

BTI 2012 | Lithuania Country Report

Status Index	1-10	9.03	# 7 of 128	
Political Transformation	1-10	9.35	# 7 of 128	➔
Economic Transformation	1-10	8.71	# 9 of 128	➔
Management Index	1-10	7.15	# 6 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Stiftung’s Transformation Index (BTI) 2012. The BTI is a global assessment of transition processes in which the state of democracy and market economy as well as the quality of political management in 128 transformation and developing countries are evaluated.

More on the BTI at <http://www.bti-project.org>

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Key Indicators

Population	mn.	3.3	HDI	0.810	GDP p.c.	\$	18184
Pop. growth ¹	% p.a.	-0.6	HDI rank of 187	40	Gini Index		37.6
Life expectancy	years	73	UN Education Index	0.883	Poverty ³	%	<2
Urban population	%	67.2	Gender inequality ²	0.192	Aid per capita	\$	-

Sources: The World Bank, World Development Indicators 2011 | UNDP, Human Development Report 2011. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

Executive Summary

In several ways, the period under review for this BTI assessment was extraordinary for Lithuania. Lithuania's high growth rates of the early 2000s were brought to an abrupt end in 2008. The global financial crisis exacerbated its economic troubles as the country struggled with severe difficulties in accessing credit. With a 14.8% drop in GDP, its economy experienced the deepest crisis since the transformation of the planned economic system in the early 1990s. Macroeconomic stability and the currency board regime in particular were preserved, albeit against the odds and predictions of many reputable international economic analysts and even some financial institutions. Like Estonia and Latvia, Lithuania chose to devalue internally, although with some delay due to the national elections in October 2008. The total effect of fiscal consolidation (cuts in public expenditure and tax reforms) amounted to nearly 12% of GDP for 2009 and 2010.

In May 2009, Lithuania elected former European Commissioner and Minister of Finance Dalia Grybauskaitė to be its next president. This represented change, not least because she was the first female to be elected to the country's highest political post. President Grybauskaitė also belongs to the new cohort of politicians whose careers do not originate in the struggle for independence in the late 1980s – early 1990s. This election has therefore changed the balance of relations between the branches of power that existed under the previous two presidents in favor of a more assertive presidential policy style. This is especially the case in domestic politics, which had previously been a domain almost exclusively in the hands of the government. This change corresponds with popular expectations, as the President's Office is the only political institution that continues to enjoy significant popular support, whereas the political parties, the Seimas (parliament) and the government (in that order) remain the least-trusted national institutions.

Against the background of economic crisis, the government managed the situation relatively well, maintaining its majority in parliament, although at times with considerable effort. During the most recent municipal elections (February 2011), the traditional parties in general and parties

of the ruling center-right coalition performed well. In short, although voters do not trust political parties, they continue to vote for them, although at continuously low turnouts.

Crisis management clearly overshadowed other plans and important initiatives of the center-right ruling coalition. After a period of political and policy stagnation following Lithuania's accession to the European Union, this government attempted to introduce more transparency in policy-making in general and in the most corruption-prone areas (such as public procurement) in particular. These initiatives should produce positive long-term effects, though they have brought some short-term benefits as well, including a modest improvement to perceived levels of corruption.

With the exception of a demonstration in Vilnius in 2009 that turned violent, the crisis did not disturb social peace. But this peace came at a price. Many Lithuanians chose exit strategies over the voice option, many emigrating in search of a more secure socioeconomic future elsewhere. Tax evasion and Lithuania's shadow economy, both of which had been on the decline during the period of economic boom, became widespread again. The economic crisis also reversed the previous trend in which social inequality had begun to decrease, despite government attempts to ease things through improved targeting during the scale-down of social benefits and pensions.

History and Characteristics of Transformation

Lacking not only the structures for transformation, but also statehood itself, Lithuania began completely anew in 1990. Occupied and annexed by the Soviet Union in the 1940s, Lithuania was a Soviet Republic for almost 50 years. Soviet rule had comprehensively reshaped the country, its resources, economy and above all, its people. Lithuanians often use the term "rebirth" to describe their return to statehood, which represented the starting point of transformation and set the goal of becoming a free and independent state within the community of European democracies. With accession to the European Union on 1 May 2004, and to NATO in March 2004, Lithuania has achieved the goals and aspirations it set in 1990. Because the creation of a democratic republic amounted to the end of foreign occupation, the change of the political system met with no opposition. The fight for independence and the founding of the new state provided a common popular basis of identity. The legitimacy of Lithuania's democratic order is thus closely tied to the Baltic revolution and the victory of the independence movement that was supported by the vast majority of the population. Political transformation progressed smoothly with few problems. The population voted for the constitution in 1992, and in 1993 a multiparty system emerged, marking the successful end of the first phase of political transformation. The constitution provided for pluralism under the rule of law and established a Constitutional Court – a first in Lithuanian history. The political system has proven itself reliable. All actors have accepted transfers of power and the impeachment of President Paksas in 2004 demonstrated both the viability of democratic institutions and the degree to which established rules have been accepted. However, the will of the electorate itself remains subject to

fluctuations. Since 1990, no government has succeeded in winning elections and staying in power (except for the Social Democratic Party, which succeeded in forming a ruling coalition for two consecutive periods, the first from 2001 to 2004 and the second from 2004 to 2008). During the Republic's first decade, the moderately fragmented party system appeared to oppose any new challenges under the constant shifts of voter support. Since 2000, however, the situation has changed as populist parties have made striking gains. The newly founded populist Labor Party achieved 28.44% during the parliamentary elections in 2004, and even became part of the government. The coalition with the Social Democrats ended in summer 2006, when two ministers of the Labor Party resigned amid allegations of corruption. Economic transformation led to massive social inequalities and imposed severe social burdens on most of the population. The Soviet legacy has proven an especially heavy load to bear. The problem here was not merely the planned economy, but the economy's orientation toward a system of planning defined by the regions of the Soviet Union. Some sectors of Lithuania's industry were too large, some too small and others almost nonexistent. Much of its technology was antiquated and several production processes relied heavily on human resources. At the start of the 1990s, the country attempted to pursue transformation without imposing heavy social costs. This strategy clearly backfired, as it initially slowed economic transformation and privatization. Like all reform-oriented states in Eastern Europe, Lithuania experienced an economic and social crisis characterized by a sharp decline in GDP and soaring unemployment figures. The worst was over by 1994. After a slump in 1999 (the "Ruble crisis"), Lithuania's GDP has shown strong growth since 2000, unabated in the years from 2004 to 2006. Thanks to EU accession, Lithuania has managed to create a market economy that is anchored in principles of social justice and equipped with modern regulatory institutions that are nearly free of political pressures. This was also a factor in the economic boom, which came to a sharp end in early 2009. The most recent economic crisis of 2009–2010 is the largest since the collapse of the planned economy in the early 1990s. Nonetheless, Lithuania has survived sharp cuts in public expenditure and has maintained the stability of its national currency, the litas. The crisis created a forced opportunity to rationalize budgetary expenditures, introduce more transparency in policy-making and to restart much needed reforms in some policy areas.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 10 (best) to 1 (worst).

Transformation Status

I. Political Transformation

1 | Stateness

There is clarity regarding the nation's existence as a state, with adequately established and differentiated power structures. The state's monopoly on the use of force is not contested.

Question
Score

Monopoly on the
use of force
10

All citizens have the same civil rights; the nation state is accepted as legitimate.

State identity
10

The state is largely defined by a secular order. Religious dogmas have no noteworthy influence on politics or law.

No interference of
religious dogmas
10

The state has a differentiated administrative structure throughout the country, making it possible to allocate state resources on a broad basis.

Basic
administration
10

2 | Political Participation

There are no constraints on free and fair elections. The municipal councils, national parliament and the president are elected by direct vote.

Free and fair
elections
10

Voter turnout has remained low, showing only 51.8% in the 2009 presidential elections, 21% in the elections to the European Parliament in 2009 and 44% in the 2011 municipal elections.

The direct election of mayors has been a subject of controversy for many years. The new president spoke in favor of direct elections, not only of mayors but also of local administrators (of the smallest administrative entities within municipalities), who now are simply appointed by municipal councils. The main reason for suggesting these changes is to overcome voter apathy. A secondary motivation is to re-animate stagnating municipal party politics. The main stumbling block for political parties in

coming to an agreement on direct elections has been the scope of authority given to directly elected mayors. Currently, mayors do not wield executive power. Instead, they have authority over municipal councils and executive power is concentrated in the council appointment of municipalities.

In November 2010, the Constitutional Court ruled that the provisions of the Law on Elections to the European Parliament were against the constitution, as they did not provide any other channels to put forward candidacies but through party lists.

There are no veto powers. Elected rulers have effective power to govern.

Effective power to govern

10

Citizens have unrestricted freedoms of association and of assembly within the basic democratic order. The government, however, continues to ban the Communist Party and other organizations associated with the former Soviet regime. After several years of banning pro-tolerance marches (involving gay groups), the Vilnius municipality administration finally granted such a permit in 2010. This decision was contested in several deliberations in the courts, before the High Administrative Court upheld it. The parade took place under heavy police protection, and there were skirmishes initiated by the opponents. According to a representative public opinion poll conducted before the march (by Spinter tyrimai), only 16% approved it and 70% disapproved it.

