by 6 percentage points in 2019, around a third of those aged 65 years and over still live below the poverty line. This rate is above the national average and around two times higher than that for the 25-64 age-group (Figure 2.3). Elderly women are more exposed to the poverty risk than men, however, that explains much of the overall gender poverty gap prevailing in Lithuania. This pattern, which is also common in other countries, can be largely explained by the lower pension income received by women (Eurostat, 2019[2]). The average pension for women in Lithuania is about 22% lower than that for men, according to official estimates, reflecting lower lifelong earnings and shorter contribution periods due to the earlier statutory retirement age and career breaks. Moreover, women often live in single households because their life expectancy is much higher than men's. Old-age poverty has risen sharply in recent years, as pensions grew at a slower pace than wages (Statistics Lithuania, 2019[4]). This differs from developments in many other countries where the rates remained broadly stable (Figure 2.5). The rise was more pronounced for elderly women than men, augmenting the gender-poverty gap. Wealth inequality is comparatively low in Lithuania (Credit Suisse, 2019[5]), reflecting high homeownership rates, to be taken into consideration when addressing poverty.

Relative poverty is also high among people with disabilities, raising important challenges. Around a third of people with activity limitations (some or severe) live below the poverty threshold, among the largest rates in the EU area (Figure 2.6). Despite the measures taken, poverty rates among people with disability have increased over time, especially among women. The difference in poverty between people with and without disabilities stood at around 16 percentage points in 2019, reflecting the more limited labour market and social integration of the former group (EAPN, 2019[6]).

Figure 2.6. People with disabilities are vulnerable to poverty

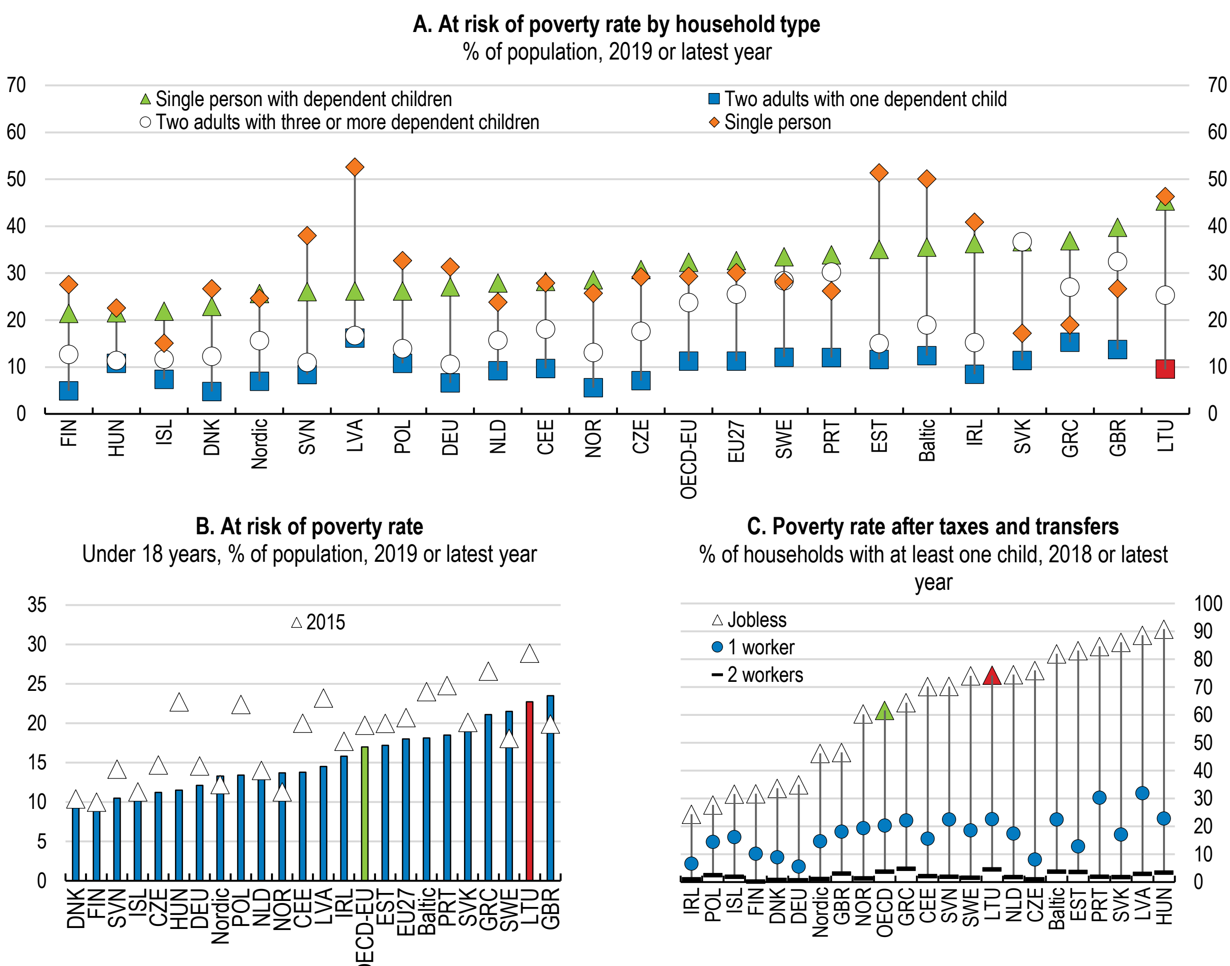


Note: The at-risk-of-poverty rate is the share of persons with an equivalised disposable income below the at-risk-of-poverty threshold, set at 60% of the national median equivalised disposable income (after social transfers) (Eurostat definition). Averages are calculated for the most recent value of all countries with available data (unweighted). Average groups are as follows: OECD-EU: EU countries who are OECD members. Baltic: Estonia, Latvia, and Lithuania; Nordic: Denmark, Finland, Iceland, Norway, and Sweden; CEE (Central European Economies): Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia.
Source: Statistics Lithuania; and EU-SILC.

StatLink https://doi.org/10.1787/888934185422

Child poverty remains closely related to vulnerability of the household. Around half of single parents in Lithuania live below the poverty line, well above the average of the OECD members of EU (Figure 2.3 and Figure 2.7). Relative poverty also affects two adult households with children, with the risk increasing with the family size. Families with three or more dependent children, in particular, face a poverty rate that is over two and a half times greater than their counterparts with one dependent child, despite a narrowing in the difference over the past few years. This raises concerns about child poverty. While child poverty rates have declined, around a quarter of children are still at risk-of-poverty, above the shares in comparator countries (Figure 2.7). The well-being of children is closely linked to the structure and employment status of the household, with children from single-parent and jobless households facing higher risk of poverty (Thévenon et al., 2018[7]). Parents' education also matters. Children with low-educated parents have a high likelihood of growing up in poverty. Single-adult households also experience high risk-of-poverty rates, that can be explained partly by the fact that in such households there is no partner to cushion the impact of temporary income shocks (Eurostat, 2019[2]). Moreover, single-adult households are usually made up of jobless young people or pensioners who have very low incomes.

Figure 2.7. Child poverty varies with the household type



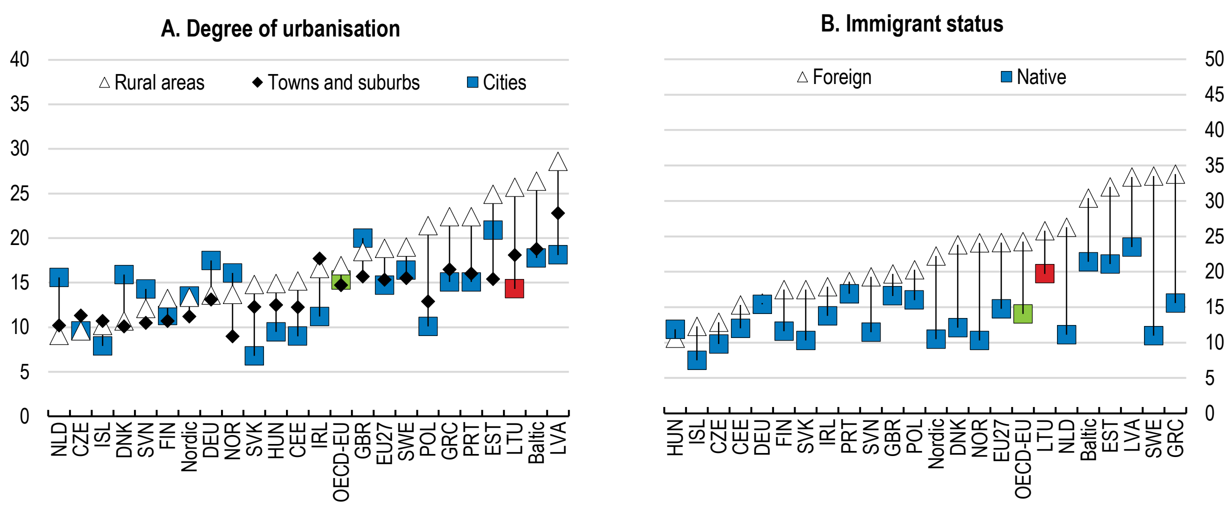
Note: The poverty rate is the ratio of the number of people (in a given age group) whose income falls below the poverty line; taken as half the median household income of the total population (OECD threshold). The at-risk-of-poverty rate is the share of persons with an equivalised disposable income below the at-risk-of-poverty threshold, which is set at 60% of the national median equivalised disposable income (after social transfers) (Eurostat threshold). Averages are calculated for the most recent value of all countries with available data (unweighted). Average groups are as follows: OECD-EU: EU countries who are OECD members; EU27: European Union members; Baltic: Estonia, Latvia, and Lithuania; Nordic: Denmark, Finland, Iceland, Norway, and Sweden; CEE (Central European Economies): Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia.
Source: Statistics Lithuania; EU-SILC; and OECD Income Distribution Database.

StatLink https://doi.org/10.1787/888934185441

Poverty rates further vary according to region and immigrant status. The risk of poverty in rural areas is nearly double that of urban areas (Figure 2.3 and Figure 2.8). This difference is large in international comparison, mirroring largely regional differences in unemployment rates. Other factors, such as remoteness and the ageing population in rural areas, may also contribute (Bertolini, 2019[8]). Despite recent declines, the poverty rate in rural areas remains at around 26%. A better integration of immigrants from non-EU countries could also help reducing poverty and social disparities. While Lithuania exhibits a relatively small poverty-origin gap at an aggregate level, immigrants from non-EU remain more exposed to the risk of poverty than the natives, and especially immigrants from EU countries (Figure 2.3 and Figure 2.8). This indicates scope for further reducing work-related obstacles, such as problems with credential recognition or language barriers (Eurostat, 2019[2]).

Figure 2.8. Poverty rates vary according to region and, to a lesser extent, immigrant status

At-risk-of-poverty rate, % of population, 2019



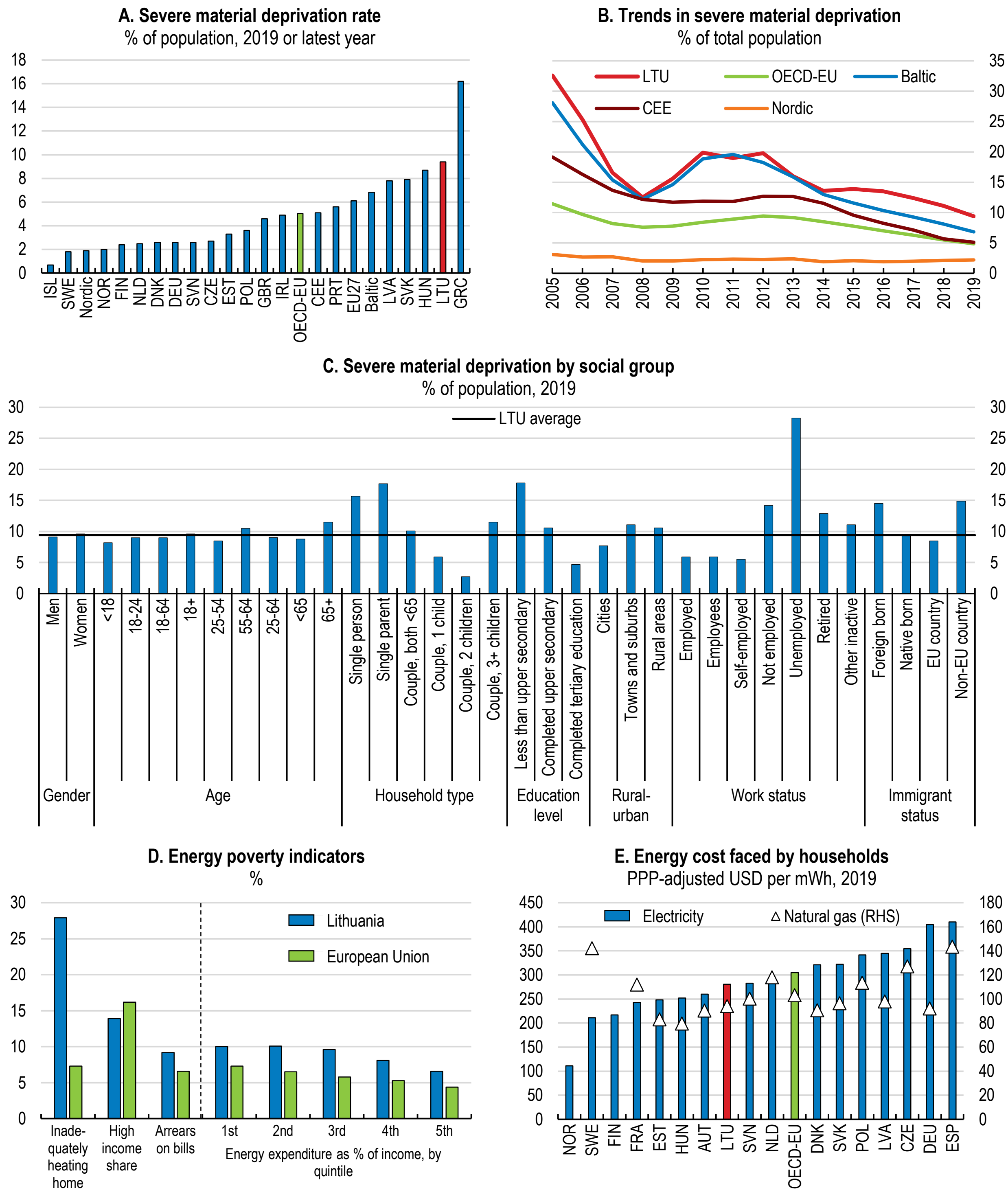
Note: The at-risk-of-poverty rate is the share of persons with an equivalised disposable income below the at-risk-of-poverty threshold, set at 60% of the national median equivalised disposable income (after social transfers) (Eurostat definition). Averages are calculated for the most recent value of all countries with available data (unweighted). Average groups are as follows: OECD-EU: EU countries who are OECD members; EU27: European Union members; Baltic: Estonia, Latvia, and Lithuania; Nordic: Denmark, Finland, Iceland, Norway, and Sweden; CEE (Central European Economies): Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia.
Source: EU-SILC.

StatLink https://doi.org/10.1787/888934185460

Some vulnerable groups are also likely to experience other forms of poverty

Certain households face absolute poverty, not being able to afford some necessities of daily life. The severe material deprivation rate (a Eurostat measure of absolute poverty), has declined steadily in recent years as incomes increased. Nevertheless, around 10% of the population remain in hardship, well above the average of European OECD countries (Figure 2.9). For some vulnerable groups, such as lone parents, larger families, immigrants, the low educated and the unemployed, severe material deprivation is comparatively high. The elderly, especially females, also tend to be more severely-materially deprived compared to younger groups. Homelessness and poor quality of housing (discussed below) is an important form of deprivation in Lithuania.

Figure 2.9. Many households experience severe material deprivation and energy poverty



Note: Panel A: Severe material deprivation rate is defined as the enforced inability to pay for at least four of a list of nine key deprivation items. Panel D: The three leftmost indicators refer to: Inability to keep home adequately warm (2018); High share of energy expenditure in income (2015); Arrears on utility bills (2018). Data on income quintiles are for 2015. Averages are calculated for the most recent value of all countries with available data (unweighted). Country average groups are defined as in Figure 2.2.
Source: Statistics Lithuania; EU-SILC; and OECD Energy Prices and Taxes database.

StatLink https://doi.org/10.1787/888934185479

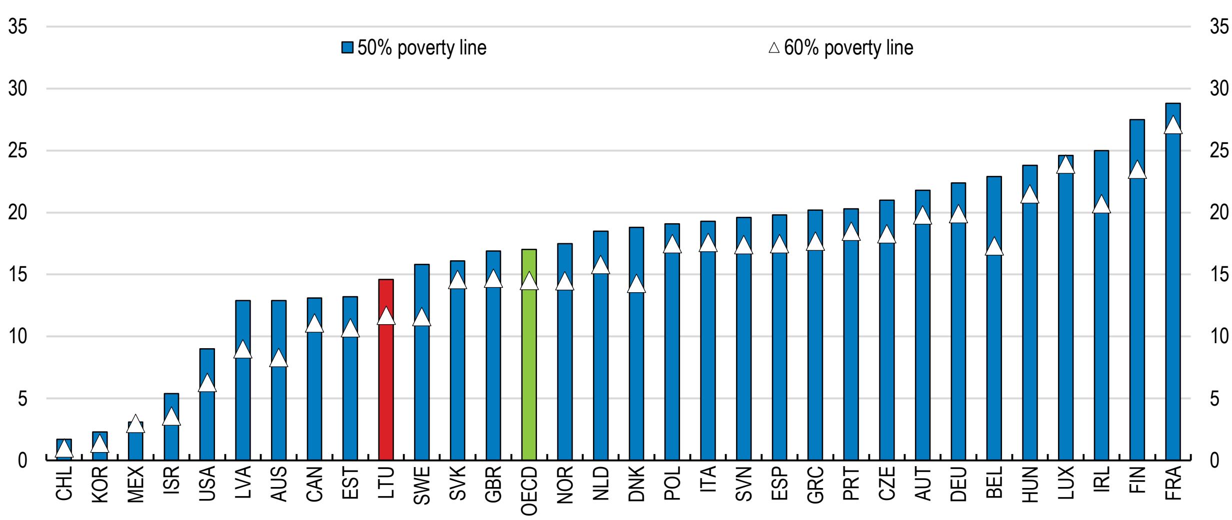
Recent EU indicators further highlight challenges arising from energy poverty. Around 28% of households in Lithuania were unable to keep their home warm in 2018, compared to an EU average of 7.5%, while 9% fell into arrears with their utility bills, with the risk of experiencing disconnection of supply (Figure 2.9) (Energy Poverty Observatory, 2020[9]). Many households, especially low-income ones, spend a high share of their income on energy bills, posing a budgetary burden. Energy poverty is closely linked to the level of household income, but low income is not the sole driver (Bouzarovski and Thomson, 2020[10]); (Longo et al., 2020[11]). The housing stock might not be of adequate quality to avoid energy poverty. Around 35 000 energy inefficient multi-apartment buildings are currently waiting to be refurbished (European Commission, 2020[12]). The poor quality of heating insulation of many dwellings in Lithuania increases household energy bills, despite comparatively low energy prices, requiring improvements in housing quality and energy efficiency, as discussed below.

Improving the effectiveness of the transfer system in reducing poverty

The tax-transfer system does not reduce poverty decisively. OECD data suggest that, in 2017, taxes and transfers have dented poverty rate by less than 15 percentage points, approximately 2 ½ percentage points less than the OECD average (Figure 2.10). The difference vis-à-vis the average increases to 3 percentage points, when the poverty threshold is set at 60% of the median income. Social spending remains low in international comparison both in the case of in-kind services and cash support, including for minimum-income benefits that can have a financial impact on all age groups (Figure 2.11). While these data do not take into account reforms over the past few years that have increased the generosity of social benefits, especially for families, they indicate scope for further increases. Low spending, together with a lack of a well-developed individualised approach to social benefit and service provision, makes the social protection system less effective in combating poverty (Box 2.1).

Figure 2.10. The tax-transfer system could be more effective in reducing poverty

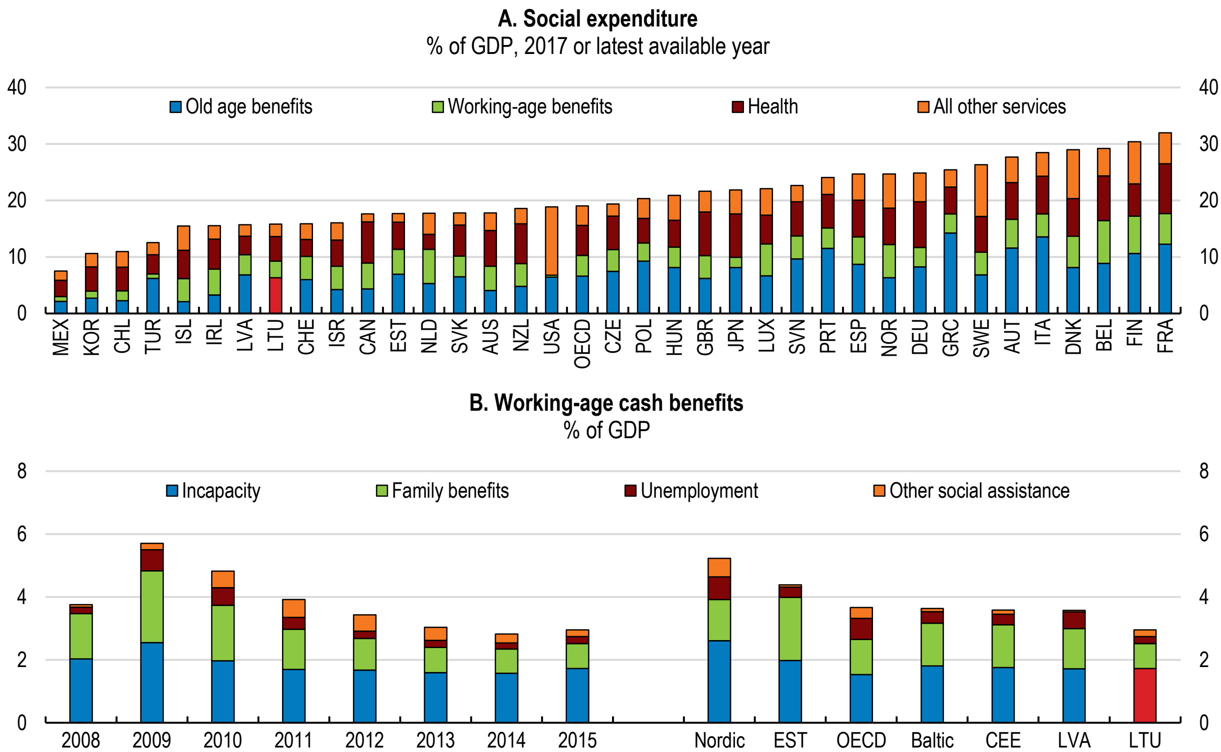
Percentage point reduction in poverty rate from taxes and transfers, 2018 or latest year



Note: Figure shows the reduction in the percentage of households with pre-tax income below 50% and 60% of the national median household income that results from taxes and transfers. Data for Lithuania refer to 2017.
Source: OECD Income Distribution Database.

StatLink https://doi.org/10.1787/888934185498

Figure 2.11. Social spending is low by international standards



Note: Panel A: Working-age benefits includes spending unemployment, family benefits, incapacity, and other social assistance. Panel B: Only cash benefits are included (i.e. excludes in-kind benefits). Average groups are as follows: OECD-EU: EU countries who are OECD members; EU27: European Union members; Baltic: Estonia, Latvia, and Lithuania; Nordic: Denmark, Finland, Iceland, Norway, and Sweden; CEE (Central European Economies): Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia. International comparison data refer to 2017 or the latest available year. Data for LTU and OECD average are for 2015.
Source: OECD Social Expenditure database.

StatLink https://doi.org/10.1787/888934185517

Additional social spending can be financed through efforts to utilise under-exploited tax bases, including by tackling tax evasion. Measures to improve tax compliance are envisaged by the government to bring in additional tax revenues of approximately 0.4% of GDP (Ministry of Finance, 2019[13]). Broadening the tax base to sources less detrimental to growth must be part of the solution for securing the revenue necessary to increase social spending and improve further the adequacy of social benefits, especially as compliance gains are uncertain given that they are difficult to forecast. There is scope, in context, to tap the revenue potential of property and environmental taxes where Lithuania collects less than the OECD average (Chapter 1). This would also allow shifting taxes away from labour, making the tax mix more inclusive.

Box 2.1. The social protection system: main features

The social support system is based on the social insurance principle (OECD, 2018[14]). Insurance-based benefits, including unemployment, incapacity and old age, are administrated and provided by the State Social Insurance Fund Board (SoDra), while the 60 municipalities administer most non-contributory income support benefits and have responsibility for the provision of social services. Cash benefits are funded directly from municipal budgets, but the central government also contributes via allocations and grants.

The financing of social services is a shared responsibility of the municipalities and central government. Under the law on Social Services, social care for the elderly, adults with disability, children with disability (except for persons with severe disability) and those exposed to social risk are financed from the municipal budget. Social care for persons with severe disability and social care of families are financed from the targeted subsidies to municipal budgets from the state budget. Municipalities provide both "general" social services, including social work counseling and provision of food, clothing and transportation; as well as "specialised" social services such as measures to develop social skills and home visits (OECD, 2018[14]). The municipalities also have responsibility for the provision of early education and care for children aged under 7 years, though a large part of the funding comes from the central government.

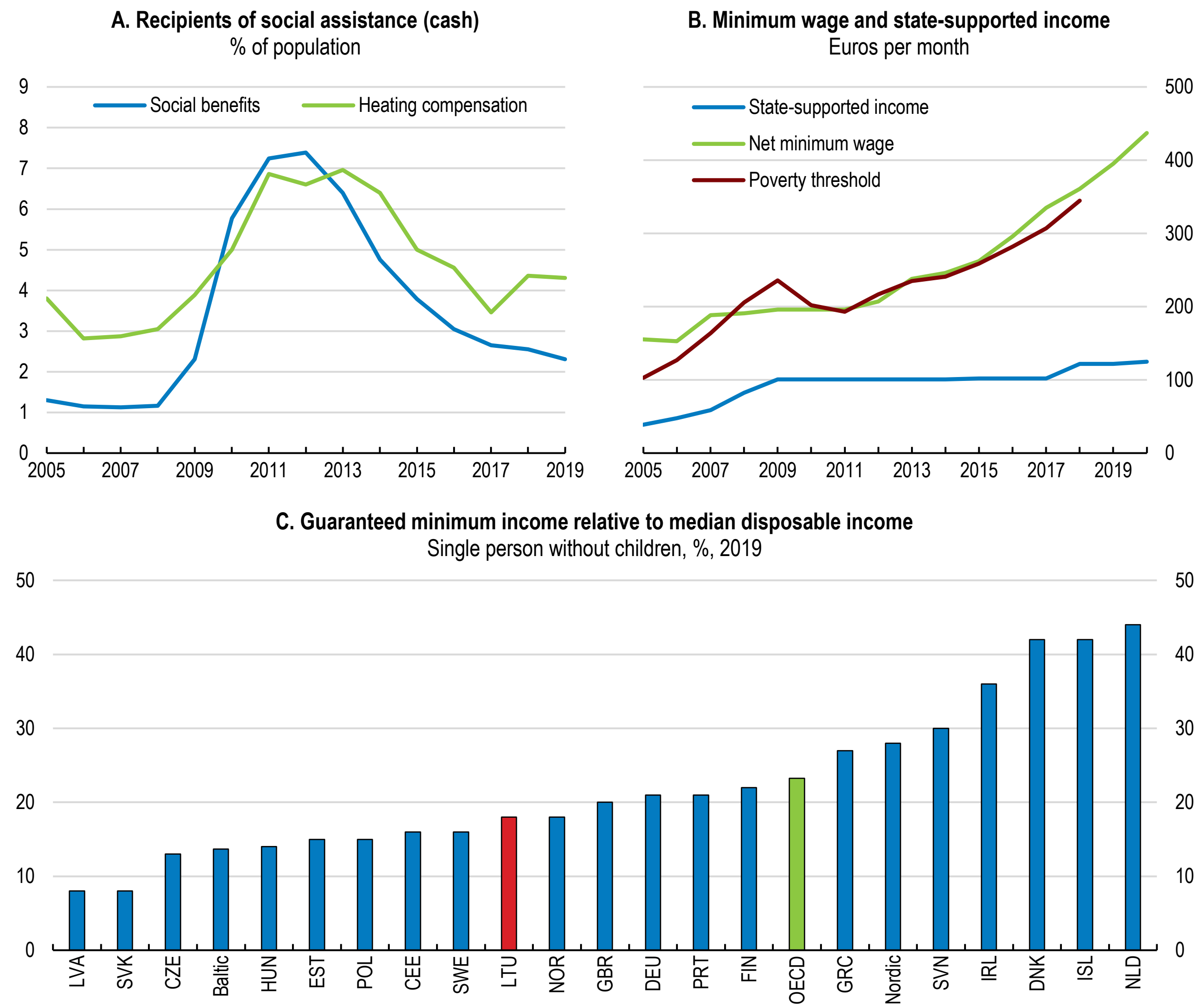
Regarding health care, Lithuania moved in the late 1990s away from a health system mainly funded through state and local budgets to one funded by the National Health Insurance Fund (OECD, 2018[15]). However, municipalities are responsible for organising the provision of primary and social care, and for public health activities at the local level. They also own the majority of polyclinics and small-to medium sized hospitals. Furthermore, municipalities provide social housing or partial assistance for the rental costs or costs related to purchase of housing (Lazutka et al., 2019[16]). Under the Constitution, municipalities are autonomous with regard to development of local policy and service provision.

