# COUNCIL RECOMMENDATION

## of 12 July 2016

## on the 2016 National Reform Programme of Lithuania and delivering a Council opinion on the 2016 Stability Programme of Lithuania

(2016/C 299/17)

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 26 November 2015, the Commission adopted the Annual Growth Survey, marking the start of the 2016 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 17-18 March 2016. On 26 November 2015, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council (2), the Commission 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 day, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area. That Recommendation was endorsed by the European Council on 18-19 February 2016 and adopted by the Council on 8 March 2016 (3). As a country 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 Recommendation.

(2) The country report for Lithuania was published on 26 February 2016. The report assessed Lithuania's progress in addressing the country-specific recommendations adopted on 14 July 2015 and Lithuania's progress towards its national Europe 2020 targets.

(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 96, 11.3.2016, p. 1.

(3) On 29 April 2016, Lithuania submitted its 2016 National Reform Programme and its 2016 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council [1], 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 this provision in guidelines on the application of the measures linking the effectiveness of the European Structural and Investment Funds to sound economic governance.

(5) In its 2016 Stability Programme, Lithuania has requested a temporary deviation of 0,6 % of GDP from the required adjustment path towards the medium-term objective in 2017, to take account of major structural reforms with a positive impact on the long-term sustainability of public finances. However, pending a final agreement, uncertainty on the set of reform measures as well as their implementation remains. Thus, while Lithuania has sufficient fiscal space to benefit from a temporary deviation, it does not appear to fulfil the eligibility criterion related to the implementation of the reform to avail itself of the structural reform clause. Moreover, it is currently not possible to assess the plausibility of the impact of the reform estimated by the Government. Therefore, the impact of these reforms has not yet been reflected in the required adjustment towards the medium-term budgetary objective for 2017.

(6) Lithuania is currently under the preventive arm of the Stability and Growth Pact. In its 2016 stability programme, the government plans an improvement of the headline balance from a deficit of 0,8 % of GDP in 2016 to a surplus of 0,9 % of GDP in 2019. The (recalculated [2]) structural balance is set to stay above the medium-term budgetary objective — a deficit of 1 % of GDP in structural terms — in 2016 and thereafter. The adjustment path incorporates the systemic pension reform in 2016 but does not reflect the planned structural reform in 2017. According to the Stability Programme, the government debt-to-GDP ratio is expected to fall from 39,9 % of GDP in 2016 to 35,7 % in 2019. The macroeconomic scenario underpinning these budgetary projections is plausible. The measures needed to support the planned deficit targets from 2018 onwards have not been sufficiently specified yet. Based on the Commission 2016 spring forecast, the structural balance is forecast to be at – 1,2 % of GDP in 2016, which can be considered as close to the medium-term budgetary objective, and at – 0,8 % of GDP in 2017, above the medium-term budgetary objective. Based on its assessment of the Stability Programme and taking into account the Commission 2016 spring forecast Lithuania is expected to comply with the provisions of the Stability and Growth Pact.

(7) A fall in the working age population, caused by ageing, poor health outcomes and significant net emigration may harm Lithuania's growth potential and ultimately its future convergence path, while putting at risk the sustainability of its pension and long-term care systems. A cumulative loss of 35 % of the working age population is estimated by 2030. If that trend is not reversed, it will jeopardise the availability of suitable labour resources, the sustainability of long-term economic growth and social security systems, in particular the pension system.

(8) Ongoing demographic trends underscore the need for a comprehensive pension reform in Lithuania that addresses the medium-term sustainability and adequacy risks of the current pension system. The level of poverty among the elderly in Lithuania is among the highest in the Union. However, at present there is no indexation mechanism in place for publicly provided pensions and spending on social insurance pensions is relatively low. The Parliament has not yet adopted the draft law proposed by the Government to introduce an indexation mechanism, link the retirement age to changes in life expectancy after 2026 and improve the way the basic part of the social insurance pension is financed.

[1] 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).

[2] The structural balance as recalculated by the Commission based on the information in the stability programme, following the commonly agreed methodology.

(9) In Lithuania, health outcomes are among the poorest in the European Union. In particular, the mortality rate of the population aged between 20 to 64 years of age is the highest in the Union, having an important impact on the potential available workforce and labour productivity. Weaknesses in the health system include too much reliance on in-patient care and low expenditure on prevention and public health. There is a need to address the negative demographic trend.

