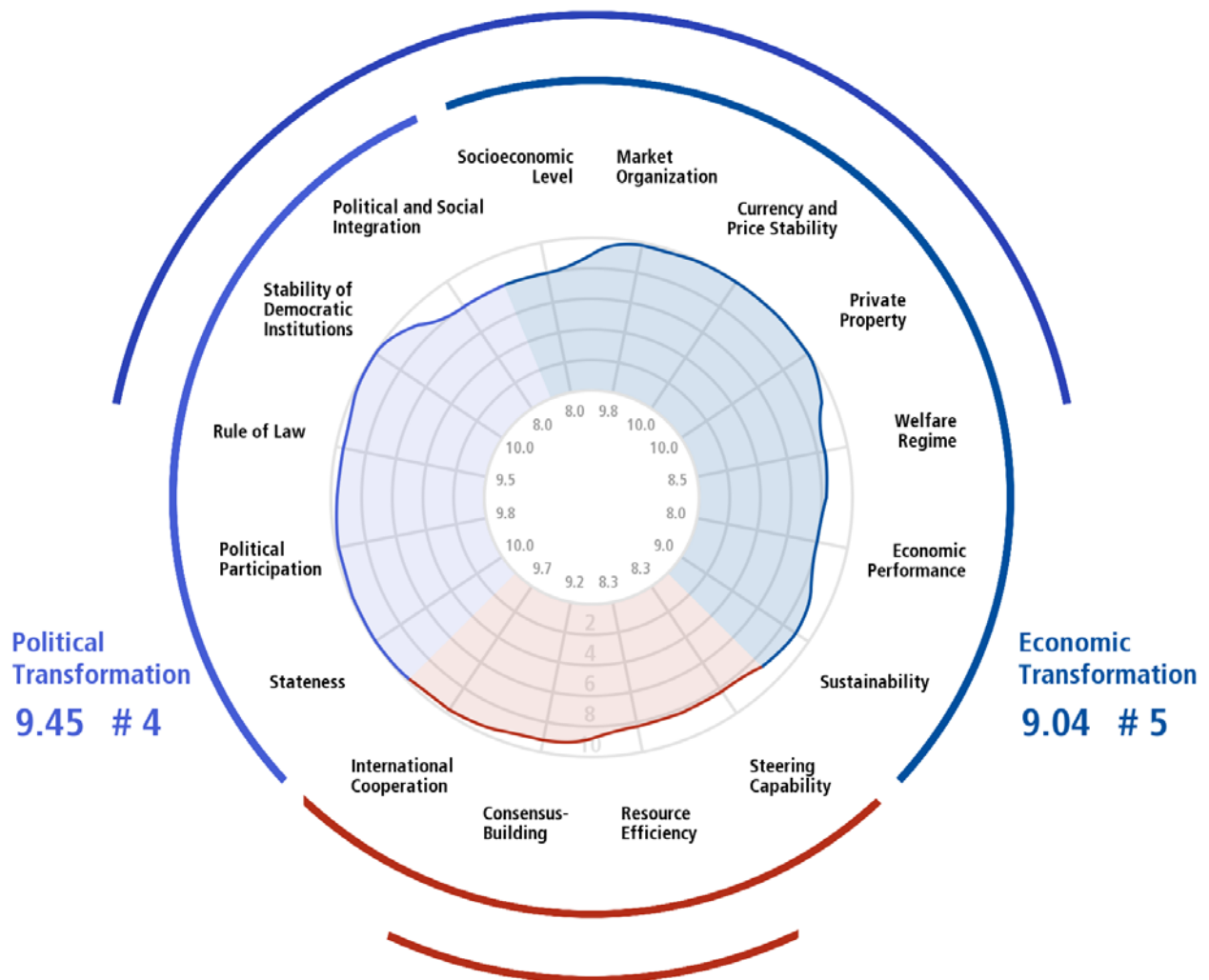


Lithuania

Status Index

9.24 # 4

on 1-10 scale out of 129



Governance Index

7.18 # 5

on 1-10 scale out of 129

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2018. It covers the period from February 1, 2015 to January 31, 2017. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

Please cite as follows: Bertelsmann Stiftung, BTI 2018 Country Report – Lithuania. Gütersloh: Bertelsmann Stiftung, 2018.

This work is licensed under a [Creative Commons Attribution 4.0 International License](https://creativecommons.org/licenses/by/4.0/).

Contact

Bertelsmann Stiftung
Carl-Bertelsmann-Strasse 256
33111 Gütersloh
Germany

Sabine Donner

Phone +49 5241 81 81501
sabine.donner@bertelsmann-stiftung.de

Hauke Hartmann

Phone +49 5241 81 81389
hauke.hartmann@bertelsmann-stiftung.de

Robert Schwarz

Phone +49 5241 81 81402
robert.schwarz@bertelsmann-stiftung.de

Sabine Steinkamp

Phone +49 5241 81 81507
sabine.steinkamp@bertelsmann-stiftung.de

Key Indicators

Population	M	2.9	HDI	0.848	GDP p.c., PPP \$	29966
Pop. growth ¹	% p.a.	-1.1	HDI rank of 188	37	Gini Index	37.7
Life expectancy	years	75.1	UN Education Index	0.904	Poverty ³	% 2.7
Urban population	%	66.5	Gender inequality ²	0.121	Aid per capita	\$ -

Sources (as of October 2017): The World Bank, World Development Indicators 2017 | UNDP, Human Development Report 2016. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

Following several years of strong growth (above 3% following the 2008-2009 crisis), during the period under review Lithuania's economy continued to grow, although at a slower pace due to the trade embargo from Russia and a temporary contraction in investment. Its macroeconomic fundamentals are in good shape with good medium-term prospects, although these will inevitably be affected by the rapidly declining and aging population in the long run. Importantly, its investment and productivity levels have not rebounded to pre-crisis levels, which are an indication of structural problems in public policies on education, innovation and labor market skills, still rather poor health outcomes and in public administration. Very little was done to address these issues during the reporting period, which coincided with the second half of the term in office of the prior center-left government. In fact, a number of indicators for human and social capital have worsened, namely, secondary education outcomes and social inequality.

In summary, progress during 2015 to 2016 has been incremental, mostly due to a sluggish political drive to implement change. This is more obvious and tangible in policy areas governed or implemented by quasi-independent agencies (independent of political leadership), such as, for example, Lietuvos bankas (the central bank), the Public Procurement Office, the Special Investigation Service – SIS (the main anti-corruption institution), or by well-governed state enterprises, such as in the energy sector.

During the period under review, Lithuania deepened its democratic credentials with important advancements in the openness of its courts, combating domestic violence and violence against children (though much more will be needed to make those efforts sustainable), combating corruption (prosecuting high-level corruption and lessening individual and corporate tolerance of bribery), improving attitudes toward the LGBT community and finally the first real, grassroots reconciliation efforts at addressing the legacy of the Holocaust in Lithuania. Importantly, Lithuania is maintaining its European Union anchor and commitments, both at the individual level

(a continuous 60-70% of the population support EU membership since accession in 2004) and within the political system.

The previous center-left government (2012-2016), led by Social Democrats, was only the second one (albeit the second in a row) to serve a full parliamentary term. There was political stability, but the diverse interests of the three governing parties meant protracted policy-making processes and few reforms. The introduction of the Euro, energy security through the liquid natural gas (LNG) terminal in Klaipėda and two electricity power bridges with Sweden and Poland, respectively, were implemented in the first half of the term (i.e., during the previous reporting period). Importantly, the previous government failed to renew the much-needed social contract through modernization of the Labor Code (it caused controversy; though adopted, parts were vetoed by the president and the new government is reworking several contentious elements in early 2017). Most importantly, the previously seemingly unassailable position of the Social Democrats, who enjoyed high rates of popular support until early 2016 (presumably due to their conciliatory approach to governing the country) collapsed before the general election in October 2016. Affected by the failure of the social contract and several implied corruption scandals, the Social Democrats came in only third (with 17 seats of 141) and, for the first time, will be junior coalition partners to the governing Farmers and Greens Union of Lithuania (which won 56 seats in the Seimas). Though the new leading party has a long historical record, as well as some government experience as a junior coalition partner in 2004 to 2008, it will take effort to maintain party discipline in the parliament (due to the diverse backgrounds and policy beliefs of the members of parliament), and the policy agenda, as described in the section on strategic outlook, is very challenging.

President Dalia Grybauskaitė was re-elected in 2014 for a second term until mid-2019. She is enjoying somewhat diminished, but still very high popular support. Most importantly, a significant increase in the Lithuanian population's trust in state and political institutions as well as their satisfaction with their private lives and personal finances, observed during the previous reporting period, has been maintained and will undoubtedly contribute to the next generation of reforms, if the new government undertakes them as promised.

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 May 1, 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, but in all instances (2000, 2004 and 2008), they were either co-opted into the governing coalitions led by the traditional parties, or (as in 2012) left at the margins of parliamentary politics. Until 2016, all the (XVI) governments were led by one of the two traditional leanings, rightwing Homeland Union/Christian Democrats of Lithuania or leftwing Social Democrats. Since late 2016, for the first time, the government is dominated by a traditional though previously small parliamentary party, the Farmers and Greens Union, which convincingly won the parliamentary elections in 2016. Though its somewhat unexpected landslide victory demonstrates voter volatility, the populist threat seems to have subsided and a broad-based reform agenda (advocated, but little implemented under the previous administrations) is likely to continue. The administrations seem to have become more stable too. Since 2008, the governments led by the conservative Kubilius and Social Democrat Butkevičius managed to serve full four-year terms.