Working-age benefits can be raised further and better tailored to recipients' needs

A number of measures were introduced over the past two years to strengthen working-age benefits. These include an increase in state-supported income and its indexation to the amount of minimum consumption needs from 2019, revisions in unemployment benefits that increased coverage and made payment rates more generous, and changes in the family benefits notably through the introduction of a universal-child benefit (non-means tested) in 2018 (OECD, 2018[15]). An income disregard for social assistance recipients was also introduced allowing recipients with income from work to keep some of their earnings. These reforms go in the right direction, striking a balance between increased income support and work incentives. Government estimates point to a positive impact of the measures in terms of poverty reduction in 2018 compared to the previous year (by around 1 to 2 percentage points), with a positive, but smaller, estimated impact also in 2019.

Reform efforts need to continue, given the scale of the poverty challenge and the need to address additional social protection gaps arising from the COVID-19 crisis (Figure 2.1). Improving further the adequacy of social benefits, which provide last resort income support to low income households, would have a broad financial impact. The state-supported income (SSI), the base for social benefits, has increased by over 20% in early 2018, for the first time in the decade (Figure 2.12). Since 2019, the SSI is indexed to the amount of minimum consumption needs, thereby adjusting automatically for price level changes. Nonetheless, the guaranteed minimum income scheme still alleviates poverty risks to a lesser extent than the OECD average, according to recent data.

Figure 2.12. Cash benefits can be strengthened further



Note: Panel B: the poverty threshold is defined as 60% of the median equivalised income. Panel C shows income of a jobless single person claiming guaranteed minimum income benefits (but not unemployment benefits) as a percentage of the median disposable income for the whole population. Housing benefits for rented accommodation are not included. For Lithuania, the calculations include social benefit.
Source: Ministry of Social Security and Labour; and OECD Tax-Benefit Model.

StatLink https://doi.org/10.1787/888934185536

Ensuring that social benefits provide a strong safety net would require additional increases in state-supported income (SSI) that are likely to go beyond those foreseen by the indexation formula, while maintaining strong work incentives. There should also be a balance between minimum income and minimum pensions. The rise in SSI would increase not only the level of social benefits, but also that of the Heating Compensation (the other component of Cash Social Assistance Scheme), which is paid if heating costs exceed more than 10% of the difference between household income and the SSI. Heating Compensation makes a significant contribution to disposable income of households eligible for such benefits, covering around 4 ½ percent of the population. It is also an important instrument to tackle energy poverty (Figure 2.9). To protect the vulnerable groups from the adverse consequences of the cessation of activities during the quarantine, the government has expanded the coverage of cash social assistance, by raising the limit of income establishing the right to social benefit, and increased the level of social payments for singles and families (Box 2.2). Moreover, social benefits were differentiated depending on the duration of payment. A higher compensation for home heating costs has also been provided in the case of single persons. It is welcome that these measures are to remain in place after the end of the quarantine. Consideration could be further given to the regional differentiation of social benefits, as recommended by a recent OECD report (OECD, 2018[14]).

There is scope to strengthen further the adequacy of other key cash benefits for the working-age population. A recent audit report concluded that the social support (cash benefits, services) provided and other income (for instance, wages and rent) do not cover sufficiently the minimum consumption needs of the poor (National Audit Office, 2019[17]). The level of universal child benefit has increased by 20% since early 2020 and the amount of the supplement granted to low income and larger families has been doubled. Official estimates suggest that these changes would reduce child poverty rates by 2.5 percentage points, adding to previous gains since the introduction of the universal child benefit scheme in 2018. Moreover, to help alleviating the impact of COVID-19 crisis, an additional child benefit of EUR 40 will be granted to low-income families with up to two children (Box 2.2). Around 33 000 children will receive such benefit, according to official estimates. Crisis-related initiatives also entail a lump-sum benefit for all children. Measures to reduce child poverty are welcome but their positive impact should be balanced against potential disincentives to work, especially for women.

The duration of unemployment benefit could be extended to help those out of work for a long time. Revisions in mid-2017, under the New Social Model, increased the coverage of unemployment benefits by easing eligibility conditions, and made them more generous by extending the duration of benefits to 9 months (regardless of contribution history) and raising payment rates. The maximum period of unemployment benefit could increase further as proposed by the previous Survey (OECD, 2018[15]) and financed, for instance, by a reduction in the relatively generous replacement rates in the initial months of an unemployment spell (OECD, 2018[14]). Most OECD countries grant unemployment benefits for at least twelve months. Such reform would strengthen the support for the long-term unemployed, which accounted already for 30% of the unemployed before the outbreak of the pandemic, while ensuring the effective labour market re-integration of these workers. An alternative reform, currently under consideration by the government, is to make the temporary jobseeker’s benefit (Box 2.2) permanent, upon a close examination of its effectiveness. Such benefit is targeted at those not eligible for unemployment insurance benefit, or when its payment has expired. The level of the permanent benefit should be aligned to that of the unemployment insurance benefit, while minimising disincentives to work.

Social spending on disability, on the other hand, needs to be carefully monitored. Spending on disability pensions and sickness benefits is relatively high, accounted in 2015 (latest available data) for over half of overall working-age income support (Figure 2.11). A recent OECD analysis highlighted, in this context, the need to further improve the quality of work capacity assessments (Pacifico, 2017[18]). Despite reforms, they continue to rely too strongly on medical certificates, with relatively little consideration is given to the persons’ physical, social and professional capabilities.

Box 2.2. Social measures in response to the COVID-19 crisis

A range of measures were introduced to protect the most exposed groups from the adverse economic consequences of the pandemic. In particular:

Confinement assistance measures

Measures applied during the quarantine period, commenced in mid-March 2020, include: short time work schemes in the form of wage subsidies (covering between 70% and 90% of the accrued wage) that ensure that workers receive at least the minimum wage during the downtime; a flat benefit (EUR 257 per month) for insured self-employed; sickness benefits for cares; and increased sickness benefits for employees infected by the virus. Official estimates suggest that over 100 000 of employees, and 60 000 of self-employed, have benefited in May 2020 from the two first measures.

The confinement measures also included a training grant (around 40% of the minimum monthly salary) for the unemployed, if the VET programme registered was suspended during the quarantine, paid to almost 2 000 people in March 2020, and the possibility for differing or arranging the payments of energy bills. Greater security of energy supply for final consumers was ensured by limiting disconnections.

Post-confinement assistance measures

Additional social measures were approved in May 2020, amounting to 2% of GDP, to support business and households after the end of the quarantine. It is estimated by the government that, upon implementation, these measures will benefit about 1.4 million people. Initiatives comprise:

Assistance measures to safeguard jobs, including the extension of short time work schemes introduced during the quarantine for another six months, on the condition that an employer had not proceeded in dismissals during the confinement period. The subsidy covers between 30% and 100% of the accrued wage, up to a maximum limit, with the highest rates applying in the first two months after the quarantine.

Assistance measures to help workers to return to the labour market include the extension of flat benefit for self-employed for another two months after the end of the quarantine; support for job creation in high unemployment regions and for vulnerable groups; easing hiring restrictions for apprentices with the public employment service (PES) subsidising 70% of their wage (up to a limit); and, increased funding through PES for vocational training. In addition, a jobseeker's benefit was introduced for unemployed persons not entitled to unemployment social insurance benefit or its payment has expired. This will apply for 6 months and amounts 33% of minimum monthly salary (MMS). Unemployment benefit recipients will get additionally 7% of MMS each month until end-2020.

Finally, measures to help those most in need include a lump sum benefit (EUR 200) for the elderly and disabled and increases in social benefits. The limit of income establishing the right to social benefit was increased from 1 to 1.1 SSI (state-support income) and the amount of social benefit was raised and differentiated according to the duration of payment. In addition, a higher share of housing heating costs will be compensated in the case of single persons. Measures further entail an increase in disregard income (the part of the work income not included when establishing a person's right to cash social assistance) by 5 percentage points, as well as of the in-work benefits for long-term unemployed. Part of the unemployment benefit and the temporary job search benefit will not be included in the disregard income, with the proportion varying according to household composition and number of children. Moreover, low-income families with one or two children will receive an additional child benefit of EUR 40. A lump-sum benefit for all children will also be granted. Initiatives further include the introduction of a temporary non-evaluation of property, as well as measures regarding social housing (discussed in the text) that will remain in place after the quarantine.

Source: Ministry of Social Security and Labour.

The development of an individual-based approach to the provision of social support is crucial for improving effectiveness. Rapid progress in this domain becomes an even higher priority in view of the expected rise in social needs in the aftermath of the COVID-19 crisis. The importance of more tailored support to individual needs is also stressed by the recent report of the national audit. According to the report, municipalities do not provide social support (income and services) on the basis of individual plans, nor do they evaluate whether it ensures minimum needs (National Audit Office, 2019[17]). Moreover, the support provided is not comprehensive as it entails mainly social cash benefits, rather than combining all forms of support. The challenges of enhancing customisation of social support should not be underestimated, however, given the complexity of identifying individual needs (de Mello and Dutz, 2012[19]). As a welcome step, a project underway aims at the creation of a “client e-file” by 2021 that will record all social benefits and services received by an individual or family. This allows for a more tailored and better-coordinated provision of social support.

There is also scope for improving the accessibility to social support. The audit report highlighted, in this context, the need for systematic and regularly updated information on the availability of benefits and services and corresponding eligibility conditions, as well as the establishment of an electronic system that enables applications for all types of social support (National Audit Office, 2019[17]). The government has prepared a plan to address these shortcomings. The creation of an e-platform is underway. Well-designed indicators to monitor the effectiveness of social assistance system are also essential and efforts to this end need to continue. The Nordic Welfare Indicator system could provide useful insights in this regard (Nordic Council of Ministers, 2017[20]). This entails 30, easily accessible, indicators that cover nine areas (health, education skills, employment, work-life balance, incomes, housing, social networking and social security), with a special emphasis on the vulnerable groups.

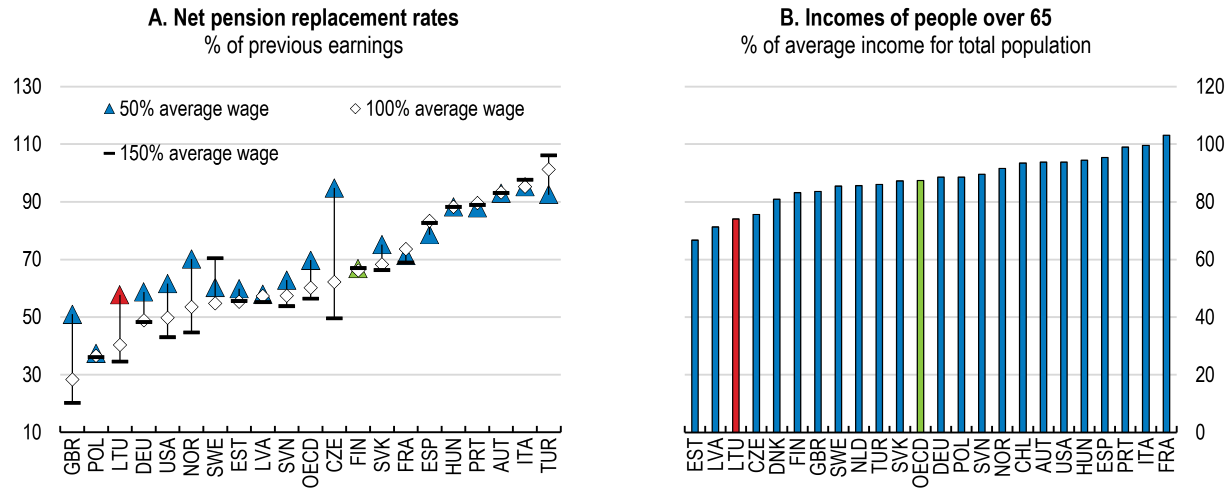
The pension system needs to safeguard more against old-age poverty

Lithuania’s pension system is very redistributive, as reflected by the higher net replacement ratios for low-income earners, but pensions remain modest (Figure 2.13). The income of people over 65 was equivalent to around three-quarters of the average income for total population in 2016, well below the OECD average (close to 90%) and the Nordic countries. Pensions account for over 60% of older people’s overall income in Lithuania (OECD, 2019[21]).

Following a recent reform, pension benefits were indexed to the overall wage bill, starting from 2018, while the insurance period for a full pension is set to increase gradually from 30 to 35 years by 2027. The reforms also entailed an ad hoc increase in the general (non-earning related) component by 16%. The changes are expected to improve the financial sustainability of the pension system but might decrease the adequacy of pensions over the longer term. Indeed, while rising initially, the benefit ratio is projected to fall in the longer term as the total wage bill, used to index pensions, is expected to rise more slowly than wages due to shrinking labour force (European Commission, 2019[22]). Those having a shorter work history will be particularly affected by the pension reform, as the increase in the insurance period for a full pension under the new rules reduces the basic (“general”) pension component for persons with the required minimum (15 years) contribution history by 14% in 2027 (OECD, 2018[14]).

To better protect the elderly against poverty, an additional top-up is granted to those receiving the lowest social insurance pensions. The government further considers to increase in 2020 and 2021 the general part (non-earnings related) of the old-age pension by more than foreseen by the automatic pension index, subject to budget constraints. Since 2019, the general part of the social insurance pension scheme, that is not earnings-related, was shifted to the state budget. It is important that pension outlays are appropriately financed out of general taxation or alternatively finances.

Figure 2.13. The pension system is very redistributive but net replacement rates are low



Note: Panel A: Net replacement rate (NRR) is defined as the individual net pension entitlement divided by net pre-retirement earnings, taking into account personal income taxes and contributions paid by workers and pensioners. NRRs s are theoretical for a person entering the labour market at the age of 20 years and working without interruption until the statutory retirement age. For Lithuania, a 2% contributions to the private funded pension scheme was assumed. Panel B: data refer to 2016 or the latest year available for each country. OECD refers to a simple average over all OECD countries with available data (latest year).
Source: OECD calculations based on pension models and Pension at a Glance 2019.

StatLink https://doi.org/10.1787/888934185555

Minimum-income pensioners, receiving a social assistance pension, require special attention. These are elderly or disabled persons with insufficient rights for a social insurance pension. While increased by 6% between 2019 and 2020, the level of social assistance pension for old-age remains low, making up less than 30% of the minimum wage. The government should consider raising gradually further social assistance pensions, to help reducing high old-age poverty rates, while strengthening means-testing. Widespread homeownership, for example, provides benefits to retirees. Older homeowners usually have paid off their mortgages, and thus fully benefit from not having to pay rent. Strengthening means-testing would require the development of an administration system to assess the "net" income of pensioners. Consideration could also be given to merge old-age social assistance pension with other social benefits, making it more transparent and simpler to be accessed by those eligible. To mitigate the impact of the COVID-19 crisis, the government has approved a lump-sum benefit of EUR 200 for the elderly and disabled (Box 2.2).

Providing high quality social services for vulnerable groups

Social services should address better the complex and different needs of the vulnerable groups by providing a tailored and comprehensive support. Spending on social services remains low in international comparison (Figure 2.11). Only 3.3% of the municipal budget in 2018 was allocated to the provision of social services such as care for the elderly and persons with disabilities (Box 2.1). Local authorities could also use more efficiently the funds allocated to their budgets for social support. Payments of cash benefits have decreased in recent years, due to rising incomes and other factors. However, municipalities use approximately only half of the funds allocated to their budgets for the provision of social benefits, even though the demand for other means of social assistance, such as services and other financial benefits, remains unmet (National Audit Office, 2019[17]). Under current legislation, any unused funds for social benefits becomes part of the municipal budgets and can be used for other social support measures (OECD, 2018[14]).

Other shortcomings of the social protection system also make it difficult to reach the needy. Well-developed systems that identify client needs and facilitate information sharing across local authorities are missing. As a positive step, the range of provided family services have widened in recent years. Social worker support has increased and a basic family service package was introduced in 2019 encompassing 14 types of services. However, important challenges remain. Reducing deficits in the provision long-term care and social housing and ensuing high quality health care services for all are crucial to reduce poverty.

Improving the provision of health care services

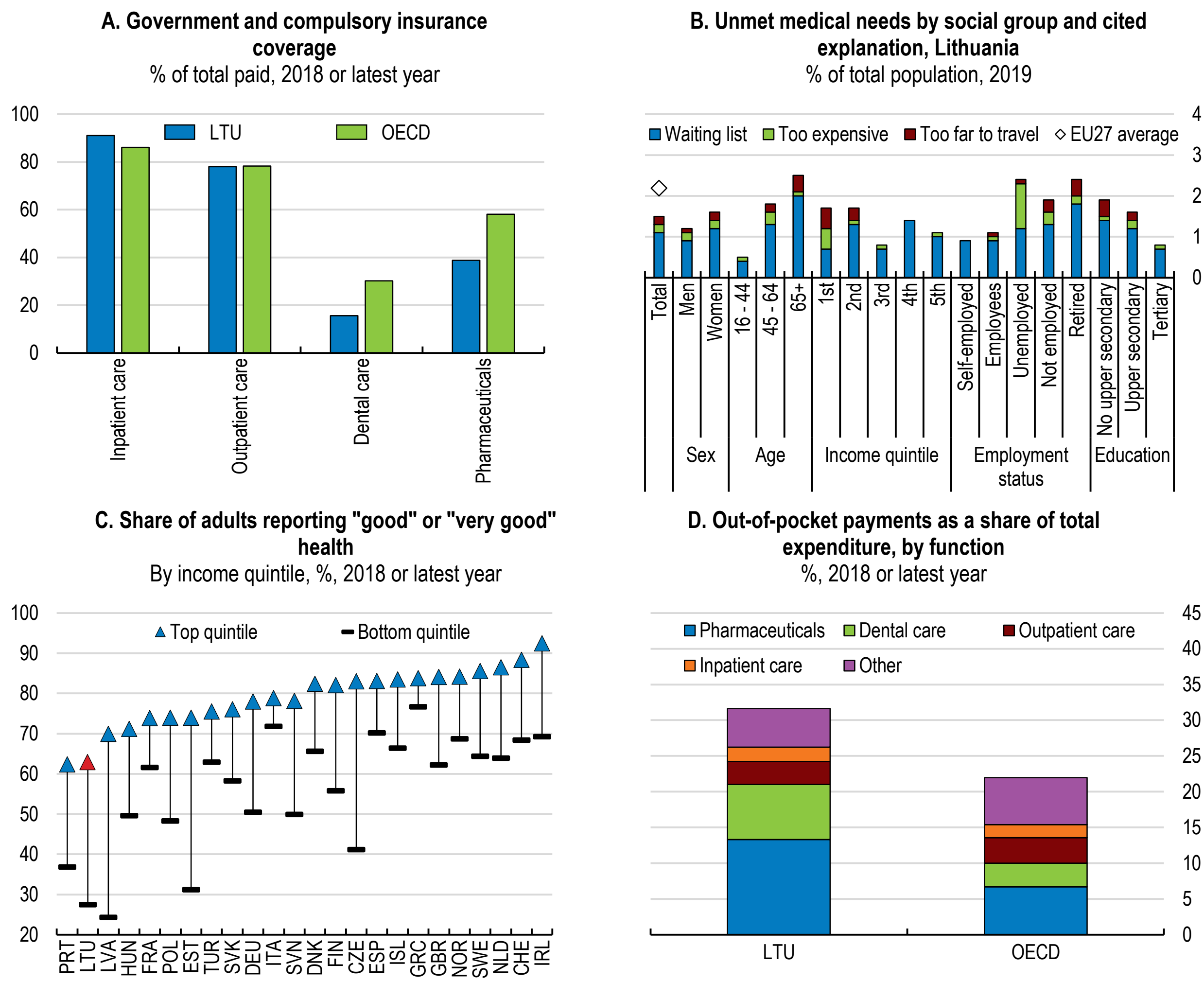
Lithuania's health insurance system compares well with the EU average in terms of coverage for outpatient and inpatient care, but coverage for dental care and pharmaceuticals is relatively low (Figure 2.14, Panel A). Less than 2% of the population reported unmet needs for medical examination in 2019, mainly due to waiting time, which is below the EU average (Figure 2.14, Panel B). Still some social groups, such as the elderly and the less educated, tend to report relatively larger unmet needs. A recent study further highlights disparities between the urban and rural population in terms of accessibility to emergency services (Lazutka, Poviliunas and Zalimiene, 2018[23]). The unequal distribution of medical personnel across the country makes it more difficult to ensure access to needed health services in certain remote municipalities. The COVID-19 crisis poses challenges with regard to healthcare access. Many medical procedures have been postponed due to pandemic with a potential impact on waiting times. There are also inequalities in health outcomes, that might be exacerbated by the crisis. More people in the top income quintile tend to report that their health is good compared to their peers in the bottom quintile, with the difference exceeding the OECD average (Figure 2.14, Panel C). Moreover, Lithuania has among the highest education-related inequalities in health outcomes (measured life expectancy at birth) in OECD area (OECD, 2019[24]). While such disparities may be explained by many factors, including differences in life-style and health literacy, access limitations to quality health care services play also an important role.

A comparatively large share of healthcare costs are born by patients in Lithuania, affecting disproportionately vulnerable groups. Out-of-pocket (OOP) payments represented around a third of health spending in Lithuania in 2018, well above the OECD average (Figure 2.14). Most OOP spending is used to pay for pharmaceuticals, followed by dental care, where public health care coverage is more limited. Private health insurance is not developed in Lithuania, and hence households incur the bulk of private spending. For over 15% of households, out-of-pocket payments exceed 40% of total household (net of subsistence needs) income, affecting mainly the poorest quintile of the population (OECD and European Observatory, 2019[25]).

Recent reforms have reduced out-of-pocket (OOP) payments on medicines. Average co-payment per prescription reduced by 61% between June 2017 and June 2019 and the share of OOP expenditure on reimbursable medicines has fallen by over 13 percentage points over the same period. This reflects the expansion of the reimbursement list, as well other reform measures such as an increase in the reimbursement levels and introduction of a maximum patient co-payment for subsidised pharmaceuticals. Moreover, since July 2020, low-income pensioners or people with disabilities, as well as those aged 75 and over, are exempted from co-payments for pharmaceutical and medical expenses. These initiatives reduce the impoverishing effect of out-of-pocket spending on part of the population. Co-payment exemptions for vulnerable groups could be expanded, on the basis of careful assessment.

The availability and accessibility of primary health care services have increased in recent years with the introduction of new mental health care services and the possibility of remote services (eHealth), including prescription of medicines and consultation. In addition, children, pensioners and people with disability were granted access to free dental services. The Lithuanian Health Strategy 2014-2025 opts to promote an integrated health care (clusters) policy involving health, education and social institutions. The aim is to ensure accessible and timely health care services for all residents, reducing prevailing urban-rural differences. Some clusters are already in operation. A systematic collection of data that allow to monitor the impact of these reforms and enable a more detailed diagnostic on the possible barriers to access in health care services is essential for effective policy response.

Figure 2.14. Access to health care can improve



Note: Panel B: unmet medical needs are self-reported. EU27 average refers to the total population reporting "Too expensive OR too far to travel OR waiting list", and is a simple average over the 27 EU members with available data. The total population refers to those aged 16 and over.
Source: OECD Health Statistics database; and EU-SILC.

StatLink https://doi.org/10.1787/888934185574

Addressing challenges in long-term care

Lithuania's demographic trends increase the need for long-term care services. As the society ages, the share of people depending on others to carry out daily activities is set to increase by over 31% within the next 50 years, around 10 percentage points higher than the EU average (European Commission, 2019[26]). The government's long-term strategy is to better integrate elderly in their communities through a transition from institutional social care to community services by 2030. Since 2013, services of integral assistance at home have been provided in municipalities via the implementation of EU-funded projects. These aim not only at quality integrated nursing and social care at home for disabled and elderly persons, but also to provide professional consultative assistance to the carers. The number of recipients of social services at home increased by over 10% between 2013 and 2018, as a result. This is important for improving the quality of life for persons with long-term nursing and care needs, but also for addressing shortfalls in the supply of institutionalised long-term care (OECD, 2018[27]). Around half of the elderly in need of residential care were on a waiting list in 2014.

Building on previous initiatives, an inter-institutional plan for the period 2019-2021 aims at the further development of integral assistance for the elderly at home and the expansion of the network of independent living and day-centres, on the basis of international experience. The establishment of a new type of social insurance for long-term nursing is under consideration. NGO projects, involving visiting the elderly, especially in the rural areas, and activities undertaken jointly with youth volunteers, are to be supported. These are promising steps towards expanding non-institutionalised long-term care. The government could also explore a more flexible model of long-term care service provision, entailing co-production from different types of providers (Lazutka, Poviliunas and Zalimiene, 2018[28]). This would increase flexibility in the combination of services and enhance competition among provides. Under current arrangements, a full range of services is usually provided by a single provider (an informal carer, a public or private provider), limiting the choice. As a welcome step, social services are to be accredited from January 2022. Under the new rules, a person eligible for social care will have the opportunity to choose a provider in accordance with the established procedures, while the municipality will be able to conclude an agreement with the chosen provider (or the social service institution providing accredited care) on financing the costs of the delivered services. The reform should go ahead as planned. The importance of informed choices is also highlighted by an in-depth OECD analysis on social service integration (OECD, 2015[29]) (Box 2.3).