(10) It is important that Lithuania strengthens investment in human capital to counteract some of the negative effects of its shrinking working age population and support Lithuania's transition towards a higher value-added economy. Although educational attainment has increased, the proportion of pupils with insufficient basic skills is high. Efforts should be pursued to ensure high quality teaching, which is crucial to tackling underachievement and educational shortcomings. Furthermore, there are weaknesses in the quality of teaching in higher education and its ability to foster innovation. The persistently low level of participation in adult learning is undermining efforts to improve the quality of human capital and increase productivity. There are signs of emerging skills shortages in certain sectors of the economy. Those skills shortages are expected to become more acute in the future. Strong wage growth and a slowdown in productivity growth may weaken cost-competitiveness. It is therefore important to improve the labour market relevance of education, streamline the structure and funding of the educational system, develop life-long learning and improve the targeting and effectiveness of active labour market policies. Lithuania has taken steps to improve its active labour market measures and other services to support job seekers, but there is still scope to improve targeting for specific groups, in particular the very long-term unemployed and those lacking necessary skills. Spending on effective labour market policy measures remains limited and social safety nets in Lithuania are weak. Around 27 % of Lithuania's population is at risk of poverty or social exclusion and income inequality is among the highest in the Union. The Government plans to improve the coverage and adequacy of unemployment and social assistance benefits, but the relevant legislation has still not been adopted.

(11) A comprehensive revision of the Labour Code and the social model is under discussion in the Parliament. The intention is to increase the flexibility of labour market relations and provide more security, but the relevant legislation still needs to be adopted. The involvement of social partners in the implementation of the reform and more extensive social dialogue are important.

(12) Investment has recovered slowly since the onset of the economic crisis and will be supported by EU structural and investment funds in the coming years. Nevertheless, the adoption and absorption of new technology has not spread across the economy and innovation is low, hampering productivity growth. Private investment in research and innovation has also been low, perhaps due to the insufficiency of incentives for business research and innovation and public-private cooperation. Strengthening private investment could mitigate the risks relating to the dependency of Lithuania's public investment in research and innovation on EU structural and investment funds. The tertiary education system shows weaknesses in quality and innovation outcomes, with limited levels of cooperation with foreign universities and research centres. The research and innovation system is fragmented and characterised by overlaps and duplication. This prevents Lithuania from reaching the critical mass of research and development capacity needed to increase innovative knowledge. Incentives for innovation and cooperation between academia and business need to be increased, inter alia, by developing and investing in human capital, which could increase the level of technology transfers to the real economy. Improving the limited capacity of Lithuanian companies to absorb external knowledge and apply it to commercial ends would raise the level of innovation.

(13) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Lithuania's economic policy and published it in the 2016 country report. It has also assessed the Stability Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Lithuania in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Lithuania but also their compliance with EU rules and guidance, given the need to strengthen the the EU's

overall economic governance by providing EU level input into future national decisions. The recommendations under the European Semester are reflected in recommendations (1) to (3) below.

(14) In the light of this assessment, the Council has examined the Stability Programme and its opinion ([1]) is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Lithuania take action in 2016 and 2017 to:

1. Ensure that the deviation from the medium-term budgetary objective is limited to the allowance linked to the systemic pension reform in 2016 and in 2017. Reduce the tax burden on low-income earners by shifting the tax burden to other sources less detrimental to growth and improve tax compliance, in particular in the area of VAT.

2. Strengthen investment in human capital and address skills shortages, by improving the labour market relevance of education, raising the quality of teaching and adult learning. Reinforce the coverage and effectiveness of active labour market policies. Strengthen the role of social dialogue mechanisms. Improve the performance of the healthcare system by strengthening outpatient care, disease prevention and health promotion. Improve the coverage and adequacy of unemployment benefits and social assistance.

3. Take measures to strengthen productivity and improve the adoption and absorption of new technology across the economy. Improve the coordination of innovation policies and encourage private investment, inter alia, by developing alternative means of financing.

Done at Brussels, 12 July 2016.

*For the Council*

*The President*

P. KAŽIMÍR

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