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. 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. This last economic crisis of 2009–2010 was the biggest one since the collapse of the planned economy in the early 1990s, but Lithuania withstood through the sharp cuts in public expenditure and managed to maintain stability of its national currency, the Litas. The crisis could have been an opportunity to rationalize budgetary expenditures, introduce more transparency in policy-making and to restart much needed reforms in some policy areas. However, policymakers confined themselves to only minor changes. A worsening demographic situation and persistent social inequalities, which affect societal

cohesion and the stability of the party system, are the most important challenges that no government has yet managed to address properly. At the same time, Lithuania managed to improve its energy security vis-à-vis Russia, to become member of the Schengen free travel area and the Eurozone, and has started to improve its social and military resilience to Russia's aggressive policies toward its neighbors. Above all, Lithuania, like its two other Baltic neighbors, Latvia and Estonia, continues to deepen its democracy against the tides of democratic reversals elsewhere in Central and Eastern Europe.

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

Transformation Status

I. Political Transformation

1 | Stateness

There is clarity regarding the country'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



State identity

10



All citizens have the same civil rights; the nation-state is accepted as legitimate. National minorities include Poles (6.6% of the population), Russians (5.8%) and Belarusians (1.2%), according to the most recent census of 2011 (data released in 2013).

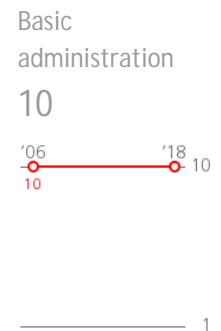
The state is largely defined by a secular order. Religious dogmas have no noteworthy influence on politics or law. Nearly 80% of Lithuanians belong to the Roman Catholic Church, but the church does not play a significant political role in the country.

No interference of
religious dogmas

10

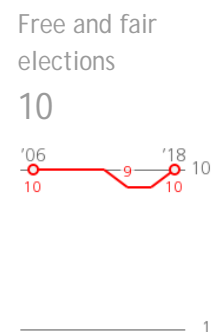


The state has a differentiated administrative structure throughout the country, making it possible to allocate state resources on a broad basis. The quality of services is generally good, even if some are not as developed as in more affluent neighboring North European countries. Trust in public institutions and satisfaction with the services they provide has been increasing.



2 | Political Participation

There are no constraints on free and fair elections. The municipal councils, members of parliament and the president are all elected by direct vote. Representatives of the various political parties monitor procedural fairness, and the validity of all past elections (including the most recent parliamentary elections in 2016) was not questioned. There are generally few irregularities and the High Elections Commission deals with them effectively. However, in 2012 it had to cancel parliamentary electoral results in two single-member electoral districts because of significant vote rigging. In the 2015 municipal elections, there had to be a re-run in three municipalities because of vote rigging. The OSCE/ODIHR election assessment mission concluded that, in “light of issues identified in past elections, and against the background of corruption scandals earlier in the year, [parliamentary] elections [in October 2016] took place under an overall strengthened legal framework with enhanced oversight and enforcement.” Electronic verification of voter identification provided an effective safeguard mechanism against voters casting ballots more than once. Since 2012, the electoral process has been monitored by a civic initiative called the White Gloves movement.



In the municipal elections in 2015, for the first time, mayors were elected by popular vote at the same time as municipal councils. Despite early concerns concerning how mayors would perform in cases when there were opposing (elected) majorities in municipal councils, by and large Lithuania’s municipalities seem to be governable. Seventy-six percent of Lithuanians approved this change.

Legislation introduced in November 2013 allowing electoral committees – like political parties – to propose candidates, brought electoral processes in line with the constitution. This change proved effective in the 2015 municipal elections when several mayors and municipal council members proposed by electoral committees were elected. European Parliament elections in 2014 and parliamentary elections in 2016 were dominated by candidate lists presented by political parties.

Despite a ruling by the European Court of Justice in January 2011 that a lifetime prohibition on any impeached politician running for any elected office imposed by Lithuania’s Constitutional Court was excessively harsh, by January 2017 the

Lithuanian parliament (Seimas) could not assemble the necessary constitutional majority to modify this ban. Thus, Rolandas Paksas, the impeached president and a former chairman of Tvarkos and Teisingumo Partija (Law and Justice Party) and now a member of European Parliament, could not run for three consecutive national elections, namely, the presidential election in 2014 and parliamentary elections in 2012 and 2016.

Electoral turnout has been low but stable. Of eligible voters 51% voted in the first round of the general elections in 2016 (53% in 2012).

In line with good electoral practice, constituency boundaries for parliamentary elections were redrawn by the Central Electoral Commission in 2015 following inclusive parliamentary discussions in order to correct deviations from an average number of voters per constituency (set at 10%) which had accrued since the 1990s.

There are no groups, such as business elites or oligarchs, with veto powers adequate to undermine democratic procedures. Elected rulers have effective power to govern.

Effective power to govern



Citizens generally have unrestricted freedom of association and of assembly within the basic democratic order. The government, however, has continued to ban the Communist Party and other organizations associated with the former Soviet regime. The legal and regulatory framework for NGOs is solid. In December 2013, the parliament adopted a law on non-governmental organizations that contains a more precise definition of the status of NGOs working for public benefit. However, the Organization for Economic Cooperation and Development (OECD) still makes recommendations (in 2015) to “support Lithuania’s third sector through capacity-building and collaboration with the activities of the newly established NGO Council [and] to increase the possibilities of engaging with NGOs in the co-design and co-delivery of public services, as well as through the provision of greater funding opportunities.” In June 2016, a third march for tolerance involving gay rights groups took place in Vilnius (Baltic Pride Parade). Since the first march in 2010, public opinion has changed to view the event positively and the peaceful parade drew a record attendance of 2,000. However, opposition to same sex partnerships in Lithuania is declining very slowly (from 79% against in 2013 to 74% in 2016, according to Vilmorus, a public opinion polling company).

Association / assembly rights



Unrestricted freedoms of expression and of the press and media are guaranteed by the constitution and also function in practice. Private media comprise a diverse selection of print and electronic outlets. An increasing concentration of media was noted in a study commissioned by the Lithuanian Ministry of Culture in 2014.

The overall level of trust in the media continues to be rather low.

In 2015, a new self-regulatory body, the Ethics Commission for Public Information was established and replaced its predecessor, the Ethics Commission of Journalists and Publishers. The new body has a bigger mandate; in addition to analyzing complaints against mass media and journalists, it mediates conflicts between journalists and media management. It is also tasked with promoting critical assessment of information provided for the general public by mass media. In 2015 the commission handled 93 complaints and found 37 infringements against the Code of Ethics of Lithuanian Publishers and Journalists. The majority of infringements were related to publications and broadcasts in conflict with ethics and law, as well as to insufficient opportunities provided to targets of investigative reporting to express their points of view. In March 2016, a new Code of Ethics for Public Information came into force. It was prepared and adopted during an inclusive process. It significantly overhauled the previous ethical standards, which were in place for over 20 years, and will be overseen by the Ethics Commission for Public Information.

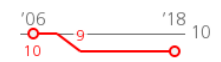
The Inspector of Journalists' Ethics handled 203 complaints in 2016 (218 in 2015), the majority of which concern internet publications and posts in social media. Nine complaints in 2016 were deemed to be about serious infringements upon the Law on Public Information.

The print media market is dominated by tabloids. In addition, during the reporting period some municipal governments entered the media market by running or sponsoring media outlets of questionable quality and integrity. According to a study conducted by the European Association for Viewers' Interests (EAVI) in 2010, media literacy in Lithuania is about average for an EU country. Lithuania's weak points were an insufficient availability of (quality) media and weak communicative abilities of media users to use social networks for access to and participation in the media.

Since 2014, the Lithuanian Television and Radio Commission (Lietuvos televizijos ir radijo komisija) has monitored Russian propaganda, mostly regarding slander concerning Russia's war in Ukraine and the Soviet occupation of the Baltic states, on TV stations watched and radio channels listened to in the territory of Lithuania. Russian TV and radio channels are watched and listened to, respectively, on a regular basis by 15% of the population. In 2015 broadcasting by three, and in 2016 of two, Russian TV channels was suspended due to pro-war and hatred-inducing propaganda. This issue was investigated by the European Commission, which found this practice to be proportionate and in line with the norms of EU law.

Freedom of expression

9



1

On April 1, 2016, removal of two provisions of the Criminal Code that criminalized insulting people (both previously punishable by prison sentences), including special protection for public figures from insult, came into effect. While welcoming the move by the Seimas, the OSCE Representative on Freedom of the Media has called for more ambitious reform and full decriminalization of defamation.

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. The judicial system is independent of the executive and administration is largely free from unjustified party political pressure. Due to the parliamentary-presidential nature of the political system, governments are accountable both to the legislature and the president. Although there are increasing discussions on president's informal involvement or interference in policy areas traditionally handled by parliament or government, the president has thus far not formally exceeded her constitutional powers.

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

Proponents of reform of the judiciary in Lithuania are asking that it balance the independence it enjoys with greater openness and public trust. Since 2010, court seats have been rotated regularly and all judges subject to periodic performance reviews. Also, a community of experts acquired the right to participate in assessing the performance of the courts, which was not the case before.

The number of judges in Lithuania's 62 courts (excluding the Constitutional Court) has been stable since 2010. In order to lower administrative running costs and strengthen the specialization of judges, from January 1, 2018, 49 district courts will be reorganized into 12 courts and five regional administrative courts into two.

The discipline and ethics of judges are improving, mostly due to the Judicial Commission for Ethics and Discipline, which has worked to raise awareness of judicial issues.

The Lithuanian chapter of Transparency International in cooperation with the National Administration of Courts (NAC) set up atvirasteismas.lt, a portal on the openness of the courts, which tracks the performance of all courts and all judges in Lithuania. This is one of the first such initiatives in Europe, enabled by open data supplied by the NAC.

According to the 2016 report of the European Commission for the Efficiency of Justice (CEPEJ), based on 2014 data, Lithuania continued to be the top performing EU member state in the courts with regard to its low disposition and high clearance

Separation of powers

10



Independent judiciary

10



rates in litigious civil, commercial and criminal cases. On the other hand, Lithuanians have a strong tendency to settle disputes in court, as in 2014 Lithuania was the fourth top European Union member state (after Romania, Belgium and Croatia) in terms of the number of civil and commercial suits per 100,000 inhabitants.