Association / assembly rights

10

Unrestricted freedoms of expression and of the press and media are guaranteed by the constitution and function in practice. A diverse selection of print and electronic outlets comprise private media. There are five national daily newspapers. According to the Department of Statistics, a total of 297 newspapers and 493 journals were published in Lithuania in 2009. There are 28 television stations and 49 radio stations.

Freedom of expression

9

According to the Global Press Freedom Survey 2010 conducted by the U.S.-based non-governmental organization (NGO) Freedom House, the diversity of coverage and quality was affected by economic pressures and a December 2010 parliamentary ban on “information that promotes ‘sexual relations’ in general, and nontraditional family structures in particular.” In 2009, the Lithuanian chapter of Transparency International carried out a printed media accountability survey of several leading Lithuanian newspapers. The survey found that only a few of the surveyed newspapers applied some of these standard accountability measures (corrections and feedback), and that by and large, the Lithuanian newspapers, instead of actively pursuing transparency policies still tend to think that the public should trust them (as was the case, until recently). Several Lithuanian newspapers are of a poor journalistic quality, and tabloids control a large share of the print media market.

The rapid growth of Internet media is expected to change public attitudes by enhancing media credibility, as public trust in the “Fourth Estate” has declined in recent years. However, public trust in the media has been relatively stable during the review period. It is the sixth-most trusted institution in Lithuania, with 50–55% of respondents showing overall trust (July 2010, ELTA - Baltijos tyrimai).

3 | Rule of Law

There continue to be no constraints on the basic functions involved in the separation of powers, especially mutual checks and balances.

Separation of powers

10

The judiciary is free from both unconstitutional intervention by other institutions and corruption. There are mechanisms for the judicial review of legislative or executive acts.

Independent judiciary

9

Long-standing attempts to reform the judiciary by balancing the independence it enjoys with greater openness and public trust were only partially successful during the previous reporting period. In June 2008, the parliament voted in favor of partial amendments to the law on courts, including a decision that court cases be assigned randomly (by computer) to judges. However, it fell short of establishing more strict and universal criteria for the professional selection of judges, nor did it establish a planned system for rotating the chairmen of various courts. These shortcomings were rectified during the reporting period, when at the insistence of the president, the real rotation of chairmen has begun. Various courts seem to be demonstrating greater cooperation. As of 2010, all judges are subject to a periodic assessment of their performance, something that is no longer limited to instances of potential promotion. Selection procedures have become stricter and more transparent since changes were made to the Law on Courts in 2009. The same changes have extended the right of the expert community to participate in assessing courts’ performance, which was not the case before.

In 2010, there were 779 judges in all courts (except for constitutional and administrative courts), and 114 judges were subject to assessment in the Judicial Commission for Ethics and Discipline. Of these, 11 disciplinary cases were considered by the Judicial Court of Honor and eight judges were found guilty of gross violations. Four judges were dismissed from service by the president. In February 2011, the president proposed changes to the Law on the Public Prosecutor’s Office, limiting the term of office for senior management to five years, with a maximum of two terms in the same position. It is envisaged that vacancy announcements will be open and could be contested by candidates outside the system (e.g., by judges and other persons meeting qualification criteria). These proposals will be deliberated in parliament.

Public trust in the judiciary remains very low and did not improve during the reporting period. According to a public opinion poll by Baltijos tyrimai, only 20% of Lithuania's citizens trust the courts and 71% do not (19% and 41% respectively in 2008). This low level of trust has to do at least partially with a pedophilia scandal which broke out in 2009. The Constitutional Court represents the only exception, as it was trusted by 51% of the population (the fifth-most trusted institution) in July 2010.

There were several high-profile cases of office abuse during the reporting period, mostly at the municipal level. For example, Vilius Navickas, the mayor of Vilnius, was forced to resign in 2010 because he had exerted pressure on the auditor of the municipal administration to resign for pursuing investigations about the construction of schools and the effectiveness of central heating in Vilnius.

Prosecution of
office abuse
8

In comparison to the previous government, the previous practice of ministers to use public funds for political and personal publicity campaigns has been discontinued, thanks to stricter government regulation. However, the economic minister (previously a businessman) has failed to declare his private interests in accordance with procedures and has been forced to resign.

In early 2011, the Prosecutor's General Office charged three high-ranking officials of the Ministry of Economy for promoting the business interests of AB Achema (a business group comprising fertilizer production, port services and media) in their bid for a tender to build a liquefied gas terminal in Klaipėda (the results of the tender were annulled in 2008).

During the reporting period, high-ranking employees of Lietuvos paštas (Lithuania's postal service) and the Rokiškis branch of Sodra (state social insurance fund) were charged with corruption and the abuse of office.

The latest available data by the Ministry of Interior shows an increase in the number of criminal acts related to corruption. In 2009, 890 such cases were registered, which is up 23% since 2008 (724). A total of 479 persons were registered as suspects in corrupt activities, which is 10% more than those registered in 2008 (435). It is not known whether this increase is a result of improvements to the fight against corruption or a rise in corrupt activities.

Several corruption cases and cases of the abuse of office reported in the last country assessment are either still unresolved or have been reversed. These cases include the trial against Viktoras Muntianas, the former speaker of the parliament, who resigned in March 2008 amid allegations that he bribed a deputy governor of Kaunas County to receive assistance for a relative's business.

There are no restrictions on civil rights. The constitutional right to the free practice of religion is respected in practice. In June 2008, the parliament amended the law on

Civil rights
9

equal rights, making discrimination based on ethnicity, religion, sexual orientation, age or disability illegal. This expanded the existing list of illegal discrimination based on gender, race, nationality, language, origin, social status or beliefs. Importantly, this law (in line with EU directives) has placed the burden of proof on the person against whom a complaint is lodged.

The structure and number of complaints submitted to the ombudswoman of equal opportunities seems to have stabilized during recent years and since the last reporting period (165 complaints in 2009 and three investigations on the initiative of the ombudswoman's office, compared to 219 complaints and three investigations in 2008).

According to a 2010 public opinion poll by Vilmorus (commissioned by the Human Rights Monitoring Institute), 22% of respondents thought that their human rights had been violated (18% in 2008), but 78% of them did not lodge any complaints about it. However, awareness of human rights issues has been growing; 54% of respondents replied that they have enough information about such issues (43% in 2008).

During the reporting period, however, there were continued instances of ethnic intolerance. In 2010, the Prosecutor's Office initiated 166 investigations into alleged discrimination or incitement of racial or ethnic hatred (84 in 2008). Twenty-four cases were completed and forwarded to courts, which solved all the cases. Convictions were made in all cases and all instigators were fined.

In April 2010, parliament turned down a draft law prepared by the government on the on the usage of Latin-based diacritics in the spelling of Polish and other foreign names; it not likely to return to this issue during its term (by the end of 2012). The issue of spelling has reached the European Court of Justice because the first district court of Vilnius asked for a decision in the case of *Runevič-Vardyn vs. Lithuania*. At the end of 2010, the advocate general of the ECJ delivered his non-binding conclusion that Lithuania does not violate EU law when issuing documents for its own citizens exclusively with Lithuanian spelling, but that it is in conflict when transcribing the names of the nationals of other EU member states.

Sanctions for the incitement of ethnic discrimination and racial hate have stepped up since the last reporting.

Intolerance in Lithuania, as measured by public opinion, has been growing since independence and remains quite high. For example, according to the public opinion survey carried out in 2007 and quoted in the Annual Report of the Ombudsman of Equal Opportunities, 68% of respondents do not want Roma living in their neighborhoods; 60% feel the same way about Muslims; 18% about Jews and 38% about people of other ethnic origins.

In 2009, Irena Degutienė became the first woman elected to be speaker of the Seimas (parliament) and in the same year Dalia Grybauskaitė was elected the first female president of Lithuania. Important ministers of defense and finance are women too. About 20% of the members of the Seimas are women (27 out of 141).

4 | Stability of Democratic Institutions

The ensemble of democratic institutions continues to work effectively and efficiently. As a rule, political decisions are prepared, made, implemented and reviewed in legitimate procedures by the appropriate authorities.

Performance of democratic institutions

10

All relevant political and social players continue to accept democratic institutions as legitimate. There are no players, even on the margins, who question constitutional democracy as the legitimate form of government.

Commitment to democratic institutions

10

5 | Political and Social Integration

The party system is fundamentally established even though its fragmentation has increased since the 2000 national elections. Nevertheless, political parties fall clearly into three ideological camps (conservative, social democratic and liberal), are well-established and represented in the parliament, and have clearly identifiable voter (socio-demographic) profiles. Electoral volatility remains quite high (by western European standards), and during the last decade, populist parties have been able to attract many votes. They have now been either co-opted into the system or contained outside of it. During the last parliamentary elections, the populist (non-systemic) parties gained about 35% of vote in total, split among three parties. Only one was co-opted into the ruling coalition led by the Homeland Union (Christian democrats). Low turnout continues to be a problem.