Box 2.3. Integrating care for the elderly: some practices based on cross-country experience

There is no optimal way to integrate elderly care, given the variety in governance and delivery methods of services, but some good-practice examples emerge from cross-country evidence. An in-depth OECD analysis concludes the following:

- Services should be integrated from a patient, rather than a provider, perspective to enable service users to make informed choices about their care.
- Strategies focused on outcomes and evidence-based guidelines contribute to an effective delivery of integrated elderly care.
- Appropriate training initiatives are also crucial for the effective delivery of integrated elderly care.
- Embedding integrated care policies within traditionally fragmented service delivery structures requires efforts. This is because such structures can create disincentives to integrating care. Enforcing central steering power or legislation to support the provision of integrated care can be a promising strategy in this context. Regional differences in the provision of integrated care need to be carefully monitored.
- Financial integration is essential to avoid cost shifting when multiple sectors are involved in services delivery. Promising examples of policies include pooling together budgets or resources under a single funding envelope or integrating budgets for defined care services.
- A more accurate measurement of the quality of care co-ordination is necessary. Data from user surveys and administrative data can be used for the development of quality indicators.

Source: (OECD, 2015[29]).

A coherent governance framework is essential for an efficient provision of long-term care services. There is no separate long-term care system in place at present in Lithuania; rather, long-term needs are addressed through a range of different healthcare and social services under the auspices of two ministries. The two parts of long-term care are financed through different budgets. The health care part is financed from the Compulsory Health Insurance Fund, while the part within the social system relies on local budgets and central budget subsidies. This duality increases complexity, making difficult the assessment of population needs. The government focus on an integrated system of long-term care services is, therefore, appropriate. Clear roles and responsibilities among the agents participating in the policy making and service delivery is essential in order to avoid potential overlaps under the integrated long-term care model.

A funding mechanism to support the provision of integrated long-term services is under development. Whereas 59 out of 60 municipalities have already implemented a more integrated model of nursing and care services at home, this is financed by EU-funds and the state or municipality budget for social service care. The preparation of a uniform regulation to underpin long-term care services, along with the establishment of a fund to finance such services that will rely on domestic sources, are part of the government agenda. A recent OECD study stresses the importance of financial integration when multiple sectors are involved in service delivery, to avoid cost-shifting (OECD, 2015[29]) (Box 2.3). Pooled funding is probably the most commonly used model across the OECD countries to finance integrated care, according to the study. This entails contributions by each body involved in service delivery to a common fund to be spent on pooled functions or agreed services.

Strengthening the provision of home nursing services is important. Insurance payments do not cover currently the real costs of such services, weakening incentives for provision (Lazutka, Poviliunas and Zalimiene, 2018[28]). Recent steps aiming to enhance the co-operation between providers of outpatient health care services at home and providers of social services at home through a formal agreement are welcome. Supporting informal carers, including via flexible working conditions, is also crucial to the provision of quality long-term care at home (European Commission, 2019[26]). The successful implementation of an integrated model of long-term care services further hinges upon a more individualised approach to the provision of social services and easily accessible information to public on the availability of, and eligibility conditions for, such integral assistance. Research suggests that greater customisation in the provision of social services contributes to inclusiveness (de Mello and Dutz, 2012[19]).

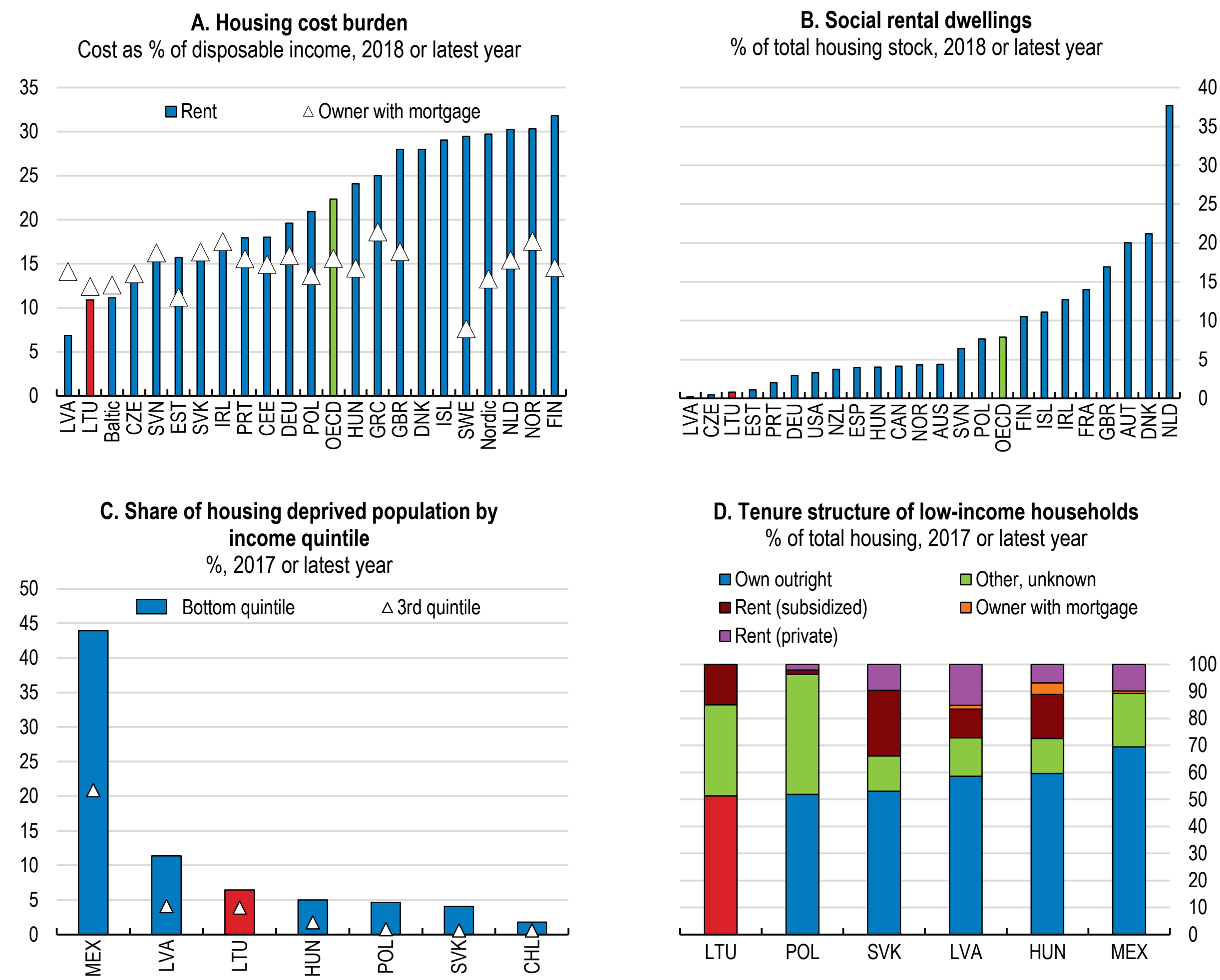
Meeting the housing needs of the less advantageous and combating homelessness

There is scope to strengthen housing support for vulnerable groups. The eligible population for social housing was streamlined and a rent subsidy was introduced in 2015 for those individuals or families who are living in rental accommodation, while awaiting for social housing. This helps to reduce the housing cost burden for tenants in Lithuania (Figure 2.15). In addition, the stock of social housing was increased by 9% between 2015 and 2019, supported by EU funds. Still the investment level remains low. Social rental housing stock accounted for less than 1% of the total in 2018, compared to an OECD average of 8%. Moreover, due to inadequate maintenance of social housing, some of the stock (around 2.2% in 2019) is at emergency condition or unfit for habitation. All the habitable social housing are currently in use, but over 10 000 households are still on the waiting list according to official estimates. The average waiting time in the largest cities can range between 10 to 15 years (FEANTSA, 2016[30]). Access to rent assistance also remains low. Around 9% of those waiting for social housing received such support in 2018, according to a recent report (Lazutka et al., 2019[16]). The rent subsidy is currently provided only in 34 out of 60 municipalities.

In an effort to address undersupply of social housing, since 2019, municipalities are permitted to rent housing from private or legal persons and sublet it to individuals (families) awaiting for social housing. This measure is welcome, especially as the eligibility conditions for social housing have eased recently. Its impact, however, will depend on home-owners' response. The lack of a well-developed housing rental market in Lithuania and insufficiently attractive renting conditions (e.g. the housing lease agreement must be for at least one year) may reduce home-owners' incentives to respond to demand. Improving the effectiveness of rent compensation scheme is also important, given the low take-up rates of the scheme and its limited coverage. To improve accessibility to rental scheme, the assessed income limits for eligibility were raised by 60% in 2019 and the requirement to be on the waiting list was removed. In addition, more favourable conditions of rent compensation were introduced in response to the COVID-19 crisis (Box 2.2). Under the new arrangements, a compensation is paid for larger floor areas, while taking better into account family composition in determining the compensation rate.

Steps were also taken to shorten the long waiting time for social housing. A new law, in particular, set the upper limit for the waiting to five years initially and then to three years. A municipality will have to reimburse the actual rental costs in case it cannot meet its obligation by the end of this period. These initiatives can help reducing unmet needs for social housing but appropriate investment levels needs to be ensured if the problem is to be addressed in a decisive manner. Well-designed projects are essential in this regard, also helping to contain costs.

Figure 2.15. Social housing stock remains low and many households face poor housing conditions



Note: Averages are calculated for the most recent value of all countries with available data (unweighted). Average groups are as follows: EU27: European Union; EU22: EU countries who are OECD members; Baltic: Estonia, Latvia, and Lithuania; Nordic: Denmark, Finland, Iceland, Norway, and Sweden; CEE (Central European Economies): Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia. Panel A: Median rental costs include both private and subsidised rent. Panel B: OECD refers to the simple average over the 26 countries for which data are available. Panel C shows the incidence of severe housing deprivation (% of total population) by income quintile. Housing deprivation is a measure of poor amenities and is calculated by referring to those households with a leaking roof, no bath/shower and no indoor toilet, or a dwelling considered too dark. Panel D shows the tenure structure of the lowest income quintile. Only countries where at least 3% of population in the bottom quintile is housing deprived are shown.
Source: EU-SILC; and OECD Affordable Housing Database.

StatLink https://doi.org/10.1787/888934185593

The COVID-19 crisis heightens the need for an effective response to persisting housing challenges, including homelessness. Over 4 000 people were homeless (living in shelters or in crisis centers) in 2019, according to official statistics. These figures, however, may underestimate the extent of the problem, especially in urban areas, as they do not include people living in rough, or doubled up with friends or family. Lithuania does not have an integrated strategy for addressing homelessness; rather the problem is tackled indirectly, mainly through social housing (Lazutka et al., 2019[16]). A number of countries, including Denmark, Finland, Norway and Poland, have introduced Housing First models that aim to meet the high and complex needs of homeless through a combination of permanent housing and support services. Cross-country evidence suggests that support following the principle of Housing First can provide a sustainable solution to address chronic homelessness (OECD, 2015[29]). Initiatives at local level, such as the Vilnius programme on homelessness over the period 2013-2018, focusing on accommodation and integration, are a positive step in this regard and could be supported through a national programme.

Improving housing quality

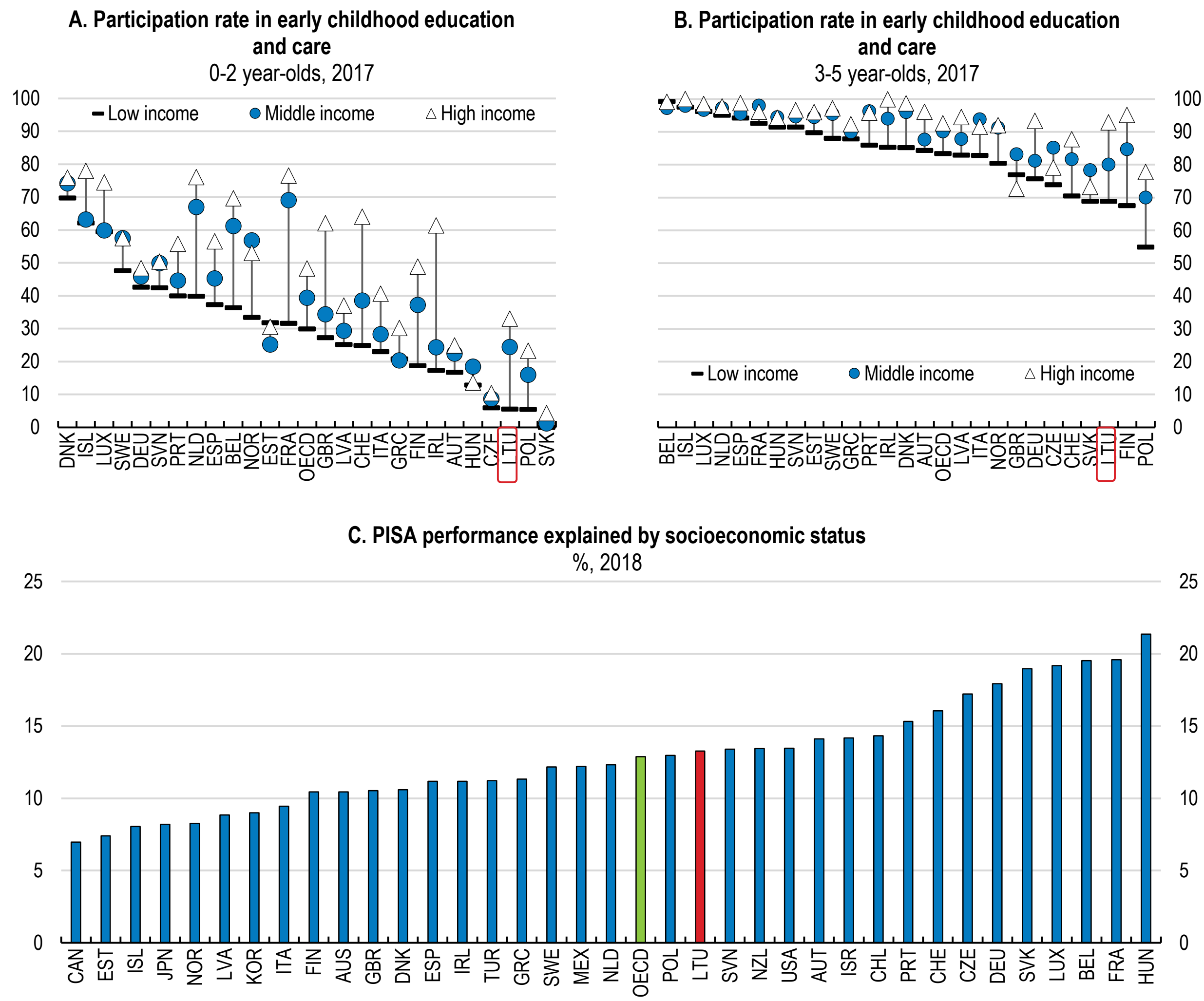
Poor quality housing adds to poverty challenges. Around 6 ½ percent of low-income population (bottom quantile) in Lithuania experience severe housing deprivation, living in overcrowded and poorly equipped dwellings (Figure 2.15, Panel C). This rate fell significantly since 2010 but it is still high in international comparison. Housing quality remains an important challenge in post-socialist countries where much of the stock of housing was privatised after the independence; the current owners of these dwellings often have financial difficulties to maintain and upgrade them (Tsenkova, 2014[31]; OECD, 2020[32]). A high share of low-income households live in dwellings that are owned outright (Figure 2.15, Panel D). Poor quality housing is more of concern in rural than urban areas, according to available data (Eurostat, 2020[33]).

To encourage renovation, low-income apartment owners receive a subsidy covering fully renovation costs. This complements previous reforms, and in particular the changes in heating compensation provisions in 2013, that stipulates reduced compensation rates for a period up to 3 years in case of non-participation in the renovation of a multi-apartment block decided by the community. Official data saw an increasing trend in renovation projects in recent years. Consideration could be given to the establishment of a carefully-designed fund to support investment in renovation, drawing on the experience of the Slovak Republic (OECD, 2020[32]) (see, Chapter 3). The Slovak Housing Development Fund has proven successful in supporting new affordable buildings and the maintenance and upgrading of existing ones. Overtime, the Fund has become increasingly reliant on its own sources of financing. The refurbishment of social housing should receive special attention, especially in light of the low social housing stock in Lithuania (Figure 2.15, Panel B). Addressing housing quality in an effective manner would improve the energy-efficiency of dwellings, helping in turn to tackle energy poverty while achieving environmental objectives (Figure 2.9).

Reducing educational inequalities

Equity in educational opportunity and outcomes could strengthen, starting at the early schooling years. Not all children benefit from early childhood education and care (ECEC) in Lithuania, despite the critical role that ECEC can play in reducing the impact of social disadvantage (OECD, 2017[34]). A recent audit report concludes that 9 out of 60 municipalities face a shortage of places, while 37 of them lack available places in the preschool institutions chosen by parents (National Audit Office, 2018[35]). Private centres make ECEC more widely accessible but, despite public support, many low-income families struggle with affordability (OECD, 2020[36]). These constraints translate into large inequalities in ECEC participation between children from less advantaged backgrounds and their more affluent peers, especially in the case of very young children (Figure 2.16).

Figure 2.16. Socio-economic background still counts for educational outcomes



Note: Panels A and B: Data for Switzerland refer to 2014, and for Iceland to 2016. Data are OECD estimates based on information from EU-SILC. Data refer to children using centre-based services (e.g. nurseries or day care centres and pre-schools, both public and private), organised family day care, care services provided by (paid) professional childminders, and, in some countries, children in primary education. Income level is based on the child's position in the national income distribution. "Low income" refers to children in the first three deciles, "middle income" to those in the middle four deciles, and "high income" to those in the top three deciles of disposable income. OECD is the simple average of the 26 countries with available data. Panel C: results show the average strength of the socioeconomic gradient: the percentage of variation in PISA performance across reading, mathematics and science that is explained by economic, social and cultural status (ESCS).
Source: OECD (2020), Is Childcare Affordable? OECD Policy Brief on Employment, Labour and Social Affairs; and PISA 2018 results.

StatLink https://doi.org/10.1787/888934185612

Regional differences in ECEC participation are also considerable, with the enrolment rates of 3-6 year-olds in rural areas being approximately half those in urban areas (European Commission, 2019[22]). This reflects the lower demand for such programmes in rural areas, as well as limited transportation services for children living in distance from their pre-school (OECD, 2017[34]). Reforms underway aiming at the modernisation and expansion of kindergartens are appropriate, given supply shortages, as is the focus on children from disadvantaged background. The expansion of early childhood education and care needs to continue, financing the cost from savings elsewhere. Better assessing imbalances in ECEC provision requires a systematic collection of information on children who were unable to access such facilities. The development of a more comprehensive monitoring system is essential to ensure consistently high quality early childhood education (OECD, 2017[37]).

There is also scope to ensure greater equity in student outcomes. The 2018 PISA results show that socioeconomic factors have a larger impact on performance in Lithuania compared to other Baltic countries and the Nordics (Figure 2.16, Panel C). This is of concern as students with poor PISA scores do not generally catch up later in life (OECD, 2015[38]). Educational achievements further vary considerably among different municipalities and schools, with a significant gap between students from rural and urban areas (EAPN, 2018[39]). Student outcomes in many smaller schools, located usually in rural areas, fall behind the EU, but as well national average (National Audit Office, 2017[40]). Recent reforms attempted to reduce inequalities in educational outcomes including through the introduction in 2019 of targeted funding ("quality basket"), as part of a two-year project to improve learning achievements, and the development of all-day schools by the municipalities. The latter helps particularly students from disadvantaged background. As a further step, a reform project underway aims to set out by 2022 the legal and financial conditions for safe and inclusive schools. It expands, in this context, the provided educational assistance, while also creating the appropriate structures for students with special needs. These initiatives should be implemented as scheduled, and go hand-in hand with ongoing reforms that upgrade and modernise core education.

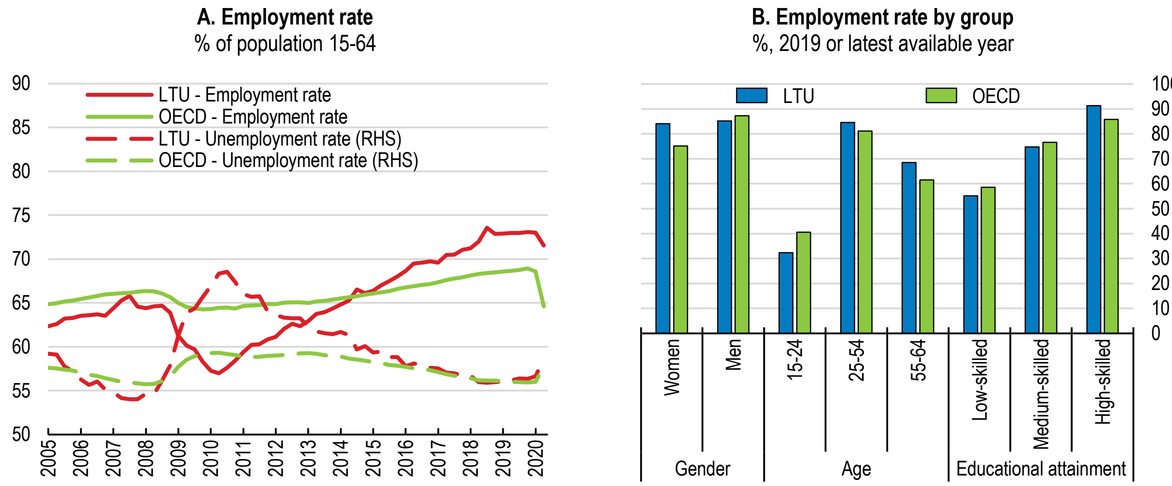
Recent reforms also aim to address social inequalities in tertiary education. Official data suggest that students from low-income families are almost three times less likely to enrol in universities than their peers from more affluent families, and when enrolled, they are less likely to attend a high-ranking university. Moreover, students from the lowest income quartile tend to have much lower completion rates compared to those in top quartile (OECD, 2017[37]). A new law for higher education sets the same admission requirements (in terms of the number of national entry tests a student has to pass) for state-funded and non-state-funded student places in universities and colleges. Under previous arrangements, such requirements were much stricter for state-funded student places, affecting particularly students from less advantaged background who are more likely to seek government support for their studies. Moreover, the monthly amount of scholarship for doctoral degrees was increased by 83% in 2019, helping students from less affluent families to pursue further studies. The outcomes of these reforms in terms of improving equity in tertiary educational opportunities need to be closely monitored.

Helping labour market integration

More and better jobs to reduce poverty

Employment outcomes for workers with lower skills remained weak, despite a comparatively strong labour market performance in recent years. The gap in employment rates between high and low-skilled workers was around 35 percentage points in 2019, well above the OECD average (Figure 2.17). The COVID-19 crisis may have a disproportional impact on low-skilled jobs, as the lockdown has directly affected sectors such as accommodation and catering services where these jobs are usually concentrated, even if the crisis-support measures alleviate somewhat the impact (Box 2.2) (Bank of Lithuania, 2020[41]).

Figure 2.17. Labour market outcomes vary considerably across skill-groups and regions



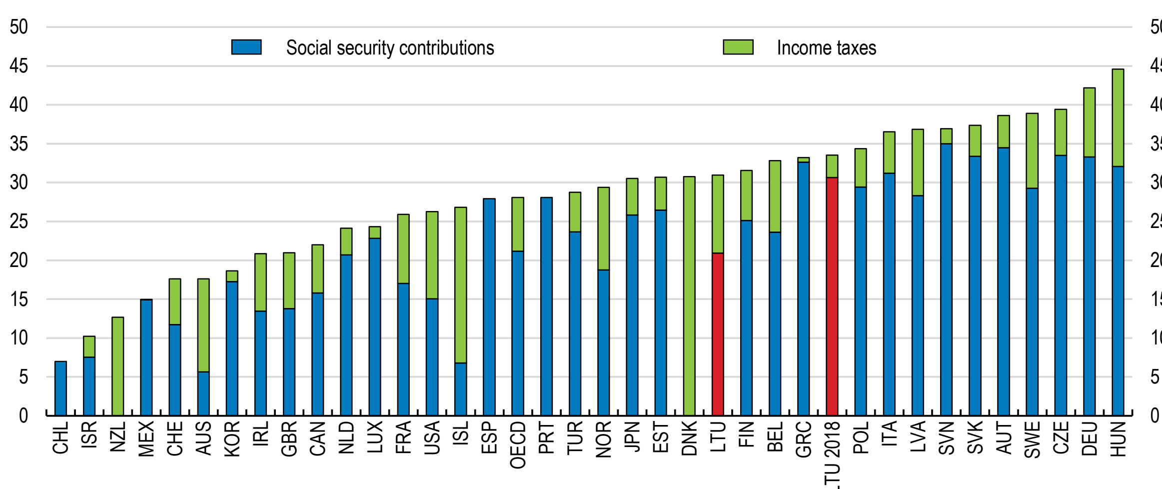
Source: OECD Economic Outlook 107 database; OECD Labour Force Statistics; OECD Education at a Glance database; and OECD Gender database.

StatLink https://doi.org/10.1787/888934185631

The tax wedge was reduced recently but it can lower further. As a positive step, the tax wedge (measuring the difference between labour cost to the employers and the corresponding net take-pay of the employee) was reduced in 2019, following a labour taxation reform (Figure 2.18). The previous Survey has identified the high tax wedge as an important obstacle to the employability of the low-skilled workers, as well as a potential driver of informality (OECD, 2018[15]). The reform has consolidated social security taxes on the employee's side, but employers are legally obliged to increase gross salaries by 28.9% in order to compensate workers for this shift in the tax burden. The combined social security contribution rate was reduced by around 19 percentage points. The changes have contributed to the reduction in tax wedge for low paid workers by about 2 ½ percentage points in 2019, improving Lithuania's international ranking. Still, the difference with OECD average remains, with scope for further lowering the tax-wedge for low-paid workers while ensuring that benefits are maintained. This needs to be financed by savings elsewhere.

