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Recommendation for a

COUNCIL RECOMMENDATION

on the 2017 National Reform Programme of Lithuania

and delivering a Council opinion on the 2017 Stability Programme of Lithuania

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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,[2]

Having regard to the resolutions of the European Parliament,[3]

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 16 November 2016, the Commission adopted the Annual Growth Survey,[4] marking the start of the 2017 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report,[5] 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 9-10 March 2017 and adopted by the Council on 21 March.[6]

(2) 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

[1] OJ L 209, 2.8.1997, p. 1.
[2] COM(2017) 514 final.
[3] P8_ TA(2017)0038, P8_ TA(2017)0039, and P8_ TA(2017)0040.
[4] COM(2016) 725 final.
[5] COM(2016) 728 final.
[6] 2017/C92/01

ensure the full and timely implementation of the Recommendation for the euro area which is reflected in recommendation 2 below.

(3) The 2017 country report for Lithuania[7] was published on 22 February 2017. It assessed Lithuania's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the recommendations adopted in previous years and Lithuania's progress towards its national Europe 2020 targets.

(4) On 27 April 2017, Lithuania submitted its 2017 National Reform Programme and on 28 April 2017 Lithuania submitted its 2017 Stability Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.

(5) The relevant country-specific recommendations have been taken into account in the Member States' programmes for the European Structural and Investment Funds (ESI Funds) covering the 2014-2020 period. As foreseen in the legislation governing the ESI Funds,[8] where it is necessary to support the implementation of relevant country-specific recommendations, the Commission may request a Member State to review and amend its relevant ESI Funds programmes. The Commission has provided further guidelines on the application of those rules.[9]

(6) Lithuania is currently under the preventive arm of the Stability and Growth Pact. In its 2017 Stability Programme, the government plans an improvement of the headline balance from a deficit of 0.4% of GDP in 2017 to a surplus of 1.3% of GDP in 2020. The medium-term budgetary objective — a deficit of 1 % of GDP in structural terms — is planned to be met with a margin throughout the programme period. The allowed adjustment path incorporates the systemic pension reform starting from 2016. In 2017 it reflects additional major structural labour market and pension reforms. According to the Stability Programme, the general government debt-to-GDP ratio is expected to fall from 40.2 % of GDP in 2016 to 33.8 % in 2020. The macroeconomic scenario underpinning these budgetary projections is plausible. At the same time, the measures needed to support the planned surplus targets from 2017 onwards have not been sufficiently specified.

(7) In its 2017 Stability Programme, Lithuania requested to avail of the temporary deviation of 0.5% of GDP under the preventive arm pursuant to the "Commonly Agreed Position on Flexibility within the Stability and Growth Pact" endorsed by the ECOFIN Council in February 2016 in view of the planned implementation of major structural reforms with a positive impact on the long-term sustainability of public finances. Notably, this concerns raising the sustainability of the pension system through a reinforced indexation and a gradual increase of the pensionable service. However, the reforms stopped short at establishing an automatic link between retirement age and life expectancy. In addition, the reforms modernise labour relations by introducing new types of employment contracts, shorter periods of

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[7] SWD(2017) 80 final.

[8] Article 23 of 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.

[9] COM(2014) 494 final.

notice, lower severance allowances and more flexible working hours. The reforms also strengthen the coverage and adequacy of unemployment and social insurance benefits, expand the scope of active labour market policies and reduce the level of illegal and uninsured employment. The authorities estimate that the reforms have a positive impact on the sustainability of public finances by generating an average annual pension expenditure savings of up to 3.8% of GDP in the long run, while the labour market part of the reform may increase an average annual number of the employed by up to 10%, which seems to be a broadly plausible assumption. Therefore, if fully and timely implemented, this reform will have a positive impact on the sustainability of public finances. On this basis, Lithuania can currently be assessed as qualifying for the requested temporary deviation in 2017, provided that it adequately implements the agreed reforms, which will be monitored under the European Semester. However, in view of the need to ensure a continued respect of the minimum benchmark (i.e. a structural deficit of 1.5% of GDP) and taking into account the previously-granted allowance under the systemic pension reform clause (0.1% of GDP), Lithuania can currently be assessed as qualifying for an additional temporary deviation of 0.4 % of GDP in 2017, which is slightly below the requested 0.5% of GDP.