Party system

7

During the last municipal elections in February 2011, the traditional political parties fared rather well despite of the impact of economic crisis which could have affected popularity of parties belonging to the ruling coalition in parliament and (all political parties) because of the newly introduced right for individuals to run for municipal office outside of party lists. The Social Democratic party and the Homeland Union/Christian Democrats received most of the seats in the municipal councils, respectively 21.5% and 16.3%.

Trust in political parties has not increased and remains very low. The latest public opinion surveys (by Vilnius in April 2010) found that only 3.2% of respondents trust political parties. Political parties continue to enjoy the least trust among 17

surveyed institutions; 3.6% of respondents trust the parliament; 10.6% trust the government.

Lithuania is on the threshold of being home to a close-knit network of interest groups that are fundamentally cooperative, reflect competing social interests and tend to balance one another.

Interest groups
8

Lithuania has an established tradition of policy deliberation through a tripartite council, which consists of the representatives of the government, business associations and trade unions. The influence of these groups on the decision-making process is much stronger in comparison to that of the third-sector, or NGOs. Though numerically inferior, business associations continue to be the most influential non-governmental players by far (12 thousand members at the end of 2009 according to the Department of Statistics' data), followed by the trade unions (which, according to the Department of Statistics, at the end of 2009 had a membership of 115 thousand or about 10% of the workforce). A total of 36 political parties had 103,000 members.

Lithuanian society remains poorly organized. Although the number of NGOs almost doubled from 1995 to 2005 (when it was estimated to have been over 14,000) and further increased to about 20,000 in 2009 (data by the NGO information and support center). However, given that the participation rate is improving only somewhat, this increase suggests further fragmentation of the NGO sector is underway. According to a representative public opinion survey commissioned by the Lithuanian Lawyers' Society (and carried out in August 2009), public participation in NGO activities increased somewhat since the last reporting period, but still remained low by comparison (22%).

During the reporting period, independent public advocacy groups continued to operate and be heard, though their voice was somewhat less pronounced than during the previous reporting period, when they dominated the public debate in the absence of articulated policy initiatives by the minority left-wing government. In addition to the long-standing Lithuanian Free Market Institute, several other institutes and movements are prominent on the public scene, including Piliėčių santalka, the Human Rights Monitoring Institute, Lietuvos Sąjūdis, and Piliėtinės visuomenės institutas.

There is a broad consensus that a democratic regime is the most acceptable form of governance; the existing constitutional framework is questioned neither openly nor latently.

Approval of
democracy
9

Public satisfaction with the Lithuanian democratic regime's efficacy fluctuates with the country's economic outlook and remains low overall, that is, practically unchanged since the last BTI assessment. Successive public opinion surveys

indicate that the share of citizens satisfied with the way democracy functions in Lithuania dropped from 44% in 2007 to 19% in 2010.

A deep mistrust of the Lithuanian state's executive institutions persists, as reported in the last BTI report. Among all surveyed institutions, political parties, parliament and the government continue to receive the lowest trust scores, which are very low. Importantly, the trust in the presidential institution has increased since Dalia Grybauskaitė assumed the office in July 2009, and remains second only to the firefighters and on par with the trust in the Catholic Church. In contrast to the low trust in other political institutions, this is significant as it demonstrates a preference for a strong hand by some of the voters, which is not commensurate with the president's relatively weak constitutional powers. Low satisfaction with the performance of democracy and mistrust of most political institutions stands in contrast to a much better assessment of Lithuania's membership in the European Union. Support for EU membership has been consistently very high since 2004 at about 70%, and accompanied by a greater satisfaction with the efficacy of EU democracy.

Volunteering as a form of community support has been on the rise during the past two years. According to a representative survey by Socialinės informacijos centras, in 2010 61% of the population participated in voluntary activities (46% in 2008), and 25% of respondents felt positive encouragement to perform such activities by their employers, including paid working time. Internet portals are credited to have been the catalysts behind such change. Lithuania has yet to achieve a consolidated civic culture although it has been making slow progress toward this goal. The web of autonomous groups, associations and organizations is robust but heterogeneous, and it enjoys the population's solid trust. As mentioned above, the legal and regulatory framework for NGOs is solid.

According to the recent EBRD (European Bank for Reconstruction and Development) survey (Life in Transition 2010), there has been a significant drop in people's trust in each other among Lithuanians. Only about 40% of respondents said that "other people could be trusted," whereas more than 60% of respondents agreed with this statement at the beginning of transition in 1989.

Social capital
8

II. Economic Transformation

6 | Level of Socioeconomic Development

Question
Score

Lithuania's level of development permits adequate freedom of choice for all citizens. Poverty and social exclusion are quantitatively and qualitatively minor and not structurally embedded.

Socioeconomic
barriers
8

The economic boom years (including 2007 and to some extent 2008) improved the overall standards of living for all strata of society, but existing socioeconomic disparities did not diminish significantly. The economic crisis has exacerbated these disparities.

The last available Human Development Index (HDI) of the United Nations Development Program for Lithuania is 0.783 (2010), ranking it 44th out of 169 countries assessed and in the high human development category. In 2005, its HDI was 0.775 (43rd out of 177). Despite this progress, among the EU 27, Lithuania's HDI surpasses only Latvia, Romania and Bulgaria.

In 2009 Lithuania's, Gini coefficient was 35.5 (the second highest in the European Union), having increased from 33.8 in 2007 (Eurostat update, February 2011). Thus, the small improvement achieved since 2005, when its Gini coefficient was highest (36.0), has been lost. This trend is confirmed by another measure, the survey of income and living conditions by the Department of Statistics of Lithuania. In 2009, the top quintile possessed 42% of total disposable income, while the bottom quintile possessed only 7%, the difference being 6.3 times (5.9 times in 2007).

The gains made in the employment rate during the times of strong economic growth (from 62.6% in 2005 to 64.9% in 2007) were lost during the economic crisis. Employment stood at 60.1% in August 2010 (Eurostat). Unemployment rose sharply too, from 4.3% in 2007 (and 5.8% in 2008) to 13.7% in 2009 and 17.3% in September 2010. During the economic boom, the percentage of citizens at risk of poverty improved slightly from 20.5% in 2005 to 19.5% in 2007, but deteriorated to 20% in 2008.

Geographic disparities in development did not improve even during the period of high economic growth. During the economic crisis, pensions were cut by 5% on average in 2009. The government has promised that the pensions will be restored to the pre-crisis levels from the beginning of 2012, but it is this promise could clash

with the plans to introduce the euro in 2014 (which would entail keeping the budgetary deficit within the Maastricht criterion of 3% of GDP).

Economic indicators		2007	2008	2009	2010
GDP	\$ mn.	39104.0	47252.9	36846.2	36306.4
GDP growth	%	9.8	2.9	-14.7	1.3
Inflation (CPI)	%	5.7	10.9	4.5	1.3
Unemployment	%	4.3	5.8	13.7	-
Foreign direct investment	% of GDP	5.2	4.4	0.3	1.7
Export growth	%	3.0	11.6	-12.7	16.3
Import growth	%	10.7	10.3	-28.4	17.6
Current account balance	\$ mn.	-5692.4	-6309.6	1724.9	533.8
Public debt	% of GDP	16.9	15.6	29.6	38.7
External debt	\$ mn.	29442.6	31788.0	31820.9	29602.2
Total debt service	\$ mn.	8463.0	9384.7	6453.8	8821.2
Cash surplus or deficit	% of GDP	-0.7	-3.1	-9.0	-
Tax revenue	% of GDP	17.7	17.4	14.0	-
Government consumption	% of GDP	17.9	19.3	21.9	19.9
Public expnd. on edu.	% of GDP	4.7	-	-	-
Public expnd. on health	% of GDP	6.2	6.6	6.6	-
R&D expenditure	% of GDP	0.82	0.80	-	-
Military expenditure	% of GDP	1.4	1.4	1.4	-

Sources: The World Bank, World Development Indicators 2011 | International Monetary Fund (IMF), World Economic Outlook 2011 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2011.

7 | Organization of the Market and Competition

The fundamentals of market-based competition were fully established in 2001, when the European Commission finally recognized Lithuania as a functioning market economy. The Lithuanian economy's legal and institutional framework was further strengthened before the country became an EU member in 2004. As in all

Market-based
competition
9

EU member states, the role of the state is limited to guaranteeing compliance with the rules of market competition.

According to the Department of Statistics of Lithuania's latest available estimate, the country's unobserved economy (as defined in EU legal documents and which is uniformly, but not regularly, measured in EU member states) made up 12.7% GDP in 2008 (14.4% of GDP in 2005) or 14 billion litas. This indicator does not include inherently illegal activities, such as smuggling or narcotics trading.

However, as the economic crisis set in, this trend was reversed and informal economic activity shot up to an estimated 27% GDP in 2010 (according to the Lithuanian Free Market Institute expert panel). Many analysts concur in the opinion that "going informal" was a dominant strategy among Lithuanian businesses in coping with the shock of economic crisis in late 2008 and especially in 2009.