Figure 2.18. The tax wedge can be lowered further

% of total labour cost for single childless worker earning 50% of average wage, 2019

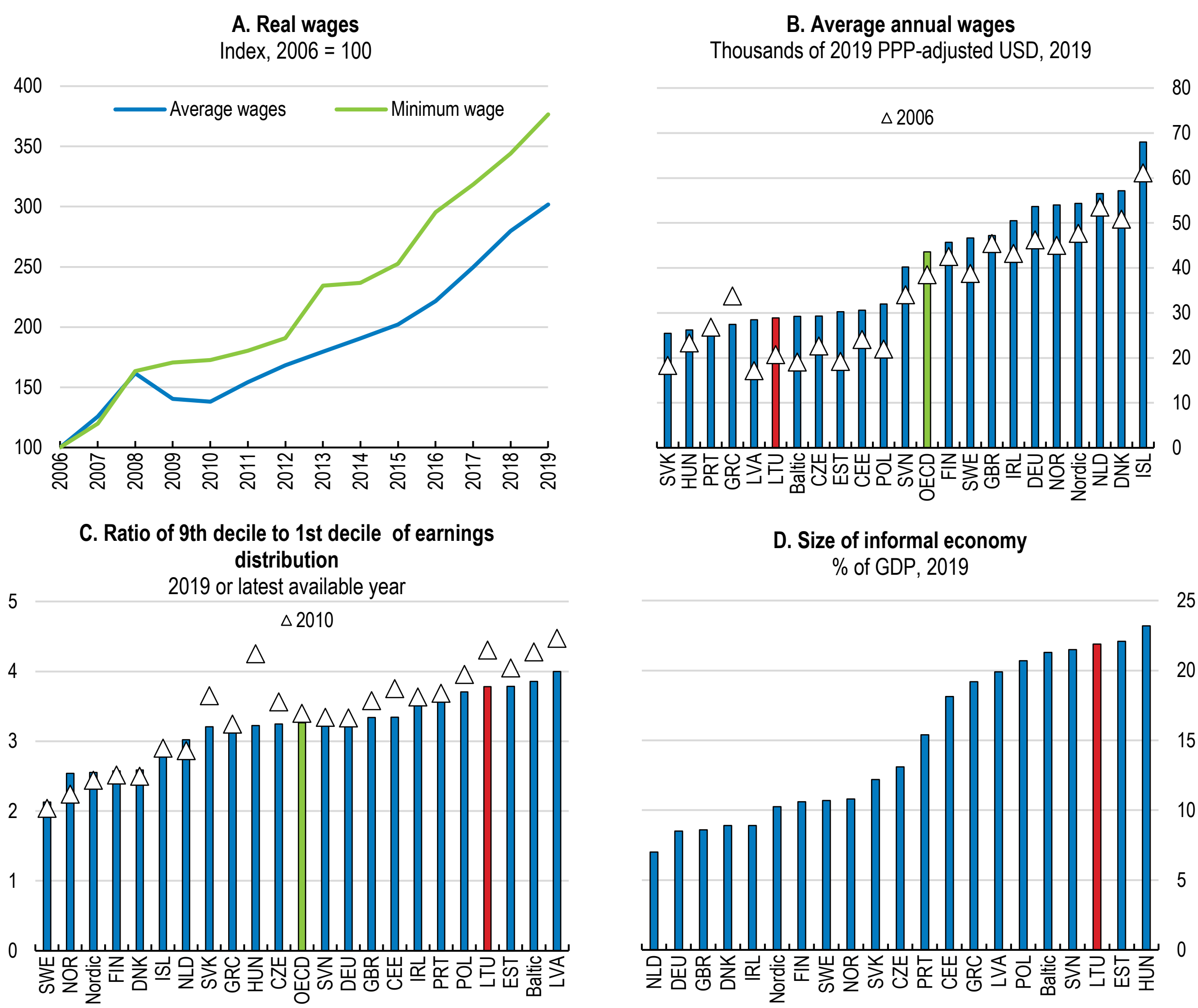


Note: Results show the average tax wedge on labour income for a single childless worker earning 50% of the average wage.
Source: OECD Taxing Wages database.

StatLink https://doi.org/10.1787/888934185650

Earnings remain low for many workers, fuelling in-work poverty. Real wages increased fast in recent years, reflecting the hikes in minimum wages, but average earnings remain at around 65% of the OECD average (Figure 2.19). Approximately a third of Lithuanian workers are low-paid, earning less than two-thirds of the average, according to the official estimates, with persisting earning inequalities. Following increases in previous years, minimum wages are set to rise further by over 9% in 2020. Additional increases may risk reducing job-market opportunities for less qualified and harm competitiveness. A better tool to fight poverty at work, and also increase work incentives, are well-designed in-work benefits. This is because such schemes address low-pay among the working population without having the disadvantages of high minimum wages (OECD, 2009[42]). As a positive step Lithuania has strengthen in-work benefits in the past two years (discussed below).

Figure 2.19. Earnings remain relatively low and informality is still high

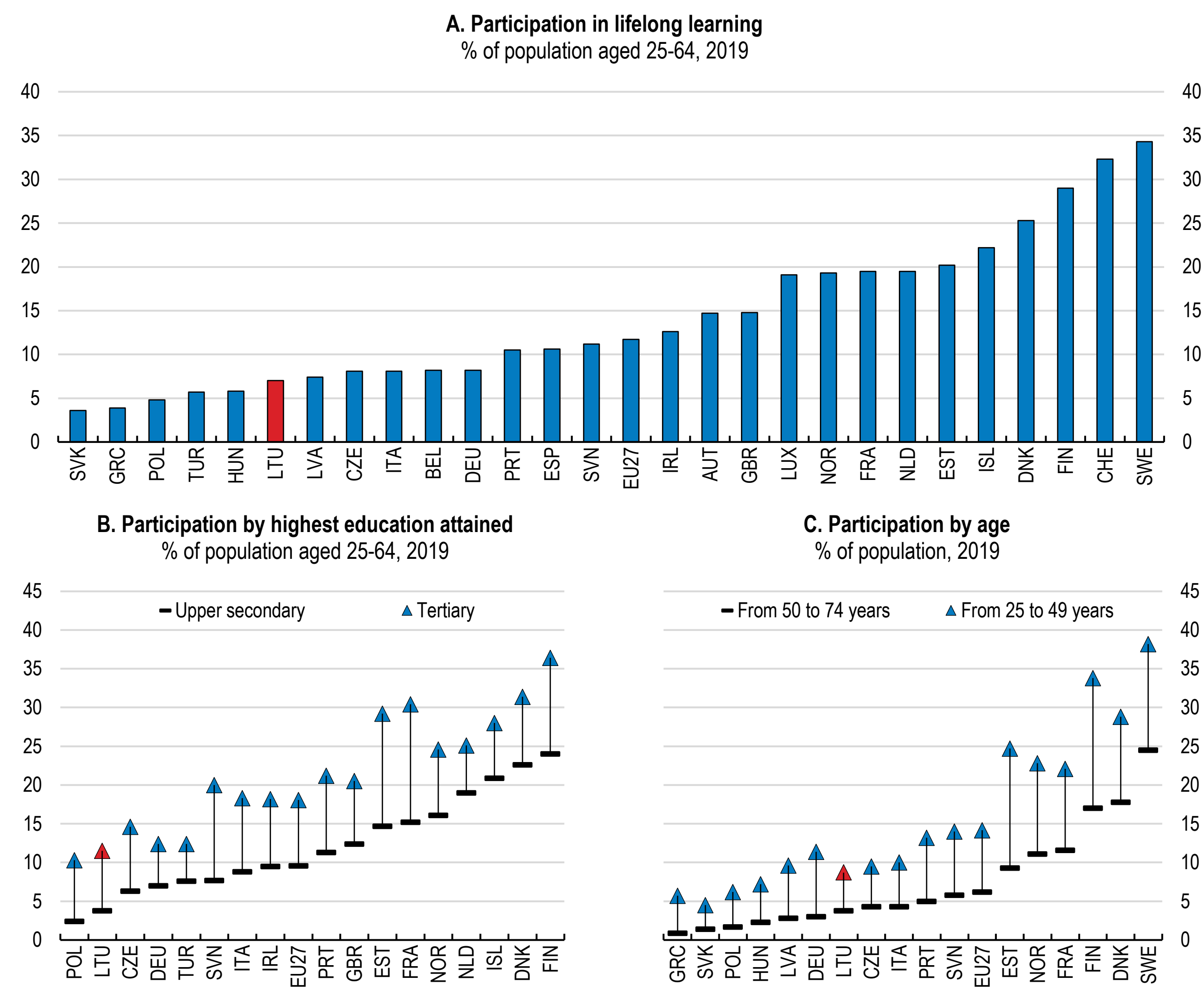


Source: OECD Labour Force Statistics; OECD National Accounts database; OECD Economic Outlook 107 database; Eurostat Labour Market database; and Schneider, F. (September 2019). Latest developments of the shadow economy in the Baltic countries: What are the major causes and what could be done? University of Linz, Austria.

StatLink https://doi.org/10.1787/888934185669

The most effective way, however, to address in-work poverty is through measures that boost the productivity level of low-skilled workers and promote their career advancement. Effective adult (lifelong) programmes play a key role in this regard, helping re-skilling and upskilling. Nonetheless, participation in such programmes remains low in international comparison, with engagement varying with age and education level (Figure 2.20). As in other countries, the less educated and those aged over 50 tend to participate less. This is unfortunate as these groups of workers could benefit substantially from re-skilling, as they would become more resilient in economic downturns and/or skills shifts related to technological changes. The relatively low engagement in lifelong programmes could reflect a number of factors including weak incentives, lack of financial support by the employers, and as well limited awareness about such programmes and their potential benefits (OECD, 2017[43]). As a welcome step, the new Labour Code allows employees to take up training for up to five (partially-paid) days per year to attend adult education programmes.

Figure 2.20. Participation in adult learning remains low



Source: EU Labour Force Survey.

StatLink https://doi.org/10.1787/888934185688

Plans to introduce second-chance education for early school leavers and implement procedures for validating non-formal learning need to go ahead (CEDEFOP, 2018[44]). This would increase flexibility in lifelong learning opportunities. Consideration could be given to the development of skills-assessment schemes that evaluate the level of work experience and acquired skills of early school leavers re-entering the formal school system, as is the practice in Iceland (OECD, 2019[45]). To induce older workers to engage in lifelong learning, incentives might be partially linked to age or length of job tenure, as proposed in the previous Survey (OECD, 2018[15]). Latter Some countries, for example France and the Netherlands, have further introduced financial incentives in the form of individual learning accounts (ILAs) that allow for portability of the training rights between jobs and also employment statuses (OECD, 2019[46]). ILAs have received increasing attention in recent years as they facilitate career transitions. A careful design of financial incentives is essential to achieve better targeting and reduce deadweight costs. These need to be accompanied by well-disseminated information on available adult learning programmes, as well as effective career counselling, to ensure the success of the strategy. A close monitoring of the effectiveness of adult learning programmes in terms of labour market outcomes of the participants is essential.

Combating poverty and social exclusion further requires reducing informality (Figure 2.19, Panel D). “Envelope wages” (i.e. cash in hand, undeclared wages) accounted for over 40% of the overall informal economy in 2018 (Stockholm School of Economics Riga, 2020[47]). While informality implies that actual incomes are underreported, and hence, actual poverty rates might be lower than represented in the official statistics, informal workers usually lack social security coverage and the protection provided by formal contracts. Such workers also tend to have poorer training opportunities, impacting further on job quality and poverty. The new Labour Code, in effect since July 2017, made progress towards tackling informality by lowering the cost of formal employment, through an easing in employment protection legislation for permanent and temporary contracts, and the introduction in 2018 of social insurance contribution “floors”. The latter requires employers to pay contributions on the basis of the minimum monthly wage for workers who receive a wage below the minimum. In addition, firms with 20 or more employees are required to establish a work remuneration system, which increases wage transparency. Moreover, under the new Labour Code, the minimum monthly wage can only be paid for unskilled work. The share of full-time employees receiving the minimum monthly wage in total has declined rapidly as a result.

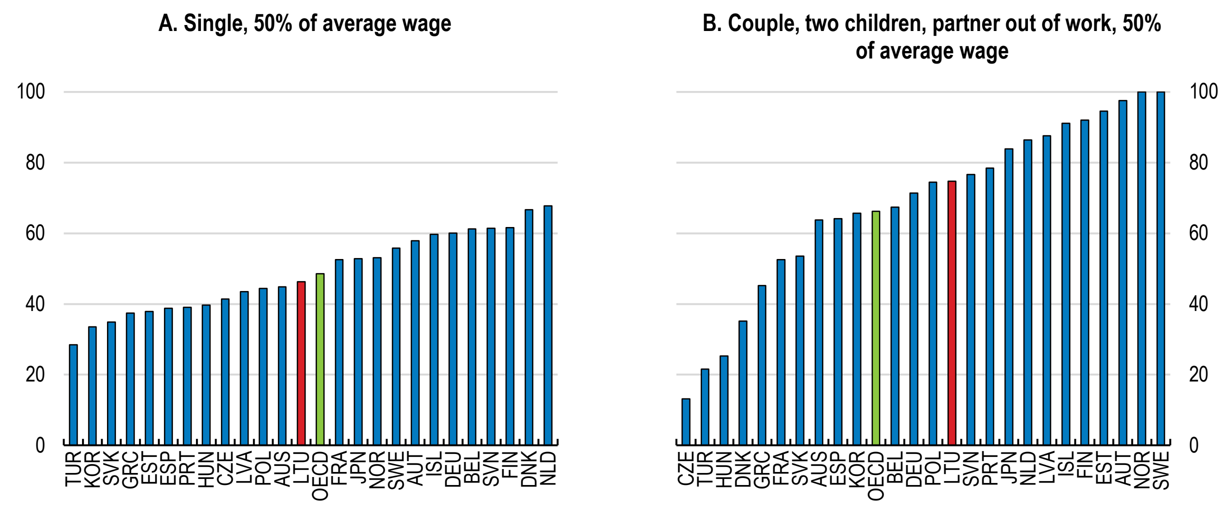
The government monitors on a systematic basis the implementation of the labour code. The State Labour Inspectorate, in particular, is responsible for monitoring the practical enforcement of the law and evaluation of its impact, submitting the results of the assessment on a half-yearly basis. This is important, especially as the number of fixed-term contracts (accounting currently for 5.2% of total) and that of new types of employment contracts, as for instance project-based and apprenticeship contracts, have risen rapidly since the introduction of the new labour code. As in other countries, some of these workers can be particularly vulnerable in the current crisis (OECD, 2020[48]). Developing a comprehensive dataset is another important pre-condition for the effective monitoring and implementation of the new labour code.

Increasing incentives to work, including by improving work-family balance

The financial incentives to work were strengthened following recent reforms. Taking up work generally pays off for benefit recipients in Lithuania, given the low level of social benefits compared to minimum wages. However, larger families have comparatively weak financial work incentives, as benefit levels increase with the household size (Figure 2.21).This increases the risk for poverty. An income disregard was introduced in 2018, in line with the experience in other OECD countries (Navicke, Avram and Demmou, 2016[49]). This permits recipients who find employment to keep part of the work income (disregard income) that is not included in the amount of household income establishing eligibility for social assistance. Households may keep between 15% and 35% of work income when receiving benefits, depending on family composition and the number of children. Such measure increases an individual’s incentive to take up a job. The amount of the disregard income was increased by 5 percentage points in June 2020, as part of the social package in response to the COVID-19 crisis (Box 2.2).

Recent reforms also increased the duration of in-work benefits for the long-term unemployed recipients of social assistance, from 6 to 12 months. The amount of benefits an unemployed can keep after taking up work was increased in June 2020, under the crisis-related package, and differentiated depending on the duration of payments (Box 2.2). The effectiveness of income disregard and in-work benefits in bringing benefit recipients into the labour market, and reducing poverty, needs to be regularly evaluated. For, instance, only 3% of social benefit recipients were registered with public employment services (PES) in 2019, according to the official data, compared to 11.5% in 2017. The reasons for the fall in take-up rates of in-work benefits needs to be investigated. Effective job-search assistance and active labour market programmes are essential for the success of these reforms.

Figure 2.21. Larger households have weaker incentives to take up work



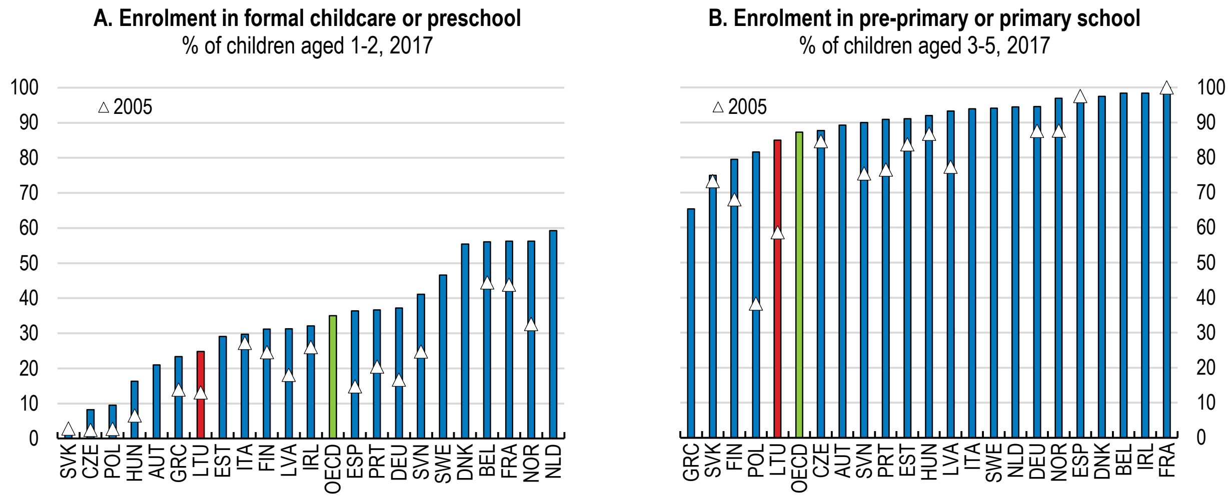
Note: This indicator measures the proportion of earnings that are lost to either higher taxes or lower benefit entitlements when a jobless person takes up employment earning 50% of the average national wage after 24 months of unemployment, giving a measure of the financial disincentives to participate in the labour market.
Source: OECD Tax-Benefit Model.

StatLink https://doi.org/10.1787/888934185707

Promising steps were also taken to help families to reconcile family and work responsibilities. The new Labour Code offers to this end more part-time work and remote working opportunities, as well as more flexible working schedules. Recent reforms also changed leave provisions for parents. A father can currently take leave up to the child's first birthday (while keeping the duration of the leave unchanged at 30 days) and, since 2018, paid parental leave is granted to one of the grandparents if both parents wish to return to work. The parental leave scheme was also revised in 2019, with the aim to improve incentives to work. Benefit payments became less generous under the new regime. Parents are still able to choose the duration of the leave – one or two years – but during the second year, the father or mother can work, while also receiving the childcare benefit at the same time.

The gains would be greater if parental leave could be split between mothers and fathers, as in some Nordic countries (OECD, 2017[50]). Only one parent per family is entitled to claim the leave benefit in Lithuania at present that may weaken labour market prospects of the carer. Improving work-family balance also hinges upon the availability of high quality early childhood education and care (ECEC). Despite increases, participation in ECEC remains low in international comparison, especially for children under two year-olds, while access to such programmes is not yet ensured for all children (see above) (Figure 2.22). Swift progress in this domain is advisable. Reducing childcare-related gaps in the employment history of women is important to reduce gender-poverty differences among elderly (Eurostat, 2019[2]).

Figure 2.22. The participation of very young children in ECEC remains low



Note: Panel A covers education designed to support early development in preparation for participation in school and society. Programmes designed for children below the age of 3. Panel B covers education designed to support early development in preparation for participation in school and society, designed for children from age 3 to the start of primary education.
Source: OECD Family database.

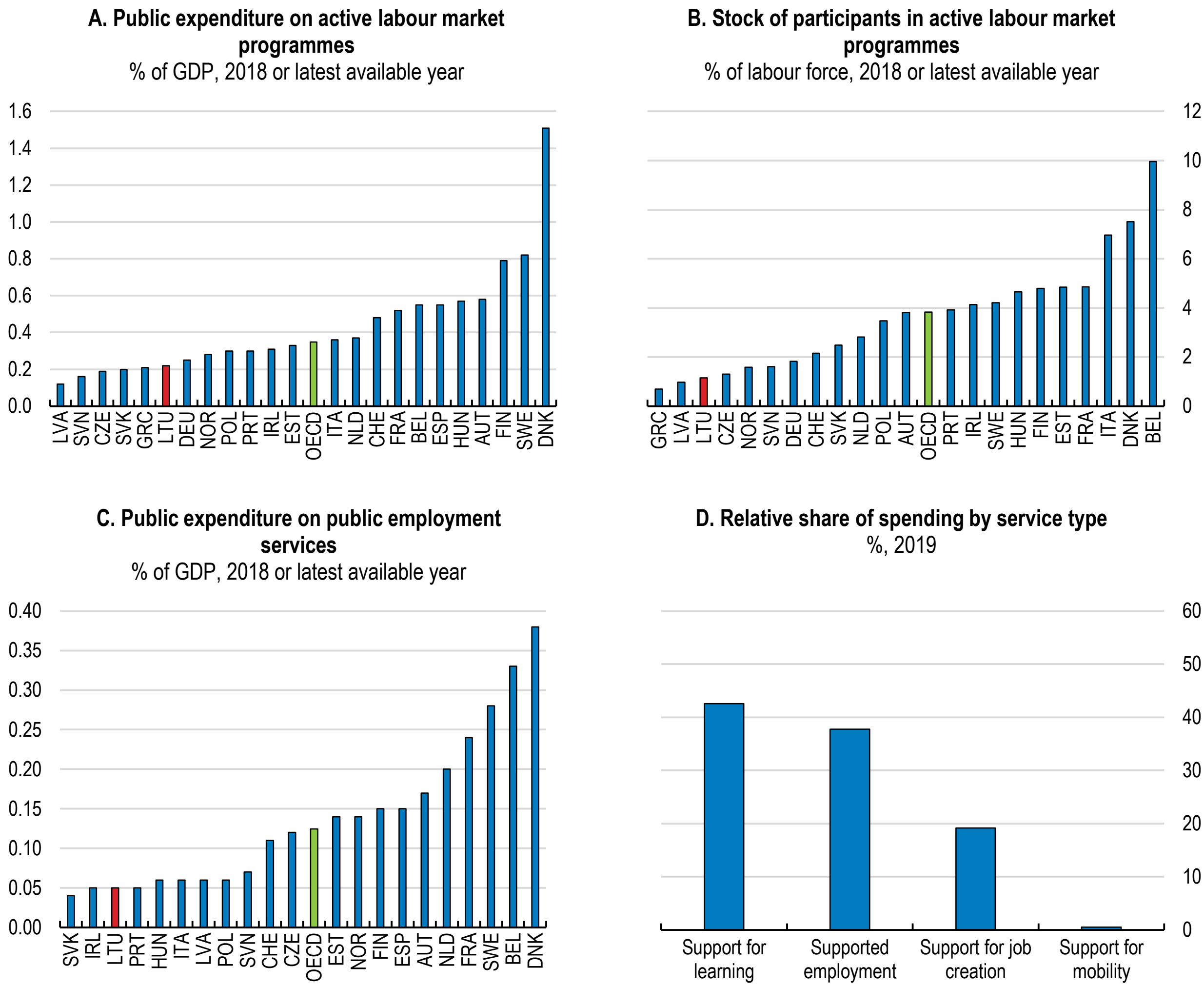
StatLink https://doi.org/10.1787/888934185726

Making activation policies more effective

The structure and management of public employment service (PES) was reformed and modernised in the past two years. Reforms included a centralization of the management process of activities planning and human resources, increasing, in turn, by 13% the number of PES employees who work directly with the clients, the establishment of a new service model focusing on face-to-face customer approach and a new performance management system based on unified indicators for all staff positions. The quality of provided services through counselling and electronic registration procedures were also improved and new forms of support for training were introduced, namely apprenticeship, internship and recognition of competencies. These reforms are an important step towards increasing the efficiency of PES and making support and services more client-oriented. According to PES, the effectiveness of ALMPs is improving both in terms of re-employment and job quality.

Important challenges remain however. Spending on active labour market policies (ALMPs) remains low in international comparison and relies heavily on external funding (Figure 2.23). Around 95% of the spending on ALMPs in 2019 came from EU structural funds. This limits the scale of activation policies, and lowers coverage, as EU funding is targeted to specific groups only. In addition, the participation rate in ALMPs fell from around 20% at end-2018 to 12% at end-2019, according to the PES data, as a result mainly of a sharp fall in state contribution. Spending on ALMPs is set to increase in 2020, also entailing crisis-related funds, with a rise in the state budget share in total. The structure of the ALMPs also needs to improve further by putting additional emphasis on support for training. The number of apprenticeships is still low, with a scope to simplify training and employment agreements (European Commission, 2020[12]). The need for appropriately funded and structured ALMPs is even more pressing to reverse the rise in unemployment triggered by the COVID-19 crisis. As part of the response package, the government has increased the PES funding for vocational training and provided wage and eased hiring restrictions for apprentices, with PES subsidising 70% of their wage (up to a limit) (Box 2.2).

Figure 2.23. Activation programmes can improve further



Note: Panels A and B refer to active labour market programmes covering training, employment incentives, supported employment and rehabilitation, direct job creation and start-up incentives.
Source: OECD Labour Market Programmes database; and Ministry of Social Security and Labour.

StatLink https://doi.org/10.1787/888934185745

The PES has developed a tool to evaluate and monitor the performance of the activation programmes (ALMPs) on the basis of the employment and wage outcomes of the participants. This is welcome. A project underway aims to strengthen the existing tool, including by adding job quality to the set of indicators measuring ALMPs' performance. It is important that a regular evaluation is undertaken for all programmes, accompanied by a systematic data collection. This would allow adjusting activation programmes, if deemed necessary, and ensure appropriate funding allocation.

Particular attention should be given on strengthening the skills of disabled workers. Around a third of this social group lives below the poverty threshold (Figure 2.6). PES provides support for disabled persons, including through vocational rehabilitation programmes and training. In addition, social enterprises create employment opportunities for individuals with disabilities and other vulnerable groups. A new law on social enterprises in 2020 restricts state subsidies to disabled people of working age only and makes registration to PES mandatory, among other provisions. It is still early, however, to assess its impact.

Ensuring a successful labour market and social integration of the vulnerable groups requires a close collaboration of all stakeholders. The co-operation of PES with municipalities, employers and non-governmental organisations (NGO's) to reduce barriers to integration that go beyond labour market skills, such as lack of social skills, addictions and mobility, is in the right direction. An ongoing pilot project of an integrated service model in six municipalities focuses on unemployed persons with multiple problems, with encouraging results for the long-term unemployed. The expansion of the integrated approach to other municipalities, upon positive outcomes of the pilot, would help the effective transition of the target groups out of poverty.

Table 2.1. Recommendations to reduce poverty and social disparities

Improving the effectiveness of social protection system	
Social spending is comparatively low and the provision of cash benefits and social services is not closely linked to needs of vulnerable groups.	**Further increase the level of minimum-income benefits, while maintaining work incentives** **Increase gradually social assistance pensions, while strengthening means-testing.** **Better tailor the provision of social benefits and services to individuals' needs.**
Accessibility to cash benefits and social services is restricted by the lack of systematic information on benefit availability and the fact that not all types of social support can be requested through electronic applications.	Ensure the timely introduction of an electronic system (e-platform) that enables applications for all forms of social support.
Capacity assessments continue to rely too strongly on medical certificates, increasing disability benefit receipt rates.	Further improve the quality of work capacity assessments by attaching greater importance to physical, social and professional capabilities of persons with disabilities.
The health insurance system has a rather broad coverage, but inequalities in access remain.	Pursue a more detailed diagnostic of possible barriers to access in health care services.
The long-term care services do not effectively reach the elderly population.	**Move to an integrated model of long-term care provision, with a focus on home-care for the elderly.**
Elderly people eligible for long-term care often have access to one provider, limiting choice.	Increase the number of providers of long-term-care services, allowing users to choose their provider.
The stock of social housing is low, with long average waiting times, while some of the stock is at emergency condition or unfit for habitation.	Ensure adequate investment in social housing, based on appropriately-designed projects. Consider establishing a carefully-designed fund for supporting renovation of dwellings, paying special attention to refurbishment of social housing.
Homelessness remains an important poverty-related challenge.	Implement a comprehensive policy, combining provision of housing and services to meet the needs of the homeless.
Tackling educational inequalities	
Access to early childhood education and care is not ensured for all children.	**Continue the expansion of early childhood education and care, with a special emphasis on children from disadvantage background and rural areas.**
Educational achievements vary considerably with students' socioeconomic background and across municipalities while students with disabilities face insufficient inclusive education opportunities.	Continue the implementation of ongoing reforms which aim at making schools more inclusive, while ensuring appropriate structures and educational assistance for students with special needs.
Facilitating labour market integration	
Labour taxes for the low-skilled workers are comparatively high, despite a recent reduction, limiting the employment opportunities for such workers in the post-crisis era.	Reduce further the tax wedge for low paid workers bringing it closer to OECD average, while ensuring that benefits are maintained.
Participation in adult learning remains low, reducing re-skilling and upskilling opportunities.	Introduce second-chance education for early school leavers. Develop skills-assessment schemes for the evaluation of work experience and acquired skills of early school leavers re-entering the formal school system.
Activation policies to strengthen to facilitate labour market integration of those out of work with high poverty rates.	**Increase spending in active labour market programmes, upon a close monitoring of their outcomes and a focus on training programmes.**
The vulnerable groups face multiple barriers to their labour market and social integration that requires a close collaboration of all stakeholders.	Evaluate the outcomes of the pilot projects, expanding the integrated service model to all municipalities upon positive outcomes.

