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Recommendation for a

COUNCIL RECOMMENDATION

on Lithuania's 2014 national reform programme

and delivering a Council opinion on Lithuania's 2014 convergence programme

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Recommendation for a

COUNCIL RECOMMENDATION

on Lithuania's 2014 national reform programme

and delivering a Council opinion on Lithuania's 2014 convergence programme

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 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 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.

1 OJ L 209, 2.8.1997, p. 1.
2 COM(2014) 416 final.
3 P7_TA(2014)0128 and P7_TA(2014)0129.

(2) On 13 July 2010, the Council, on the basis of the Commission's proposals, 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, 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 9 July 2013, the Council adopted a recommendation on Lithuania’s national reform programme for 2013 and delivered its opinion on Lithuania’s updated convergence programme for 2012-2016.

(5) On 13 November 2013, the Commission adopted the Annual Growth Survey[4], marking the start of the 2014 European Semester of economic policy coordination. On the same day 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.

(6) On 20 December 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 1 April 2014, Lithuania submitted its 2014 national reform programme and on 22 April 2014 its 2014 convergence programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(8) The objective of the budgetary strategy outlined in the 2014 Convergence Programme is to reach the medium-term objective by 2015 and to achieve a structural surplus of 0.9% of GDP at the end of the programme in 2017. The programme confirms the previous medium-term objective of -1% of GDP, which reflects the requirements of the Stability and Growth Pact. Based on the (recalculated) structural budget balance, annual progress towards the medium-term objective is at least 0.5% of GDP in 2014 and 2015. At the same time there is a risk of deviation from the expenditure benchmark in 2015. Overall, the adjustment path towards the medium-term objective is broadly in line with the requirements of the Stability and Growth Pact. The programme shows the debt decreasing substantially over the programme period to around 35% by 2017. The macroeconomic scenario underpinning the budgetary projections in the programme is broadly plausible. At the same time, for the years 2015-2017, consolidation measures have yet to be specified. According to the Commission 2014 spring forecast, the structural adjustment in 2014

[4] COM(2013) 800 final.
[5] COM(2013) 790 final.

and 2015 is expected to be at 0.2% and 0.6% of GDP respectively, and thus for 2014 0.3% of GDP below the required tightening of 0.5% of GDP. Furthermore, the expenditure benchmark is at risk of a significant deviation in 2014, with an additional albeit more limited deviation in 2015. Based on its assessment of the programme and the Commission forecast, pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that there is a risk of a significant deviation from the adjustment path towards the medium-term objective as of 2014.

(9) The relative importance of taxes considered less detrimental to growth, such as property and environmental taxes, remains low. Tax revenues rely to a large extent on indirect and labour taxation while the proportion accounted for by environmental taxation remains low. Increased revenue from more growth-friendly taxes could be used to alleviate the tax burden on low- income earners, in particular the low- skilled. A partial review of the tax system was undertaken at the beginning of 2013 and the government decided to adjust capital taxation, raise the taxable income threshold and increase excise duties for tobacco and alcohol. Overall, however, these measures will have a rather negative effect on revenues. Further steps on improving the sustainability of public finances and strengthening the revenue side therefore remain crucial. No major measures were taken following the 2013 country-specific recommendation on environmental taxation. There was limited progress in strengthening the fiscal framework, as expenditure ceilings remain insufficiently binding and legislative changes have not yet been approved. Lithuania continues to face challenges in terms of tax compliance, in particular to tackle VAT fraud by, among others, strengthening risk management measures. The 2013-14 tax compliance action plan is being implemented and first estimates suggest some positive effects. In 2013, a set of measures was taken to strengthen tax compliance in the field of VAT and excise duties. For 2014-2015 a new targeted strategy has been launched.

(10) Unfavourable demographic developments cast doubts on Lithuania's long-term fiscal sustainability. Pension spending is projected to increase substantially and is estimated over 50 years to reach almost double the EU average. The gradual increase of the statutory retirement age that started in 2012 is not enough to keep up with shrinkage in the labour force and rising life expectancy. In addition, the sharp rise in poverty and severe material deprivation among older people points to problems linked to pension adequacy. Lithuania has made important but isolated steps in the right direction and more significant changes are needed to implement a comprehensive reform. It has completed the reform of the second pension pillar, but neither occupational schemes nor voluntary pension accumulation are widely used. Alongside the increase in the statutory retirement age, measures that ensure the employability of older workers and age-friendly working environments are also necessary.

(11) Overall unemployment has gone down but structural unemployment remains high, suggesting skills mismatches, in particular for the low-skilled. Youth unemployment and the rates of young people not in education employment or training are decreasing, but are still high. The limited coverage of active labour market policies remains a challenge, and its effectiveness and timeliness needs to be improved. Skilled labour shortages are forecast to become even more pronounced in the future. To improve young people's employability it is important to improve the labour-market relevance of vocational and higher education, improve the quality of

apprenticeship schemes and work-based learning, in partnership with the private sector including SMEs. Increased participation in lifelong learning remains insufficient. A comprehensive review of the labour law, with the involvement of social partners, is needed to find ways of alleviating the administrative burden on employers. Primarily it will be essential to identify and eliminate unnecessary restrictions affecting flexible contractual agreements, dismissal provisions and working time arrangements.