In the World Bank's (IFC) 2011 Doing Business rankings, Lithuania ranks 23rd out of 183 countries for ease of doing business, somewhat better than its 2009 rank of 28th out of 181 countries. Among the new EU member states, Estonia (17th) surpassed Lithuania and Latvia came close (24th). Tightening the time limit for completing the registration of a company, lowering corporate tax rates, and reducing the time to import by introducing (in compliance with EU law) an electronic system for submitting customs declarations mark the most significant steps forward by Lithuania in improving the conduct of business. Lithuania also made progress in the area of closing a business by tightening regulations relating to insolvency procedures. Overall, Lithuania is doing very well in the categories of registration of property (7th rank in the category), and rather well in enforcing contracts (17th), trading across borders (31st) and closing business (39th). The weaker points remain protection of investors (93rd) and, despite recent progress, starting business (87th).

The amount of state aid granted by Lithuanian authorities in accordance with EU state aid law has been low. According to the report of Competition Council of Lithuania, in 2008 the state aid granted constituted 0.82% GDP at current prices (compared to an average of 2.1% in EU 27).

There is a coherent and effective anti-monopoly policy supported by trade policies that are consistent with non-discrimination principles. It is enforced by the Competition Council of Lithuania, while the legal and institutional framework fully complies with the norms of EU law. President Dalia Grybauskaitė was elected in 2009 on a strong promise to curb what she considered "oligarchic monopolies." She appears to be showing initiative, especially as regards the energy and central heating sectors.

However, a recent performance audit report by the National Audit Office of Lithuania (December 2010) points to numerous continued weaknesses in the

competition policy and institutional capacity of the Competition Council, which de facto does not enjoy sufficient independence from political influence, rarely takes initiatives to investigate the most important markets, and imposes relatively mild fines on business entities for violations of competition without assessing the damage done to the market and consumers (therefore fines do not have a sufficient deterrent impact). Crucially, the Competition Council does not have sufficient finances to perform its activities.

Since its membership in the European Union, Lithuania has not had an independent foreign trade policy and follows the Common Commercial Policy of the EU.

Liberalization of
foreign trade
10

Lithuania is an open liberal economy, and its export/import volume ratio to GDP exceeds 100% (112% in 2006, 115% in 2008, and 122.6% in 2010, according to the data of Lithuania's Department of Statistics).

The institutional foundations have been laid for a solid banking system oriented toward international standards with functional banking supervision, minimum capital requirements and market discipline. Capital markets are open to domestic and foreign capital with sufficient resilience to cope with speculative investment.

Banking system
9

There were nine commercial banks (and 13 branches and subsidiaries of foreign banks) in early 2011, mostly foreign-owned.

Although Lithuania's banking system survived the global financial crisis rather well, it was criticized (in the absence of proper restrictions from the central bank) for both contributing to the economy overheating with an oversupply of cheap credit from Scandinavian and German- owned banks and then, during the crisis, for sharply restricting the lending policies and thus aggravating an economic free fall in 2009. New credit (loan) volume to customers (physical persons and companies) contracted by 15% during 2009–2010. In 2010, the banking system was stabilized by the Law on Financial Stability (adopted in May 2009) which provided for the ways and means management of emergency situations, should it be necessary (it was not). Scandinavian banks injected the amounts needed to increase capitalization and the banks were able to maintain their exposures. Since mid-2010, the banks operate profitably. Deposit volume grew even during the year of crisis (in 2009) by 7.4%, and in 2010 it further grew by 5.7%. All banks complied well with prudential requirements of Lietuvos bankas.

As of 1 January 2012, all three supervisory institutions – the Insurance Supervisory Commission, Securities Commission, and Credit Institutions Supervision Department of Lietuvos bankas (the Bank of Lithuania, central bank) will be merged into one institution under the auspices of Lietuvos bankas. This decision was made in response to the financial crisis and the need to consolidate a

supervisory function in the context of a rapidly growing variety of financial instruments on the market.

8 | Currency and Price Stability

Lithuania has pursued a consistent budgetary and monetary policy. Since 1994, the Lithuanian litas has been under a currency board regime in which the litas is pegged to the euro. Inflation has decreased significantly since 2008 (4.5% in 2009, 1.3% in 2010). Electricity price hikes after the final closure of the Ignalina nuclear power plant and rising food prices were subdued by weak domestic demand, falling labor costs and ample spare capacity.

The government's macroeconomic policy during 2009 and 2010 was centered around preserving the stability of its national currency and the currency board regime. It therefore resorted to the policy of the so-called internal devaluation by severely reducing public expenditures and wages.

Lithuania's fiscal deficit was about 8% of GDP in 2010 and is not expected to be in line with the Maastricht requirement of 3% of GDP until 2012.

The government targets 2014 as a date for introducing the euro.

The global financial crisis and resulting economic contraction, which adversely affected a very open and liberal Lithuanian economy, posed a threat to Lithuania's macroeconomic stability. Through tax reforms and sharp cuts in public expenditures, including social benefits, the government managed to stabilize the situation without recourse to International Monetary Fund or European Union lending facilities. The combined value of fiscal correction in 2009 and 2010 amounted to 12% GDP.

The shortfall of budgetary revenues was partially covered by borrowing in the financial markets, and the public debt reached nearly 40% of GDP in comparison to 30% of GDP in 2009. In addition, the fiscal deficit increased from 3.3 % of GDP in 2008 to 9.2% of GDP in 2009, which was considerably in excess of the 3% of GDP limit prescribed by the Maastricht criteria. The current account balance went from a deficit of 13.1% of GDP in 2008 to a surplus of 4.2% of GDP in 2009 and (preliminary data) 0.5% of GDP in 2010. In the medium term, the management issue of public debt poses the biggest challenge to maintaining macroeconomic stability.

Anti-inflation /
forex policy

9

Macrostability

9

9 | Private Property

Property rights and the regulation of the acquisition of property are well defined in terms of acquisition, benefits, use and sale, and are limited only by basic liberal rights. Land restitution has further advanced during the reporting period and is nearing completion, although well behind the formerly planned target date of 2008. The biggest arrears are in the county of Vilnius, where only 40.74% of claimed land in the cities has been restituted by 1 January 2011, resulting in continued complaints from the Polish community in Lithuania.

Lithuania continues to maintain restrictions on the sale of agricultural land to foreign subjects, which were negotiated with the European Union but are contrary to EU law. In January 2011, the government applied for a prolongation of the relevant transition period (stipulated in the EU Accession Treaty) for three additional years. If this request is approved, these restrictions will apply until 1 May 2014.

In June 2010, the government of Lithuania submitted to parliament a draft Law on Compensation for Real Estate formerly owned by the Jewish Religious Communities.

Private companies are seen as the primary engines of economic production, and are given appropriate legal safeguards. According to data from the Department of Statistics of Lithuania, 77.2% of GDP was generated in the private sector in 2009. In 2008, small and medium-sized enterprises (SMEs) made up 99.78% of the total number of enterprises, and they generate 76.9% of total employment.

In 2009, the government pledged to reduce by 30% existing administrative burdens on businesses by the end of 2011 in seven policy areas where obligations to provide information are most frequent (i.e., tax administration, labor law, statistics, environmental protection, transport, real estate transactions, territorial planning and construction). This plan was introduced also as a means of winning the approval of businesses for the government-initiated National Agreement (on Macroeconomic Stability) in 2009. Lithuania is lagging behind in undertaking more flexible forms of employment, such as part-time schedules and temporary contracts (8% and 2.2% of total employment, respectively, while EU 27 averages are 18.1% and 13.5%).

Larg- scale privatization is by and large complete. In 2009, the government sold its remaining 10% of shares in the oil refinery AB Mažeikių nafta to the Polish owner PKN Orlen. During 2009, Valstybės turto fondas (State Property Fund) sold 93 objects for 21.3 million litas, mostly real estate.

Property rights
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Private enterprise
10

10 | Welfare Regime

Lithuania continues to have a solid network in place that compensates for social risks, and national health care is especially robust. Problems persist, especially as regards the sustainability of public finances in the wake of the financial crisis. This includes in particular the revenues of the state social insurance fund, which registered a deficit of 3.3% of GDP in 2009. While the basic monthly pension and minimum unemployment benefits were maintained during the crisis, pensions had to be cut and maternity benefits scaled back in order to contain the deficit. Unemployment and sickness benefits were also reduced and eligibility requirements were tightened.

The center-right government took some very decisive steps in 2008 to bring a wide selection of professions into the social security system, such as sportsmen and self-employed individuals, who are included through the “business license” or “author’s honoraria” schemes. From 2011, they now fully contribute to the state social insurance fund.

Pension reform suffered a setback when 3.5% of the total contribution rate of 5.5%, which had been directed to capital-funded pension schemes, was temporarily (until 2011) redirected back to the pay-as-you-go system in order to finance the struggling state social insurance fund (Sodra). This redirection was further extended, initiating a debate as to whether the obligatory transfers to the funded schemes should not be abolished altogether.