Note: Key recommendations are in bold and can be found again at the end of the executive summary.

References

Bank of Lithuania (2020), *Financial Stability Report, May*. [41]

Bertolini, P. (2019), *Overview of Income and Non-Income Rural Poverty in Developed Countries, Expert Group Meeting on Eradicating Rural Poverty to Implement*. [8]

Bouzarovski, S. and H. Thomson (2020), *Towards an Inclusive Energy Transition in the European Union: Confronting Energy Poverty Amidst a Global Crisis,EU Energy Poverty Observatory*. [10]

Causa, O., M. Hermansen and N. Ruiz (2016), "The Distributional Impact of Structural Reforms", *OECD Economics Department Working Papers*, No. 1342, OECD Publishing, Paris, https://dx.doi.org/10.1787/5jln041nkpwc-en. [1]

CEDEFOP (2018), *Lithuania: Strengthening Lifelong Learning, European Centre for the Development of Vocational Training*, https://www.cedefop.europa.eu/en/news-and-press/news/lithuania-strengthening-lifelong-learning. [44]

Credit Suisse (2019), *Global Wealth Databook 2019, Research Institute, October*. [5]

de Mello, L. and M. Dutz (eds.) (2012), *Promoting Inclusive Growth: Challenges and Policies*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264168305-en. [19]

EAPN (2019), *Poverty and Social Exclusion Report 2019, European Anti-Poverty Network (EAPN) Lithuania (report in Lithuanian)*. [6]

EAPN (2018), *Poverty and Social Exclusion in Lithuania 2018, European Anti-Poverty Network (EAPN) Lithuania*. [39]

Energy Poverty Observatory (2020), *Energy Poverty: Lithuania, Member State Report of the EU Energy Poverty Observatory, June*. [9]

European Commission (2020), *Country Report Lithuania 2020*. [12]

European Commission (2019), *Country Report Lithuania 2019*. [22]

European Commission (2019), *Joint Report on Health Care and Long-Term Systems & Fiscal Sustainability, Country Documents 2019 Update, Institutional Paper 105, June*. [26]

Eurostat (2020), *European Union Statistics on Income and Living Conditions-Database*, https://ec.europa.eu/eurostat/web/income-and-living-conditions/data/database. [33]

Eurostat (2019), *Europe 2020 Indicators - Poverty and Social Exclusion: Statistics Explained*. [2]

FEANTSA (2016), *Homeless in Lithuania, November*. [30]

IMF (2019), *Republic of Lithuania, IMF Country Report No. 19/252, July*. [51]

Lazutka, R. et al. (2019), *National Strategies to Fight Homelessness and Housing Exclusion: Lithuania, European Social Policy Network (ESPN)*. [16]

Lazutka, R., A. Poviliunas and L. Zalimiene (2018), *ESPN Thematic Report on Challenges in Long-Term Care: Lithuania 2018, European Commission, February*. [28]

Lazutka, R., A. Poviliunas and L. Zalimiene (2018), *ESPN Thematic Report on Inequalities in Access to Healthcare - Lithuania, European Social Policy Network (ESPN), May*. [23]

Longo, D. et al. (2020), *Energy Poverty and Protection of Vulnerable Consumers - Overview of the EU Funding Programs, Energies, 13, 1030*. [11]

Ministry of Finance (2019), *2020 Lithuanian Draft Budgetary Plan, October*. [13]

National Audit Office (2019), *Does Social Assistance Ensure the Minimum Consumption Needs of People Living in Poverty and Promote the Labour Market Integration, July (summary in English)*. [17]

National Audit Office (2018), *Do we Use the Preschool Education Opportunities to Ensure a More Succesful Future for Children, News Release, 27 September, National Audit Office of Lithuania*. [35]

National Audit Office (2017), *Could Lithuanian Students Perform Better, Press Release 29 November, National Audit Office of Lithuania*. [40]

Navicke, J., S. Avram and L. Demmou (2016), *The Effects of Reform Scenarios for Unemployment Benefits and Social Assistance on Financial incentives to Work and Poverty in Lithuania, OECD Economics Department Working Papers, No. 1310, OECD Publishing, Paris*. [49]

Nordic Council of Ministers (2017), *"The Nordic Welfare Watch", Final Report*. [20]

OECD (2020), *Affordable Housing in Latvia, OECD Publishing, Paris*. [32]

OECD (2020), *Distributional Risks Associated with Non-standard Work: Stylised Facts and Policy Considerations, OECD Policy Responses to Coronavirus (COVID-19), 12 June*. [48]

OECD (2020), *Is Childcare Affordable? OECD Policy Brief on Employment, Labour and Social Affairs, June*. [36]

OECD (2019), *Health for Everyone?: Social Inequalities in Health and Health Systems*, OECD Health Policy Studies, OECD Publishing, Paris, https://dx.doi.org/10.1787/3c8385d0-en. [24]

OECD (2019), *OECD Economic Surveys: Iceland, OECD Publishing, Paris*, https://doi.org/10.1787/c362e536-en. [45]

OECD (2019), *OECD Employment Outlook 2019: The Future of Work*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9ee00155-en. [46]

OECD (2019), *Society at a Glance 2019: OECD Social Indicators*, OECD Publishing, Paris, https://dx.doi.org/10.1787/soc_glance-2019-en. [21]

OECD (2018), *A Broken Social Elevator? How to Promote Social Mobility*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264301085-en. [3]

OECD (2018), *OECD Economic Surveys: Lithuania 2018*, OECD Publishing, Paris, https://dx.doi.org/10.1787/eco_surveys-ltu-2018-en. [15]

OECD (2018), *OECD Reviews of Health Systems: Lithuania 2018*, OECD Reviews of Health Systems, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264300873-en. [27]

OECD (2018), *OECD Reviews of Labour Market and Social Policies: Lithuania*, OECD Reviews of Labour Market and Social Policies, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264189935-en. [14]

OECD (2017), *Education in Lithuania*, Reviews of National Policies for Education, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264281486-en. [37]

OECD (2017), *OECD Economic Surveys: Estonia 2017*, OECD Publishing, Paris, https://dx.doi.org/10.1787/eco_surveys-est-2017-en. [50]

OECD (2017), *OECD Economic Surveys: Switzerland 2017*, OECD Publishing, Paris, https://dx.doi.org/10.1787/eco_surveys-che-2017-en. [43]

OECD (2017), *Starting Strong 2017: Key OECD Indicators on Early Childhood Education and Care*, Starting Strong, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264276116-en. [34]

OECD (2015), *Economic Surveys: Sweden 2015, OECD Publishing, Paris*. [38]

OECD (2015), *Integrating Social Services for Vulnerable Groups: Bridging Sectors for Better Service Delivery*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264233775-en. [29]

OECD (2009), *In-work Poverty : What Can Governments Do?, Policy Brief*. [42]

OECD and European Observatory (2019), *State of Health in the EU - Lithuania : Country Health Profile 2019*. [25]

Pacifico, D. (2017), *Faces of Joblessness in Lithuania: Main Results and Policy Inventory, OECD, Paris*. [18]

Statistics Lithuania (2019), *At-Risk-of-Poverty Indicators, News Releases, 26 June*. [4]

Stockholm School of Economics Riga (2020), *Shadow Economy Index for the Baltic Countries*, https://www.sseriga.edu/shadow-economy-index-baltic-countries. [47]

Thévenon, O. et al. (2018), "Child poverty in the OECD: Trends, Determinants and Policies to Tackle it"*, OECD Social, Employment and Migration Working Papers*, No. 218, OECD Publishing, Paris, https://dx.doi.org/10.1787/c69de229-en. [7]

Tsenkova, S. (2014), *The Housing Policy Nexus and People's Responses to Housing Challenges in Post-Comminist Cities, Urbani Izziv, Vol. 25(2) pp 90-107*. [31]

3 Fostering regional development

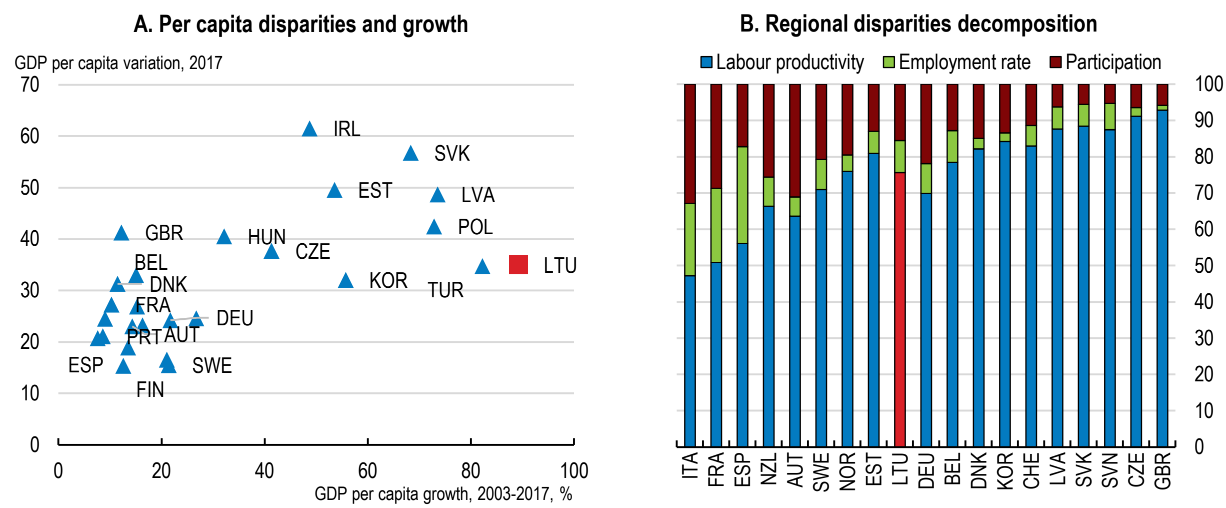
Regional differences in GDP per capita, productivity, employment and poverty in Lithuania are among the largest in the OECD, and they have increased over the last decade. The country still recovers from the legacy of the Soviet planning system which aimed at balanced geographical distribution of industrial activity and left many unviable firms and jobs across the country. Unemployment is high in many regions, while mobility of excess labour towards economically stronger areas remains insufficient. Some regions feature "surplus infrastructure", while others lack investment. This chapter looks at potential reasons for persisting disparities and assesses recent policy initiatives to reduce imbalances. The digital infrastructure is weak in rural regions and should be strengthened to allow access to high-quality jobs in all parts of the country, including through teleworking. Housing supply in economically strong areas should be increased, while urban sprawl should be avoided. Stark gaps in education outcomes between rural and urban areas should be addressed, mainly by reorganising the municipal school network and by fostering firm-based learning (apprenticeships). Finally, municipal governments should be given more power, while the planned functional regions should help foster inter-municipal coordination.

Regional disparities are high

The state and evolution of disparities

Lithuania is a tale of two economies. The capital area and other large conurbations boast GDP per capita, household income and productivity levels close to or above OECD averages. Yet a large part of the peripheral countryside and most small- and medium sized towns are lagging behind, with incomes hardly progressing, unemployment high and emigration abroad often the only way to escape poverty. Overall, Lithuania is among the OECD countries with the highest regional disparities, although on an international scale large regional differences tend to go together with more rapid growth (Figure 3.1 A). As in most countries, productivity gaps account for a large share of the differences in Lithuanian regional GDPs, while employment and participation also contribute to regional disparities (Figure 3.1 B). In particular, older and poor people concentrate in the more rural and remote regions.

Figure 3.1. Regional disparities are large, reflecting differences in productivity

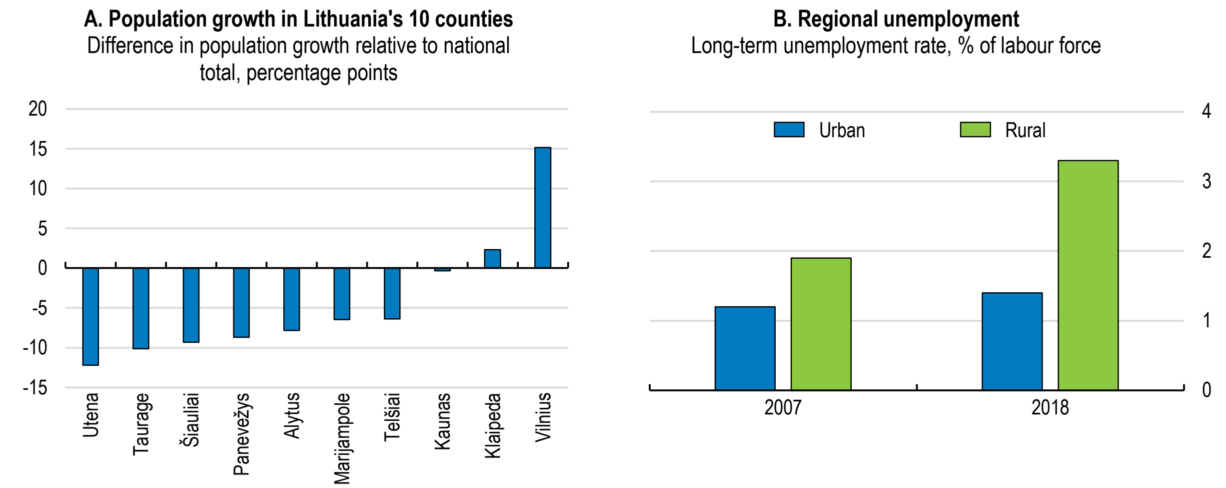


Note: Panel A: the vertical axis refers to the coefficient of variation for regional GDP per capita. Panel B: the variation of regional GDP per capita is decomposed into the contributions of labour productivity (GDP per worker), labour utilisation (share of employed in active working population) and the activity rate (share of active working population in total population). Since an additive aggregation as shown in the figure does not take into account the covariance across components, the variations in each component do not add up to the exact variation in GDP per capita.
Source: OECD Regional database.

StatLink https://doi.org/10.1787/888934185764

The main reason for high and, since 2011, rising regional disparities is a combination of low economic growth and job creation in peripheral areas and insufficient labour mobility, in particular of low-skilled workers, towards economically stronger regions. The gains of Lithuania's globalising economy have concentrated in a few regions that have a qualified workforce and are well integrated in global value chains (Rusticelli and al, 2018[1]). As many countries, Lithuania is converging towards the OECD average, while its individual parts are diverging (Bartolini, Stossberg and Blöchliger, 2016[2]) (Bisciari, Essers and Vincent, 2020[3]). Only four out of 60 municipalities registered population growth over the past decade, namely the largest cities and the resorts along the Baltic coast (Figure 3.2 A). Still rapid urbanisation was not sufficient to bring regional labour markets back to equilibrium: while structural unemployment in the urban areas was almost the same in 2007 as in 2018 (1.2% against 1.4%), it considerably increased in rural areas (1.9% in 2007 against 3.3% in 2018), pointing at growing difficulties to match jobs with people (Figure 3.2 B). The poverty rate in urban areas is 19%, while 31% in rural areas, with the gap increasing from 10% to 12% percent points between 2014 and 2018 (see also chapter 2).

Figure 3.2. Disparities are growing

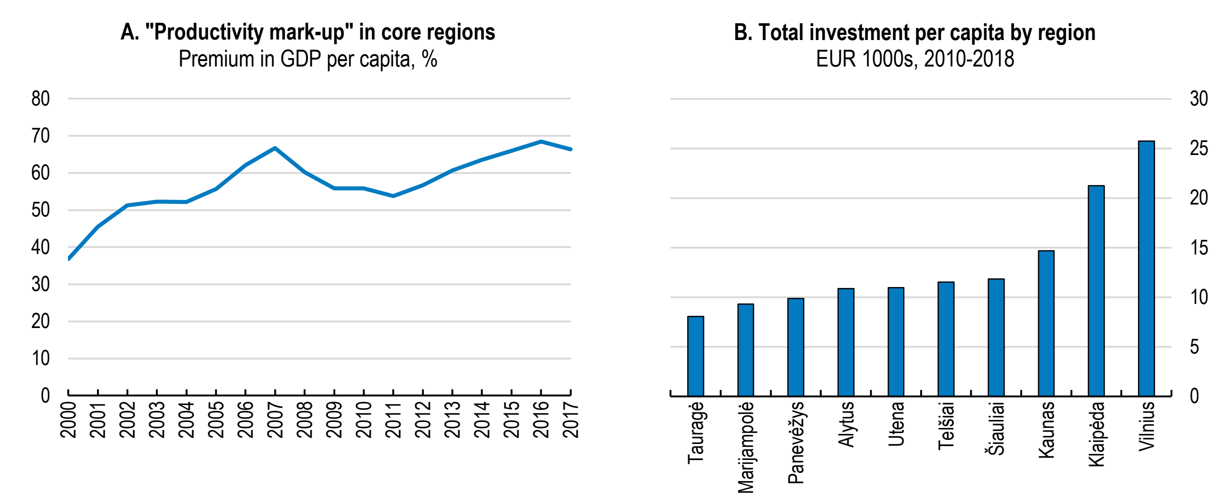


Note: Panel A: overall population in Lithuania decreased by 20% between 2000 and 2019; counties' growth is plotted relative to this general decline in population. E.g. Vilnius only saw its population diminish by 5% over the same period.
Source: OECD Regional database.

StatLink https://doi.org/10.1787/888934185783

Economic and social imbalances are driven by rising economies of agglomeration, suggesting that metropolitan areas are the source of knowledge, innovation and productivity, as in most countries (Glaeser, 2008[4]). The gap between productivity in agglomerations and peripheral areas is rising, implying that highly productive activities concentrate in ever fewer places (Figure 3.3 A), (Schwellnus et al., 2018[5]). More than twice of per capita investment, including EU funds, is going to urban than to rural and peripheral regions (Figure 3.3 B). Around 25’000 FDI-jobs were created over the past five years in Lithuania, of which 16’000 in the capital area alone (Invest Lithuania, 2019[6]). The declining gap after the 2009 crisis is probably the result of a stronger cycle in wealthier regions, thereby reducing disparities in an economic downturn, although the pattern might again be different following the covid-19 pandemic (Smart, 2004[7]). Spillovers from more to less productive firms and regions, the core drivers of regional convergence, seem to be weak, suggesting a lack of knowledge transfer across regional borders.

Figure 3.3. Agglomeration economies are at work



Source: OECD Regional database; and Ministry of Economy.

StatLink https://doi.org/10.1787/888934185802

Lithuania's economic geography partly reflects the legacy of the Soviet planning system (Pociute-Sereikiene, Kriauciunas and Ubareciviene, 2014[8]). Soviet-era regional development consisted mainly of assigning industries to selected places and eliminating differences in living conditions between first- and second-tier cities. The economy was evenly developed across the country, sometimes creating specialized medium-sized "monocities" that depended on a single industrial sector or even plant (Blöchliger and Durand-Lasserve, 2018[9]). The town of Elektrenai – electricity plant – carries the name of its sectoral specialization. Labour mobility was restricted as workers were often assigned to a workplace. Industrialization went together with a tightly-knit network of public infrastructure such as schools, hospitals, cultural institutions and others, providing similar service levels across the country. When the industrial and spatial fabric unwound after renewed independence, public infrastructure followed suit more slowly, partly because the sector offered jobs in areas in decline. As a result, a shrinking population and a move to conurbations left large parts of the country with a dense but inadequate network of public services, sometimes referred to as "surplus infrastructure".

Policies to foster regional convergence

As a response to persisting regional imbalances, the government published a White Paper on regional development in 2017 (National Regional Development Council, 2017[10]). The strategy's main policy objective is to raise the growth potential of physical and human capital in each region through adequate institutional and governance reforms, rather than to redistribute wealth between rich and poor regions. The paper states two specific and actionable objectives, namely that citizens should be able to work within one hour of their residence, and that residents should have access to adequate public services within 30 minutes of reach. The development strategy brings up the concept of "functional regions", defined by regional labour markets or catchment areas of public services. Mid-2020 the parliament adopted a new law on regional development, establishing regional development councils as supra-municipal institutions that will implement national regional policy in the specific region and promote co-operation between municipalities.

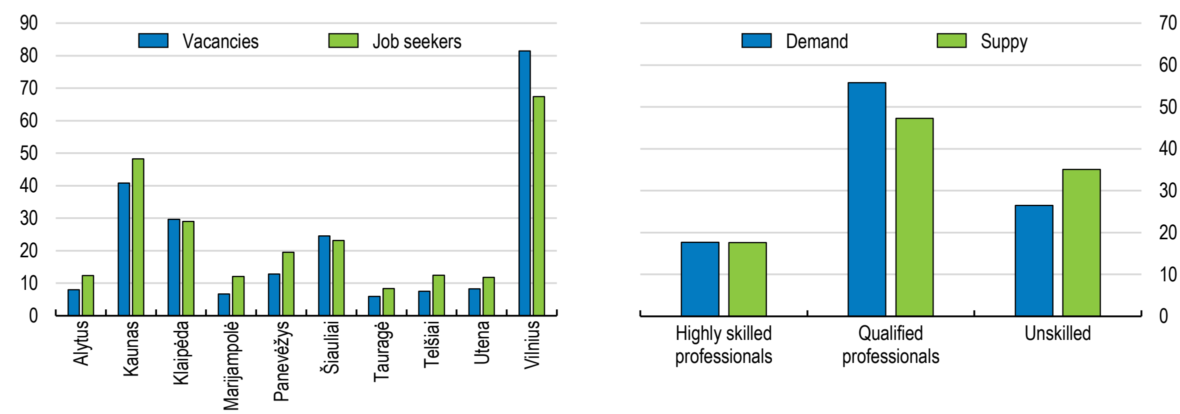
The rest of the chapter deals with the core policies that affect regional development in Lithuania. While urbanisation and agglomeration economies are fundamental drivers of regional growth and convergence, these drivers depend on and are amenable to policy (Tsvetkova et al., 2020[11]). Policies such as setting up physical and digital infrastructure, strengthening high and relevant skills to match local firms' needs, providing adequate housing for those moving to areas with more and better jobs, or else fostering the willingness and capacity of local governments to fund and provide adequate public service levels can help improve productivity, employment and well-being in each region. The chapter will focus on transport and digital infrastructure, on housing markets, on education and on municipal public finance and their role for sustainable and inclusive growth across Lithuania.

Fostering skills across the country

Education and skills, key drivers of long-term development, vary significantly across Lithuania's regions. Differences in educational outcomes between core and peripheral regions belong to the deepest in the OECD, in a context of relatively low overall PISA outcomes. The extent to which students terminate secondary and VET education varies strongly across regions, contributing to differences in labour market outcomes. Skills mismatch is above the OECD average. Skills shortages vary across regions, with more productive regions usually having more labour shortages and a higher demand for qualified professions (Figure 3.4). Differences in the skills composition might be self-reinforcing, with some areas potentially becoming low-skill and low-income traps. In 2020 the government launched a requalification programme for highly-skilled professionals in all regions, thought to reduce skills mismatch.

Figure 3.4. Demand for jobs is higher in more productive regions and for qualified professionals

Vacancies and job seekers, 2019



Source: Ministry of Labour and Social Affairs.

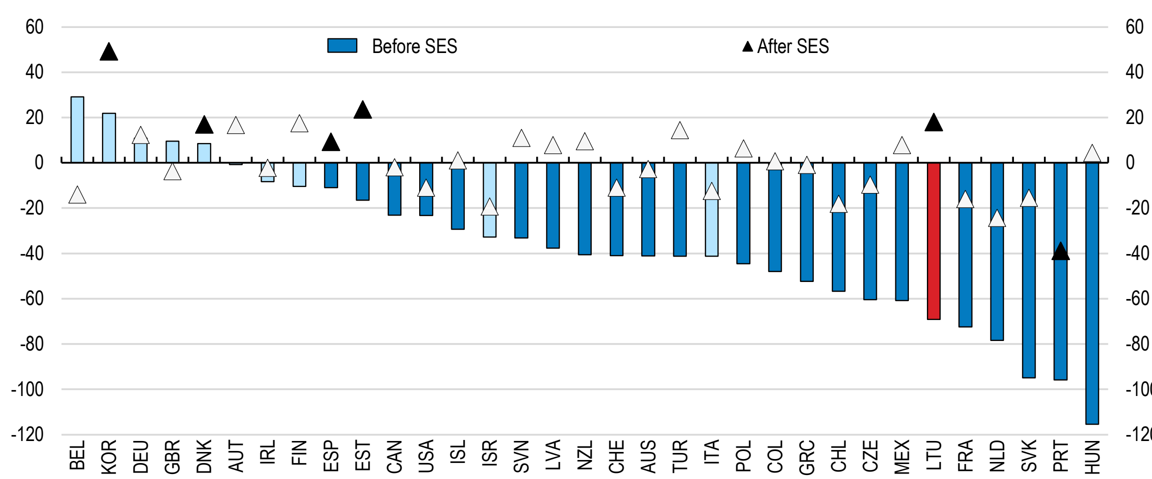
StatLink https://doi.org/10.1787/888934185821

The primary and secondary education system lacks scale

Regional differences in PISA scores at the end of compulsory education are large, strongly driven by different levels of economic development (Figure 3.5). Urban/rural differences in socioeconomic and cultural status of pupils are especially wide; the performance of pupils from rural areas is persistently lower than that of urban students, and by a wider margin than is typical within the OECD. Low attendance in early childhood education in rural areas also contributes to the performance gap (see also chapter 2). Still, Lithuania is one of the few countries where rural students fare significantly better than urban ones if controlling for social-economic status. As such, more rural and peripheral areas are not *per se* disadvantaged by education policy and the school system. Rather, primary and secondary education could do more to improve outcomes and make up for disadvantages students are facing in all regions.

Figure 3.5. In Lithuania, urban-rural gaps in educational achievements are large

Difference in overall PISA score when living in a rural area, 2018



Note: Based on regression analysis using 2018 data from PISA. SES is the social and economic background of students. Darker shaded series are statistically significant.

Source: Based on: Echazarra and Radinger (2019), "Learning in rural schools: Insights from PISA, TALIS and the Literature", OECD Education Working Papers, No. 196.

StatLink https://doi.org/10.1787/888934185840

Box 3.1. Are small schools responsible for low education outcomes? An empirical test

Responsibility for primary and lower secondary education in Lithuania is split between several agencies. The Ministry of Education and Science is responsible for policy design and supervision and provides financial transfers to both municipalities and schools to cover current spending, known as the "student basket" or, more recently, "class basket". The 60 municipalities fund infrastructure and maintenance of the roughly 800 schools. A specialised body within the ministry develops the curriculum and teaching material; carries out country-wide test exams; and provides data for school monitoring.

