# COUNCIL RECOMMENDATION

## of 9 July 2019

## on the 2019 National Reform Programme of Lithuania and delivering a Council opinion on the 2019 Stability Programme of Lithuania

(2019/C 301/15)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies ([1]), and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council ([2]), the Commission also adopted the Alert Mechanism Report, in which it did not identify Lithuania as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area ([3]) ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').

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([1]) OJ L 209, 2.8.1997, p. 1.

([2]) Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, p. 25).

([3]) OJ C 136, 12.4.2019, p. 1.

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Lithuania should ensure the full and timely implementation of the 2019 Recommendation for the euro area, as reflected in recommendations (2) and (3) below. In particular, investment measures will help address the second euro-area recommendation as regards supporting investment and education measures will help address the third euro-area recommendation as regards the functioning of the labour market.

(3) The 2019 country report for Lithuania was published on 27 February 2019. It assessed Lithuania's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018 ([4]), the follow-up given to the country-specific recommendations adopted in previous years and Lithuania's progress towards its national Europe 2020 targets.

(4) Lithuania submitted its 2019 National Reform Programme on 10 May 2019 and its 2019 Stability Programme on 30 April 2019. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council ([5]), where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(6) Lithuania is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, the government plans to achieve a headline surplus of 0,4 % of gross domestic product (GDP) in 2019 and 0,2 % of GDP in 2020, before it is projected to decrease further to 0,1 % of GDP in 2021. Based on the recalculated structural balance ([6]), the medium-term budgetary objective, set at a deficit of 1 % of GDP in structural terms, is overachieved throughout the programme period. In 2017, Lithuania was also granted a temporary deviation linked to the implementation of the structural reforms. This deviation is carried forward for a period of three years. According to the 2019 Stability Programme, the general government debt-to-GDP ratio is expected to fall from 34,2 % of GDP in 2018 to 32,9 % in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned surplus targets from 2020 onwards have not been sufficiently specified. Based on the Commission 2019 spring forecast, the structural balance is forecast to register a deficit of 1 % of GDP in 2019 and 0,9 % of GDP in 2020, in compliance with the medium-term budgetary objective. At the same time, expenditure developments should be monitored carefully in the short and the medium term, especially in light of possible future risks to the robustness of revenues. Overall, the Council is of the opinion that Lithuania is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.

(7) In June 2018, the government adopted a set of legislative acts to implement a comprehensive package of six structural reforms covering the key areas of education, health, taxation, informal economy, pensions and innovation.

([4]) OJ C 320, 10.9.2018, p. 64.

([5]) Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

([6]) Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

(8) Lithuania has continued to take measures to combat the shadow economy and improve tax compliance. While these measures have shown encouraging results, overall tax compliance remains low. Lithuania still has one of the largest VAT gaps in the Union. Further increasing tax compliance would raise revenues and make the tax system more fair. No measures were taken to broaden the tax base to sources less detrimental to growth. Environmental and property taxes remain below the Union average and there are no changes envisaged to car taxation or the road-use tax for private passengers.

(9) Since 2018, public pensions are automatically indexed to the wage bill growth. This is expected to reduce public pension expenditure from 6,9 % of GDP in 2016 to 5,2 % in 2070. However, due to the projected fall in employment, pension adequacy is set to decrease because pension benefits would not keep pace with wage growth. The pension benefit ratio — which expresses the average pension in terms of the average wage — is expected to steadily decline from what is already one of the lowest levels in the Union. Current legislation states that when the benefit ratio declines, the government needs to propose corrective measures. Due to uncertainty over the precise nature and timing of such future measures, they are not accounted for in the Ageing Report projections. They do, however, represent a risk to the sustainability of public finances. If the total benefit ratio were kept unchanged until 2070, pension expenditure would increase to 7 % of GDP instead of decreasing to 5,2 % as projected. There is, therefore, uncertainty about how pension legislation will be applied in practice and what its consequences would be for fiscal sustainability and pension adequacy over time.