However, these changes are not sufficient to ensure the long-term sustainability of the state-run social insurance system. The debate about social insurance system reforms has been ongoing since 2010. Such reforms include, for example, introducing the so-called points system which would enable payers to monitor their contributions and gradually extending the pension age to 65 years for both men and women.

There are sufficient institutions to compensate for gross social inequality. The rights of ethnic and religious minorities are protected by the constitution. Access to higher education and public office are determined by one’s ability. Nevertheless, socioeconomic status has a great influence on student performance.

According to the Social Report of Lithuania 2009–2010 (by the Ministry of Social Security and Labor), during 2009, the female unemployment rate (10.4%) was significantly smaller than the male unemployment rate (17%). In 2010, female managers constituted 30% of managers of all economic entities (and 35% of individual enterprises).

Social safety nets

7

Equal opportunity

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Although men and women enjoy the same legal rights, women earn lower average wages than men for the same work. In 2009, the average monthly salary for women was 1990 litas while for men it stood at 2349 litas (the gaps were similar both in public and private sectors). This gap is reportedly highest among all the EU countries.

National minorities have access to education in their languages. Although enrollment rates of Roma improved during the past decade according to a recent survey by Etninių tyrimų centras, 56% of Roma children do not acquire higher education than their parents, and most Roma do not acquire basic education. A total 58% of Roma are unemployed, and only 9% of them are employed with labor contracts. Among the unemployed, ethnic minorities tend to be overrepresented, mostly due to the lack of knowledge of Lithuanian language and computer skills.

The rural population is suffering from poorer access to public services, as reflected by lower educational levels and health indicators.

11 | Economic Performance

Domestic and external demand fell significantly in 2009, sending the Lithuanian economy into a free fall for a number of months during that year. Its GDP fell by 14.8% GDP. Recovery of external demand, especially in Lithuania's most important export markets (i.e., Germany, Poland, Latvia and Estonia) led to a rise of exports and thus to a modest economic recovery in 2010, when GDP grew by 1.3%. The volume of exports in 2010 has nearly recovered to the peak levels of 2008. Thus, the recovery has been led by the open sectors of the economy, that is, industry and transport.

However, domestic demand remains sluggish. Domestic consumption fell by 16.8% in 2009 and by 4.2% in 2010. Unemployment went up from the historically low rate of 4.3% in early 2008 to 17.8% in 2010. It was partially alleviated by significant emigration, but is expected to ease only gradually. A drop in domestic demand eased the current account deficit from 13.1% of GDP in 2008 to surplus of 4.2% of GDP in 2009 and (preliminary data) 0.5% of GDP in 2010.

The stock of foreign direct investment (FDI) decreased from €10.3 billion in 2008 to €9.2 billion in 2009 and rebounded to €9.6 billion in 2010, thanks to the personal campaigns abroad by the prime minister and minister of economy targeting high value-added generating sectors.

In 2010, the government of Lithuania declared the goal of becoming the hub of services in the Nordic and Baltic region by 2015 and to reorient its economy

Output strength
8

towards higher value-added generating sectors (in 2009, the share of high value added goods and services in the total volume of exports was 6.1%).

12 | Sustainability

Although ecologically sustainable growth is considered essential to economic activity, it is often subordinate to growth efforts. Environmental protection awareness is clearly overshadowed by the economy's upswing, the change in urban areas, and the population's changing attitudes. According to the Eurobarometer in December 2007, Lithuanians still tend to associate quality of life with economic and social well-being rather than with a clean environment. Only 55% of Lithuanian respondents agree that environmental concerns are important to them personally, and twice less than the EU average think that individual efforts could help the environment (22%) and sort out waste (30%). Environmental consciousness has started gaining traction. During the reporting period there has been a notable increase of participation in voluntary activities and the most popular form is contribution to environmental cleanup efforts (about half of all voluntary activities). Lithuania complies with international agreements and with the requirements of the EU law. EU membership, the associated significant financial investments and state policy are mostly responsible for any improvement in this regard. According to the most recent report by the European Environment Agency (European Environment State and Outlook Report 2010) and Lithuania's most recent national comprehensive assessment (Lithuania's Environment: State, Processes and Development 2008), Lithuania is on track to reach the long-term goals identified in the National Sustainable Development Strategy (2003). Importantly, in many areas the efforts of state policy entailed a decoupling of the rate of environmental pollution from economic growth, for example, in urban air pollution, manufacturing waste and the emission of greenhouse gases (until the closure of the Ignalina nuclear power plant at the end of 2009).

The state and the private sector ensure a national system of education and training, a dynamic research and technology sector, and a viable infrastructure. State investment in education and training increased to 6.8% of GDP in 2009 (from 5.2% in 2007), however, this was mostly due to the sharp decrease of GDP rather than a higher absolute rate of investment. Investment in research and development was increasing slowly, from 0.75% of GDP in 2005 to 0.82% in 2007, but was halted during the economic crisis (0.80% in 2008). The national target of 2% for 2010 has not been reached and Lithuania is still way below the EU average, which was 1.9% in 2008. Only 21.4% of the total expenditure for research and development came from the business sector in 2008, which, although up from 16.7% in 2003, also falls clearly below the EU Lisbon strategy target of a two-thirds share in the total investment for research and development (Eurostat).

Environmental
policy
8

Education policy /
R&D
9

Lithuania's well-educated labor force is a strong attraction for foreign investors. The potential for lifelong learning is still limited in Lithuania, and in fact, it deteriorated further since the last BTI review period. According to data from the Ministry of Education and Science, only 4.5% of the population aged 15 to 64 were enrolled in a study program during the last four weeks of 2009, while the average in the EU 27 was 9.5% in 2009. Results of the National Survey of Pupils' Achievements (2008) show statistically significant differences in educational achievements for different levels of urbanization and type of school, especially among students of higher grades. According to the Programme for International Students Assessment (PISA, the latest available results for 2006) of OECD and partner countries, 15 year-old Lithuanian students scored below the OECD averages in all three tests, natural sciences, mathematics and literacy (reading).

In 2009, the parliament adopted a higher education reform package to make the rectors of universities less dependent on the university senates (councils) and to encourage greater competition among universities.

In addition to management and financing reforms, the government wants to reorient more secondary school graduates and have them take up vocational training, and it wants to direct a larger number of students toward professions in the natural sciences and technology. The current government is determined to complete a reform of education financing and introduce a system of "basket" financing to pre-school education and informal education. In 2008, the government of Lithuania has committed 1.27 billion litas to be invested by 2013 into five integrated centers of science, business and studies (in the "valleys" of Saulėtekis and Santara in Vilnius, Santaka and Nemunas in Kaunas, and Jūrinis in Klaipėda). This financing is expected not only to facilitate cooperation between science and business, but also to increase the share of employment in the high- and medium-value generating industries, which in 2006 stood at 2.48% of total employment.

Transformation Management

I. Level of Difficulty

Structural constraints on governance are moderate overall.

Structural
constraints

1

Lithuania continues to be dependent on the import of Russian energy resources, drawing 100% of its gas supply from Russia. This dependence only intensified following the closure of the Ignalina nuclear power plant at the end of 2009. Lithuania switched to conventional electricity generation and thus consumes more Russian gas and oil. The share of gas increased from 30% in primary energy in 2008 to 45% in 2010. In 2011, the Russian corporation charged Lithuania 15% more for gas than its neighbor Latvia, because Lithuania chose to implement the EU directive requiring the separation of gas extraction from the distribution network.

Though progress is being made, civil society traditions remain weak in Lithuania. The Vilnius-based Civil Society Institute continues its annual measurement of civil society's influence. The latest survey shows that the influence is slowly growing, even though it remains low overall. On a scale of 100 points (devised by the methodology of the institute), it improved somewhat from 33.9 in 2007 to 35.5 in 2010. The most important change was observed in its civil activity component which increased from 27.4 to 37.8 points, and is attributed to the fact that more people are participating in various civic initiatives.

Civil society
traditions

4

There are no major ethnic, religious or social conflicts that threaten the existing political or economic systems. The remaining important issues for ethnic communities, such as the spelling of Polish names, the restoration of Jewish collective property and a Roma settlement in Vilnius, are solved within the existing legal framework.

Conflict intensity

1

II. Management Performance

14 | Steering Capability

Question
Score

Prioritization
9

Even though governments change rather frequently (so far, no government has been able to serve its full four-year term), the degree of policy continuity has been very high, especially on foreign and defense/security policy. Lithuania's strategic priorities include firmly establishing its membership in the EU and NATO (through accession to the Schengen agreement and euro zone), pursuing an active foreign policy beyond its immediate neighbors, making the economy more competitive (especially through health and education reforms and paving the way for more value-added generating sectors) and ensuring energy security and efficiency.