(12) Despite recent improvement, working-age poverty remains above the EU average. Increases in the minimum monthly wage and non-taxable threshold have helped to address poverty. However, old-age poverty and severe material deprivation have risen steeply in recent years. In 2012-13, the cash social assistance reform pilot resulted in a lower number of social beneficiaries and expenditure on cash social benefits. In 2014, the pilot was expanded to all municipalities. There is a need to ensure monitoring and evaluation as regards the effects of the reform on the neediest. The coverage of activation measures for long-term unemployed social assistance beneficiaries is insufficient. Moreover, the measures are still focused on public works schemes, and thus provide income support, but do not help to improve the beneficiaries' employability. The impact of the reform on those on low incomes needs to be assessed. Lithuania adopted the 2014-20 Action Plan for Enhancing Social Inclusion. However, there remains a need to establish the main target groups, the budget and concrete measures, specifying how the targets will be achieved and how the various ministries, local governments and civil society actors implementing the Action Plan will cooperate.

(13) The government has been undertaking an ambitious reform of state-owned enterprises since 2010. Final legal acts were approved in December 2013, amending the transparency guidelines requiring all state-owned enterprises, as of 2014, to provide separate data for commercial and non-commercial functions in their annual reports. A first report detailing this breakdown is envisaged for August 2014. It should allow a more detailed assessment of the success of this change. However, the number of independent board members in state-owned enterprises remains small, partly due to legal constraints applying to state and municipal enterprises. Legal changes are being proposed that would allow for independent members to be appointed to the boards of for all state-owned enterprises. The effectiveness of separation commercial and non-commercial functions and the professionalisation of boards will have to be assessed once fully implemented.

(14) Electricity and gas links to neighbouring Member States remain underdeveloped, resulting in limited competition and high prices. Competition in the domestic markets has been strengthened through the liberalisation of the gas and electricity markets, but so far customers have not exercised their rights to change suppliers. While the government has made energy interconnections a priority, these have yet to be finalised. An important gas pipeline has been commissioned and the LNG terminal in Klaipeda is expected to become operational by December 2014. Some progress has been achieved with regard to the interconnections of the Lithuanian energy network with the EU energy market. Furthermore, energy efficiency needs to improve. Lithuania has made some progress on the energy efficiency of buildings, including with respect to investments under the JESSICA holding fund. In 2013 legislative measures were taken to accelerate the absorption of the holding fund. At the beginning of 2014, projects had been finalised, and initial applications have

increased considerably. Legal changes involve heating subsidies being reduced if residents reject renovation, thus removing disincentives to renovation.

(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 the 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[6] is reflected in particular in recommendation (1) below.

HEREBY RECOMMENDS that Lithuania take action within the period 2014-2015 to:

1. Reinforce the budgetary measures for 2014 in the light of expenditure growth exceeding the benchmark and the emerging gap of 0.3% of GDP in terms of structural effort based on the Commission 2014 spring forecast, pointing to a risk of significant deviation relative to the Stability and Growth Pact requirements. In 2015, strengthen the budgetary strategy to ensure the required adjustment of 0.5% of GDP towards the medium-term objective. Thereafter ensure that the medium-term objective is adhered to. Complement the budgetary strategy with a further strengthened fiscal framework, in particular by ensuring binding expenditure ceilings when setting the medium-term budgetary framework. Further review the tax system and consider increasing those taxes that are least detrimental to growth, such as recurrent property and environmental taxation, while continuing to improve tax compliance.

2. Adopt and implement legislation on a comprehensive pension system reform. In particular, 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. Underpin pension reform with measures that promote the employability of older workers.

3. Better target active labour market policy measures to the low-skilled and long-term unemployed. . Improve coverage and adequacy of unemployment benefits and link them to activation. Address persistent skills mismatches by improving the labour-market relevance of education and promote life-long learning. In order to increase employability of young people, prioritise offering quality apprenticeships and strengthen partnership with the private sector. Review the appropriateness of labour legislation, in particular with regard to the framework for labour contracts and for working-time arrangements, in consultation with social partners.

4. Ensure adequate coverage of those most in need and continue to strengthen the links between cash social assistance and activation measures.

5. Complete the implementation of the reform of state-owned enterprises as planned; in particular by finalising the separation of commercial and non-commercial activities,

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

further professionalising executive boards and closely monitoring compliance with the requirements of the reform.

6. Step up measures to improve the energy efficiency of buildings, through a rapid implementation of the holding fund. Continue the development of cross-border connections to neighbouring Member States for both electricity and gas to diversify energy sources and promote competition through improved integration of the Baltic energy markets.

Done at Brussels,

For the Council
The President