**COUNCIL OF
THE EUROPEAN UNION**

Brussels, 19 June 2013

**10643/1/13
REV 1**

**UEM 200
ECOFIN 508
SOC 438
COMPET 422
ENV 522
EDUC 213
RECH 247
ENER 267**

NOTE

from:	Permanent Representatives Committee
to:	Council
No. Cion prop.:	10000/13 UEM 100 ECOFIN 387 SOC 355 COMPET 333 ENV 444 EDUC 157 RECH 187 ENER 208 - COM(2013) 365 final
Subject:	Recommendation for a COUNCIL RECOMMENDATION on Lithuania's 2013 national reform programme and delivering a Council opinion on Lithuania's convergence programme for 2012-2016

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission proposal COM(2013) 365 final.

ANNEX

Recommendation for a

COUNCIL RECOMMENDATION

on Lithuania's 2013 national reform programme

and delivering a Council opinion on Lithuania's 2013 convergence programme for 2012-2016

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 9(2) thereof,

Having regard to the recommendations 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,

After consulting the Economic Policy Committee,

Whereas:

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

[2] COM(2013) 365 final.

[3] P7_TA(2013)0052 and P7_TA(2013)0053.

(1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, on the basis of the Commission's proposals, the Council adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States[4], which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

(3) On 29 June 2012, the Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.

(4) On 10 July 2012, the Council adopted a recommendation on Lithuania's national reform programme for 2012 and delivered its opinion on Lithuania's updated convergence programme for 2011-2015.

(5) On 28 November 2012, the Commission adopted the Annual Growth Survey[5], marking the start of the 2013 European Semester of economic policy coordination. Also on 28 November 2012, the Commission, on the basis of Regulation (EU) No 1176/2011, adopted the Alert Mechanism Report[6], in which it did not identify Lithuania as one of the Member States for which an in-depth review would be carried out.

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[4] 2013/208/EU of 22 April 2013

[5] COM(2012) 750 final.

[6] COM(2012) 751 final.

(6) On 14 March 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) On 9 April 2013, Lithuania submitted its updated 2013 national reform programme and, on 26 April 2013, its convergence programme covering the period 2012-2016. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(8) Based on the assessment of the 2013 convergence programme pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible and broadly in line with the assessment in the Commission's spring forecast. Following an ambitious fiscal consolidation since 2009, the general government deficit has been brought to 3.2% of GDP in 2012, which is considered sufficient for abrogation of the decision on the existence of an excessive deficit, taking into account the cost of the systemic pension reform. The deficit reduction was to some extent also based on robust economic growth and temporary expenditure freezes. The programme has changed the medium-term objective (MTO) from +0.5% to -1.0%, which is still in line with the objectives of the Stability and Growth Pact. The budgetary strategy outlined in the programme aims to reach the MTO by 2016. Based on the (recalculated) structural budget balance, annual progress towards the MTO in structural terms is higher than 0.5% of GDP. The expenditure benchmark over the programme period is met. The adjustment is slightly front-loaded and relies mainly on expenditure restraint, but is only partially supported by concrete measures, including one-offs that are not always specified. According to the Commission's forecast, the structural adjustment in 2013 and 2014 is expected to be at 0.3% and 0.0% of GDP respectively and thus below the required progress of 0.5% of GDP, which also casts doubt on the programme's adjustment path.

Further consolidation measures have yet to be specified, and structural reforms including a shift to revenue based measures, should be considered. General government debt remains below 60% of GDP with 40.7% in 2012 and is expected to drop slightly over the programme period. While the convergence programme expects debt to ease to 39.7% in 2013 and to decline further to 34.5% by 2016, the Commission's forecast projects it to drop to 40.1% of GDP in 2013 and 39.4% in 2014. Differences are above all the result of lower assumed deficits in the convergence programme.

(9) Although its deficit position has improved over the years, Lithuania still lacks sufficient fiscal space to react to adverse shocks. There is, however, scope for a less-distortive taxation and further improvements in tax compliance. Lithuania continues to have the lowest tax-to-GDP ratio in the EU and consolidation has mainly been focused on the expenditure side. There is still scope to look at additional tax revenue sources that are least detrimental to growth, such as environmental and recurrent immovable property taxation. While Lithuania has taken steps to increase recurrent property tax revenue, there seems to be scope for further effort. Lithuania's revenues from environmental taxes are on a downward trend and were the second lowest in the EU in 2011, also due to the lowest level of transport taxes in the EU; this does not facilitate reductions in the high energy intensity of the Lithuanian economy. At the same time, growth-enhancing expenditure, for example on research and education, should be prioritised in fiscal consolidation. The implementation of laws strengthening the fiscal framework has been delayed. Lithuania's fiscal framework has failed to prevent pro-cyclical fiscal policy in years of positive output gap. The amendment of the Law on Budget Structure in 2012 is a step in the right direction. There is a need to improve monitoring, accountability and execution of the budgetary process in particular of municipalities, and securing the binding character of the medium-term framework.