The government took important steps to revitalize its policy priorities through several important amendments to the process of strategic planning. In particular, this meant bringing an end to the previous proliferation of various sectoral "strategic" initiatives (which tended to overload the system) and reducing the number of strategic planning documents. It also introduced clear goals with a corresponding limited number of priorities that have quantitative targets (indicators both as results and impacts) and linkages to budgets. It established monitoring by the Prime Minister's Office with publicly available information on progress, and completely restructured its annual report to parliament, which is no longer a synthetic compilation of reports from various institutions, but instead a focused report on achieved priorities. To this end, the former Office of the Government was reorganized to become the Office of Prime Minister so as to facilitate analytical input and guidance and institute an early warning mechanism for key priority actions.

However, at times, this means that "non priority" sectoral issues, which are now the exclusive responsibility of ministers, are neglected in terms of implementation. The record on the implementation of policy is not even (see, for example, the case of renovating energy-inefficient buildings and health care). This is attributable for the most part to the consolidation of a doctrine of ministerial responsibility, which in a minimal winning coalition government makes it hard to put pressure on non-performing ministers. The overriding policy objective to preserve macroeconomic stability in the wake of the financial and economic crisis also consumed precious government time.

The government is developing a long-term state development strategy entitled "Lithuania 2030," which correctly identifies the main structural obstacles – a lack

of trust in public institutions, a lack of initiative and weak faith in the impact of individual actions on government behavior.

The government can still implement many of its reforms effectively, although its record has not yet rebounded to what it was during the years prior to EU accession and the first years of EU membership. Although enjoying only a small majority in the parliament, the current government, in parallel to downsizing the government and fiscal consolidation, managed to introduce several reform-oriented initiatives. Notably, the government addressed all the issues which the previous BTI report flagged as being in need of attention, that is, fighting corruption, ensuring energy security and efficiency, higher education reform, reducing over-regulation, improving efficiency, accountability and responsibility of the civil service, further decentralization of policy-making, transparency of the central government (through a more elaborate process of consultation and impact assessment), and flexibility of labor.

Lithuania managed to maintain a rather good record in transposing and implementing EU law, as evidenced by the low transposition deficit and relatively small number of infringement cases initiated by the European Commission for incorrect or non-transposition. Lithuania is among the five best EU members on almost all parameters. But implementation still remains clearly insufficient, especially when it comes to mobilizing public administration to implement large-scale, long-term projects and achieve results.

For example, Lithuania established an electricity market operator Baltpool in 2009, which is organizing the market according to the principles of the Nordic market NordPool. During the reporting period, a real breakthrough was achieved in beginning the construction of two important electricity grids, which are part of the EU plan to integrate the Baltic energy grids and markets into those of the European Union.

However, the plans of Lithuania to build a new nuclear power station together with other Baltic states and Poland in order to both meet their electricity demands and reduce dependence on Russia remain uncertain, as the center-right government reversed the policy of the previous government and dismantled the national (public-private) investor LEO LT in 2009, while the new plans to attract strategic investors from abroad were not successful in 2010.

Due to the lack of administrative capacity, the program to renovate old, energy-inefficient apartment blocks did not gain momentum during the review period, despite quite innovative financial engineering through the JESSICA fund.

On the positive side, drastic measures against traffic rule violations and improved infrastructure enabled Lithuania to reduce significantly the number of deaths in

Implementation
8

traffic accidents from 202 per 1 million inhabitants in 2001 (worst position among EU 15 and then candidate countries) to 92 in 2010.

Lithuania's good historical record on economic, social and administrative reforms can be best explained by its aim to become an EU member and the associated policy agenda. In reforming the country, several successive governments did more than just fulfill EU rules, but often managed to internalize them with genuine innovation. The center-right government that took office in late 2008 responded generally well in circumstances of a free-falling economy in 2009 and managed to maintain financial stability. Some of the measures aiming at fiscal consolidation (e.g., taxation and widening the group of social security and health insurance contributors in particular) admittedly could have been designed better, but the government responded to criticism and corrected them or adopted a more gradual approach. The government learned from past failures (of other governments) and managed to advance some important reform areas, such as higher education, public procurement, use of state-owned assets, safety on roads, the electricity market, energy infrastructure, attracting high value-added generating FDI, and overall a significantly more transparent public administration. At times it used innovative approaches and at times it prevailed by sheer political will. The ability to learn will be tested by those areas of reform left wanting, such as health care and the renovation of old, energy-inefficient homes, which are typically large-scale, long-term reform projects.

Policy learning
8

15 | Resource Efficiency

The government uses all available resources efficiently. Even though there is occasionally a debate in the Lithuanian media about excessive bureaucracy from time to time, personnel expenses are in fact not very high relative to the services offered by the state. The center-right government scaled back the number of administrative posts, which has expanded since Lithuania's entry into the EU. This cutback from 34,136 to 30,247 posts (11.4%) in public administration by 1 October 2010 (NB: exclusive of statutory posts such as the police and administrative posts established by non-executive state institutions) marked both the honoring of election pledges and a response to budgetary pressure caused by the financial crisis. Also, in 2010 alone, the wages for civil servants and other state officials (politicians and judges) were cut by 10% on average, which contributed 1.56 billion litas to the government's fiscal consolidation efforts (in 2009, salaries in state institutions were cut by 10.4%).

Efficient use of
assets
9

In terms of improving efficiency, the government has, since 2009, been implementing a large-scale project to introduce evidence-based policy-making. This is driven by the desire to make more systematic use of performance indicators, improve result-oriented budgeting, institute functional reviews and improve impact

assessment systems in Lithuania. The work of the so-called Sunset Commission under the auspices of the Prime Minister's Office has been revitalized by the new government in 2009. In addition to its original aims of eliminating unnecessary bureaucracies and advising on the most appropriate public administration adjustments during the 2009 financial crisis, from 2010 onwards the Commission is increasingly taking up issues related to public administration performance, including the delivery of public services in particular.

A recent report by SIGMA, an EU-OECD program supporting public administration reform, has shown that "Lithuania's civil service demonstrates the closest fit with European principles of administration in comparison with the other new CEE Member States, and it is the only case that can be classified as a high fit." This report also stated, that unlike other Central and East European countries, the Baltic countries and Lithuania in particular have continued civil service reforms after their accession to the EU. However, since this last assessment, the politicization of Lithuanian civil service offices has increased. In mid-2009, the center-right government abolished the institute of "state secretaries" in the ministries, stripped the top career civil servants of their policy formulation and advisory functions, and increased the number of political appointees (ministries can now appoint up to four rather than one deputy ministers). The appointment procedure for civil servants is largely protected from political influences.

In general, the state uses its budgetary resources efficiently. In mid 2010, the Ministry of Economy performed the first ever assessment of assets owned by the state. The assessment concluded that at the end of 2009, state-owned assets (mostly in energy, transport and land) were worth 18 billion litas (about 20% of GDP), but provided only 45 million litas in dividends. The Ministry of Finance estimated that the overhauled management of state-owned companies could generate 1.5 billion litas for the budget in two years (1.6% of GDP). However, the initial proposal by the Ministry of Finance to improve returns from these assets by pulling the 300 state-owned companies into a holding company and shielding them from political influence while increasing transparency, did not receive political support. The government instead opted for a less radical approach in early 2011. It passed mandatory transparency guidelines for state-owned companies in which the companies are obliged to disclose quarterly financial reports. Their strategic goals and financial performance targets will be monitored closely. The government also intends to separately assess their non-commercial (public service) functions. Policy formation, regulatory and asset management functions will be separated in order to minimize the risk of a conflict of interests and increase transparency.

During the reporting period, the state audit office continued to be very outspoken in its audit reports and recommendations to the parliament. It published and commented various important audit reports, which resonated well both among the

general public and in parliament. According to an agreement among all political parties, the parliamentary audit committee is headed by the opposition.

The government coordinates its policies effectively and acts in a coherent manner. A 2006 World Bank assessment of administrative capacity in the new EU member states acknowledged that the strategic planning system had been well developed in Lithuania since the early 2000s and that this system has been maintained by several governments of various ideological orientations. The variable achievement of policy results should be attributed to the government's political strength and will (or lack of it), rather than to the system itself. The new center-right government has been advancing this system, especially as regards budgetary efficiency and government capacity to respond to long-term challenges in a timely fashion, such as an aging population, climate change and energy efficiency. The administration's weakness remains its poor capacity to undertake and implement large-scale projects, such as the construction of the new Visaginas nuclear power plant and renovation of energy-inefficient homes. While the government through the Office of Prime Ministers seems to have significantly enhanced its coordination and monitoring of key priorities and associated activities, the "non-priority" policy agenda is less coordinated under this government due to the consolidation of the doctrine of ministerial responsibility (and hence autonomy).

Policy
coordination
8

Despite the fact that all integrity mechanisms are in place, functioning, and supported by the government, corruption continues to be a serious problem in Lithuania, despite some progress achieved during the reporting period. In fact, 34% of Lithuanian residents admit to having given a bribe to a provider of public services during the past twelve months (data from the Map of Corruption in Lithuania 2008).

Anti-corruption
policy
8

The latest available data by the Ministry of Interior shows an increase in the number of criminal acts related to corruption. In 2009, 890 such cases were registered, which is 23% up since 2008 (724). It is not known whether this increase has resulted from improved mechanisms in the fight against corruption or by a rise in corrupt activities.