(10) The high proportion of people at risk of poverty or social exclusion, together with high income inequality, remain major challenges for Lithuania that hinder its prospects for inclusive economic growth. Despite continued economic growth, many members of Lithuanian society (e.g. the elderly, people with disabilities, children, single-parent households and the unemployed) face a particularly high risk of poverty and social exclusion. While the social safety net has been improved in recent years, the overall corrective power of the Lithuanian tax and benefit system and social protection expenditure as a share of GDP remain among the lowest in the Union. Some first steps were taken to address the high level of poverty and income inequality, such as the introduction of the 'amount of minimum consumption needs', the increase in the universal child benefit and the indexation of old-age pensions. However, the persistently high levels of poverty and inequality show that the country still has a long way to go to converge towards the Union average levels of social security and that investment to address social exclusion is needed. Active inclusion strategies for vulnerable groups are more effective when they combine better adequacy of minimum income and pension schemes, labour market activation and enhanced provision of social services, including childcare and social housing.

(11) The labour market has become tight as a result of employment growth, but also due to adverse demographic developments, including emigration. To mitigate the effect of the shrinking working-age population, investment in human capital and enhanced access to the labour market for all are needed. In the face of the persistent skills' shortages and mismatches, it is important that Lithuania speed up the reforms to improve the quality and efficiency at all education levels and ensure equitable access to quality and inclusive education and training. Demographic decline has put the school network under pressure. The demographic shift calls for strategies to preserve access to high-quality education for all while ensuring the efficiency of the school network and supporting teachers affected by school consolidation. Significant steps are still required to consolidate the higher education network, comprising more than 40 State-owned and private universities and colleges. Vocational education and training providers need to modernise the curricula as well as improve their responsiveness to the needs of local and regional labour markets. Effective and easily accessible adult learning, reskilling and upskilling measures, together with the provision of social services, could bring more people into the labour market. Participation in adult learning remains low, at 6,6 % in 2018, well below the Union average of 11,1 %. The Lithuanian economy has potential to benefit from investment in skills upgrading, including digital skills, innovation and better integration of the disadvantaged into the labour market (for example persons with disabilities, and older, unemployed or inactive adults). In a broader context, strengthening the capacity of the social partners is important to foster their engagement.

(12) Weak health outcomes and low investment in healthcare are persisting challenges. There remains significant potential to rationalise the use of resources through a further shift from inpatient to outpatient care. The

consumption of hospital services continues to be high, with high rates of hospitalisations for chronic diseases coupled with relatively low bed occupancy rates. Further rationalisation of hospital resources use, together with targeted investments to strengthen primary care services, including in the healthcare workforce, are necessary to drive efficiency gains and improve health outcomes. The quality of care remains one of the main reasons for poor health outcomes. Measures to improve the quality of care are fragmented, with very low take-up of accreditation in the primary care sector and a lack of application of the accreditation system in hospitals. Investment in disease prevention measures is particularly low. Moreover, steps taken to strengthen disease prevention measures at local level lack an overarching vision and are impaired by a lack of systemic cooperation between public health offices and primary care. Lastly, low levels of health spending coupled with relatively high informal payments and high out-of-pocket payments have negative implications for equity of access to healthcare.

(13) Some measures have been taken in the fight against corruption, but an integrated registry of interest declarations is still missing. Implementing legislation to the whistleblowers' protection law was adopted in 2018, and a new law regulating lobbying is under discussion. Irregularities persist in addressing corruption in the healthcare system.

(14) Investment as a share of GDP in Lithuania remains below both the averages in the Union and in other Baltic countries. The level of innovation and the technology absorption capacity of businesses in Lithuania is low. Higher investment levels in research and innovation are needed, especially in the private sector. This would boost productivity, which, despite a recent pick-up, remains well below the Union level. The shortage of information and communication technology specialists points to the need to invest in digital skills which support competitiveness, innovation and Lithuania's capacity to absorb technology, and foster the shift toward more knowledge-based and higher value added economy.