Following organizational reform of the office of the Prosecutor General in 2011, the number of solved crimes increased significantly. Since then, this ratio has been stable and in 2015 the number of crimes solved was 55%. The number of reported crimes has decreased since 2013 by 15% to 72,400 in 2015.

After a significant boost in public confidence in the judiciary during the previous reporting period, public trust continued to rise in 2015 to 2016, albeit moderately.

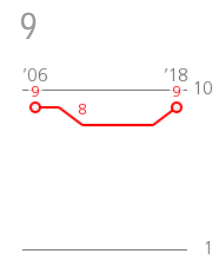
Officeholders who break the law and engage in corruption are prosecuted rigorously under established laws and always attract negative publicity. During the reporting period a number of high profile cases were brought up for investigation and court procedures by the anti-corruption agency, the SIS, which has clearly stepped up its activity. Seventy-seven pre-trial investigations into corruption allegations were launched in 2015 (88 in 2012). While the workload of SIS (measured in number of investigations) has somewhat decreased thanks to improvements in the anti-corruption situation, the SIS is now targeting high-office holders. In 2015, the courts sentenced or upheld previous convictions against 110 individuals (100 in 2014), of which 14 were elected politicians and top managers of public administration organizations, three were judges and 12 directors and high-ranking staff of state-owned companies.

In February 2016, the Appeals Court of Lithuania upheld the decision of the Vilnius regional court, which found the founder and honorary chairman of the then-governing Labor Party Viktor Uspaskich, a Labor Party member of parliament and the party's accountant guilty of violating the accounting rules governing party finances, but acquitted them of tax fraud. Financial penalties against all three were handed out. This decision has effectively forced Uspaskich to quit national politics, though he remains a member of the European Parliament until 2019.

In May 2016, the SIS conducted an operation against Eligijus Masiulis, the chairman of Lithuania's Liberal Movement, and charged him with taking a bribe of €106,000 in cash from the deputy president of MG Baltic, one of the biggest financial groups in Lithuania. Masiulis quickly resigned from parliament and from his party. The pre-trial investigation was still ongoing in early 2017.

The pre-trial investigation into suspected corruption (buying influence) continues against former Chairman of the Law and Order Party and Member of European Parliament Rolandas Paksas and Gedvydas Vainauskas, owner of the largest Lithuanian daily, Lietuvos rytas. The Prosecutor General's Office has asked the European Parliament to lift immunity for Mr. Paksas.

Prosecution of
office abuse



During the reporting period, the Public Procurement Office analyzed potential misuse of public funds through public procurement and detected systemic problems, most notably in Lietuvos geležinkeliai (Lithuanian Railways) and the Lithuanian Armed Forces, which led either to resignations of management or the overhaul of public procurement schemes.

The Prosecutor General's activity report shows that in 2015 there were 1,019 registered cases of office abuse or violations of the public interest (1,203 in 2014). One thousand one hundred forty-nine pre-trial investigations were initiated, of which 94 (7%) concerned corruption-related felonies; 92% of these investigations reached the court.

The courts handed down eight decisions in 2015 and all nine charged individuals were acquitted. The Constitutional Court of Lithuania is currently examining a case at the request of a regional court about whether amendments to the Criminal Code against unlawful acquisition of wealth passed in 2010, targeting mostly corrupt politicians and civil servants, and subsequent additional changes in 2014, passed by the parliament, are in line with the constitution.

Since private or corporate donations to political parties by companies and individuals have been tightly restricted since 2011, the major source of party finances is the national budget.

There are no restrictions on civil rights in Lithuania. The overall number of complaints of rights violations, reported to the ombudsman of equal opportunities, has been steady during the reporting period (265 in 2015). In comparison to previous reporting periods, the new ombuds(wo)man (appointed in 2015) now initiates more investigations.

According to the European Barometer survey in 2015, sexual orientation is the most perceived grounds for discrimination, followed by age and disability.

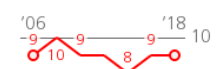
According to a 2016 public opinion poll by Spinter tyrimai (commissioned by the Lithuania-based Human Rights Monitoring Institute), 19% of respondents thought that their human rights had been violated, but 93% of them did not lodge any complaints, mostly because they do not believe that the violation will be rectified.

Intolerance in Lithuania, as measured by public opinion, has somewhat decreased but remains quite high in comparison to other countries of the European Union. According to the official statistics provided by Ministry of Interior, the number of criminal acts driven by ethnic, religious, linguistic, racial hate or hate based on sexual orientation further decreased since the last reporting period. In this category, 45 criminal acts of were registered in 2016.

As regards gender equality, Lithuania scores below the EU-28 average based on the Gender Equality aggregate index designed by the European Institute for Gender

Civil rights

9



1

Equality (latest available data from 2012) in all its six domains. As regards temporal trends (2005-2012), the gender gap in Lithuania is closing in the areas of financial resources and economic situation, as well as knowledge, while it has worsened in the areas of power, health and work.

Domestic violence against women and children continues to be a big problem and has not decreased. The number of recorded cases increased sharply following the criminalization of domestic violence in 2011 and the launch of pre-trial investigations without a statement from the victim. Following the murders of several children by their parents and guardians in 2015 to 2016 which caused big public outcry, the Lithuanian Seimas in February 2017 finally passed a law explicitly criminalizing all forms of violence against children.

The prevalence of sexual harassment in the workplace remains a problem. About 25% of employees' report harassment in the workplace as a source of stress (2012 study of the Lithuanian Institute of Hygiene), which is more than the EU average. The U.S. Department of State's Report on Human Rights in Lithuania states that there is a "a culture of silence" on this matter.

According to the report, "conditions were substandard in a number of prison and detention facilities, and lengthy pre-trial detention continued to be a problem."

The Lithuanian government failed to meet its deadline of 2017 for full modernization of prison and pre-trial facilities and in 2014 it extended the deadline to 2022. According to data collected by the Supreme Audit Authority of Lithuania, the number of inmates suing the government in national courts and European Court of Human Rights has increased six-fold from 2013 (to 935 in 2015). Lithuania tops the EU in the number of incarcerated persons per 100,000 people – 263 in 2014 (Eurostat). According to the Ministry of Justice of Lithuania, only about 25% of incarceration places have been modernized since restoration of statehood in 1990. The U.S. Department of State Report mentions child abuse (both in families and institutions) and intolerance towards sexual and ethnic minorities as other pressing problems.

During the reporting period, some progress has been made regarding the spelling of names in official documents of persons belonging to Lithuania's ethnic Polish minority, but the issue is far from being resolved. They are obliged to use the Lithuanian spelling of their names in official documents, which some find discriminatory.

4 | Stability of Democratic Institutions

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

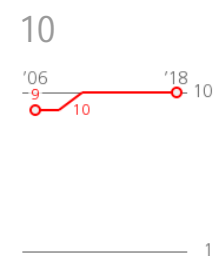
Though conflicts between the various branches of power are, in general, more likely to occur due to the semi-presidential political system, in which the president has partial responsibility over the executive, conflicts are not frequent. After the last elections in 2016 the government was formed quickly, smoothly and in full agreement between the new ruling majority and the president. The occasional arguments between municipal governments of the major cities and the central government about the fairness of existing redistributive system of tax revenues (it does not favor the municipalities) have subsided, after the Vilnius region administrative court ruled in favor of the city of Vilnius and the government committed to hand back a portion of collected personal income taxes (€55 million by 2018) to Vilnius. Though in about one-third of municipal councils, directly elected mayors (in 2015) faced opposition majorities, this proved to be a problem only in Šiauliai (the fourth largest city in Lithuania), where at the time of drafting this report (January 2017), early mayoral elections seemed to be very likely.

There are no players, even on the margins, who question constitutional democracy as the legitimate form of government. The problem of vote rigging, which was a problem in the parliamentary elections of 2012 and municipal elections of 2015, did not occur at significant levels (necessitating re-runs) during the parliamentary elections of 2016 due to a strengthened legal framework with enhanced oversight and enforcement.

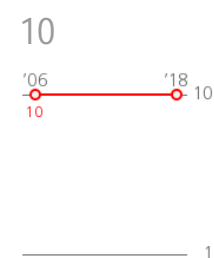
5 | Political and Social Integration

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 of conservative, social democratic and liberal, are well-established and represented in the Seimas, and have clearly identifiable voter profiles that fall along socio-demographic lines. Electoral volatility remains quite high by western European standards, and during the last decade, populist parties have been able to attract many votes. However, in recent years, their influence diminished as they were either co-opted into the system or contained outside of it.

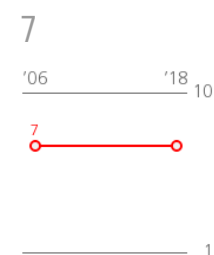
Performance of democratic institutions



Commitment to democratic institutions



Party system



During the last elections in October 2016, an anti-establishment party (The Way of Courage, with seven seats in the previous Seimas) and a populist, governing Labor Party failed to clear the 5% electoral threshold. The national elections in 2016 produced a center-left governing majority again, but, for the first time since the reestablishment of independence in 1990, without the lead of either the conservative Homeland Union (TS-LKD) or the Social Democrats (LSDP). The historical and small parliamentary Lithuanian Farmers and Greens Union skyrocketed from a single member in parliament in 2012 to capturing of 56 seats in 2016 and thus becoming a pivot for the new center-left coalition with the Social Democrats (17 seats). TS-LKD holds 31 seats and the Lithuanian Liberal Movement (LRLS) captured 14 seats, despite a major corruption scandal around the chairman of the party. These two parties form the backbone of opposition in parliament. The Order and Justice Party and Polish Electoral Action have eight members each in parliament.

Trust in political parties has somewhat increased but remains very low. The latest public opinion survey by Vilmorus in January 2017 found that only 9.5% of respondents trust political parties (5.9% in January 2015, 6.4% in December 2012, 3.2% in April 2010). They remain the least trusted institution in Lithuania.

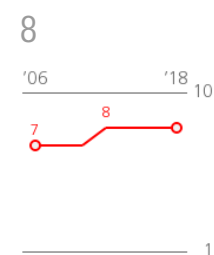
Lithuania is on the threshold of being home to a close-knit network of interest groups that are fundamentally cooperative, reflect competing social interests and tend to balance one another.