The Council of Europe's Group of States against Corruption (GRECO) presented recommendations to Lithuania in July 2009. In response, the Lithuanian government prepared amendments to the Criminal Code and expanded the definition of a bribe, modified sanctions against corrupt activities and extended the deadlines for courts to reach verdicts. In December 2010, Lithuania signed the additional protocol of the Criminal Law Convention on Corruption (ESS No 191), which at the time of writing is undergoing ratification.

A number of initiatives by the current government have contributed to transparency in public administration and reducing corruption. These initiatives will continue to

have a long-term positive effect. For example, the government drafted a new Programme for the Fight Against Corruption for 2011–2013, in which for the first time, various measures will be referenced against clear indicators of results and impacts to be achieved.

The High Commission of Ethics in Office significantly stepped up its activities (and visibility) in passing verdicts in cases of conflicts of private and public interests during the previous reporting period. Regrettably, many of them were overruled by the administrative court. Because of the 2008 changes made to the Law on Prevention of Conflict between Public and Private Interests, the number of persons who are required to present their annual declarations publicly has increased from 3,567 in 2007 to 10,745 in 2009. About 50% declared their private interests and various stakes in profit-oriented establishments.

Party finances remain the weak link; the capacity of the authorized institutions (State Tax Inspectorate) and High Electoral Commission to effectively monitor them is insufficient. This conclusion was confirmed by the last (July 2009) assessment on party and political campaign finances in Lithuania by the Council of Europe's Group of States against Corruption (GRECO). It estimated that about 15% to 20% of party and political campaign funding goes unrecorded despite elaborate requirements for reporting and publishing donor lists.

Importantly, the changes in legislation governing political campaigns in the mass media, which were first applicable during the October 2008 national elections, have led to the containment of expenditures by political parties and have made the political debate much more policy- and issue-oriented. However, the presidential election and European Parliament election campaigns in 2009 were very sluggish, and this led in May 2010 to a re-installation of political advertisements in the media during an electoral campaign, although with capped expenditures.

The May 2010 amendments to the Law on Party and Political Campaign Financing also required all funding donors to declare their income prior to donations and increased fines served to political parties (through the temporary deprivation from state funding) for failures to comply with the provision of the law. However, despite a long ongoing debate, the Lithuanian parliament (due to the impact of financial crisis on the budgetary revenues) again postponed a decision to substantially increase the state funding of political parties.

The arm of the State Tax Inspectorate has been strengthened by a requirement (as of May 2010) obliging all donors to declare their income with the Inspectorate prior to making donations. The volume of finances raised by political parties in 2009 stood at 19.6 million litas, of which nearly two-thirds are subsidies from the state budget. The court case against the Labor Party, which in 2005 was accused of false accounting in its party finances and tax evasion (which enabled the party to receive

a state subsidy greater than that to which it was entitled), was still ongoing at the time of reporting.

According to surveys by Transparency International, administrative corruption remains the biggest problem, especially in health care, territorial planning and construction, and public procurement. The situation is expected to improve in the areas of territorial planning and construction because of simplified procedures, and has begun to improve in the public procurement sector. According to sociological research, in 2008, 32% of managers of Lithuanian companies assessed the public procurement procedures negatively (35% in 2005).

The changes to the Law on Public Procurement in 2009 increased transparency in public procurement procedures and in the disclosure of information. The government in 2009 adopted a new and significantly improved program to improve the public procurement system by 2013 with clear result measures and impact indicators.

The center-right government has pledged to shift the burden of proof of lawful acquisitions of any property for persons in office from the law enforcement agencies to civil servants, and to thus make strides in the fight against corruption. In 2010, for the first time, the assets owned by civil servants as declared in the mandatory declarations were scrutinized by the Tax Inspectorate.

16 | Consensus-Building

All major political actors clearly agree on the goals of building a market economy as well as democracy.

Consensus on goals
10

In practical terms, this is expressed through three key documents, namely the Long-term Development Strategy of the State adopted by the parliament in 2002, the Long-term Economic Development Strategy adopted by the government in 2002, and the National Reform Program, which was first adopted in 2005 and has been updated annually (the new National Program for 2008–2010 was adopted in October 2008). Political parties have continued the tradition of renewing an inter-party agreement on foreign policy priorities for Lithuania every four years or so. Such a document was signed in October 2008, immediately after the national elections, although the Homeland Union (Lithuanian conservatives and Christian democrats) did not sign it for tactical reasons. The center-right government led by Prime Minister Andrius Kubilius in 2009 negotiated a National Agreement with main socioeconomic partners. Its key elements included a long-term strategy for the sustainability of public finances, improving economic competitiveness and reforming public administration.

There are no anti-democratic veto actors in Lithuania. The populist parties or parties with clearly identifiable populist appeal have been co-opted into the system and are playing by democratic rules. Some have already been voted out of parliament, such as the social liberal New Union, which relied on populist slogans in the 2000 elections but subsequently became a system-oriented party. On the other hand, the potential for populist or protest votes did not decline significantly in the 2008 national elections, which was split among several competitors (the Labor Party, Law and Order Party, and National Resurrection Party). Populist influences on policy direction have been minimal. Even these parties agreed that fiscal adjustment was needed in order to address the impact of the global financial crisis on Lithuania and its economy's hard landing. Nevertheless, the Lithuanian party system is not yet immune to such appeals, mostly as a result of considerable voter apathy as national election turnouts remain low.

Anti-democratic
actors
10

During the reporting period, there have been media reports of a revival of activities by political groups that either opposed re-establishing Lithuania's independence in 1990 or deny the forceful annexation of Lithuania by the Soviet Union in 1940 as well as the Soviet military crackdown in January 1991. The head of the parliament's National Security Committee even alleged that these groups are financed by "unfriendly" foreign countries. However, the electoral success of such groups is barely palpable.

For most of the first decade after independence, the main conflict line in Lithuanian society (and thus the basis for the party system's structure) was formed by attitudes toward Lithuania's Soviet past. Since then, this dominant line has been replaced by socioeconomic differences, as issues other than the assessment of the Soviet system accrued greater attention. Interestingly, these lines cut across all social groups for a long time and were not cumulative, keeping the polarization of society and the party system moderate. This led to a paradoxical situation in which many of those who suffered under transition tended to support reforms and an even faster integration into the European Union. Just before the completion of the transition to a fully functioning democratic and market system, however, the Law and Order party of the impeached president Paksas tapped into the potential of disillusioned voters (the so-called losers of transition), thus polarizing both the party system and society.

Cleavage /
conflict
management
8

The conflict created by the Paksas impeachment in 2003–2004 seems to have subsided and is no longer acute, partly because Paksas himself and his party have de facto (though not in rhetoric) accepted the Constitutional Court's and parliament's verdict and seek to redress what they see as an injustice through democratic means. In January 2011, the European Court of Human Rights ruled as disproportionate the lifetime ban on the impeached president to run for any office which requires an oath to the Lithuanian state. From 2006 to 2008, other populist pressures were contained by partial co-optation and by a subsequent de facto coalition of the two biggest political parties (the Homeland Union and Social

Democrats) in support of the minority government. At best, this partnership produced only a mixed policy record, but it helped to stabilize the party and political system. The potential for a polarization of society remains, and a significant portion of voters did not vote for established systemic parties in the last parliamentary elections (2008). The introduction of austerity measures triggered a series of protests in early 2009, but the situation calmed as the government negotiated measures to maintain economic and financial stability with various socioeconomic partners in autumn 2009 through the so called National Agreement.

The political leadership continues to assign an important role to civil society actors in deliberating and determining policies.

The role of the Tripartite Council in consulting major socioeconomic policy decisions is formally assured and is honored in practice. The parliamentary and governmental procedures for civil society's access to decisions are in place, and their application has improved. There has been an important attempt to improve non-governmental actors' access to decision-making since the publication of the last report. The transparency of decision-making has increased since 2009, when the government introduced a requirement that all draft decisions along with accompanying documents have to be made publicly available on the parliament's website. Importantly, this rule seems to have been extended to municipal draft decisions which can be accessed from the same website before the vote in municipal councils. Also, interested members of the public can comment on most of the drafts online. The government also introduced stricter requirements for public consultations to be organized by proponents of legislative initiatives. Some ministries seem to be following this by producing non-technical documents for consultations on major policy decisions, placing them on their websites, and/or organizing public discussions.

The government's EU membership information management system (LINESIS), which is partially open to non-governmental actors and which allows Lithuania's position on EU issues and its implementation of EU law to be tracked, continues to be used. This is a welcome improvement in line with commitments undertaken by Lithuania in its response to the OECD/Sigma peer review on regulatory management capacities (2006) to improve civil society actors' access to and the quality of public consultations on draft decisions. It is also in line with the center-right coalition government's agenda. However, these practices are hitherto limited in scope and not systematic, while the access to the database of draft decisions on the parliament's website is not sufficiently user friendly.

