COUNCIL RECOMMENDATION

of 13 July 2018

on the 2018 National Reform Programme of Lithuania and delivering a Council opinion on the 2018 Stability Programme of Lithuania

(2018/C 320/14)

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 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 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 22 March 2018. On 22 November 2017, 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 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area ([3]) ('Recommendation for the euro area').

(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 Recommendation for the euro area, as reflected in the recommendations below, in particular recommendation (1).

(3) The 2018 country report for Lithuania was published on 7 March 2018. It assessed Lithuania's progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 ([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 2018 National Reform Programme on 26 April 2018 and its 2018 Stability Programme on 30 April 2018. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

([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 179, 25.5.2018, p. 1.
([4]) OJ C 261, 9.8.2017, p. 1.

(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 [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 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 2018 Stability Programme, the Government plans to maintain a headline surplus of 0,6 % of GDP from 2018 to 2020, before it is projected to decrease to 0,3 % of GDP in 2021. The medium-term budgetary objective — a deficit of 1 % of GDP in structural terms — is planned to be met throughout the programme period. In 2016 and 2017, Lithuania was also granted a temporary deviation linked to the implementation of the systemic pension reform and of the structural reforms. These deviations are carried forward for a period of three years. According to the 2018 Stability Programme, the general government debt-to-GDP ratio is expected to fall from 39,7 % of GDP in 2017 to 35,3 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned surplus targets from 2019 onwards have not been sufficiently specified.

(7) On 11 July 2017, for 2017 the Council recommended Lithuania 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 was granted. This is consistent with a maximum nominal growth rate of net primary government expenditure [2] of 6,4 % in 2018, corresponding to an allowed deterioration in the structural balance by 0,6 % of GDP. Based on the Commission 2018 spring forecast, Lithuania's structural deficit is forecast to stand at 0,7 % of GDP in 2018 and 0,6 % of GDP in 2019. The structural balance is thus forecast to remain above the medium-term budgetary objective in both years. Overall, the Council is of the opinion that Lithuania is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019.

(8) Revenues from environmental and recurrent property taxes remain below the Union average. Lithuania has undertaken a reform of its property tax system, which introduces an element of progressivity into the system, and abolished excise duty exemptions for coal and coke used for heating purposes. However, scope remains to broaden the tax base to sources that are less detrimental to growth. Although Lithuania has made progress in recent years on improving tax collection, its value added tax gap is still among the widest in the Union. Lithuania is taking further steps to combat tax evasion and improve tax compliance, and recently implemented measures are showing positive early results. Further increasing tax compliance would raise budget revenues and contribute to improving the fairness of the tax system.

(9) With the introduction of a new pension indexation formula in 2018, which links pensions to the wage bill growth, the share of public pension expenditure in GDP is projected to stay flat until 2040. This would ensure the fiscal sustainability of the Lithuanian pension system. However, this is largely driven by a decline in the benefit ratio since the total wage bill is projected to increase at a slower pace than wages due to the rapidly shrinking working-age population. This raises concerns about pension adequacy, which is already among the lowest in the Union. It is also unclear how this reform will work in practice since the Government is legally obliged to propose measures in the event of a falling replacement ratio. If the replacement ratio were kept unchanged, total pension expenditure as a share of GDP would increase by almost 45 % by the end of the 2040s, putting a strain on public finances. It is therefore important to clarify legal uncertainties over pension legislation and to ensure the long-term fiscal sustainability of the pension system while addressing its low adequacy.

[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] Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

(10) The labour market is tightening quickly as a result of robust economic growth, but also due to adverse demographic developments and emigration, leading already to skills shortages. Such a situation demands an education and training system able to provide everybody with the relevant skills. While the reforms launched over the past year are a step in the right direction, it is important that Lithuania implements these reforms to improve the outcomes of its education and training system. The financing and accreditation rules in Lithuania's tertiary education are helping to increase the number of people with tertiary education, but at the same time have contributed to concerns about its quality, fragmentation and labour market relevance. The ongoing university consolidation, if complemented by changes to accreditation and financing rules, should help address the current challenges. In addition, persistent demographic pressures have affected the efficiency of the education system and made more urgent the need to provide equitable access to quality and inclusive education. To address the below-average performance of Lithuania's pupils in basic skills, reforms are needed in teachers' initial training, careers and working conditions, complemented by other quality-focused reforms.