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. While being less numerous than NGOs in other sectors, business associations continue to be the most influential non-governmental players by far.

Some business groups continue to have disproportionate access to policy-making, notably in the energy and development sectors, which tend to dominate municipal politics. The number and nature of corruption scandals over the past decade, which mostly occurred at the municipal level and involved local politicians being bought off by business interests, are evidence of this influence. However, during the reporting period the main anti-corruption body, the SIS unveiled several high-profile cases of corruption related to party financing in exchange for favors to business groups.

From 2010 to 2015, the government implemented three special EU-financed programs for strengthening social dialog and partnership as well as for capacity building to increase cooperation with NGOs. This financing will be continued in the current EU budgetary perspective until 2020.

Interest groups



There is broad consensus that a democratic regime is the most acceptable form of governance; there are no powerful groups or individuals who either openly or latently question the existing constitutional framework.

Yet public satisfaction with the efficacy of Lithuania's democratic regime has fluctuated with the country's economic outlook. It was low in the past, but according to Eurobarometer surveys, since 2014 there seems to have been a significant increase in the Lithuanian population's trust in state and political institutions as well as their satisfaction with their private lives (70%) and personal finances (61% in autumn 2016), the country's highest such numbers since the reestablishment of statehood. Along with economic recovery, Lithuanians' satisfaction with democracy has also improved. In March 2016, 38% were satisfied with the way democracy functions in Lithuania, while 51% were not.

During the past three reporting periods, Lithuania has become significantly closer to the EU average in levels of trust in political institutions. Among all surveyed institutions, political parties, Seimas and the government continue to receive the lowest trust scores, although trust in political parties, the Seimas and the government further improved since the previous report.

It is noteworthy that in Lithuania (as in other Baltic states) the lack of popular support is offset by strong support among the political elite. Some 64% of the political elite are satisfied with the functioning of democracy in Lithuania (data from a 2014 survey of the political elite by the Institute of International Relations and Political Science, University of Vilnius and ESTEP).

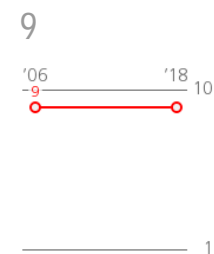
Lithuania has yet to achieve a consolidated civic culture, although it has been making incremental progress toward this goal. The web of autonomous groups, associations and organizations is robust but heterogeneous, and it enjoys the population's solid trust.

According to the World Giving Index 2016 by Charity Aid Foundation (CAF), Lithuania ranked 124th in the world down from 119th place in 2014. Comparable countries ranked somewhat higher – Poland – 109th, Latvia – 113th, Estonia – 118th. According to this survey, only 11% of Lithuania's donated their time to volunteer activities.

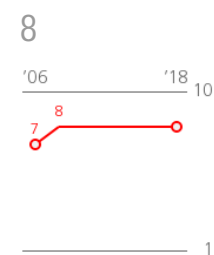
During reporting period, there was a decline in the civic engagement activities. A survey by the Civil Society Institute (Pilietinės visuomenės institutas) showed that in 2015, 41.1% of the population participated in environmental clean-up campaigns, 43.5% provided donations to charities and 28.5% participated in activities in their local communities.

Yet, institutionalized civic engagement is not increasing in any significant way. In 2015 membership in non-governmental organizations was 8%, but engagement in the activities of NGOs, trade unions, political parties, religious organizations was 22%

Approval of democracy



Social capital



(in one of the surveys, by the Civil Society Institute; 68% of population did not participate in any activities).

Only about 40% in 2010 and 24% in 2014 (survey by Socialinės informacijos centras and ESTEP) said that “other people could be trusted,” while at the beginning of the transition in 1989 over 60% of respondents agreed with this statement.

The number of registered NGOs has gone up every year since 1994 and in 2015 reached 28,000, according to data from the Ministry of Social Security and Labor. Only about 12,000 NGOs are active, however. Given that the participation rate has only risen somewhat, this increase indicates fragmentation of the NGO sector.

The number of village communities in Lithuania further increased, totaling 1,862 in 2017 with 100,800 members (1,700 in 2013 with 83,000 members).

II. Economic Transformation

6 | Level of Socioeconomic Development

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.

During the reporting period, in 2015 Lithuania improved its score (from 0.834 in 2014 to 0.839), but lowered its rank (from 35th to 37th out of 187 countries) in the Human Development Index (HDI) of the United Nations Development Program. Lithuania maintained membership in the very high human development category.

While the economy has been growing for several years in a row and its performance is one of the EU’s highest, inequality persists and indeed has worsened. In 2015, Lithuania’s Gini coefficient was 37.9 (the worst in the EU, based on Eurostat’s Survey of Income and Living Conditions), and down close to that of the economic crisis days (37 in 2010). However, about 90% of Lithuanians own their own homes, most of them without a mortgage, indicating a less unequal distribution of assets.

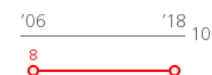
The employment rate continued its upward trend during the period under the review. In 2016, (for people aged 15-64 years) it stood at 69.4% (62% in 2012), according to Lithuania’s Department of Statistics. The unemployment rate contracted from a peak of 17.8% in 2010 to 8% in 2016 and is forecasted to further decrease to 7.1% in 2018 (European Commission). Of those unemployed 38% have been so for more than one year (45% in 2014).

The percentage of those at risk of poverty (after social transfers) increased to 22.2% in 2015 (Eurostat).

Question
Score

Socioeconomic
barriers

8



1

Economic indicators		2013	2014	2015	2016
GDP	\$ M	46473.6	48545.3	41402.0	42738.9
GDP growth	%	3.5	3.5	1.8	2.3
Inflation (CPI)	%	1.0	0.1	-0.9	0.9
Unemployment	%	11.8	10.7	9.1	9.2
Foreign direct investment	% of GDP	1.5	1.0	2.3	0.9
Export growth	%	9.6	3.5	-0.4	3.5
Import growth	%	9.3	3.3	6.2	3.9
Current account balance	\$ M	726.0	1701.4	-976.7	-398.0
Public debt	% of GDP	38.7	40.5	42.7	40.2
External debt	\$ M	-	-	-	-
Total debt service	\$ M	-	-	-	-
Net lending/borrowing	% of GDP	-0.7	-0.2	-0.2	-
Tax revenue	% of GDP	4.5	4.6	4.8	-
Government consumption	% of GDP	16.9	16.9	17.6	17.7
Public education spending	% of GDP	4.6	-	-	-
Public health spending	% of GDP	4.3	4.4	-	-
R&D expenditure	% of GDP	1.0	1.0	1.0	-
Military expenditure	% of GDP	0.8	0.9	1.1	1.5

Sources (as of October 2017): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

Market competition is consistently defined and implemented in Lithuania. As in all EU member states, the role of the state is limited and prices are fully liberalized.

Many analysts concur that “going informal” was one of the dominant strategies of Lithuanian businesses in order to cope with the shock of the economic crisis in late 2008 and especially in 2009. The size of the shadow economy has been declining ever since, although estimates of its size vary between 15% and 28% of GDP. Nevertheless, all evaluation sources point to a downward trend. However, the OECD

Market-based
competition

9

assessment in 2016 concluded that “the informal economy is relatively large, creating an uneven playing field for firms and exacerbating economic inequality.”

Lithuania made a further modest advancement in the World Bank rankings for ease of doing business. According to the 2017 Doing Business report, Lithuania now ranks 21st of 190 countries surveyed (compared to 24th out of 189 in 2015, 27th out of 185 countries in 2013 and 23rd out of 183 in 2011).

The amount of state aid granted by Lithuanian authorities in accordance with EU state aid law traditionally has been low. According to the Competition Council in Lithuania, in 2015 state aid in Lithuania granted to agriculture, industry, transport and horizontal objectives of common interest (total amount of state aid) was €294 million or 0.78% GDP, the highest amount during the past five years. This is close to the EU-28 average (based on 2014 data).

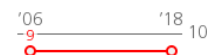
There is a coherent and effective anti-monopoly policy supported by trade policies that are consistent with non-discrimination principles. The Competition Council of Lithuania enforces these policies, and the legal and institutional framework fully complies with the norms of EU law.

In 2012 the government adopted a policy document to strengthen its competition policy, among others, by encouraging more competition in utilities and infrastructure services.

However, since then only incremental and very modest progress can be reported. Despite the 26% rise in the Competitions Council annual budget in 2015, its financing remains one of the smallest budgets for a national competition authority in the world, and thus threatens to compromise the council’s ability to thoroughly ensure supervision of the Competition Law.

In 2015, the Competition Council cleared 36 concentrations. In 2015 and 2016 the council blocked the first-ever two notified concentrations in the areas of advertising and malt production. During the period of 2000–2015, the council investigated more than 50 cases of restrictive agreements. The latest most notable cases in 2015 include a €1.38 million fine against Forum Cinemas, the largest Lithuanian cinema operator, for fixing ticket prices in agreement with its competitors, and €19 million and €3.5 million fines against Vilniaus energija (the central heating provider) and First Opportunity (a biofuel supplier) for an exclusive purchase agreement resulting in a foreclosure effect on the biofuel market.

A very important (historical) achievement occurred in the energy sector. The opening of the LNG terminal in Klaipėda in 2014 forced Russia’s Gazprom, which formerly enjoyed a monopoly as a gas supplier, to offer market-based rates to its Lithuanian customers.



1

Anti-monopoly
policy

10



1

Foreign trade is widely liberalized, with uniform, low tariffs and few non-tariff barriers. Since its membership in the European Union, Lithuania has not had an independent foreign trade policy and follows the Common Commercial Policy of the European Union. Lithuania is an open liberal economy, and its export/import volume ratio to GDP exceeds 100%. In 2016, this ratio was 123% (147% in 2013).