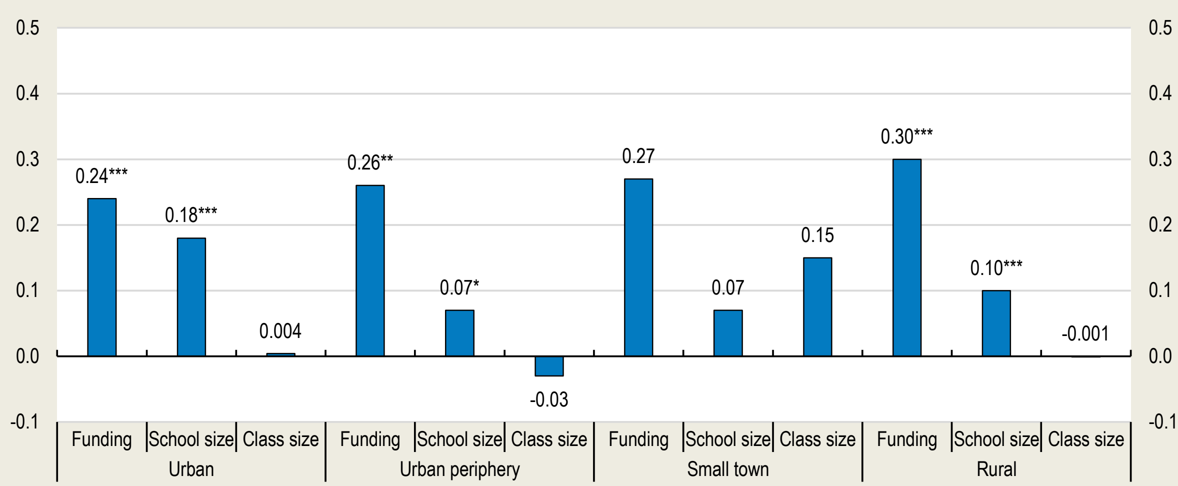
To assess the school network's role for educational outcomes, the OECD carried out an empirical analysis, linking school and class size to 10th grade test scores at the end of compulsory education (*Pagrindinio ugdymo pasiekimų patikrinimas* or PUPP) (Figure 3.6). Funding per student was also included to assess the extent to which the funding formula reduces the role of school and class size for educational outcomes. Schools are divided into four types of regions, partly capturing student's socio-economic background, which is strongly correlated with the urban-rural divide.

Results can be summarised as follows:

- School size and test scores are positively associated. This holds true for all types of regions, yet the association is strongest for urban schools, where a 10% larger school is associated with 1.8% better test scores.
- Funding plays an important role in improving test scores in all types of regions. Funding becomes more important the less "urban" an individual school. A 10% increase in spending in rural areas is associated with improved test scores of almost 3%. In urban schools the increase is between 2.4 and 2.6%.
- There is hardly any relationship between class sizes and test scores in any region, suggesting that class size has no clear impact on educational success.

Restructuring the school network until each school has at least 200 pupils would improve test scores by 9% overall or imply savings of around 10 Mill. Euro, not including less municipal infrastructure spending. The analysis covers the year 2019, so captures the concurrent role of the school network. Its long-term role for student's success would require a panel data analysis covering several years.

Figure 3.6. Smaller schools are associated with weaker outcomes and higher cost everywhere

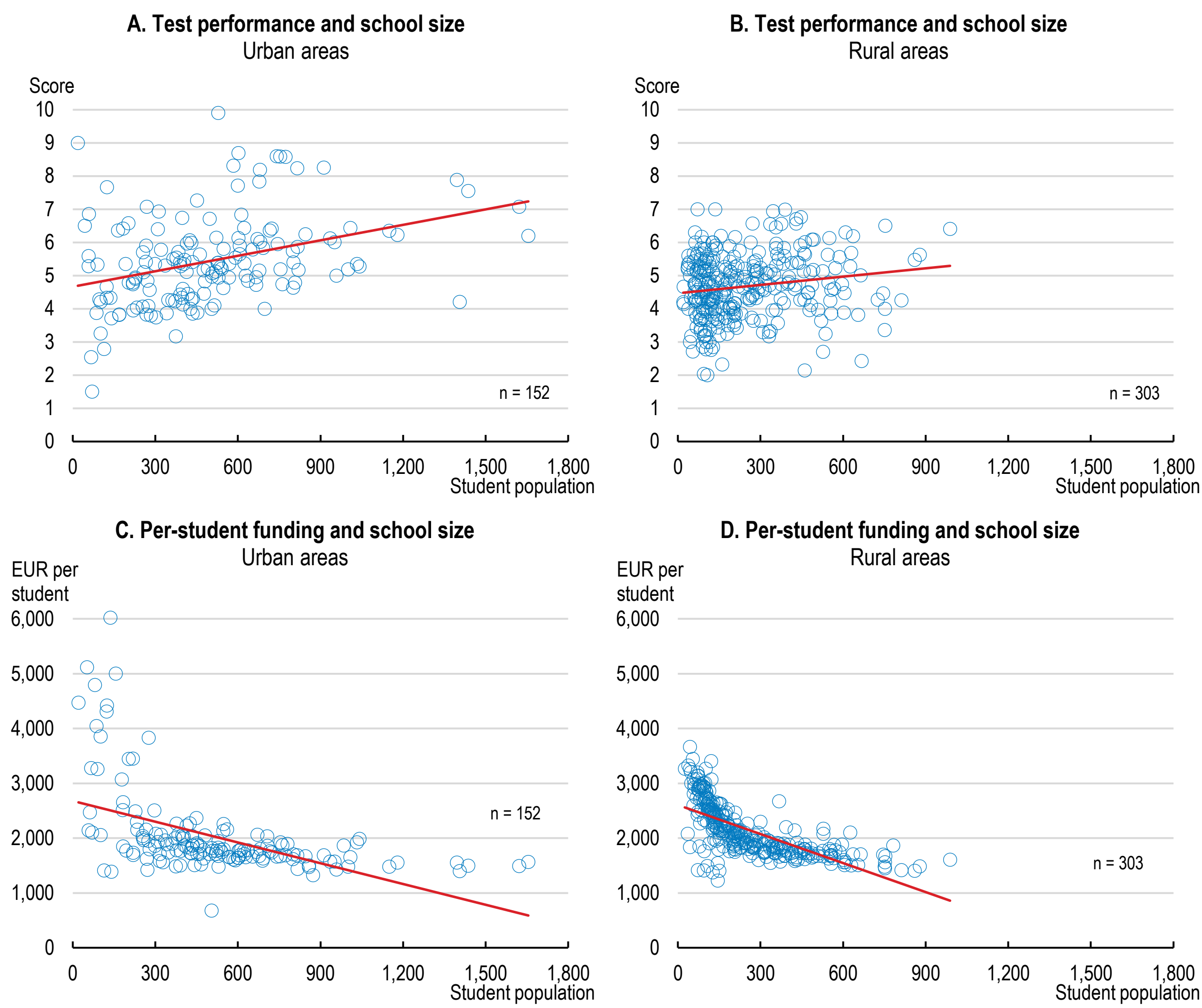


Note: Results show the estimated percentage increase in test scores for a one percentage increase in each independent variable, by type of region.
Source: Ministry of Education, Science and Innovation.

StatLink https://doi.org/10.1787/888934185859

The gap in education outcomes is partly the result of an outdated school network with too many small schools and, to a lesser extent, small classes. The school infrastructure failed to adapt to declining student numbers (National Audit Office, 2017[12]). In 2019 around 20% of all schools had fewer than 50 pupils, often taught in multi-level classes. Such fragmentation could negatively affect education quality and cost (Figure 3.7). *First*, educational outcomes tend to be weaker in smaller schools as education, in particular above the primary level, underlies scale effects. Larger schools can offer a broader curriculum, more specialised courses, and more interaction between and among students and teachers, generating knowledge spillovers (Shewbridge et al., 2016[13]). In this vein, school restructuring, i.e. creating larger schools, generates educational benefits, especially at the secondary level. *Second*, smaller schools cost more per student. Lithuanian schools below 200 pupils seem particularly cost-intensive. Bringing each school to at least 200 pupils would mechanically improve test scores by 9% percent or imply savings of a total of around 10 million Euro per year, not including lower infrastructure spending borne by the municipalities (Box 3.1).

Figure 3.7. Educational outcomes in small schools are weaker, while cost is higher



Note: Test scores are from standardised exams circulated to Grade 10 students and are scaled from 1 to 10. Cost per student includes the ministry of education's total current spending allocated to municipalities and schools. These numbers do not include municipal spending on school infrastructure.

Source: Ministry of Education, Science and Innovation.

StatLink https://doi.org/10.1787/888934185878

The current funding system provides few incentives for municipalities to reorganise the school network and to improve schooling. Grants are unrelated to education outcomes, nor are schools regularly and systematically evaluated (National Audit Office, 2016[14]). In 2018 the Ministry of Education introduced a per-class funding system ("class basket"), replacing the former per-student funding ("student basket"). Although class-based funding leaves schools and municipalities sufficient flexibility in resource use, it considerably lowered incentives to increase school and class size and to help students with special needs (Shewbridge et al., 2016[13]). Smaller schools receive larger per-student contributions, so a school merger reduces the level of funding for a municipality. Moreover, around 25% of schools, especially small ones, receive additional non-formula-based funds, lowering incentives to reorganise even further. The Ministry of Education has little direct influence on the school network since infrastructure and maintenance is under the sole responsibility of the municipalities.

Political economy constraints make school mergers challenging to implement. Municipalities tend to resist mergers since this is seen as cutting access to a core public service. In 2018 and 2019 the government had to backtrack on planned restructuring and has become more cautious. The recent change in school organisation, namely assigning one head teacher to several schools, is a welcome first step towards reaching higher school quality. Lithuania will soon face a shortage of teachers as many approach retirement, facilitating further reorganisation. The government should hence continue school network reform, essentially by applying appropriate funding formulas and improving school monitoring, while weighing the benefits of school reorganisation against drawbacks such as a longer way to go to school or the loss of community life. Overall, the share of spending for teaching, especially digital skills, should rise, while infrastructure spending should decline.

Vocational education and training should better match local labour market needs

Vocational education and training (VET) helps students develop professional skills in upper- and post-secondary education. VET, which integrates school- and work-based learning, provides a strong link between students and the business sector. VET is more reactive to local and regional labour market needs and is associated with less skills mismatch. In countries with a strong tradition of professional education, post-secondary VET improves protection against unemployment and inactivity, especially for the youth, and labour market outcomes such as wages or employment levels are often better than those of comparable academic programmes (OECD, 2014[15]) (OECD, 2018[16]).

Lithuania has one of the lowest enrolment rates in VET with around 27% of all students in upper secondary education (Figure 3.8). VET has a relatively poor reputation with students, although many university students start VET after graduation, pointing at the relatively strong value of professional rather than general education (OECD, 2017[17]). Upper secondary vocational education has struggled to increase its attractiveness to learners, and to provide them strong labour market outcomes (National Audit Office, 2016[18]). Curricula are too constrained by the interests of training providers and not sufficiently driven by fast-changing business requirements, generating skill and labour market mismatches. Since VET is relatively more important outside the large conurbations, the more peripheral areas are relatively more affected by the low level of professional education. To improve the reputation of VET, the government in 2017 established a pathway from upper secondary vocational studies to tertiary education, yet few upper secondary graduates follow this path.

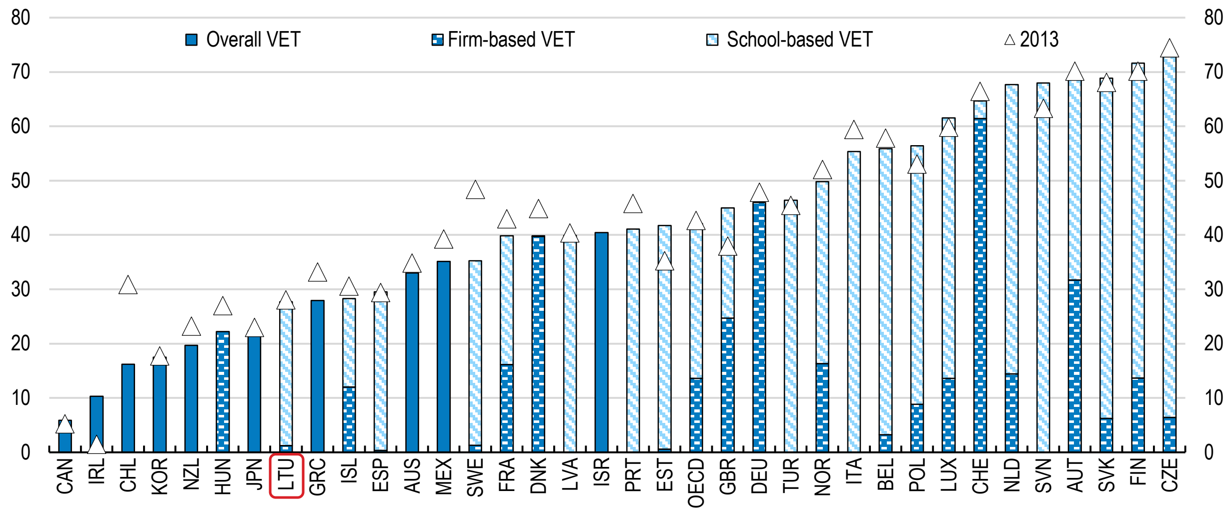
The government has reacted to weaknesses in the VET system and is improving the vocational curriculum. The new VET law of 2017 brought significant changes likely to increase labour market performance of VET, in line with recommendations of the last Survey. Reforms include:

- Establishing sectoral professional committees comprising employers, employees and education providers, to approve vocational standards and assess vocational training programmes.
- Strengthening business association's participation in the governance of VET schools through school self-governing councils.

- Strengthening financial autonomy of VET schools.
- Broadening access to VET, with new flexible and modular programmes based on learning outcomes rather than length of the programmes.

Figure 3.8. Vocational education and training, including apprenticeships, is weak

Share of school- and firm-based education in total upper secondary education, 2018 or latest year, %



Source: OECD calculations based on OECD Education at a Glance database and European Center for the Development of Vocational Training (CEDEFOP) database.

StatLink https://doi.org/10.1787/888934185897

To meet its own target of rising the share of upper-secondary VET students in all students from 27% in 2016 to 35% by 2022, Lithuania should continue to invest in the development and modernization of VET infrastructure, including by reorganizing schools and training centers to reach economies of scale and scope in rural areas. Performance of the VET system should be regularly assessed, especially with respect to labour market outcomes, and curricula adapted if appropriate. Finally, VET should offer more pathways towards other curricula, especially tertiary education, as is increasingly done in France, Germany and Switzerland.

Importantly, firm-based learning – apprenticeships or "dual system" – should be made more attractive. The attractiveness of firm-based learning relies on a few factors such as the apprentice wage, the value of the professional certificate, the duration of the apprenticeship and the alignment with school-based VET education (Moretti et al., 2017[19]). In other words, firm-based learning works if employers have an incentive to offer and students to take up apprenticeships. In Lithuania, where employer resistance to apprenticeships is considerable because of the cost-free school-based VET system, government could nudge them with some additional incentives such as limited financial support or the creation of an employer-managed training fund. The administrative burden should be kept low, which is important for smaller employers. The dual system should be developed in close partnership with industry stakeholders and local governments. In this vein, stakeholders should create platforms – including in the recently set-up regional councils – for standard setting, assessing programmes, and collective bargaining (Box 3.2). Going beyond the traditional technical realm, apprenticeships could extend to new areas like health care or tourism, particularly suitable in regions with an ageing population or tourism resorts.

Box 3.2. Implementing firm-based learning successfully

The significance of firm-based professional learning – apprenticeships – varies widely across OECD countries. For example, Lithuania counts around 900 apprenticeship contracts, while Finland counts 50 000 or Austria 110 000. On average around 80% of upper-secondary vocational education has the form of firm-based learning or apprenticeships in the European Union.

Building apprenticeships in countries where they are uncommon like in Lithuania, creating new programmes in sectors that typically rely on other forms of training, and ensuring labour market relevance is challenging. Experience from countries with strong apprenticeship systems – e.g. Austria, Denmark, Germany, Hungary or Switzerland - suggest a few guiding principles for effective firm-based learning:

- Social partners, i.e. trade and employer organisations and trade unions and their regional counterparts must be involved in the design and implementation of apprenticeship schemes. "Ownership" is essential to encourage their willingness to provide placements.
- The attractiveness of apprenticeships and alternative learning pathways such as school-based training or academic tertiary education should be balanced, and competition between different learning pathways should be fair.
- Diplomas and other forms of formal qualification must bring substantial benefits to apprentices.
- The main parameters of apprenticeship schemes must remain flexible to ensure that an apprenticeship remains attractive to both potential employers and apprentices.
- Costs and benefits of apprenticeships should be monitored to inform the design of new schemes and the reform of existing schemes.

The sub-national context matters, especially as the regional industrial structure or average firm size may determine varying needs across regions and districts. To take local labour market needs into account, a part of the apprenticeship arrangements could be negotiated locally, e.g. by involving the regional councils planned in the new law on regional development.

Source: (OECD, 2018[16]) (European Commission, 2012[20]).

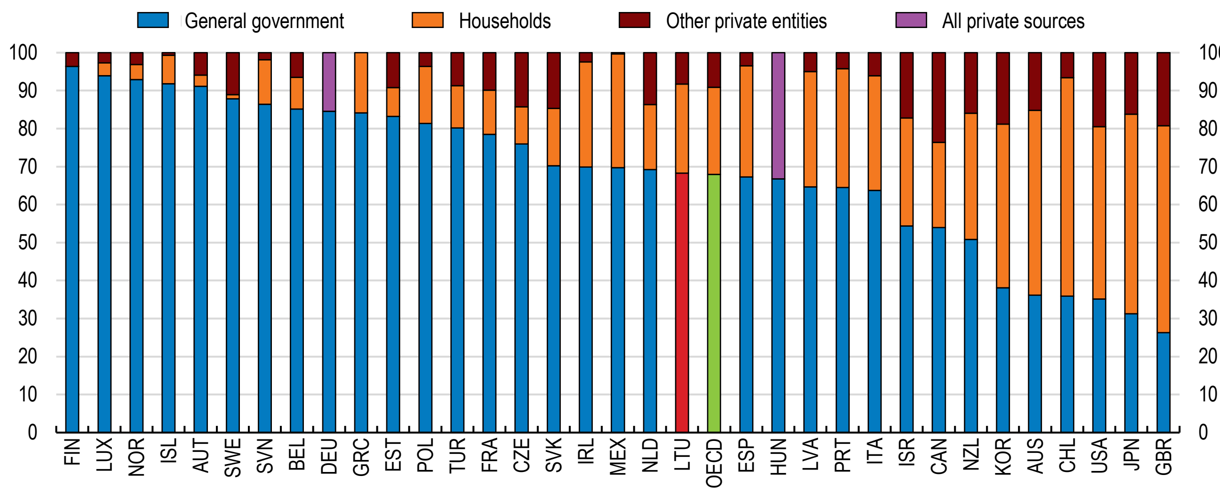
Universities should specialise more

The tertiary sector suffers from the problem of "surplus infrastructure" as well. With 19 public universities and 22 colleges, Lithuania's tertiary institutions struggle to reach scale, performing well below OECD averages with respect to research and innovation (OECD, 2017[17]). Recent attempts to consolidate the network have failed as the Ministry has no power to merge tertiary educations, and mergers that were carried out did not bring the expected results. The government is currently preparing new legislation providing universities with more incentives to deliver on quality and closer to the labour market, hoping that consolidation will then happen from universities' own interest. The student voucher system will be adapted to partly reflect the number of graduates rather than students.

Given Lithuania's size and geography, the country should continue scaling down the number of universities and colleges, with smaller ones potentially being regrouped under a joint leadership or becoming subsidiaries of larger institutions. A combination of university closures and reorganisation could accommodate political economy concerns about an even distribution of higher education institutions across the country. The remaining campuses should specialise in fewer study areas to reach critical mass and to avoid overlap and duplication. Finally, strengthening collaboration between firms and universities and colleges could also help strengthen links to regional labour markets. This could be achieved by increasing incentives for firms to invest in research in universities - and for universities to endorse such funding -, thereby raising funding which is currently low (Figure 3.9).

Figure 3.9. Firms contribute little to university funding in Lithuania

Share of public, household and corporate private funding at tertiary level, 2018



Note: Excludes international expenditure on tertiary education.
Source: OECD Education at a Glance database.

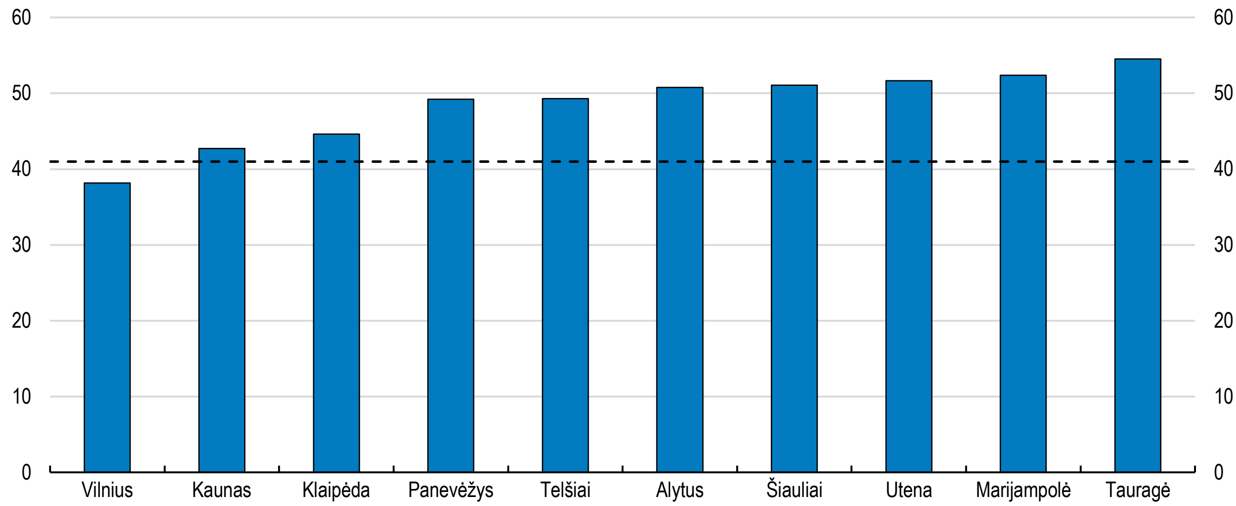
StatLink https://doi.org/10.1787/888934185916

The national minimum wage particularly affects regions with many low-skilled workers

Minimum wage legislation may require policy responses to increase skills of low-skilled workers. The Lithuanian minimum wage is relatively high compared to the median. More importantly, its bite varies strongly across regions, affecting less than 40% of wage earners in the capital and more than 55% in other parts of the country (Figure 3.10). These differences might affect employment across regions. Research for Germany, which introduced a minimum wage in 2015, suggests that minimum wages reduce employment in regions with a high share of low-skilled, low-income jobs, while regions with a large share of well-paid high-skill jobs are hardly affected (Dustmann et al., 2020[21]) (Bonin et al., 2019[22]). Such an asymmetric effect of the minimum wage could hence explain more rapidly rising unemployment in regions with fewer high-skill and high-productivity jobs in Lithuania (Figure 3.2B). Against this background, the government should pursue education and skills policies that help improve productivity and hence reduce the bite of the minimum wage in low-skill regions. Another option is to regionalise the minimum wage, as before the labour market reforms of 2017.

Figure 3.10. The minimum wage has a strong bite in less productive regions

Ratio of minimum wage to average gross wage by county, 2019



Note: the 41% horizontal line reflects the national average.
Source: Statistics Lithuania; and Lithuania Free Market Institute.

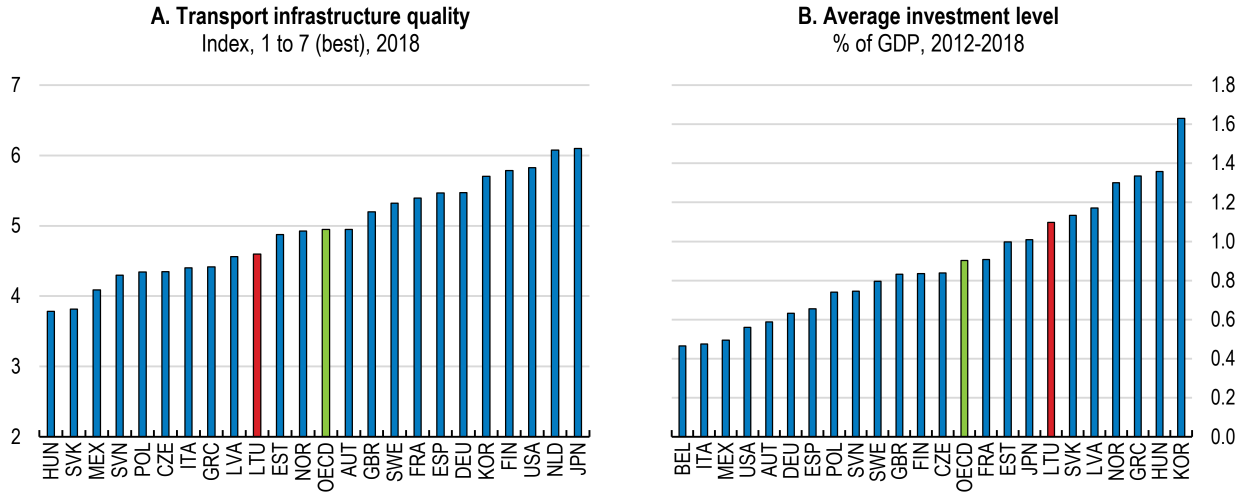
StatLink https://doi.org/10.1787/888934185935

Investing in sustainable infrastructure

Transport should be improved and become more sustainable

Lithuania's transport infrastructure remains below OECD standards, despite high investments largely covered by European Union funds (Figure 3.11). Transport is dominated by an international East-West axis linking Russia and Europe, while South-North infrastructure is underdeveloped. Efficiency in the rail sector is low, and road fatalities, albeit decreasing, are high, partly owing to inadequate road infrastructure. Moreover, transport is responsible for above-average amounts of CO_2 emissions (see green growth background paper). With regard to local and regional transport, several studies point at low accessibility in and around conurbations, mainly due to congestion (Jakimavičius and Burinskiene, 2007[23]), (ESPON, 2015[24]). Investment is focused on international projects such as *Rail* and *Via Baltica*, thought to improve links between the Baltic states and Central, Western and Northern Europe. Against this background, improving sustainable local and regional transport infrastructure, especially in urban areas, is an essential ingredient to raise productivity and well-being across regions.

Figure 3.11. Transport infrastructure needs improvement



Note: Panel A: overall indicator is the simple average across four sub-indicators: Quality of Roads, Efficiency of Seaport Services, Efficiency of Air Transport Services, and Efficiency of Train Services. Averages are calculated for the most recent value of all countries with available data (unweighted).
Source: World Economic Forum Global Competitiveness Indicators 2019; OECD Transport database; and OECD Economic Outlook database.

StatLink https://doi.org/10.1787/888934185954

Local and regional public transport still suffer from neglect after renewed independence, despite having improved over the past few years (European Commission, 2019[25]). Lacking investment and fragmented decision making across municipalities have prevented the development of adequate public transport networks, especially in urban areas. Rail has almost no role in urban transport. For that reason the National Transport Development Plan identified investment into sustainable urban transport as one of the five priorities to improve the transport and communication system (Ministry of Transport and Communications, 2014[26]). Since local and regional public transport in Lithuania is mainly by bus, a high-quality bus network and innovative solutions such as a stronger reliance on ride-sharing in sparsely populated areas could help increase accessibility and reduce private car use responsible for congestion and declining environmental quality (Box 3.1). Since higher transport quality increases real estate values, transport investment could be partly financed through higher property taxes as in the United States (Gupta, Van Nieuwerburgh and Kontokosta, 2020[27]).