NGOs do have some influence on decision-making, but business groups and, to a lesser degree, trade unions are more influential players. A national NGO coalition (uniting various sectoral NGO associations) was set up at the end of 2009 and it has already made its position clear on some policy issues, though its real impact on

policy-making is still difficult to assess. The government is determined to strengthen the development of NGOs and their access to decision-making. In 2010 it adopted a strategy for developing the NGO sector and established a Commission for NGO issues led by the Deputy Minister of Social Security and Labor.

While attitudes toward and assessment of the communist past still vary, Lithuanian society is clearly not divided in any significant way about these issues. Importantly, it has ceased to be the most important cleavage line in party politics. Historical research into resistance and collaboration under Soviet rule continues. In June 2010, parliament amended Article 170 of the Criminal Code in which it made public condoning, denying or grossly trivializing international crimes and crimes committed by the USSR or Nazi Germany against the Republic of Lithuania or residents thereof a criminal offence (punishable up to imprisonment of two years). Lithuania is one of four EU member states where denial of Stalinist crimes has become a criminal offence, though there is no case law yet.

The only exception to completed reconciliation is the policy toward former KGB agents and reservists. The deadline for voluntary confessions by former agents has been extended several times and the process of lustration has been thought to be completed by 1 January 2012, but the officially designated Lustration Commission has not been very successful in defending its decisions on collaboration with the former KGB when challenged in the courts. Therefore, whereas 2010 amendments by parliament to the Law on Lustration continue to maintain the lifetime ban for secret collaborators and KGB agents to enroll in many posts of political and public service and parliament still wants to complete the process of legal lustration, it has also decided to begin a moral path of lustration by gradually making KGB documents publicly available as of 1 January 2011. Accusations of collaboration with the KGB tend to resurface from time to time and are still occasionally used as a political weapon, although its importance is subsiding.

17 | International Cooperation

In terms of international financial assistance, Lithuania has changed its status from a beneficiary country to a donor country thanks to EU membership and associated improvements brought by economic development. For example, Lithuania graduated in 2006 from being eligible for World Bank financial assistance, switching from recipient to donor status. Lithuania's Official Development Assistance (ODA) went up from 25.2 million litas (0.04% GNI) in 2004 to 119 million litas (0.11% GNI) in 2008 and 103.5 million litas (0.11% GNI) in 2009. However, due to the financial constraints caused by the economic crisis, Lithuania was not able to meet its obligation to the European Union to allocate 0.17% of GNI for ODA by 2010.

Reconciliation
9

Effective use of
support
9

As a result of the EU's principle of solidarity, its structural assistance policies, and Lithuania's EU accession treaty, Lithuania is entitled to very significant EU financial support to boost development and help decommission its Chernobyl-type Ignalina nuclear power plant (closed at the end of 2009), which includes assistance in overcoming the negative consequences associated with closure.

According to a study commissioned by the Ministry of Finance, the highest impact of EU Structural Funds was observed in 2008, when they accounted for an additional 2.1 percentage points in GDP growth (and 7 percentage points in construction). However, these funds also contributed to economic overheating, and their positive impact was almost wiped out by the economic slump of 2009.

As of February 2011, 20.7 billion litas of EU structural funds had been contracted to finance 4,174 projects during the 2007–2013 financing period. Of this amount, 7.1 billion litas have already been absorbed into the Lithuanian economy (www.esparama.lt). For the sake of comparison, state budget revenues in 2010 stood at 21.3 billion litas, which included 7.8 billion in EU transfers (for investments from EU structural funds, funds slated for decommissioning the Ignalina nuclear power plant and agricultural subsidies).

Irregularities in utilizing EU financial support are not significant considering the overall amounts absorbed, and are investigated quickly by the authorities.

Lithuania is regarded as a credible and reliable partner by the international community. It completed its transition to democracy and establishing a fully functioning market economy in the late 1990s, and is now actively working with the international community (especially within the EU) in stabilizing the region and encouraging its neighbors to reform, especially through the format of the Eastern Partnership of the European Neighborhood Policy.

Credibility
10

Lithuania promotes regional and international cooperation, and actively and successfully builds and expands as many international relationships as possible.

Regional
cooperation
9

In addition to its bilateral foreign policy agenda, Lithuania continues to cooperate with its other Baltic neighbors within the framework of the Baltic Council and Baltic Parliamentary Assembly. Cooperation with Lithuania's Nordic neighbors is conducted through regular meetings of the prime ministers of the Nordic and Baltic states. Six-party meetings are held to coordinate positions on EU issues, and eight-party meetings (with Norway and Iceland) on a range of various policy issues. This cooperation is now especially important in view of the government's objective to integrate into Nordic markets (especially services) and energy grids, and also at a time when the so-called strategic partnership with Poland is deteriorating. The Polish side has claimed that Lithuania dishonored its long-made promises about the spelling of Polish names in official documents, the use of the Polish language alongside Lithuanian in regions with Polish majorities, the restitution of land in the

Vilnius region and the support for Polish investment in the oil refinery AB Mažeikių nafta.

The Council of Baltic Sea States continues to be an important multilateral forum for fostering closer regional cooperation in the Baltic Sea area.

Under the leadership of President Adamkus, Lithuania was actively cooperating with the OECD (of the Black and Caspian Sea states, GUAM) in 2004–2009. However, given the recently strained Lithuania-Poland relationship, new foreign policy preferences by President Grybauskaitė and Ukraine's changed priorities under President Yanukovich, this cooperation seems to be stalled.

Both President Dalia Grybauskaitė and the center-right government made important adjustments in foreign and security policy. The policy has become driven more by pragmatic and economic interests and less driven by the promotion of democratic values in the countries of the Eastern Partnership of the European Union. Relations with Russia have improved and are based on the need to find solutions to issues of economic cooperation.

Lithuania is an active participant and promoter of the European Union's engagement with its eastern neighbors under the Eastern Partnership initiative. It contributed actively to facilitating a warmer relationship between its immediate neighbor, Belarus, and the European Union, until the Belarusian government cracked down on the opposition during the last presidential elections in December 2010.

In 2011, Lithuania presided over the Organisation for Security and Cooperation in Europe (OSCE) and has started preparations for its first presidency of the European Union, which is scheduled for the second half of 2013.

Strategic Outlook

Though at the time of writing uncertainties about the pace and sustainability of Lithuania's economic recovery remain, it appears to have weathered the global financial crisis and ensuing domestic economic crisis rather well. The overall performance and policies pursued justify cautious optimism that the economy will soon be back on a path of sustainable high growth and that policymakers will have learned lessons from its somewhat complacent economic, fiscal and administrative policies, as well as the relaxed reform discipline which set in after accession to the European Union.

In addition to the overall competent management of economy and public finances, the center-right government established many signposts for much needed reforms, especially in the areas of energy, public procurement, education, better management of state-owned assets, regulatory policies and public administration. It now operates with much improved transparency mechanisms and is consequently subject to greater public scrutiny. It ambitiously formulated the goals of making the Lithuanian economy a hub of services in the Nordic and Baltic region by 2015 and reorienting itself towards higher value-added sectors (i.e., facilitating value-added services and technologies, innovative industries and clusterized traditional industries). By 2030 this government wants Lithuania to number among the top-10 EU member states in terms of competitiveness, innovation, HDI, happiness, democracy and globalization.

However, its legacy will be shaped by two factors. First, with the recovery of the economy in 2011 and onwards, populist pressures will resume. This could destabilize the currently narrow governing majority. Second, this government needs to improve its record of implementation and to deliver clear assurances regarding several initiated reforms. The management of large-scale complex projects, such as the new nuclear power plant or the renovation of energy inefficient buildings need to have their credibility restored. Health care reform, in particular health care insurance, has barely begun.

The government is acutely aware that the main threat to its longer term initiatives is not just the possible swing in electoral mood, but the absence of a strong anchor similar to that of EU accession a decade ago, around which society can be mobilized.

The main structural obstacles include the lack of trust in public institutions, the absence of initiative and little faith that individual actions can impact government behavior. On these indices, Lithuania appears to have fallen well behind its Baltic comparator (Estonia). Overcoming these deficiencies and the ability to rally the public support will be a challenge for any future Lithuanian government. This will have to be achieved against the background of a depletion of social capital as a result of the recent wave of emigration and ongoing demographic change, that is, an aging population that will require better public services.

Government plans to introduce the euro in 2014 appear credible. They will be tested when the 2012 state budget is established. National elections are scheduled for 2012, and bringing the projected fiscal deficit of 5.8% of GDP within the Maastricht requirement of 3% will prove challenging. A key priority is to bring an end to the very rapid rise in public debt ratios. A comprehensive reform of the pension system and efficiency improvements in the education and health sectors as well as improved use of state-owned property could supplement other fiscal consolidation efforts. Further efforts to improve business environments in order to attract more strategic investors (after a successful start in 2009–2010), encourage research and development activities, and upgrade the technological content of exports should generate an additional stimulus for economic growth. Finally, further reforms aiming at reducing energy dependency and inefficiency is the key to economic growth, political stability and the improved situation of household economies. The future of the planned new nuclear power plant remains uncertain. After a good start with transparency initiatives, anti-corruption efforts should continue.