(8) On 12 July 2016, for 2017 the Council recommended Lithuania to ensure that the deviation from the medium-term budgetary objective is limited to the allowance linked to the systemic pension reform.[10] Taking into account the allowances linked to the pension reform granted for 2016 and the temporary deviation linked to the implementation of structural reforms granted for 2017, the structural balance would be allowed to deteriorate by 1.3% of GDP in 2017. Based on the Commission 2017 spring forecast Lithuania is projected to comply with this requirement in 2017. In 2018, Lithuania should achieve its medium-term objective, taking into account the allowances related to the implementation of the systemic pension reform granted for 2016 and the structural reform granted for 2017, as temporary deviations are carried forward for a period of three years. Based on the Commission 2017 spring forecast, this is consistent with a maximum nominal growth rate of net primary government expenditure of 6.4% in 2018, corresponding to a deterioration in the structural balance of -0.6% of GDP. Under unchanged policies, Lithuania is projected to comply with this requirement in 2018. Overall, the Council is of the opinion that Lithuania is projected to comply with the provisions of the Stability and Growth Pact in 2017 and 2018.

(9) Following the latest increase in the non-taxable minimum wage, the tax burden on low-income earners has been substantially reduced over recent years and is now close to the EU average. At the same time, compensating tax increases have been limited and consequently, tax revenue as a share of GDP remains among the lowest in EU, limiting Lithuania’s ability to address its social challenges. The low tax revenue is due to the relatively large share of the shadow economy and relatively low revenue from environmental and capital taxation.

(10) Although Lithuania has made progress in recent years to improve VAT collection, its VAT gap is among the highest in the EU. Underreporting of wages adds to the problem of low tax collection. Increasing tax compliance would raise budget

[10] Lithuania is allowed to deviate from its medium-term budgetary objective in 2017 and 2018 by allowance under the systemic pension reform clause granted for 2016, as temporary deviations are carried forward for a period of three years.

revenues and improve the fairness of the tax system and the efficiency of the economy.

(11) The rise in the old-age dependency ratio is set to intensify and under the existing pension rules expenditure on pensions as a share of GDP is projected to rise by some 50 % by the end of the 2030s. Linking the pension benefits with life expectancy is essential to limit the strain the pension expenditure will put on public finances.

(12) Lithuania has postponed the entry into force of the new Labour Code and other legislation on the new social model. This gives it an opportunity to ensure a good balance between flexibility and security in its labour relations. The high proportion of people at risk of poverty or social exclusion, together with growing income inequality, remain major challenges for Lithuania. The ratio of the incomes of the richest 20 % of households to that of the poorest 20 % rose from 5.3 in 2012 to 7.5 in 2015 and is the second highest in the EU. This is detrimental to economic growth, macroeconomic stability and development of an inclusive society. At the moment, the social safety net does not effectively address this challenge due to low spending on social protection. Moreover, the difference in income inequality before and after taxes and social transfers is amongst the smallest in the EU. However, the government has put the fight against poverty and social exclusion high on its agenda. The legislation on the new social model envisages increasing the adequacy and coverage of unemployment benefits, and there are some discussions on improving the adequacy of social assistance. These important decisions still have to be adopted and implemented. To tackle poverty among the elderly, in 2016 Lithuania added an indexation mechanism to its pension legislation which can be used to improve the adequacy of pensions.

(13) It is important that Lithuania address its skills challenges and tackle the negative effects of its shrinking working age population. The proportion of pupils with insufficient basic skills remains high. Despite high tertiary education attainment rates, higher education is marred by poor quality standards and financial incentives that promote oversize and inefficiency rather than performance. Efforts should be pursued to ensure high quality teaching at all levels of education (including through reforming careers and working conditions). This is crucial to tackling underachievement and educational shortcomings and to ensuring quality in higher education (including by introducing performance-based funding and by consolidating higher education institutions). The persistence of low levels of participation in adult learning in Lithuania is hindering the effectiveness of labour market reforms and the development of a better skilled workforce. Lithuania has been focusing its efforts on increasing the offer and relevance of publicly provided learning opportunities, but so far this has not yielded tangible results. To achieve higher and sustainable participation rates in adult learning, Lithuania also needs to encourage individuals to take up learning and incentivise more employers to provide learning opportunities for their employees.