Appropriate pricing of transport infrastructure can help manage demand, address environmental damage, and provide funding for new infrastructure, especially in the context of declining EU payments as planned from 2021. Medium-sized cities such as Bergen or Trondheim in Norway introduced road pricing schemes as early as the 1980s, to help fund infrastructure upgrades (International Transport Forum, 2010[28]). In Lithuania’s larger cities, road-pricing (or mobility pricing) could support environmental policy, e.g. by differentiating prices according to emissions, or it could help fund public transport infrastructure such as dedicated bus lanes. Given the political economy headwinds for pricing schemes, their benefits should be clearly visible, for instance in the form of better infrastructure both for public and private transport or higher environmental quality. Road pricing could complement CO_2 taxes, and it might compensate revenue from fuel taxation which could decline by 25% over the next 10 years as private transport moves towards electric cars (OECD/ITF, 2019[29]).

Box 3.3. Modernising local and regional public passenger transport

Following rapid urbanisation, rising car ownership and lacking investment, most Central and Eastern European economies have witnessed a dramatic decline in the use of public transport over the past twenty years. Urban public transport was entirely disbanded in some areas, with a fragmented and poorly regulated private minibus ("marshrutka*")* market replacing the former public operators. Poor service quality tended to exceed potential efficiency gains arising from competition among operators. In the more rural and peripheral areas, low demand following population decline and strong reliance on private cars made it difficult to sustain public transport services, or only at high cost.

Under these circumstances, policy measures to improve public transport, in particular to encourage commuting, should build on different approaches depending on population density.

- Densely populated areas: Integrated transport systems have proven the most effective way to improve urban public transport. Network externalities arising from congestion, density and environmental impact call for organisation by a single agency, with routes, timetables and fares based on cost-benefit analysis. Since urban public transport in Lithuania is overwhelmingly by bus, the regulatory framework should allow for efficient service provision, with operation of the network or parts of it being tendered. Investment should focus on separate bus lanes and fast high-quality buses. Kaunas, Lithuania's second city, in 2013 integrated the minibus system into the urban public transport network, considerably increasing quality at almost no additional cost.
- Sparsely populated areas: Traditional public transport lacks flexibility and scale in peripheral areas to remain sustainable. As such, the government might initiate new transport on demand concepts. Demand-responsive transport has shown promising results in Norway, providing door-to-door services at the user's desired time rather than with a fixed route and timetable. Car- and ride-sharing services can suit markets in peripheral areas. In 2017 Innisfil, a rural town in Canada, was the first to hand over responsibility for public transport entirely to a ride-sharing operator. To save cost and improve services, the government might also bundle different transport providers, e.g. combining municipal buses with the yellow school buses or the postal service, jointly funded by the responsible agencies.

Finally, regulatory reform in the transport sector, including harmonised rules for concessionary services and tendering bus services, joint tendering across municipal borders, and a more flexible taxi licencing system, could help underpin better public transport in all areas.

Source: (European Bank for Reconstruction and Development, 2019[30]), (Dotterud and Skollerud, 2015[31]), (OECD, 2017[32]), (The Guardian, 2019[33]).

Finally, competition and regulatory reform could help improve transport services and reduce gaps in accessibility between regions. (OECD, 2016[34]). The state-owned rail company LG still dominates transport services, which is important given that rail accounts for 34% of freight transport, against 16% in the European Union. In 2017, the European Union fined LG for anti-competitive behaviour, and despite open access, there is no private provider of rail passenger services. Buses operate on an open-access basis, yet municipalities are not obliged to tender bus services, and they hardly collaborate to provide joint services, which often results in insufficient network size and low service quality (Lithuanian Free Market Institute, 2019[35]). If hail-riding apps are to become a new form of public transport, concession rules must ensure all operators are treated equally. In order to strengthen competition further and to allow regional transport operators reach scale and scope, regulation could be harmonised across the three Baltic countries. The *Rail Baltica* and *Via Baltica* projects could be an opportunity to set up a single trans-Baltic transport competition and regulation authority.

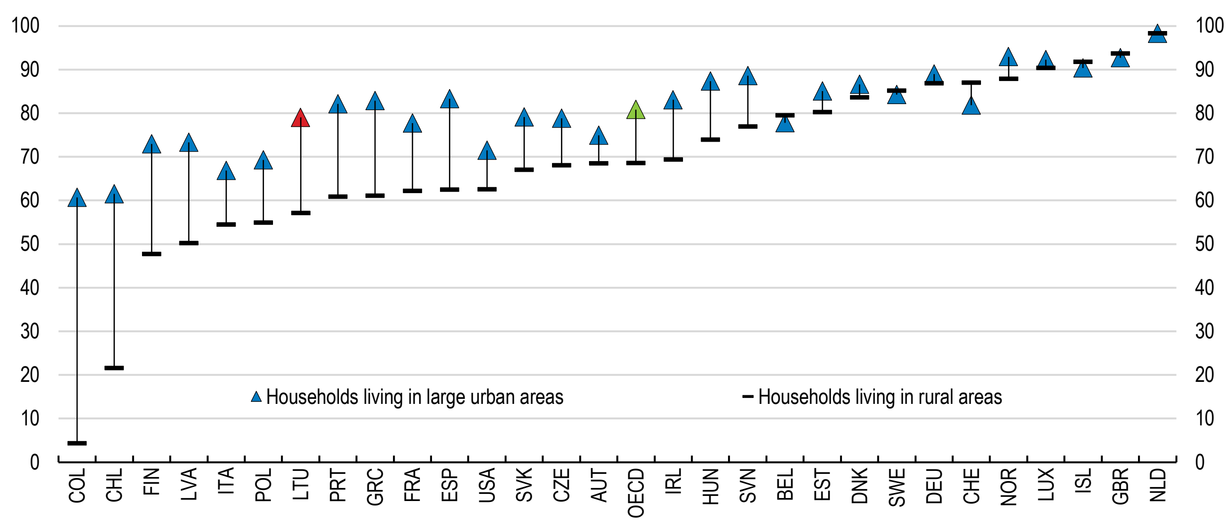
Digital infrastructure should be improved in rural areas

Digital transformation and upgrades foster higher productivity and well-being (OECD, 2019[36]). Cross-country regressions suggest that boosting high-speed Internet connections by 10% would boost productivity directly by 2%, while adoption of cloud computing and other advanced digital technologies would add another 1.5% to productivity, although these gains are stronger for more productive firms and weaker in the presence of skill shortages (Gal et al., 2019[37]). In Norway, higher broadband connection increased online vacancy-postings and lowered the average duration of a vacancy and the share of establishments with unfilled vacancies (Bhuller et al., 2019[38]). The covid-19 crisis has revealed the benefits of a well-developed digital infrastructure across all regions of a country enabling teleworking and improving access to public administrations.

Broadband coverage and uptake are well advanced in Lithuania on average, but the digital divide between regions is wide (Figure 3.12). Fixed broadband coverage of households is still below the European Union average, but rising steeply. As one of five OECD countries only, fibre provides the majority of broadband connections. The mobile phone network is well-developed and advanced. The use of digital tools by businesses is above the OECD average. Broadband prices are among the lowest in the European Union. However, he lack of fast broadband connectivity in rural areas prevent parts of the population from taking advantage of the digital and technological transformation, and digital skills remain below the EU average (European Commission, 2020[39]). Urban-rural divides in access occur for a variety of reasons including fixed broadband, in particular of higher speeds, not extending to some rural areas as well as low uptake.

Figure 3.12. The digital divide between regions is stark

Share of households with fixed broadband Internet access at home, 2019 or latest available year



Source: OECD Information and Communication Technology database.

StatLink https://doi.org/10.1787/888934185973

Since 2005 Lithuania has used an array of EU-funded programmes (RAIN, Rural Area Information Technology Broadband Network) to improve digital access in remote and sparsely populated areas. The Ministry of Transport and Communications is currently implementing the Next Generation Access Infrastructure (NGA) to ensure high-speed access. Lithuania should continue reducing the digital divide between urban and rural regions – among others to allow for more teleworking in the countryside -, thereby following recent recommendations of the OECD to ensure efficient coverage (Box 3.4).Since digital services can be provided by different technologies - fixed line broadband, mobile, wireless, and satellite connections -, the government should establish a technology-neutral policy, *i.e.* a regulatory and funding framework that focuses on outcomes – namely connectivity – rather than a specific type of infrastructure. Finally, digital skills to help households and business make use of new infrastructures should be improved, especially in rural areas.

Box 3.4. How to bridge the digital divide between urban and rural regions?

Most OECD countries have established specific policies to expand high-speed connectivity in rural and remote areas. However, challenges remain, especially with respect to the cost of improved broadband in regions with low population density as well as the need to enhance the use of digital services. Against this background, in 2018 the OECD published a set of benchmarks and best practices to improve access to and use of broadband in sparsely populated regions. The recommendations based on experience in Australia, Canada, Denmark, Ireland, the United Kingdom, and Sweden can be summarised as follows:

- *Understand the existing broadband gaps*: Measure the different availability and adoption gaps through indicators and maps, and make information on connectivity and prices available to consumers and operators
- *Foster sound regulatory frameworks*: Establish technology-neutral and consumer-centred regulatory frameworks that rely on clear rules for all market actors and enable fair competition.
- *Streamline administrative procedures*: Improve co-ordination across levels of government and eliminate administrative redundancies, to reduce deployment costs.
- *Enhance access to networks*: Remove existing barriers to access infrastructure, such as restrictive rights of way, limitations of access to poles, ducts etc. Promote open access networks if they involve public funding.
- *Stimulate local and municipality level initiatives*: Implement bottom-up models to finance and deploy high-speed networks, such as those of municipal or community networks.
- *Foster demand and adoption of broadband services*: Foster the use of broadband-services, through awareness, affordability, digital literacy, relevant content and trust.
- *Improve dialogue between private and public sectors*: Governments and regulatory authorities should engage in dialogue with market actors to reach a common understanding of how best to improve coverage and to improve digital skills.

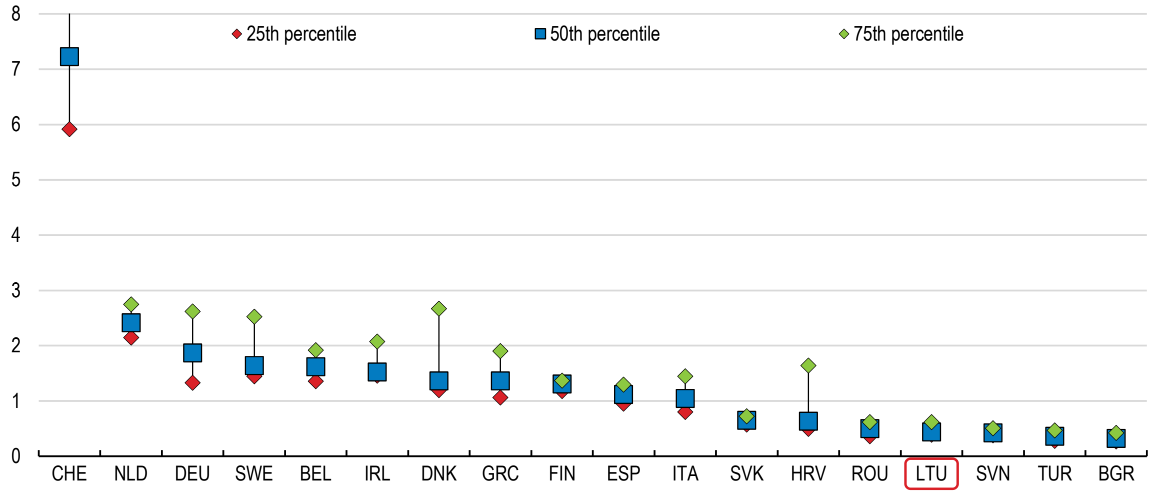
Source: (OECD, 2018[40]).

Scaling up housing, while reducing urban sprawl

House prices in Lithuania are low, but differ more across regions than in other Central and Eastern European countries (Figure 3.13). Residential mobility has resulted in markedly stronger demand and higher house prices in economically dynamic areas. Although housing supply is elastic overall, in some fast-growing cities with good amenities, construction could not keep up with rising demand, slowing migration towards more productive places. Also, affordable housing has become an issue in the capital area of Vilnius (Binovska, Kauskale and Vanags, 2018[41]).

Figure 3.13. House prices are low in Lithuania but vary across regions

Price per square metre, by region, EUR 1000s, 2019



Source: European Union, Houselev database.

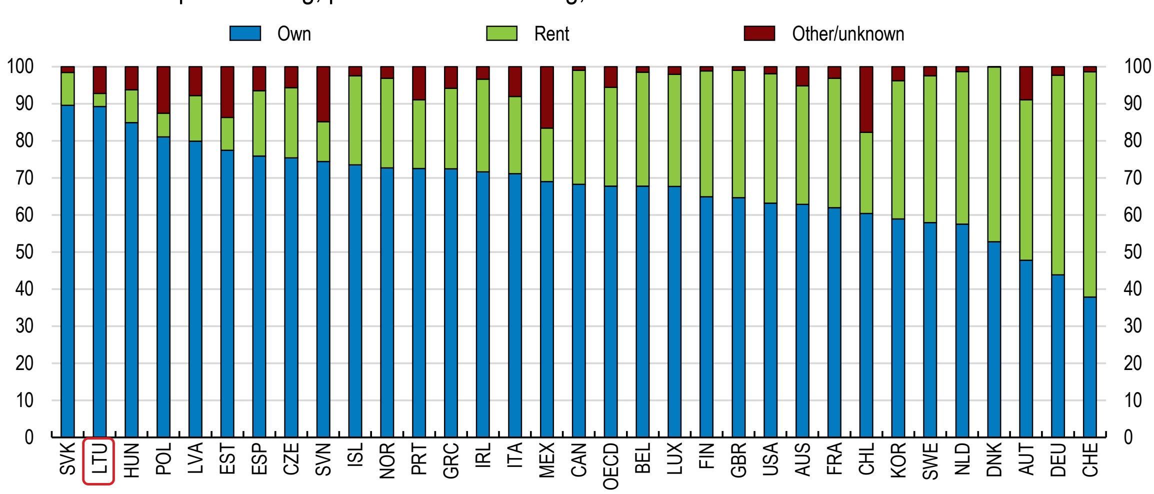
StatLink https://doi.org/10.1787/888934185992

High ownership rate is likely to reduce labour mobility

At 90%, Lithuania features the highest homeownership rate of the OECD besides Slovakia (Figure 3.14). In rural areas virtually all homes are owner-occupied following mass privatisation after renewed independence. While owner-occupied houses and apartments are an asset, they are also an obstacle to residential mobility. Recent OECD research suggests that homeowners are much less mobile than renters (Causa and Pichelmann, forthcoming[42]). Financial constraints reduce the capacity to move: selling a house in the countryside generally does not provide sufficient financial resources to buy appropriate accommodation in urban areas. The mortgage market is rather shallow, reducing further incentives to accept jobs that require moving residence to meet mortgage payments (Andrews et al., 2011). Against this background, improving residential mobility is an important policy challenge for more balanced regional development.

Figure 3.14. High home ownership rates could create a barrier to labour mobility

Share of owner-occupied housing, percent of total housing, 2018



Source: OECD Affordable Housing Database.

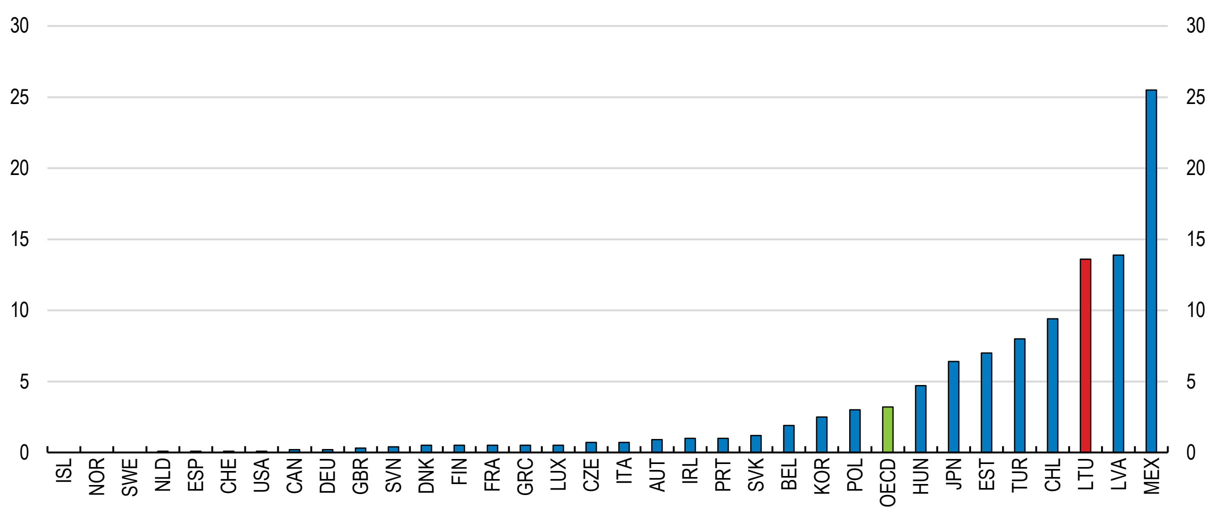
StatLink https://doi.org/10.1787/888934186011

The small rental market is an additional barrier to residential mobility, prompting labour market “lock-in” effects (Glocker and Plouin, 2016[43]) (Andrews and Caldera Sánchez, 2011[44]). Less than 10% of the Lithuanian population lives in rental housing, compared to 25% in the European Union (Eurostat, 2019[45]). Renting is mainly for mobile high-income households, unlike in other European countries where the rental market targets low- and medium-income households. Complex and opaque regulation could be a reason for the lack of rented dwellings. Constitutional law protects both “integrity of the home”, especially for families, and individual property, raising insecurity for both tenants and landlords. As a result, owners set higher rents to price in risks of financial losses, or rent out informally (70-80% of renting might be informal according to the authorities). To deepen the rental market, to increase residential mobility and to improve housing affordability, the government should strive for a reform of the civil code that clarifies and enforces rights for both renters and owners.

Fragmented ownership adds another problem. Lithuania’s housing stock consists for a large part of multi-apartment dwellings built during the Soviet era, privatised to individual dwellers after renewed independence. Fragmented ownership of these buildings makes management and coordination of upgrading works difficult as an absolute majority of dwellers need to consent. Moreover, many owners have limited financial resources and access to credit. As a result, renovation and maintenance work is often insufficient, leaving many apartments without basic facilities, especially in rural areas (Figure 3.15). Moreover, while the area-heating system functions well, residential energy consumption is high since dwellings are badly insulated. In 2019 the government amended the law on support of multi-apartment houses and increased contributions especially for improving energy-efficiency which had been modest in the past few years. Creating a housing fund, akin to the State Housing Development Fund in the Slovak Republic, could be an effective way to improve quality and energy-efficiency of dwellings (Box 3.5).

Figure 3.15. Many apartments need upgrading

Share of population living in facilities without basic infrastructure, 2017



Note: Basic facilities refers to having an indoor flushing toilet for the sole use of the respective household. The index includes single-family houses, where the issue is more prevalent than in multi-apartment dwellings.
Source: OECD Better Life Index.

StatLink https://doi.org/10.1787/888934186030

Box 3.5. The Slovak Republic's State Housing Development Fund

Slovakia's State Housing Development Fund, introduced in 1996, is a key tool in supporting the expansion of property and rental housing and improvements to housing quality. The Fund provides favourable long-term loans, financing up to 100% of acquisition costs for up to 40 years. Loans can be accessed by individuals, local governments and not-for-profit organisations. The Fund also helps to finance the acquisition of rental dwelling as well as the renewal or upgrades of residential buildings. The Fund was initially funded almost entirely through the state budget yet has progressively become self-sufficient while doubling its initial capital.

In recent years the Fund has been effective in funding maintenance and refurbishments. As of 2016, approximately half of the country's dwelling stock had been refurbished. Around 25% of the total housing stock have been refurbished with the support of the Fund. The Ministry of Transport and Construction, which manages the Fund, has been very active in engaging with housing managers and associations of owners to explain the opportunities offered by the Fund. Financing is provided after the presentation of a technical assessment, which has further contributed to better understand the state of the housing stock and raise awareness of the need to intervene.

To complement the Fund, a housing development programme, introduced in 1998, provides subsidies to municipalities to finance i) the construction of social rental housing; ii) the construction of technical infrastructure; and iii) the elimination of systematic technical failures in building construction. Depending on the building features and quality standards, the subsidies to municipalities can cover between 40 and 75% of the acquisition costs.

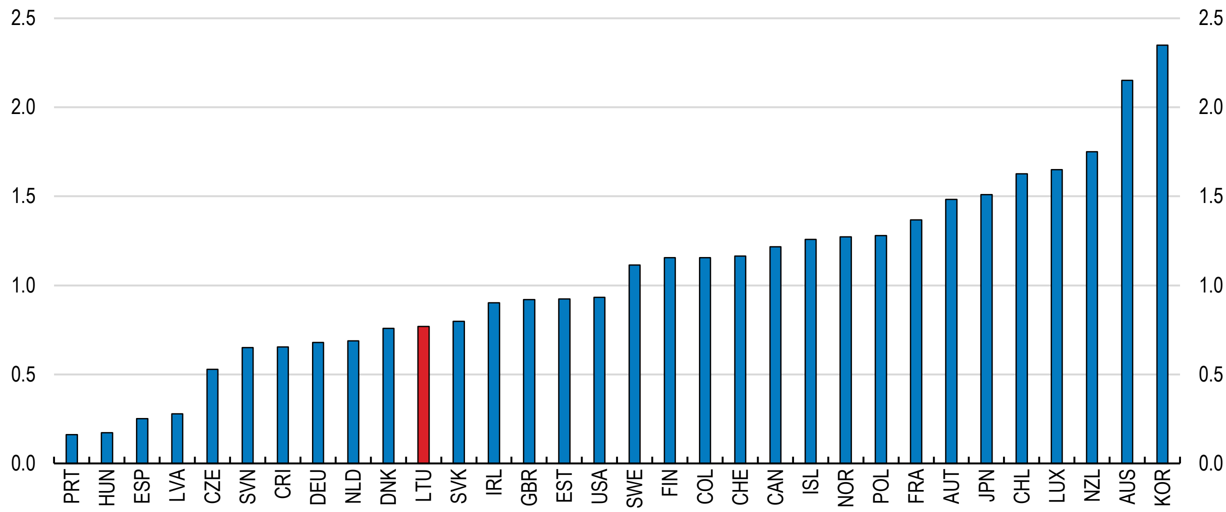
Source: (OECD, 2020[46]).

Fostering sustainable urban housing supply could facilitate mobility

International experience suggests that flexible housing supply can be a powerful tool to facilitate mobility towards high-productivity areas, while keeping local house price excesses at bay (Glaeser and Gyourko, 2018[47]). Housing supply, i.e. new construction, seems not to have kept up with rising demand in economically active areas, although OECD supply-side elasticities do not exist for the Baltic countries (Iacovos, 2018[48]) (Cavalleri, Cournède and Özsöğüt, 2019[49]). The share of new construction in the total housing stock is below the OECD average (Figure 3.16). The land use planning process and issuance of construction permits can be slow and prone to mistakes, heightening insecurity and cost for firms and households (National Audit Office, 2019[50]). Municipalities, which are responsible for development, often lack the resources to provide necessary infrastructure, and they have few incentives to do so since additional tax revenues accrue overwhelmingly to central government. The supply of social housing, provided by municipalities, is very low and often in areas far from job opportunities.

Figure 3.16. Housing supply seems not to follow demand

Total dwellings completed in a year as a share of the existing housing stock, %, 2018 or latest year



Source: OECD Affordable Housing Database.

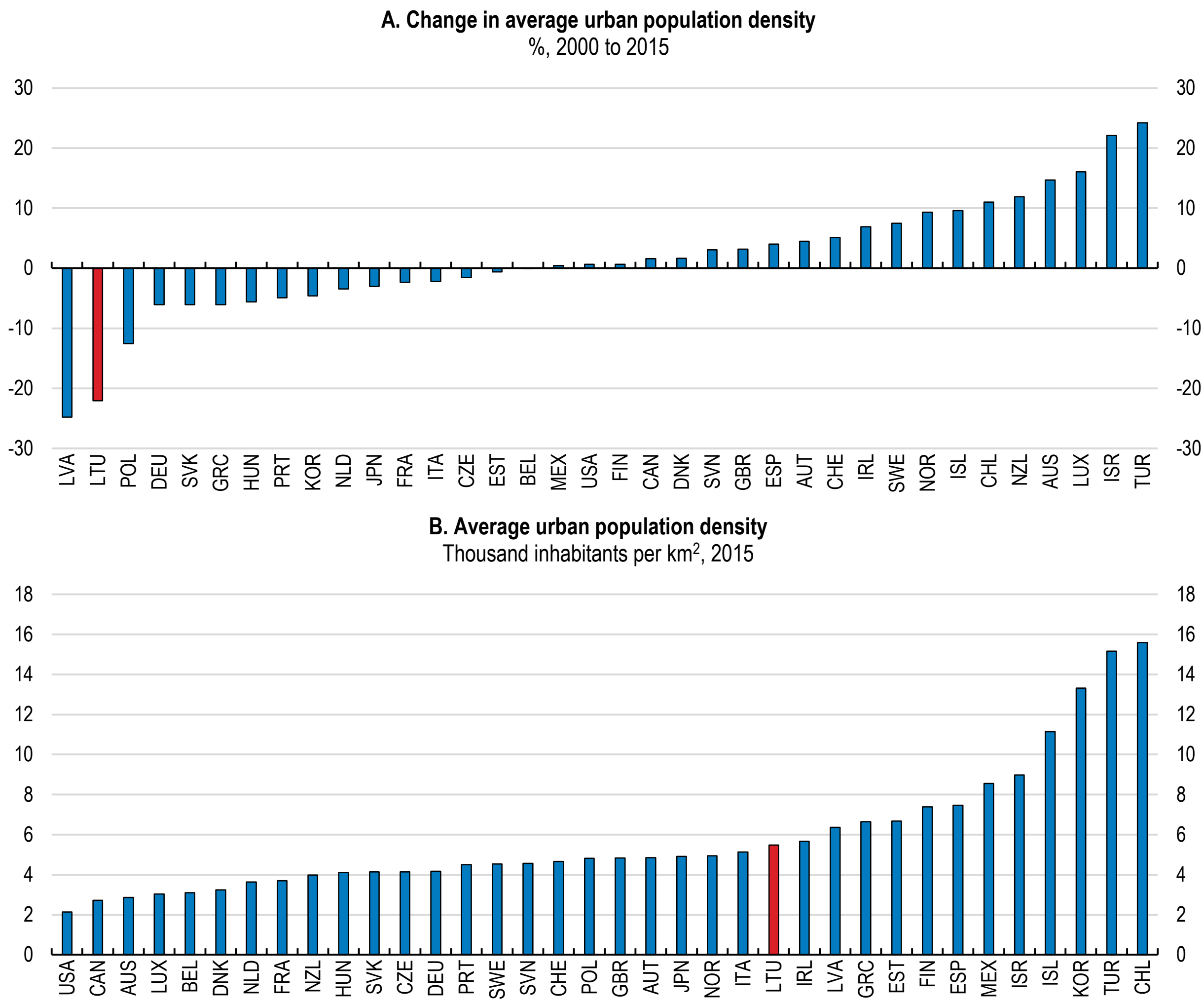
StatLink https://doi.org/10.1787/888934186049

Low-density urban development could be one of the main reasons for elevated house prices in urban areas and a lack of residential mobility in Lithuania (OECD, 2018[51]). Population density in urban areas - although still high compared to other countries - has considerably decreased over the past two decades, similar to other Central and Eastern European countries, with development mainly taking place at the extensive margin around large conurbations (Figure 3.17). Low-density development, sometimes following regulation requiring minimum lot size, not only reduces supply in a given area, it also tends to rise property prices, discouraging lower-income households to move towards core areas (Blöchliger et al., 2017[52]). Moreover, low-density development could be responsible for excessive urban sprawl, especially if zoning regulation sets explicit building limits. Low-density development and urban sprawl are also associated with higher per capita public infrastructure cost, higher energy consumption and higher car use.