(15) The economy is relatively resource-intensive, with high dependency on imports of energy and materials. Resource productivity is low while energy consumption is high, especially in the residential and transport sectors. More investment in energy efficiency, in particular in the buildings sector and domestic energy generation from renewable sources would help to 'green' the economy and put it on a more sustainable growth path, while also reducing dependency on energy imports.

(16) Lithuania still suffers from low international accessibility in terms of rail, road, maritime and air transport and needs to be integrated further with the rest of Europe. Better transport connectivity would increase the economy's productivity and allow it to take full advantage of the internal market. Transport sector performance is far below the Union average in terms of the extent of the TEN-T road and rail networks, research and innovation investment in the transport sector, sustainability aspects and road safety. Rail traffic is dominated by East-West flows, while the North-South axis remains underdeveloped. Significant investments are therefore needed to develop a sustainable, climate-resilient, smart, secure and intermodal TEN-T network and its accessibility, as well as to promote sustainable urban mobility. Moreover, greenhouse gas emissions from road transport have increased strongly over the last five years. The synchronisation of Lithuania's electricity system with the continental European network is key to ensuring the security of the electricity supply in the entire Baltic region.

(17) Regional disparities in Lithuania are wider than the Union average and have been widening over the past two decades. The benefits of Lithuania's speedy economic convergence are heavily concentrated in the two metropolitan areas. Predominantly rural regions, which cover most of the territory and host nearly 55 % of the population, are experiencing strong population declines compounded by decreasing access to quality public services. Significant socioeconomic disparities within the country show that certain regions have distinct investment needs. Increasing links between adjacent territories within Lithuania, including transport and digital connections, also remains a challenge.

(18) To improve the efficiency of public investment, the Lithuanian authorities updated the rules for preparing and selecting investment projects financed from the State budget. Since 2018 all new investment projects should be screened with a cost-benefit analysis and fulfil additional selection criteria. While this is an important first step, more is needed to maximise the impact of public investment on increasing the long-term growth potential and addressing growing regional disparities. The authorities have started the revision of the State budgeting system with the objective of lengthening the time horizon for budgeting and strengthening the link between expenditure and the overall economic goals. It is crucial to ensure that the new strategic investment planning system is ready for the 2021-2023 budgeting process and the start of the new Union funding cycle in 2021.

(19) Lithuania has no single strategy for research and innovation. The landscape is characterised by fragmented policies and a proliferation of support schemes that lack synergies. The existence of several implementing agencies that do not take a concerted approach to supporting the research and innovation policy mix adds to a complex governance system that appears to restrict users' access to the panoply of available instruments. This state of affairs is particularly harmful for science-business cooperation and hampers innovative activity. The new division of responsibility for research and innovation policy between the Ministry of Economics and Innovation and the Ministry of Education and Science is not yet conducive to a coherent policy framework with synergetic support schemes, as would be available through a one-stop shop for potential beneficiaries.

(20) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Lithuania to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.

(21) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Lithuania's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Lithuania in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Lithuania, but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(22) In the light of this assessment, the Council has examined the 2019 Stability Programme and is of the opinion ([7]) that Lithuania is expected to comply with the Stability and Growth Pact,

HEREBY RECOMMENDS that Lithuania take action in 2019 and 2020 to:

1. Improve tax compliance and broaden the tax base to sources less detrimental to growth. Address income inequality, poverty and social exclusion, including by improving the design of the tax and benefit system.

2. Improve quality and efficiency at all education and training levels, including adult learning. Increase the quality, affordability and efficiency of the healthcare system.

([7]) Under Article 5(2) of Regulation (EC) No 1466/97.

3. Focus investment-related economic policy on innovation, energy and resource efficiency, sustainable transport and energy interconnections, taking into account regional disparities. Stimulate productivity growth by improving the efficiency of public investment. Develop a coherent policy framework to support science-business cooperation and consolidate research and innovation implementing agencies.

Done at Brussels, 9 July 2019.

*For the Council*

*The President*

M. LINTILÄ