Liberalization of foreign trade



The institutional foundations have been laid in Lithuania 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



With the membership of Lithuania in the eurozone as of January 1, 2015, Lithuanian banks are members of the EU banking union. Their situation is financially sound, as confirmed by the European Central Bank Comprehensive Assessment published in October 2014, which found the three largest banks (Swedbank, SEB and DNB) in possession of high capital adequacy ratios (2-3 times exceeding the required 8 %).

In 2016, six banks and eight foreign bank branches operated in the country. Thus, Lithuania's banking sector is the third most concentrated in the eurozone (after Estonia and Greece). The top three banks (SEB, Swedbank and DNB Nord) are Scandinavian owned, with 75% of the total banking sector assets in 2016. DNB Nord and the similarly Scandinavian-owned Nordea Bank announced the intention to merge their operations in the Baltic States in 2017. The rest of the market is controlled by two domestic banks (Šiaulių bankas and Medicinos bankas), Latvian Citadele bankas and eight branches of foreign banks and credit unions. Assets of the banking sector in 2016 were 64% of GDP, which is far below that of other Baltic countries.

The loan portfolio of Lithuania's banks amounted to €18.1 billion in the third quarter of 2016 and the share of non-performing loans shrank to 4.2% (data from Lietuvos bankas).

According to an assessment by Lietuvos bankas, in 2016 Lithuania's financial sector remained healthy and sound, so much so that it would be capable of operating smoothly in the face of substantial systemic risk.

In 2015, the Bank of Lithuania was given the role of resolution authority for financial institutions. Since then, systemically important banks have to be resolved according to a pre-existing resolution plan, instead of going through bankruptcy proceedings. Moreover, Lithuania started building up a resolution fund in order to make sure that financial institutions in distress are resolved using their own money rather than

taxpayers' money. In 2015, the Bank of Lithuania started to apply the countercyclical capital buffer requirement to limit and prevent excessive credit growth and leverage.

The biggest current systemic risks to financial stability in Lithuania stem from potential real estate bubbles in the Nordic countries, as well as the prolonged low interest rate environment. Despite closure of five credit unions during 2013-2014, further development of the credit union sector continues to be a challenge for the Lithuanian financial system, though this sector owns only 2.5% of financial sector-related assets. The regulatory changes instituted in 2015 by the Bank of Lithuania will not be sufficient and thus a system-wide reform is necessary.

8 | Currency and Price Stability

Lithuania has pursued a consistent budgetary and monetary policy. Lithuania adopted the euro in 2015. In 2014, inflation dropped to a mere 0.2% and went negative (0.7% deflation in 2015), mainly due to the fall in world prices for primary energy products (especially oil), a price cut for imported gas from Gazprom, low prices for processed food, and wage moderation. However, in 2016 inflation was positive again (0.7%) and the forecast for 2017 is 2.1% (1.9% for 2018, according to the European Commission), due to wage growth and recovering oil prices.

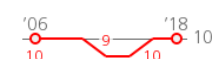
The review period has been characterized by continuous economic growth, driven mostly by domestic demand (2.3% in 2016 (preliminary data), 1.8% in 2015), though somewhat slower than during the previous period (3.5% of GDP in 2013 and 2014). The forecast for 2017 is 2.9% and 2.8% for 2016 (according to the European Commission), and growth will be mostly the result of increased investments and exports.

Government debt declined to 40.8% of GDP in 2016, down from a peak value of 42.7% in 2015. It is expected to fall to 39.6% in 2018.

Since 2015, Lithuania has applied the rules of the European Union Fiscal Compact by incorporating the structural budget-balance into its constitution. The Fiscal Council was established within an independent State Audit Office in 2015; this has provided external scrutiny of the draft budget for the past two years and the government has responded to this scrutiny, though doing so is not a legal obligation. The general government deficit was 0.2% of GDP in 2015 and 0.5% of GDP in 2016. The previous plans to achieve a balanced budget in 2017 will not materialize, due to the labor market and pension reforms, which will push the deficit up to 0.7% of GDP in 2017. Assuming a no policy change scenario, the European Commission predicts it will stay at this level for 2018. Though the fiscal position of Lithuania has been evaluated as broadly neutral by the OECD, it is clear that one of the fastest declining

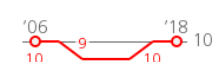
Anti-inflation /
forex policy

10



Macrostability

10



populations in the European Union and increasing dependency ratios will drive increases in expenditure on pensions, health care, long-term care and education.

After a ten-year run of successive deficit budgets, in 2017 the state-run social security system (Sodra) is expected to register its first surplus of €63 million (the forecasted Sodra expenditures are €3.68 billion). In 2016, the deficit was €60 million. The forecast accounts for the indexation of pensions, which are set to increase by 6% in 2017; the average monthly pension will be €281, still one of the lowest in the European Union. However, the social security system will need to be further reformed, as Lithuania is one of the fastest-aging countries in the EU: the old-age dependency ratio in Lithuania will rise from the current ratio of one senior (person over 65 years old) for every 2.4 workers to 1:1.2 in 2040, thus implying additional annual fiscal costs that will peak at around 2% of GDP in 2040.

9 | Private Property

Property rights and the regulation of the acquisition of property are well-defined in terms of acquisition, benefits, use and sale. Property rights are limited solely and rarely, by overriding rights of the constitutionally defined public. The new government has pledged to settle all remaining claims for land restitution in kind and through financial compensation by 1 January 2019. In October 2013, the Constitutional Court ordered financial compensations for titles that cannot be returned in kind.

According to National Land Service data, land restitution in rural areas has by and large been completed. In cities, despite progress made during the reporting period (the number of claimants has been cut almost by 40%), on 1 January 2017, 5,327 claims had not yet been satisfied.

In 2015, the European Commission started an infringement procedure against a law Lithuania adopted in 2014 to limit the sale and purchase of agricultural land by individuals and companies. Following the national elections in October 2016, the new government submitted amendments to the law in January 2017. If adopted by parliament, these amendments will abolish six main requirements for the purchase of land plots, namely, a three-year track record of engagement in agricultural activity before purchase of the land, declaration of agricultural assets, registration of a farm, diploma in agricultural sciences, at least 50% of one's annual income coming from agricultural activities and economic viability.

In June 2011, the Seimas adopted the Law on Compensation for Real Estate for property formerly owned by Jewish religious communities in Lithuania; in 2012, a Good Will Foundation, recipient of the compensation was established by the Foundation of Lithuania's Jewish Heritage. By 1 January 2017, the government transferred €15 million (about 40% of the committed amount) to the Good Will Foundation, which in order of priority paid symbolic benefits to the surviving Jewish victims of totalitarian regimes.

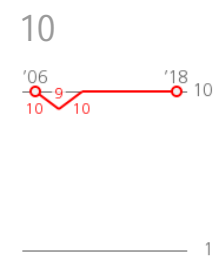
Property rights



1

Private companies are seen as the primary engines of economic production, and are given appropriate legal safeguards. According to the data from the Department of Statistics, in 2015, the general government sector accounted for 12.5% of total GDP (based on national accounts data from the Department of Statistics). The private sector is the main engine of economic growth. Since 2005, the role of small and medium-sized enterprises (SMEs) has been rather stable and very significant. These companies make up over 99% of the total number of all enterprises and generate about 75% of total employment (data for the beginning of 2017 from the Department of Statistics of Lithuania, no change during the reporting period).

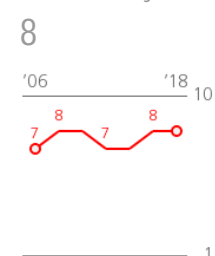
Private enterprise



10 | Welfare Regime

There continues to be a solid network to compensate for social risks, and national health care is especially robust. Like in many European nations, however, Lithuania is faced with problems in sustaining its social benefits, especially because of the worsening demographic outlook (Lithuania is the most quickly aging country in the EU).

Social safety nets



During the reporting period, monthly unemployment benefits were raised and now are between €102 (minimum) and €333 (maximum). The average monthly pension in early 2016 was €255 per month (44.1% of an average salary; a 12.8% increase since 2011). However, the risk of poverty or social exclusion for the unemployed, people of pension age (65+) and with disabilities are very high (among the highest in the EU-28: 74.5%, 37.7%, and 65.7%, respectively) and the situation is worsening. These trends suggest that Lithuania's welfare system is failing to keep pace with economic growth and that unemployment insurance benefits and pensions are inadequate.

Lithuania's social security system is posing several challenges. Firstly, its pension system needs to be further reformed to become sustainable in the long run, while safeguarding its adequacy aspects. (The gap will reach 2% of GDP, because of the aging population, by late 2030s). The retirement age (by law from June 2011) will gradually increase to 65 years for both men and women by 2026. Supplementary voluntary pension contributions introduced in 2013 are not sufficient to meet the demographic challenges.

Around one-third (29.3% in 2015) of the Lithuanian population is at risk of poverty or exclusion – the fifth highest value in the EU – as they live in households with very low work intensity or are materially deprived. In fact, the situation has only worsened during the reporting period. Single parents, families with three or more children, unemployed persons, single adults and retired persons are particularly vulnerable. The relatively low level of social assistance benefits, together with limited quality training and active labor market policy measures, put vulnerable groups particularly at risk of long-term exclusion. In the European Commission assessment of Lithuania

in 2017 as part of the European Semester, risk of poverty and social exclusion is again mentioned as one of the key areas of concern.

According to a 2017 assessment by the European Commission, “poor health outcomes exacerbate the problem of the declining working age population by further reducing the country’s workforce. High mortality rates hamper the potential of the Lithuanian workforce and economy. Amenable mortality in Lithuania is among the highest in the EU, indicating a poor performance of the health system. The main challenges in health care provision are high regional inequalities in access...too high reliance on inpatient care...and ineffective health promotion policies...Corruption in the health sector, in particular the frequent practice of informal payments, further reduce equity in access to health care.”

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 and regional differences have a great influence on student performance.

According to the 2016 Social Justice Index of the Bertelsmann Stiftung, Lithuania’s overall score of 5.69 places it 15th in the EU and just below the EU average of 5.75. Across the six dimensions measured, as regards equitable education and intergenerational justice, Lithuania ranks among the top five in the EU and it finds itself in the bottom half on the issues of poverty prevention, social cohesion and non-discrimination, and health.