Fostering higher-density development and slowing excessive urban sprawl to provide better access to housing is a complex endeavour, requiring reforms in various policy areas. The main lever is to provide incentives for local governments to increase housing supply while to reduce land consumption (Moreno Monroy, A., et al., 2020[53]). The Comprehensive Plan for the Territory of Lithuania foresees the establishment of financial instruments that encourage local planners to increase population density in built-up areas. Mid-2020 the parliament adopted the law on municipal infrastructure, thereby establishing a development fee for municipal infrastructure, similar to existing schemes at the local level in the United States and other countries. This is welcome. Other policy initiatives should include better coordination of planning at the regional level. Regional councils could ensure the coordination of land use planning across municipal borders and between other policy areas, in particular transport, to ensure balanced development and affordable housing.

Figure 3.17. Urban sprawl is increasing, pushing up infrastructure cost

Population density in built-up areas, 2015 and evolution 2000-2015



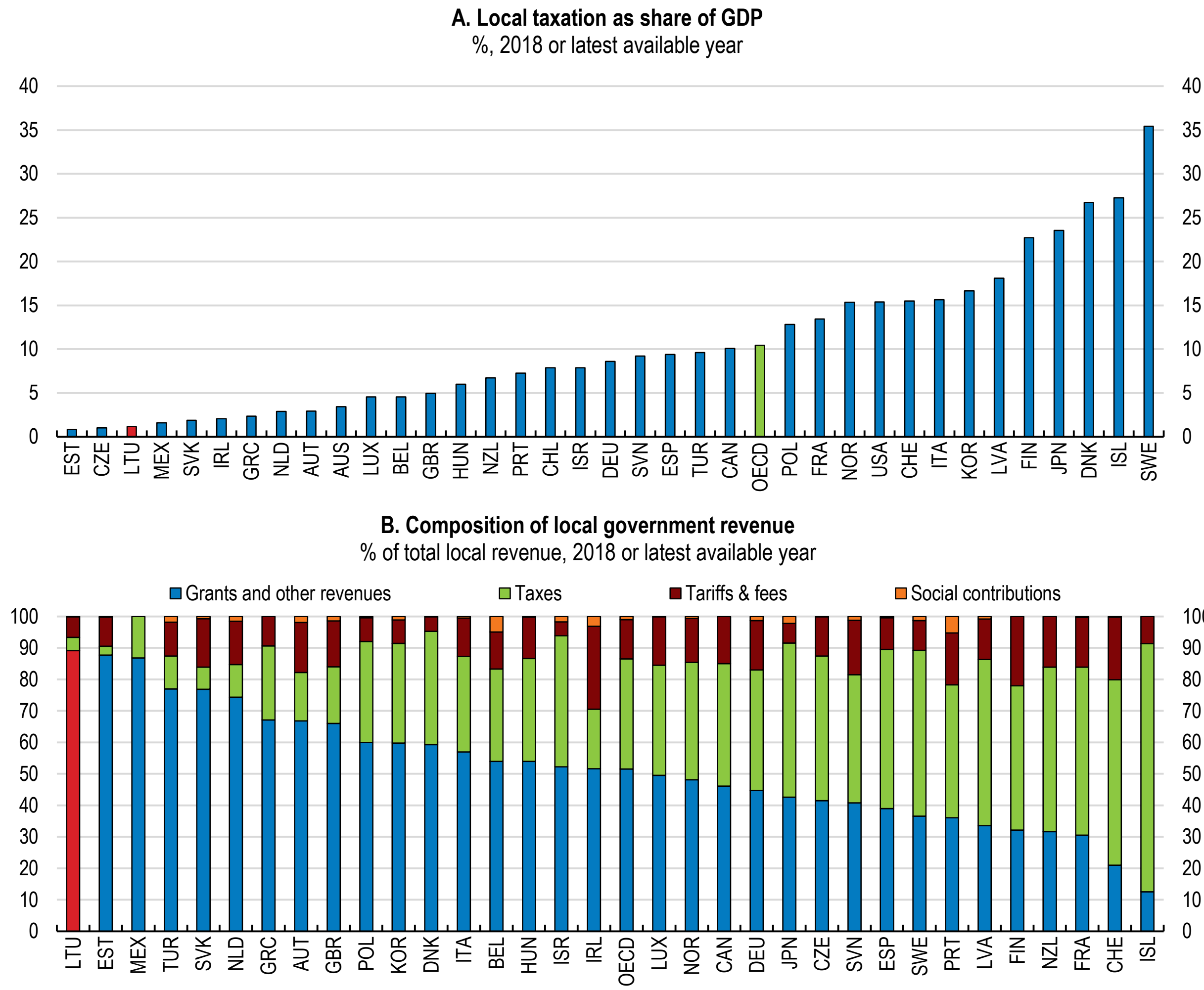
Source: OECD Regional database.

StatLink https://doi.org/10.1787/888934186068

Improving multi-level governance

Lithuania is highly centralised, leaving sub-national governments little autonomy to develop and implement their own policies (Figure 3.18). Although relatively large in size on average, the 60 municipalities have few own tax revenues and rely heavily on transfers from the central government to cover spending responsibilities in education, health care and social services. The gap between spending and own revenue is even larger for municipalities outside large conurbations. Following an administrative reform in 2010, the 10 counties, an intermediate administrative level created in 1995, were abolished. The law on regional development of 2020 introduced a regional level again, by creating regional development councils. A stronger role of the municipalities could raise the local potential for growth, while the newly institutionalised regional level could help address policy coordination across municipalities and the reorganisation of "surplus infrastructure".

Figure 3.18. Lithuania is highly centralised



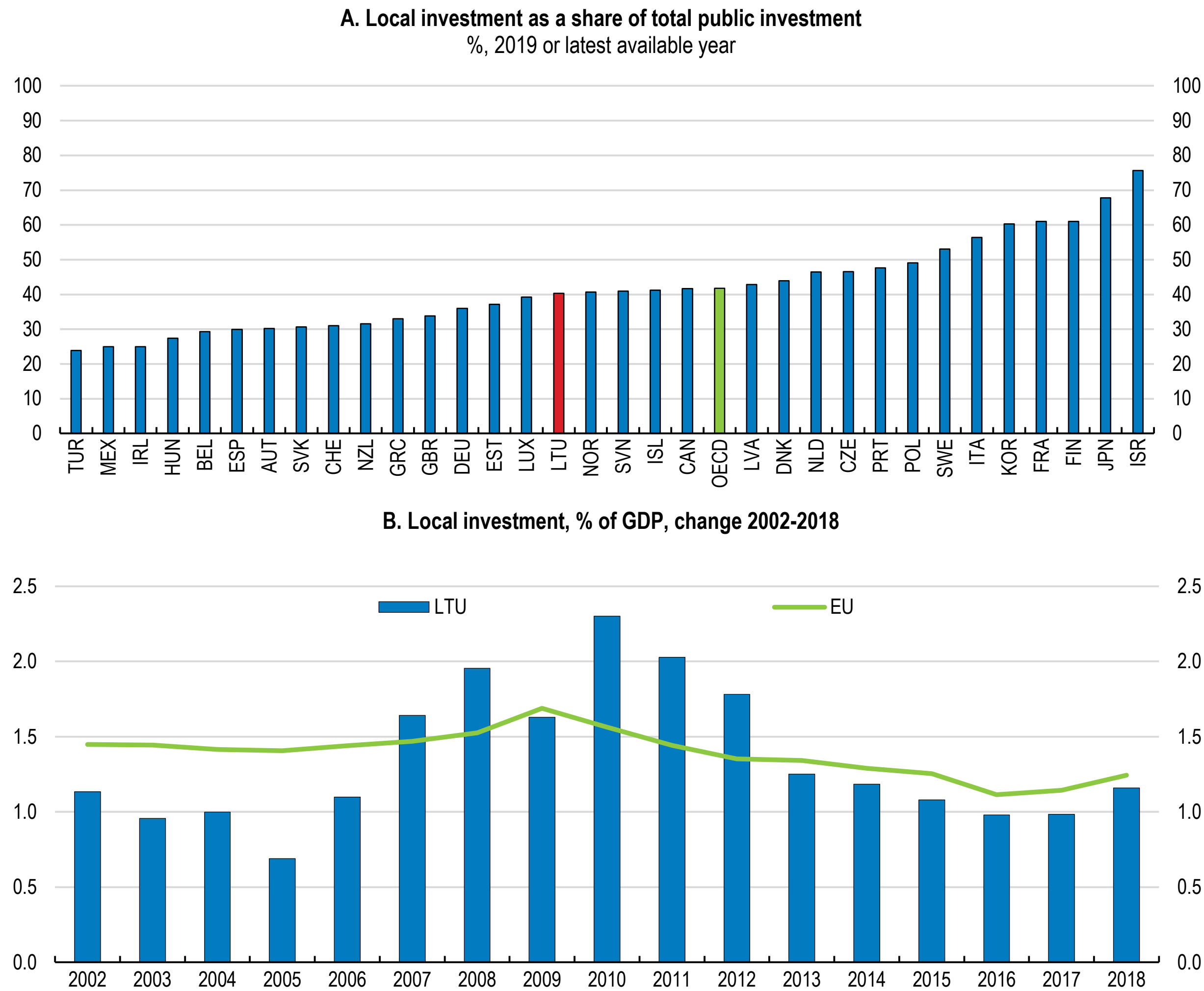
Source: OECD Global Revenue Statistics database; and OECD Government at a Glance database.

StatLink https://doi.org/10.1787/888934186087

Local investment is low and declining

Local investment is low and declining, in a context of low overall public investment (Figure 3.19). Low own-source revenues and tight local fiscal rules limit willingness and capacity of municipalities to renew or upgrade infrastructure to increase productivity and quality of public services. Municipalities, responsible for land development, have no strong fiscal incentives to attract business investment since they have to assume infrastructure cost while resulting tax revenues accrue mainly to the central government. Central government retains the residential property tax, reducing local fiscal capacity and development incentives further. As a result, many development sites lack sufficient scale to cater to foreign firms that want to set up business in Lithuania. Overall, a higher share of own-source revenue is associated with higher public, including local, investment (Forman, Dougherty and Blöchliger, 2020[54]).

Figure 3.19. Local investment is low and declining



Source: OECD Government at a Glance database; and Eurostat (2020[2]), The Government Finance Statistics (GFS), https://ec.europa.eu/eurostat/web/government-finance-statistics/data.

StatLink https://doi.org/10.1787/888934186106

Over the past few years the government took several initiatives to make the local fiscal framework more investment-friendly. In 2018 it adapted the allocation formula for the personal income tax to better reward municipal efforts to attract residents and payroll and eased the local fiscal rule for some types of investment. Moreover, reforms to the local property tax in 2018 and 2020, namely a lower tax-free threshold for property values, helps fuel property tax revenues, although its share in GDP or total tax revenue remains widely below OECD averages. The government introduced “development fees” charged to the beneficiaries of new developments, akin to models existing in the United States and other countries (Brandt, 2014[55]). There are also plans for local governments to fully retain the central government share in the property tax, similar to plans in the United Kingdom (OECD, 2020[56]). Finally, the government eased regulation and reduced taxation of large-scale investment projects (“green corridor”). To strengthen local willingness and capacity to invest further, the government should continue to increase local own-source revenue, in particular property taxes.

The planned functional regions will improve investment quality

A flexible policy coordination across municipalities could help improve level and quality of public investment (Blöchliger and Akgun, 2018[57]). Services like schools, hospitals or transport often require coordination at the supra-local level to reach optimal size and network effects. Moreover, the geographical reach is different for each policy area. Against this background, the establishment of functional regions is a bold step in the right direction. The new regions and their development councils could address the political economy resistance preventing reorganisation of municipal services. As discussed in the previous Survey, regional councils could take over responsibility for the hospital network, for instance. The planned regional administrations should receive adequate decision-making power and funding, and any existing funds discouraging service reorganisation should be abandoned.

Regional councils could also help improve policy coordination in urban areas ("metropolitan governance"). Lithuania counts no bodies covering policymaking and service provision in urban areas, with the exception of Klaipeda, the main port with a supra-municipal body responsible for regional development, land use regulation and cooperation in the Baltic Sea. The counties, initially formed to cover a city or town plus surroundings, have no administrative power. Against this background, productivity in Lithuanian metropolitan areas might be below potential (Ahrend et al., 2014[58]). Improving metropolitan governance along the lines of OECD peer countries could help improve economic performance in metropolitan areas (Box 3.6). In particular, coordination of urban transport and land use could help reduce infrastructure cost, limit urban sprawl and improve environmental performance. While a metropolitan organisation with an appropriate budget should be set up by local governments, the central government may provide financial support. The new functional regions could act as the springboard for enhanced metropolitan governance.

Box 3.6. Metropolitan governance: current approaches in OECD countries

Metropolitan governance varies widely across OECD countries, ranging from lightly organised single-purpose organisations to fully-fledged government levels covering core policy tasks, mostly as an institutionalised forum for policy makers to strategic planning and coordination of policies across an urban area. More than two-thirds of metropolitan areas, i.e. functional areas with more than 500,000 inhabitants, in OECD countries have some form of institutionalised governance. Organisations dealing with metropolitan areas usually cover a "functional economic area", i.e. commuting zones or the catchment area of a regional labour market. The policy areas these organisations are covering include regional economic development, land use planning, transportation and infrastructure planning and investment. Also, most metropolitan bodies run metro-wide integrated transport systems. In line with a "light" institutional approach, very few metropolitan bodies have their own fiscal power to levy taxes but are funded by contributions from the member municipalities or fees for services.

A number of studies highlight the positive long-term economic and environmental impact of institutionalised metropolitan governance. Where organisations responsible for metropolitan governance exist, metropolitan areas tend to be larger and record lower levels of urban sprawl. Similarly, the existence of metro-wide public transport organisations is correlated with higher levels of public satisfaction and lower levels of air pollution. Growth and productivity are higher in areas with some sort of metropolitan governance body, especially if responsible for transport infrastructure and land use planning. Finally, income inequality seems to be lower in areas with strong metropolitan governance. Given the variety and flexibility of arrangements, governments wishing to achieve better metropolitan governance should aim at these "light" approaches before creating additional intermediate regional government levels.

Source: (Ahrend and Schumann, 2014[59]) (Ahrend, Gamper and Schumann, 2014[60]) (Blöchliger et al., 2017[52]).

Table 3.1. Recommendations to foster regional convergence

Fostering skills across the country	
PISA scores are weak, especially in small rural schools.	**Improve educational outcomes by reforming the school network and by strengthening supervision.**
Vocational education and training is little developed, contributing to skills mismatch.	**Foster and improve vocational education and training, and strengthen firm-based learning (apprenticeships).**
The quality of tertiary education is low, and many universities lack scale.	Merge universities, with existing campuses specialising in certain study fields.
Investing in sustainable infrastructure	
The quality of local and regional transport infrastructure is low.	Invest in public transport in urban areas. In rural areas, implement innovative concepts such as ride-sharing and bundle transport services.
Transport and its environmental impact is under-priced.	Implement mobility-pricing schemes including environmental damage.
Digital infrastructure is thin in rural areas, slowing job creation and teleworking.	Improve digital infrastructure in rural areas, and establish a technology-neutral regulatory and funding framework for digital providers.
Scaling up housing and reducing urban sprawl	
Housing supply in economically strong areas does not fully keep up with demand, while signs of excessive urban sprawl appear.	Foster housing through a swift planning and permit system. Slow excessive urban sprawl by providing municipalities with incentives for higher-density development, and improve coordination between transport and land use planning.
The housing rental market is very small, discouraging mobility.	**Revise rental legislation by clarifying the rights of tenants and landlords.**
Improving multi-level governance	
Policy coordination between municipalities is weak, driving cost and reducing public service quality.	**Improve coordination of infrastructure and public services across municipalities.**
Local public investment is low and declining.	Increase local own-source revenues, in particular property taxes and development fees.

Note: Key recommendations are in bold and can be found again at the end of the executive summary.

References

Ahrend, R. et al. (2014), “What makes cities more productive? Evidence on the role of urban governance from five countries”, *OECD Regional Development Working Papers*. [58]

Ahrend, R., C. Gamper and A. Schumann (2014), “The OECD Metropolitan Governance Survey: A Quantitative Description of Governance Structures in large Urban Agglomerations”, *OECD Regional Development Working Papers*, No. 2014/4, OECD Publishing, Paris, https://dx.doi.org/10.1787/5jz43zldh08p-en. [60]

Ahrend, R. and A. Schumann (2014), “Approaches to Metropolitan Area Governance: A Country Overview”*, OECD Regional Development Working Papers*, No. 2014/3, OECD Publishing, Paris, https://dx.doi.org/10.1787/5jz5j1q7s128-en. [59]

Andrews, D. and A. Caldera Sánchez (2011), “Drivers of Homeownership Rates in Selected OECD Countries”*, OECD Economics Department Working Papers*, No. 849, OECD Publishing, Paris, https://dx.doi.org/10.1787/5kgg9mcwc7jf-en. [44]

Bartolini, D., S. Stossberg and H. Blöchliger (2016), “Fiscal Decentralisation and Regional Disparities”, *OECD Economic Department Working Papers*, https://doi.org/10.1787/18151973. [2]

Bhuller, M. et al. (2019), “How Broadband Internet Affects Labour Market Matching”, *CESifo Working Paper 8022*, http://www.cesifo-group.org/wp. [38]

Binovska, I., L. Kauskale and J. Vanags (2018), "The Comparative Analysis of Real Estate Market Development Tendencies in the Baltic States", *Baltic Journal of Real Estate Economics and Construction Management*, http://dx.doi.org/doi: 10.1515/bjreecm-2018-0001. [41]

Bisciari, P., D. Essers and E. Vincent (2020), "Does the EU convergence machine still work ?", *National Bank of Belgium Economic Review*. [3]

Blöchliger, H. and O. Durand-Lasserve (2018), "The drivers of regional growth in Russia: A baseline model with applications", *OECD Economics Department Working Papers*, No. 1523, OECD Publishing, Paris, https://dx.doi.org/10.1787/9279f6c3-en. [9]

Blöchliger, H. et al. (2017), "Local taxation, land use regulation, and land use: A survey of the evidence", *OECD Economics Department Working Papers*, No. 1375, OECD Publishing, Paris, https://dx.doi.org/10.1787/52da7c6a-en. [52]

Bonin, I. et al. (2019), "The German Statutory Minimum Wage and its Effect on Regional Employment and Unemployment", *Institute of Labour Ecomics Working Paper Policy Paper 145*, http://www.iza.org. [22]

Brandt, N. (2014), "Greening the Property Tax", *OECD Working Papers on Fiscal Federalism*, No. 17, OECD Publishing, Paris, https://dx.doi.org/10.1787/5jz5pzw9mwzn-en. [55]

Causa, O. and J. Pichelmann (forthcoming), "Should I Stay or Should I go? Residential Mobility Across OECD Countries", *OECD Economics Department Working Paper*. [42]

Cavalleri, M., B. Cournède and E. Özsöğüt (2019), "How responsive are housing markets in the OECD? National level estimates", *OECD Economics Department Working Papers*, No. 1589, OECD Publishing, Paris, https://dx.doi.org/10.1787/4777e29a-en. [49]

Dotterud, L. and K. Skollerud (2015), *Public Transport Services in Norway: Focus on Rural Areas*. [31]

Dustmann, D. et al. (2020), "Reallocation Effects of the Minimum Wage", *Centre for Research and Analysis of Migration Working Paper 7/20*, https://www.cream-migration.org/publ_uploads/CDP_07_20.pdf. [21]

ESPON (2015), *Transport Accessibility at regional/local scale in Europe*. [24]

European Bank for Reconstruction and Development (2019), *Driving change: reforming urban bus services*. [30]

European Commission (2020), *Digital Economy and Society Index*. [39]

European Commission (2019), *Transport in the European Union. Current Trends and Issues*. [25]

European Commission (2012), *Apprenticeship Supply in the Member States of the European Union*. [20]

Eurostat (2019), *Distribution of population by tenure status, type of household and income group - EU-SILC survey*, https://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do (accessed on 17 October 2019). [45]

Forman, K., S. Dougherty and H. Blöchliger (2020), "Synthesising Good Practices in Fiscal Federalism: Key recommendations from 15 years of country surveys", *OECD Economic Policy Paper 28*. [54]

Gal, P. et al. (2019), "Digitalisation and productivity: In search of the holy grail – Firm-level empirical evidence from EU countries", *OECD Economics Department Working Papers*, No. 1533, OECD Publishing, Paris, https://dx.doi.org/10.1787/5080f4b6-en. [37]

Glaeser, E. (2008), *Cities, Agglomeration and Spatial Equilibrium*, Oxford. [4]

Glaeser, E. and J. Gyourko (2018), "The Economic Implications of Housing Supply", *Journal of Economic Perspectives*. [47]

Glocker, D. and M. Plouin (2016), "(2016), "Overview of Housing Policy Interventions in Poland",", *OECD Regional Development Working Papers*, http://dx.doi.org/dx.doi.org/10.1787/5jlpl4n838f2-en. [43]

Gupta, A., S. Van Nieuwerburgh and C. Kontokosta (2020), "Take the Q Train: Value Capture of Public Infrastructure Projects", *NBER Working Paper 26789*, http://www.nber.org/papers/w26789. [27]

Iacovos, I. (2018), "Housing Price, Credit, and Output Cycles: How Domestic and External Shocks Impact Lithuania's Credit", *IMF Working Paper 18/160*. [48]

International Transport Forum (2010), *Implementing Congestion Charges*, https://www.itf-oecd.org/road-pricing-roundtable. [28]

Invest Lithuania (2019), *The manufacturing landscape in Lithuania*. [6]

Jakimavičius, M. and M. Burinskiene (2007), "Automobile transport system analysis and ranking in Lithuanian administrative regions", *Transport*, http://dx.doi.org/doi.org/10.1080/16484142.2007.9638127. [23]

Kim, J. (ed.) (2018), *Fiscal Decentralisation and Economic Growth*, OECD Publishing, http://dx.doi.org/doi.org/10.1787/9789264302488-en. [57]

Lithuanian Free Market Institute (2019), *How do municipal undertakings work?*. [35]

Ministry of Transport and Communications (2014), *National Transport Development Plan 2014-22*. [26]

Moreno Monroy, A., et al. (2020), "Housing policies for sustainable and inclusive cities", *OECD Regional Development Working Papers 2020/03*, http://dx.doi.org/doi.org/10.1787/d63e9434-en. [53]

Moretti, L. et al. (2017), "So Similar and yet so Different: A Comparative Analysis of a Firm's Cost and Benefits of Apprenticeship Training in Austria and Switzerland", *IZA Institute of Labor Economics Discussion Paper 11081*, http://www.iza.org. [19]

National Audit Office (2019), *Granting Construction Permit and Compliance of Construction Process to the Set Requirements*, http://www.vkontrole.lt. [50]

National Audit Office (2017), *Could Lithuanian Students perform better?*, http://www.vkontrole.lt. [12]

National Audit Office (2016), *Monitoring of Education*, http://www.vkontrole.lt. [14]

National Audit Office (2016), *Taking Advantage of Vocational Training Possibilities*. [18]

National Regional Development Council (2017), *Lithuanian Regional Policy White Paper for Harmonious and Sustainable Development*. [10]

OECD (2020), *Economic Surveys: United Kingdom*, OECD Publishing, Paris. [56]

OECD (2020), *Policy Actions for Affordable Housing in Latvia*. [46]

OECD (2019), *Measuring the Digital Transformation: A Roadmap for the Future*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264311992-en. [36]

OECD (2018), "Bridging the rural digital divide", *OECD Digital Economy Papers*, No. 265, OECD Publishing, Paris, https://dx.doi.org/10.1787/852bd3b9-en. [40]

OECD (2018), *Rethinking Urban Sprawl: Moving Towards Sustainable Cities*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264189881-en. [51]

OECD (2018), *Seven Questions about Apprenticeships: Answers from International Experience*, OECD Reviews of Vocational Education and Training, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264306486-en. [16]

OECD (2017), *Education in Lithuania*, Reviews of National Policies for Education, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264281486-en. [17]

OECD (2017), *OECD Economic Surveys: Latvia 2017*, OECD Publishing, Paris, https://dx.doi.org/10.1787/eco_surveys-lva-2017-en. [32]

OECD (2016), *Competition and Innovation in Land Transport*. [34]

OECD (2014), *Skills beyond School: Synthesis Report*, OECD Reviews of Vocational Education and Training, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264214682-en. [15]

OECD/ITF (2019), *Tax Revenue Implications of Decarbonising Road Transport: Scenarios for Slovenia*, OECD Publishing, Paris, http://dx.doi.org/doi.org/10.1787/87b39a2f-en. [29]

Pociute-Sereikiene, G., E. Kriauciunas and R. Ubareciviene (2014), "Peripheralisation trends in rural territories: the case of Lithuania", *Studies in Agricultural Economics* 116, pp. 122-130, http://dx.doi.org/dx.doi.org/10.7896/j.1421. [8]

Rusticelli, E. and al (2018), "Going local: a regional perspective on how trade affects labour markets and inequality", *OECD Economics Department Working Papers 1530*, http://dx.doi.org/doi.org/10.1787/2981f94c-en. [1]

Schwellnus, C. et al. (2018), "Labour share developments over the past two decades: The role of technological progress, globalisation and "winner-takes-most" dynamics", *OECD Economics Department Working Papers*, No. 1503, OECD Publishing, Paris, https://dx.doi.org/10.1787/3eb9f9ed-en. [5]

Shewbridge, C. et al. (2016), *OECD Reviews of School Resources: Lithuania 2016*, OECD Reviews of School Resources, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264252547-en. [13]

Smart, M. (2004), "Equalisation and Stabilisation", *Canadian Public Policy*, Vol. 30/2, http://citec.repec.org/rss/cppissuedv_30_y_2004_i_2_p_195-208.xml. [7]

The Guardian (2019), *The Innisfil experiment*, https://www.theguardian.com/cities/2019/jul/16/the-innisfil-experiment-the-town-that-replaced-public-transit-with-uber. [33]

Tsvetkova, A. et al. (2020), “The spatial dimension of productivity: Connecting the dots across industries, firms and places”*, OECD Regional Development Working Papers*, No. 2020/01, OECD Publishing, Paris, https://dx.doi.org/10.1787/ba5edb47-en. [11]

OECD Economic Surveys

LITHUANIA

Lithuania's economy is performing strongly and converging fast towards the most-developed OECD countries, driven by growing exports and investments and supported by a sound macroeconomic framework as well as a friendly business climate. For the first time since renewed independence, more people are settling in the country than leaving it. The peak of the COVID-19 crisis was one of the mildest in Europe, thanks to a well-functioning health system, effective containment measures and a relatively short lockdown. Yet prosperity is unevenly distributed across people and places. Further reform could help sustain achievements to date. Providing adequate income support for the needy, especially the elderly, and high quality social services, while improving integration into the labour market, could help reduce poverty. Stronger local and regional institutions, better education and skills particularly in rural areas and a more flexible housing market could make regional development more balanced. Finally, strengthening the regulatory framework, reducing the scope of state-owned enterprises and moving towards a low-carbon economy will help raise productivity while ensuring resilient and sustainable growth.

SPECIAL FEATURES: REDUCING POVERTY; FOSTERING REGIONAL DEVELOPMENT

PRINT ISBN 978-92-64-70180-9
PDF ISBN 978-92-64-92435-2

Volume 2020/13
November 2020

ISSN 0376-6438
2020 SUBSCRIPTION
(18 ISSUES)

9 789264 701809