(14) Unemployment among low-skilled and medium-skilled individuals is still above the EU average. Persons with disabilities have a high poverty rate, partly due to their weak labour market integration. Active labour market policy measures currently play a limited role in helping people re-enter the labour market in Lithuania. Lithuania has substantial scope to make its labour market more inclusive, including by offering more support measures to persons with disabilities. This implies, for instance, scaling up supported employment and the Vocational Rehabilitation Programme, and enhancing the availability of rehabilitation budgets. The recently adopted Law on

Employment has the potential to improve the provision of active labour market policy measures.

(15) Lithuania has made progress in recent years to improve the social dialogue. The social partners are actively involved in the discussions on the new labour code and the new social model, and the government has put in place the action plan to strengthen the social dialogue. It is aimed at capacity building of the social partners, promoting collective bargaining and improving the social dialogue at all levels.

(16) In Lithuania, health outcomes continue to have a significant negative impact on the potential available workforce and labour productivity. Although efforts are being made to shift patients to more cost-effective types of healthcare, the health system's performance continues to be hampered by high reliance on in-patient care and low expenditure on prevention and public health. Out-of-pocket payments are very high, in particular for pharmaceuticals.

(17) Adverse demographic developments mean that growth will increasingly depend on labour productivity. Over the period 2000-2015 Lithuania had one of the highest labour productivity growth rates among EU Member States, but recently growth rates have slowed down. Lithuania's public investment suffers from poor planning and linkage to the country's strategic goals. Public R&D intensity increased to a value slightly above the EU average in 2015, while business R&D intensity still lags behind. The 'Lithuanian Science and Innovation Policy Reform Guidelines' adopted in 2016 aim to address the persisting challenges in research and innovation. They do so by calling for reform of institutional R&D funding; consolidation of research and higher education institutions, science valleys and technology parks; and improved policy coordination, monitoring and evaluation. Lithuania has made some progress in supporting alternative means of finance. It has helped to establish a number of venture capital and seed capital funds. The government has also recently passed a law on crowd-investing.

(18) The number of bribery cases brought to courts has been on a steady rise in recent years, thus showing Lithuania's stepped up efforts to fight corruption. However, in some important areas, like healthcare and public procurement the provisions against petty and high-level corruption are not always applied in practice. The health care sector suffers from the frequent practice of informal payments to doctors. There is insufficient transparency in public procurement, in particular at the municipal level. In addition, weak whistle-blower arrangements discourage tip-offs about potential irregularities in the public and private sectors. The government has set tackling the corruption in health care sector as a priority in its anti-corruption programme. Also, to reduce corruption risks and conflicts of interest in low-value procurement, the government has obliged contracting authorities to publish online information on initiated tenders, the successful bidders and the contracts awarded. However, continued monitoring is necessary to ensure implementation of these policies.

(19) 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 2017 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 EU's overall economic governance by providing EU-level input into future national decisions.

(20) In the light of this assessment, the Council has examined the Stability Programme and its opinion[11] is reflected in particular in recommendation 1 below,

HEREBY RECOMMENDS that Lithuania take action in 2017 and 2018 to:

1. Pursue its fiscal policy in line with the requirements of the preventive arm of the Stability and Growth Pact, which implies to remain at its medium term budgetary objective in 2018, taking into account the allowances linked to the implementation of the systemic pension reform and of the structural reforms for which a temporary deviation is granted. Improve tax compliance and broaden the tax base to sources that are less detrimental to growth. Take steps to address the medium term fiscal sustainability challenge related to pensions.
2. Address skills shortages through effective active labour market policy measures and adult learning and improve educational outcomes by rewarding quality in teaching and in higher education. Improve the performance of the healthcare system by strengthening outpatient care, disease prevention and affordability. Improve the adequacy of the social safety net.
3. Take measures to strengthen productivity by improving the efficiency of public investment and strengthening its linkage with the country's strategic objectives.

Done at Brussels,

For the Council
The President

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