(11) The low participation of adults in learning in Lithuania indicates that adult learning remains underdeveloped and is not enabling the economy to benefit from skills upgrading, innovation and better integration of the disadvantaged into the labour market (for example older, unemployed or inactive adults). Despite investment in infrastructure, the content of the vocational education and training curriculum is often outdated, while alignment with the needs of local and regional labour markets could be more developed. Work-based learning is still at the initial phase and could be expanded. Active labour market policy measures contain a larger training offer, but this offer could be enhanced further. The recent reforms and measures taken in this field have not had significant results so far. In a broader context, strengthening social partners' capacity is important to foster their engagement.

(12) Challenges in healthcare outcomes persist; these are having a negative impact on productivity, competitiveness of the economy and quality of life. The delivery of health services remains too hospital-centric, leaving room for further strengthening of primary care. Further rationalisation of resources together with measures to improve quality of both hospital and primary care are key to making healthcare more effective. Disease prevention and health promotion policies should curb risk behaviours more strongly and rapidly. However, the scale of such policies remains small, while cross-sectoral collaboration is underdeveloped and accountability for results is not sufficiently embedded at municipality level. High reliance on out-of-pocket payments, a low level of health spending and an inefficient allocation of resources are limiting the efficiency of the healthcare system.

(13) 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 economic growth. They also threaten social cohesion and could fuel emigration. Despite continued economic growth, the elderly, people with disabilities, children, single-parent households and the unemployed face the highest risk of poverty and social exclusion. The corrective power of the Lithuanian tax and benefit system is one of the lowest in the Union. While some significant initial steps were taken to fight poverty and income inequality, the country still has a long way to go to converge towards the Union poverty and income inequality averages. The relatively high tax wedge on low income earners may limit their incentive to work and increase the risk of poverty and inequalities. Levels of poverty and inequality could be lowered by incentivising labour market participation, in particular among people from vulnerable groups and low income earners, and by increasing the corrective power of the tax and benefit system supported by better collection of taxes. Such measures could also increase social fairness.

(14) After being subdued since 2012, productivity growth rebounded in 2017, alleviating pressures on cost competitiveness. However, this improvement is largely driven by the private sector. Only limited progress has been made in improving the efficiency of public investment. In particular, the efficiency of public R&D expenditure and the cooperation between businesses and science remain low. Moreover, public investment in R&D dropped significantly in 2016. Fragmented coordination and governance of research and innovation policy lead to inefficiencies and prevent businesses from fully benefiting from the variety of support schemes. Further progress in the ongoing reform of the organisation and funding of the public research sector should help achieve better use of the available resources.

(15) Lithuania made progress in strengthening its corruption prevention framework by adopting legislation on lobbying and whistle-blower protection for both public- and private-sector workers. However, implementing the legislation remains a challenge. Corruption in the health sector still raises concerns, despite the commendable results of the Government's 'clean hands' programme.

(16) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Lithuania's economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 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 the extent to which they comply 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.

(17) In the light of this assessment, the Council has examined the 2018 Stability Programme and is of the opinion [1] that Lithuania is expected to comply with the Stability and Growth Pact.

HEREBY RECOMMENDS that Lithuania take action in 2018 and 2019 to:

1. Improve tax compliance and broaden the tax base to sources less detrimental to growth. Ensure the long-term sustainability of the pension system while addressing the adequacy of pensions.

2. Improve the quality, efficiency and labour market relevance of education and training, including adult learning. Improve the performance of the healthcare system by a further shift from hospital to outpatient care, strengthening disease prevention measures, including at local level, and increasing the quality and affordability of care. Improve the design of the tax and benefit system to reduce poverty and income inequality.

3. Stimulate productivity growth by improving the efficiency of public investment, ensuring efficient governmental coordination of research and innovation policy and addressing gaps and inefficiencies in public measures supporting science-businesses cooperation.

Done at Brussels, 13 July 2018.

For the Council

The President

H. LÖGER

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