According to the Department of Statistics of Lithuania, the employment rate for women aged 15 to 64 in 2016 was 68.8% and for men was 70% (in 2014, 64.9% versus 66.5%, respectively), while unemployment rates for women and men stood at 6.8% and 9.3% (in 2014, 9.4% and 12.4%, respectively).

Although men and women enjoy the same legal rights and, the unadjusted wage gap between men and women in Lithuania in 2014 was 15% (Eurostat; this has increased from 12% in 2012). However, according to the (synthetic Eurostat measure) gender overall earnings gap (which captures the impact of average hourly earnings, the monthly average number of hours paid (before any adjustment for part-time work) and the employment rate), Lithuania performed best in the EU in 2014 (latest available data) with 19.2%.

National minorities have access to education in their languages. However, as before, Roma continued to be seriously disadvantaged both with regard to access to education and to the labor market (once again proven by research commissioned in 2015 by the Office of Equal Opportunities Ombudsperson).

Equal opportunity



1

11 | Economic Performance

Lithuania is on a solid track of sustainable growth. The economy grew by 1.8% in 2015 and by 2.2% in 2016. It is forecast to grow by 2.9% in 2017 and 2.8% in 2018. The slower than forecasted growth in 2014 to 2016 was due to trade restrictions with Russia and the associated drop in exports, as well as to lower than expected investment rates. Actual GDP growth lived up to its potential in 2013 and exceeded it since. In 2016, it was 1.9% (European Commission).

The main export partners of Lithuania have not changed since 2010 and were as follows: Russia, Latvia, Germany, Poland and Estonia. Lithuania's economic recovery starting in 2010 to a very big degree was related to recovery of external demand, although now growth is primarily driven by domestic consumption. Since 2014, exports continue to grow (with the exception of 2015, when the growth rate was negative at -0.4%), but at a much slower pace: 3.5% in 2014, 2.6% in 2016 (the forecast for 2017 is 3.4% and 3.7%). In addition to the effect of trade sanctions on and by Russia, this suggests a worsening competitive position for Lithuania, due to rising wages and slower productivity growth. The current account balance in 2016 was -0.7% GDP (Bank of Lithuania).

Stock of foreign direct investment (FDI) reached €1.8 billion in 2014 and €12.9 billion on July 1, 2016, thanks to campaigns abroad by members of the previous and current governments targeting high value-added generating sectors. However, the investment level in Lithuania is considerably lower than before the crisis. During the last five years, investment in Lithuania has remained stable at around 18% of GDP. Since the global financial crisis, Lithuania's investment rate has lagged both behind the EU average and the other Baltic countries (European Commission).

The unemployment rate further declined to 8% in 2016 (European Commission).

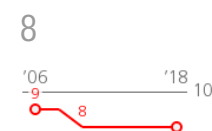
12 | Sustainability

Although ecologically sustainable growth is considered essential to economic activity, it is occasionally subordinated to growth efforts.

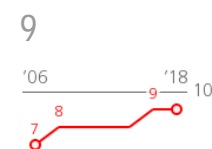
According to the 2016 Environmental Performance Index, Lithuania scored 85.49 and ranked 23rd out of 180 evaluated countries. While its ten-year trend is positive (an improvement of 4.7%), it nevertheless ranks only 17th among the EU's 28 member states and below its regional comparables, Estonia and Latvia, though above Poland).

According to the State of Environment Report 2015 by the European Environmental Agency, GDP grew faster than growth in greenhouse gas emissions in Lithuania,

Output strength



Environmental policy



which amount to an annual 4 to 5 tons per capita and are among the lowest in the EU; total emissions in 2014 were 59.3% below 1990 levels. The energy sector remains a major source of greenhouse emissions, as well as agriculture and industry.

In 2014, Lithuania reached the target for 2020 of 23% of energy produced from renewable sources as a total of primary energy. As regards effectiveness of energy consumption, energy intensity of the economy (gross inland consumption of energy divided by GDP) decreased by 30% during 2010 to 2015 and in 2015 stood at 205.4 (kg of oil equivalent per 1,000 euro). Despite this progress, the gap with regards to the EU-28 average (120 kg) remains large.

Up to 97% of wastewater from households and industry has been cleaned to target standards. Effective wastewater treatment has a positive effect on surface water bodies, and particularly on the largest Lithuanian inland body of water, the Curonian Lagoon, which is highly susceptible to pollutants from rivers.

During the last decade, downward trends were recorded for all pollutants except nitrogen inflow (no clear trend), which largely consists of diffuse pollution from agriculture; this is more complicated to control and was facilitated by crop growing subsidized by the EU Common Agricultural Policy. Inadequate energy-efficiency remains another area of concern contributing to pollution.

Emissions of several air pollutants have decreased significantly in Lithuania. At the same time, air quality in Lithuania is affected by high levels of fine particulate matter.

Since 2013, penalties have been increased tenfold for damages to the environment, including biodiversity. To ensure a decrease in environmental damage, the government is taking action to modernize the environmental supervision system.

Meeting recycling and waste management obligations within the EU context remains difficult, although the situation is improving.

Lithuania complies with international agreements and with the requirements of EU law concerning environmental policy. Indeed, EU membership has played a large role in these improvements. According to the first EU Environmental Implementation Review (published in early 2017 by the European Commission), the status of the environment and especially of air and water quality is good in Lithuania, but Lithuania remains a resource- and energy-intensive country that is only taking the first steps toward a circular economy. In the view of the European Commission, a good compliance (with EU laws) record, with few complaints and infringements, is a point of excellence for Lithuania to be shared with other EU member states.

A landfill tax and excise duties on natural gas were introduced in January 2016. The landfill tax could encourage resource efficiency in waste management and divert waste from landfills. However, green taxation opportunities remain underexploited, especially as regards vehicle taxation, which could support a modal shift from private to public transport.

The state and the private sector ensure a national system of education and training, a dynamic research and technology sector, and viable educational infrastructure. State investment in education and training in 2015 was 5.4% of GDP (Eurostat). Though in absolute terms the investment has been slowly increasing, economic growth outpaced education expenditure.

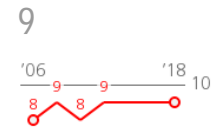
Investment in R&D in Lithuania is still below the EU target, but has increased somewhat during the reporting period. According to Eurostat in 2015 it stood at 1.04% of GDP, 28% of which came from the business sector – a figure well below the EU target of 66%.

Lithuania's well-educated labor force is a strong attraction for foreign investors. In fact, according to Eurostat, Lithuania's 2015 tertiary education attainment rate of 54.8% (for ages 25-34) and was a top one in the EU and significantly above the OECD average of 42.1%. In terms of leaving school early, in 2015 Lithuania had a share of 5.5% among those 18 to 24 years of age with lower education and not engaged in further education or training. Adult participation in lifelong learning was among the lowest in the EU (5.8% in 2016 compared to the EU average of 10.8%) and has been stagnant for almost a decade.

Due to relatively weak performance, a complex reform aimed at increasing the quality of higher education, its effectiveness, efficiency and access was launched in 2009. The measures related to improvement of the governance of universities have been implemented by 2015, but questions remain about the quality of what is offered.

According to the European Commission, "Lithuania's education system outcomes are worsening and the system is inefficient. Lithuania's PISA scores are lower than those of the other Baltic countries and the proportion of low achievers has increased significantly in recent years." Despite high tertiary education attainment rates, the reported lack of high-skilled workers is increasing. Lithuania's education system has struggled to adapt to rapidly decreasing numbers of pupils and students and hence its education system is overstaffed and burdened with maintaining infrastructure that is too large for its needs. Furthermore, low salaries and limited opportunities for professional development hinder schools from attracting talented graduates to replace retiring teachers. Higher education is marred by poor quality standards and financial incentives that promote oversize and inefficiency."

Education policy /
R&D



————— 1

Governance

I. Level of Difficulty

Structural constraints on governance are moderate overall. However, in general there were no major changes in the types of structural constraints to governance reported in the previous country assessments. Nevertheless, two constraints are worth emphasizing.

With the construction of a LNG terminal in the port of Klaipėda in 2014 and two electricity power bridges to Sweden and Poland in 2015, Lithuania has effectively ended structural dependency on Russian energy resources, especially natural gas.

Another sizable challenge is Lithuania's negative demographic outlook. The working age population is shrinking rapidly and threatening growth; it will add pressure on public finances in the foreseeable future. Population decline is due to negative demographic developments but is aggravated by net emigration and, in the context of the EU, low life expectancy and high morbidity rates. The aggravating factors in turn very much depend on existing high social inequality, which during the reporting period only worsened.

Civil society traditions are relatively strong in Lithuania. These traditions date back to the Soviet times and the struggle for independence. For example, the Lithuanian independence movement was led by civic associations like Sajūdis (the Reform Movement of Lithuania). It is also noteworthy that these groups and organizations stood for violence-free resistance and civil disobedience. In Soviet times, there was also a rather strong dissident movement in Lithuania. Since independence, civil society organizations have established stronger roots in society. The number of organizations has increased, although not all registered NGOs are active. Volunteering and donations have recently increased, while interpersonal trust remains low and has even decreased.

Structural constraints

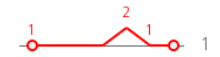


Civil society traditions



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, and Roma settlement in Vilnius, are being solved within the existing legal framework, even if without much success during the past decade.

Conflict intensity



II. Governance Performance

14 | Steering Capability

In Lithuania, the degree of policy continuity has been very high, especially on foreign and defense/security policy. Lithuania achieved all its strategic priorities in 2004, gaining membership to NATO and the EU. Lithuania's new strategic priorities include firmly establishing its membership in the EU and in NATO (through membership in the Schengen area and eurozone), 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.