(10) Demographic developments are a challenge for Lithuania's long-term fiscal sustainability. A comprehensive pension reform, targeting both sustainability and adequacy of pensions, therefore remains important. Adequacy of pensions is a challenge as the older population is at a high risk of poverty and exclusion. The 2012 reform of the pension accumulation system encourages 2nd pillar pension accumulation with financial incentives from the state budget. It also introduces the possibility to opt out from private pension accumulation and return to the state social insurance fund during a transitional period as well as a gradual increase of retirement age. The reform will enter into force as of 1 January 2014. These are important but isolated steps in the right direction and more significant changes are needed, particularly within the 1st pension pillar. In addition, measures that promote the employability of older workers and age friendly working environments are necessary.

(11) Tackling unemployment and low labour market participation of the low-skilled remains a key challenge. Young and unskilled workers in particular suffer from high unemployment rates. Skill mismatches became especially evident during the crisis and represent a growing problem, hinting at structural shortcomings in education and labour market policies. Ensuing shortages of skilled labour are compounded by high emigration rates. Hence, additional measures to improve labour market flexibility and to boost participation in the labour market, especially for young people, unskilled persons and older workers are necessary. The overall coverage of active labour market measures and the financial allocation per individual measure remain insufficient and measures are poorly targeted for low skilled and long term unemployed. A comprehensive review of labour law, with the involvement of social partners, could identify unnecessary restrictions and administrative hurdles affecting flexible contractual agreements, dismissal provisions and flexible working time arrangements. To ensure a better transfer from education to the labour market, apprenticeships and internships could be made more attractive.

(12) Poverty and social exclusion are still worryingly high. In particular, the increase in child poverty is of concern. Cash social assistance reform measures designed to increase work incentives (in-work benefits for the long-term unemployed, gradual reduction of social benefits for people of working age who are inactive) and reduce poverty were launched in 2012. A pilot project in five municipalities delivered impressive results on saving expenditure and better targeting beneficiaries. It is now necessary to put in place a monitoring system to assess its efficiency and impact on tackling poverty and exclusion. The reform should also be linked with activation measures that enhance participation, in particular for long-term social beneficiaries. Measures taken to reduce poverty include increased coverage of social benefits and a new method for calculating the benefit amounts. Moreover, on 1 January 2013 the minimum wage increased by 18 %, which might help reduce the inactivity trap and in-work poverty. However, these measures appear insufficient given the size of the challenge and a comprehensive strategy or action plan to fight poverty is lacking.

(13) The government has been undertaking an ambitious reform of state-owned enterprises (SOEs) since 2010. The reform is relevant and credible, involving legislative as well as organisational changes. The regulatory aspects of the reform have been put in place and broad compliance with reporting requirements has been achieved. The challenge now is to avoid conflicts of interest, with respect to regulatory and non-regulatory functions, and to distinguish between commercial and non-commercial activities of SOEs. Once fully implemented, the reform could help to boost competitiveness and growth. Monitoring of compliance will therefore be key.

(14) Electricity and gas links to neighbours remain underdeveloped. As a result, competition in the energy sector is very limited and energy prices are high. Furthermore, energy efficiency continues to be an issue. Progress has been sluggish as regards the renovation of buildings, including with respect to investments under the JESSICA holding fund, and major challenges in the renovation of private housing remain.

(15) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Lithuania's economic policy. It has assessed the convergence programme and national reform programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Lithuania but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (6) below.

(16) In the light of this assessment, the Council has examined Lithuania's convergence programme, and its opinion[7] is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Lithuania should take action within the period 2013-2014 to:

1. Ensure growth friendly fiscal consolidation and implement the budgetary strategy as planned, pursuing a structural adjustment effort that will enable Lithuania to reach the medium-term objective. Prioritise growth-enhancing expenditure. Continue to strengthen the fiscal framework, in particular by securing enforceable and binding expenditure ceilings in the medium-term budgetary framework. Review the tax system and consider increasing those taxes that are least detrimental to growth, such as recurrent property and environmental taxation, including introducing car taxation, while continuing to reinforce tax compliance.

2. Adopt and implement legislation on a comprehensive pension system reform. Align the statutory retirement age with life expectancy, restrict access to early retirement, establish clear rules for the indexation of pensions, and promote the use of complementary savings schemes while ensuring implementation of ongoing reforms. Underpin pension reform with measures that promote the employability of older workers.

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[7] Under Article 9(2) of Council Regulation (EC) No 1466/97.

3. Tackle high unemployment amongst low-skilled and long-term by refocusing resources on active labour market policies while improving their coverage and efficiency. Improve the employability of young people, for example through a Youth Guarantee, enhance the implementation and effectiveness of apprenticeship schemes, and address persistent skill mismatches. Review the appropriateness of labour legislation with regard to flexible contract agreements, dismissal provisions and flexible working time arrangements, in consultation with social partners.

4. Implement concrete targeted measures to reduce poverty and social exclusion. Continue strengthening the links between the cash social assistance reform and activation measures.

5. Complete the implementation of the reform of the State-Owned Enterprises, in particular to ensure separation of ownership and regulatory functions, and closely monitor compliance with the requirements of the reform.

6. Step up measures to improve the energy efficiency of buildings, including through removing disincentives and rapid implementation of the holding fund. Promote competition in energy networks by improving interconnectivity with other Member States for both electricity and gas.

Done at Brussels,

For the Council
The President