Although from December 2016 the government for the first time since independence in 1990 is not led by one of the traditional parties (Homeland Union/Christian Democrats or Social Democrats), the long-term agenda set by the previous governments, the National Development Strategy Lithuania 2030, and its operational National Development Program 2014–2020 will be generally continued. The new government is emphasizing the fight against demographic decline, and for public administration efficiency and quality of services, the promotion of healthy lifestyles, culture and education, bridging the gap between the rich and poor, better management of state-owned assets and combating corruption. However, it seems to be less keen on the economy, innovations and competitiveness, which are vital to escaping the medium-income trap. Above all, against significant backsliding elsewhere in Central and Eastern Europe, Lithuania, like the other Baltic States, is very likely to stay democratic and deepen the quality of its democracy. Since 2014, the new priority, in the wake of assertive Russian expansionist policies, is to build up military defense and resilience capabilities across a broad spectrum of policy areas.

Question
Score

Prioritization



The government can still implement many of its reforms effectively, although its record is not as solid as it was prior to EU accession. The motivation of civil servants was affected by pay cuts during the economic crisis of 2008 to 2009 (pay levels, except for the lower ranks, had not been restored by 2017), layoffs and internal restructuring, known as “optimization.” Still, administrative structures are quite strong with sufficient capacity to implement many of the envisaged reforms.

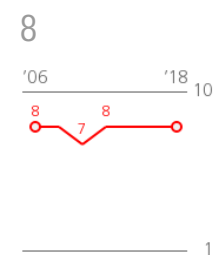
The previous center-left government, despite its low appetite for much-needed structural reform, maintained the continuity of prior reform-oriented initiatives, such as fiscal consolidation, transparency of the central government, higher education reform, reduction of the excessive regulation of business and reform of the management of state-owned enterprises. It also completed construction on three important energy security infrastructural objects (the LNG terminal in Klaipėda and electricity power bridges to Sweden and Poland) and achieved membership in the eurozone as of January 1, 2015. It maintained fiscally responsible policy-making and implementation and started a much-needed fortification of defense capabilities. However, it failed to deliver on its flagship policy initiative, namely, the “new social model,” which was meant to increase the flexibility of labor. In many areas, progress was at best mixed or only very incremental. In some cases, implementation fell short of the government’s initial aims, especially in combating corruption, ensuring energy efficiency, increasing the overall efficiency and accountability of the civil service and further decentralizing policy-making. So, while continuity has been high, success has been mixed.

Lithuania continues to maintain a good record of transposition and implementation of EU laws, but its record has visibly declined since 2004 when it was a star EU member state. The transposition deficit has increased to 0.5% in 2015, though it is still in line with the EU target (0.5%) and above the EU-28 average (0.7%). The compliance deficit in 2015 also increased to 0.8% (from 0.7% in 2014) and is now above both the EU average and the target of 0.5%. A relatively small number of infringement cases have been initiated for non-transposition, or incorrect transposition, by the European Commission – 16 cases at the end of 2015, while the EU-28 average is 26.

While it has a good track record in building the “hard” infrastructural objects, most importantly, Lithuania lacks the capacity (knowhow) to implement the “soft” projects that would change behavior among its citizens and social groups in order to achieve better social outcomes and cohesion (especially in secondary education, child welfare and social protection and healthy lifestyles).

The previous center-left government demonstrated its ability to learn from past mistakes, notably concerning the introduction of the euro, the renovation of old homes for energy insulation and tackling cultural policy as a means to improving the stock of social capital within the country. However, in other policy areas it was hindered by low ambition to achieve more than just a continuation of business as

Implementation



Policy learning

8

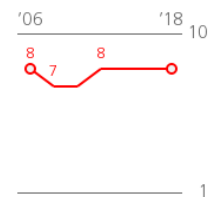
usual. While decisions were not rushed through the parliamentary and executive agenda, the government's policy of active consultation with society and interest groups regarding policy decisions has not been thoroughly carried out, despite the pledges of several governments to do so. The importance of this promise has been recently highlighted by the OECD. However, all draft decisions, with explanatory material, are published on the Seimas website (e-seimas.lrs.lt) at the time of their submission for interagency consultation, so the minimal standards of transparency and policy input are observed.

Lithuania became a candidate to join the OECD in 2015 and is expected to become a member in 2018. This will also increase policy-learning opportunities, especially in areas less available through EU membership.

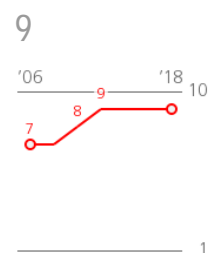
There are two challenges related to policy learning. The first one results from the parliamentary majority being led by a party (the Farmers and Greens Union) that scored a much bigger victory than expected in the parliamentary elections in 2016. High turnover in parliament is not new to Lithuania, but the new members of parliament will have to learn fast. There is a risk of clash with the government, which is composed mostly of experienced technocratic ministers. The second challenge derives from the developmental path of Lithuania. It has reached the point of potentially falling into the middle-income trap and moving beyond this will require more sophisticated policy measures and more advanced learning than was necessary in the past.

15 | Resource Efficiency

The government generally uses all available resources efficiently. Even though there is occasionally a debate in the Lithuanian media about excessive bureaucracy, personnel expenses are in fact not very high relative to the services offered by the state. During the economic crisis, the number of civil service and contract posts in public administration institutions was cut. It has since rebounded to 54,625 in early 2017 (Data of the Civil Service Department). The payroll was cut by 17%. The number of institutions reporting to the government was reduced from 521 in 2008 to 355 in 2011. Overall, in 2015 there were 736 state- and 3,565 municipal-level public sector organizations (69 fewer than in 2014). The new government (in office from December 2016) promised to further downsize public administration institutions and the civil service (in line with negative demographic growth) and to use the savings to pay higher salaries to civil servants, similarly to how this has been occurring in the internal security sector (police and adjacent organizations) since 2015. It also plans by 2020 to achieve central management (through the state enterprise Turto bankas) of 60% of all state-owned area zoned for construction (the current level is 4%).



Efficient use of assets



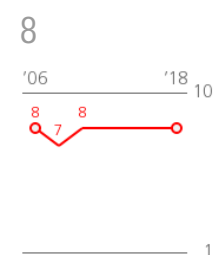
Since 2009, the government has decisively opted for results-driven public management and evidence-based decision-making. It implemented a large-scale project aiming at introduction of evidence-based policy-making, introducing a more systematic use of performance indicators, improvement of results-oriented budgeting, functional review and improvement of the impact assessment system in Lithuania. The so-called Sunset Commission improving governance quality continues to function, although more by inertia than by decisive push. Functional reviews still occur, although improvements are carried out only a small scale. Notable initiatives include attempts to reduce the number of the market surveillance inspectorates and to improve governance of state-funded cultural organizations, although changes there are incremental and improvements have yet to take place.

Reform of the management of state-owned companies (SOE) was initiated in 2011 and can now be considered more or less complete (assessment of the Country Specific Recommendations 2015 for Lithuania by the European Commission). It was an exemplary reform in which Lithuania set the pace for states in the Baltic region and all of East-Central Europe. However, the depth of the reforms to SOEs in various policy areas varies. In the energy sector, the reforms have been initiated in an exemplary fashion, while railways and state-owned forest management SOEs continue to be inefficient and dominated by particularistic interests. The new coalition of the Farmer and Green Union and the Social Democratic Party promise much needed reforms. Similar reforms are still needed for municipal enterprises, where better state management could create sizable gains in efficiency. Only the three biggest cities (Vilnius, Kaunas and Klaipėda) have started to take action on these measures.

The State Audit Office continues to be very outspoken in its audit reports and recommendations to the Seimas. It publishes and provides comments on various important audit reports, which resonate well both in the general public and in the Seimas. Under the fiscal discipline law, from 2014 onwards it acquired the additional role of assessing the quality of the government's draft budget and presenting its assessment to parliament. Since then, the office has criticized almost every single draft budget as too ambitious in expenditures and urged a faster approach toward creating a balanced budget. Though these recommendations are not legally binding, the government took action on some of them.

The government generally coordinates its policies effectively and coherently. Inter-ministerial coordination is managed through a cabinet committee concerned with strategic planning. However, 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. Also, policy fragmentation, especially as regards implementation continues to be notoriously persistent in areas of social capital, namely, social security, culture, and to a lesser degree, education and health care.

Policy coordination



In the early 2010s, the government, through the Office of the Government, significantly enhanced coordination and monitoring of the government's key priorities and their associated activities. However, the “non-priority” policy agenda is less coordinated due to the consolidation of the doctrine of ministerial responsibility, and hence, autonomy, as well as because of sometimes ideologically diverse governing party coalitions. Unlike in Scandinavia, the “whole of government” approach has not yet taken root in Lithuania, as institutional allegiances continue to prevail. At the same time, major political priorities – such as (among the most recent) the introduction of the euro, the construction of the LNG terminal and the beefing up military defense capabilities have been achieved, although with some push or mediation by the president. For the newly appointed government (consisting of the ministers representing Farmers and Greens Union and the Social Democrats), the main obstacles may lay not in ideological compatibility between the governing parties, but in controlling their own parliamentary majority with regards to policy initiatives and agenda.

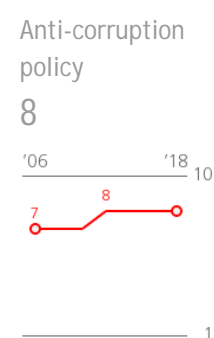
Despite the fact that all integrity mechanisms are in place, functioning and supported by the government, corruption continues to be a serious problem in Lithuania, above the EU average. According to popular perception, it is considered the fifth most important issue by the general population (56% agree that it is very serious problem) and enterprises (35% of representatives responded that it is very serious problem). The data come from a public opinion poll conducted by Vilmorus in October 2016 that was commissioned by the Special Intelligence Service.

In recent years, noteworthy transparency efforts targeted a number of sectors and institutions, among them party financing and electoral campaigns, territorial planning, police, public procurement, market surveillance systems and the work of special institutions, such as the intelligence services and the High Commission on Ethics in Office (HOEC).

Since 2012, the declarations of personal finances of civil servants and public officials are submitted to the HOEC via electronic means, except for categories of (security) officials whose declarations are classified by law. However, the welcome processes of centralized storage and increased public access to electronic declarations have not been matched by the resources and capacity of the HOEC to analyze the data.

The HOEC received 160,000 declarations in 2015. In the same year, it initiated 69 investigations (and reviewed 108 investigations carried out by other institutions), of which only 7% were pursued after in-house analysis. The potential for pro-active investigation is clearly unused, but during the reporting period there was no breakthrough in this area.

The European Commission, in its first-ever report on anti-corruption in the member states in 2014, recommends the development of public procurement service capabilities in detecting corruption – especially at the municipal level and in health



care. It also recommends a strategy against informal payments in health care as well as the strengthening of the monitoring and enforcement capacities of the High Official Ethics Commission, the Central Electoral Commission (as regards party financing) and the SIS in investigating high-level corruption.

Out of the three mentioned institutions, during the period under review, only the SIS has clearly managed to step up operations targeted at high-level corruption. According to 2015 data, courts handed down decisions regarding 76 SIS-initiated cases, 61 (85%) of which resulted in prison sentences for 110 people. Forty-two (38%) were politicians, top managers in the public sector, judges and defense lawyers. The highest-profile cases included sentences passed against former mayors, deputy mayors and high-ranking officials in the city administrations of Alytus, Vilnius and Panevėžys. In 2016, the SIS conducted two high-profile operations against the chairman of Lithuania's Liberal Union and the member of the European Parliament representing the Law and Order Party (both parties are in parliament). That same year the Public Procurement Service uncovered corruption in the Armed Forces of Lithuania and in Kaunas Prison.

16 | Consensus-Building

All major political actors clearly agree on the goals of democracy, although ideas about the values and policies to be prioritized in Lithuania's democracy differ among political actors. Political parties have an established tradition of inter-party agreements on the most important policy issues. The latest such example was in March 2014, when all parliamentary parties agreed to raise defense spending to 2% of GDP (0.77% of GDP in 2012) by 2020.

All major political actors concur in their commitment to a market economy. In practical terms, this is expressed through three key documents, namely the Long-term Development Strategy of the State of Lithuania 2030 adopted by the Seimas in 2012, the operational National Progress Program 2014 – 2020, adopted in November 2012, as well as the National Reform Program, which was first adopted in 2005 and has been updated annually. The latter serves as a document for policy dialog with the European Commission on economic competitiveness issues during the so-called European semester.

There are no anti-democratic veto actors in Lithuania. The populist parties or parties with clearly identifiable populist appeal traditionally have been co-opted into the system and are playing by democratic rules, and some have already been voted out of Seimas. For example, the social liberal New Union, which relied on populist slogans in the 2000 elections, subsequently became a system-oriented party and in July 2011 merged with the Labor Party. The latter was wiped out from the parliament during the 2016 national elections, as was a protest party (the Courage Way), which held six seats in the Seimas during 2012-2016. At the same time, the potential for

Consensus on goals



Anti-democratic actors



Anti-democratic actors

10

populist or protest votes did not decline significantly during the several last parliamentary elections, thus adding to fragmentation of the party system. In the 2016 national elections, many of these votes landed in the basket of Lithuania's Farmers and Green Union (a traditional and historical party), rather unexpectedly making it a strong winner (it captured 59 seats out of 141).

Populist influence on policy direction has been minimal and in the past was typically controlled by the major traditional party of any governing coalition, the Social Democrats or Homeland Union until late 2016, when for the first time since independence the parliamentary majority and the government are led by neither of those parties.

For most of the first decade after independence, the main division in Lithuanian society (and thus the basis for the party system's structure) was based on attitudes toward Lithuania's Soviet past. Since then, this dominant line has been replaced by socioeconomic differences, as issues other than the Soviet system gained more weight in society. Interestingly, these lines cut across all social groups for a long time and did not coincide, keeping the polarization of society and the party system moderate. This led to a paradoxical situation in which many transition "losers" tended to support reforms and even faster integration into the EU. 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 Rolandas Paksas tapped into the potential of disillusioned voters (those who have reaped little from the benefits of transition), thus polarizing both the party system and society.

The conflict created by the Paksas impeachment in 2003 – 2004 seems to have subsided, partly because Paksas himself and his party have de facto (though not in rhetoric) accepted the verdict of the Constitutional Court and Seimas and seek to redress what they see as an injustice through democratic means. In January 2011, the European Court of Human Rights ruled that the lifetime ban for the impeached president to run for any office, which requires an oath to the Lithuanian state, violated the principle of commensurability. Compliance with the ruling of the European Court of Human Rights (ECHR) will require an amendment to the constitution. The Seimas has thus far been unable to agree on the amendment to the constitution, leaving the issue unresolved.

The potential for a polarization of society remains, however, as a significant portion of voters does not vote for established parties. In the 2016 elections many voters supported the Party of Farmers and Greens because they were disappointed with the hitherto leading parties and attracted by the party's promises of strengthening public integrity, reducing Lithuania's brain drain, and combating alcoholism.

In the early 2010s, a new line of polarization in Lithuanian society has appeared, again a recast version of striving for justice, but this time triggered by a so-called pedophilia scandal that erupted in Kaunas and resulted in several killings, including



Cleavage / conflict management

8



a judge. A political party was organized around the issue and managed to secure six seats in the Seimas in 2012-2016. In 2013, the conflict over the alleged involvement of judges in the scandal and the damaged integrity of the judicial system subsided and the new party won only 0.27% of the total votes in the parliamentary elections in October 2016. In 2014, the traditional party system was challenged yet again by a group of ideologically diverse fringe parties and movements (mostly of nationalist and euro-skeptic orientation), which managed to collect 300,000 signatures demanding a referendum extending the ban of sale of agricultural land to foreign nationals. Such an extension would have been a violation of Lithuania's EU accession treaty. The referendum was held in July 2014 but was declared invalid due to insufficient voter turnout (15 %).

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

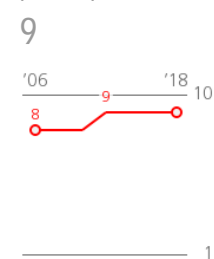
The role of the Tripartite Council in consulting on major socioeconomic policy decisions is formally assured and is honored in practice. Transparency of decision-making has increased since 2009, when the government introduced a requirement that all draft decisions along with accompanying documents (such as explanatory letters, impact assessments and other supporting documents) have to be made publicly available on the Seimas website (e-seimas.lrs.lt) no later than at the time of beginning of inter-ministerial consultations over the draft decisions.

The government also introduced stricter requirements to promote public consultations. Proponents of legislative initiatives are required to organize consultations and some ministries are indeed producing non-technical documents and placing them on their websites and/or organizing public discussions for consultations on major policy decisions.

NGOs do have some influence on decision-making, but business groups and, to a lesser degree, trade unions are more influential players. The government is determined to strengthen the development of the NGOs through an improved regulatory framework and their role in decision-making. In 2010, the government adopted a strategy for development of the NGO sector and established a commission for NGO issues, led by the Deputy Minister of Social Security and Labor. Due to the changes in the law, the commission was replaced with a council for NGO issues in 2015. The council meets regularly. In February 2017, the Minister of Social Security and Labor approved a 2017-2019 plan for supporting NGOs and community activities with an annual budget of €3.7 million.

The government and individual ministries routinely use the technical expertise of various scientific institutions and individual experts for broader policy setting. Various experts have been drawn into the formulation of the long-term development strategy of Lithuania until 2030 and are consulted on various policy issues. Most of these studies are publicly available on official websites.

Civil society participation



While attitudes toward Lithuania's communist past still vary, Lithuanian society is clearly not divided in any significant way by these issues. Importantly, communist attitudes have ceased to be the most important cleavage line in party politics, even if it remains one of the best predictors of voter preferences. Historical research into resistance and collaboration under Soviet rule continues. Together with many other new EU member states, the government of Lithuania was actively encouraging the European Union to officially proclaim Stalinism as a criminal regime. In 2009, the government achieved a recognition of the General Affairs Council that "in order to strengthen European awareness of crimes committed by totalitarian regimes, the memory of Europe's troubled past must be preserved, as reconciliation would be difficult without remembrance" and a commitment of the European Commission to promote remembrance of Stalinist crimes. Domestically, the Seimas in June 2010 amended Article 170 of the criminal code to make it a criminal offense to public condone, deny or grossly trivialize international crimes committed by the USSR or Nazi Germany against the Republic of Lithuania or residents thereof (punishable up to two years in prison).

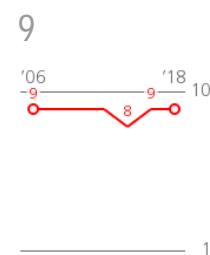
The lustration process for former KGB agents and reservists was largely completed in 2013 with respect to known persons and evidence. Since then, the officially designated Lustration Commission has switched from active pursuit of lustration to standby mode, and only responds to requests for clarification and information. Even if politically the lustration is closed, the so-called "moral path" to admitting collaboration will continue, and surviving KGB documents will continue to be published on the website (www.kgbveikla.lt). During the reporting period, surviving KGB documents and data from the inventories created by KGB agents in Lithuania were published on this website on a regular basis.

In January 2013, the Supreme Court of Lithuania passed the final verdict in the case of the leader of the Socialist People's Front leader Algirdas Paleckis, who was found guilty of denying Soviet aggression against Lithuania in 1991.

In 2014, the Genocide and Resistance Research Center of Lithuania finished compiling a list of 2,055 Lithuanian citizens who are potential Nazi war criminals, although it is not yet clear whether, when and how this list will be published. In 2014, 876 Lithuanian carriers of Righteous Among the Nations status were awarded the title of Lithuanian Freedom Fighter; the surviving 98 persons were granted a right to receive Lithuanian state pensions of the second degree as of October 1, 2014. During the reporting period several books that had high public impact were published in Lithuania analyzing complicity of Lithuanians in the Holocaust.

To commemorate 75 years since the genocide of the Jews, at the end of August and beginning of September 2016 (i.e., the time period in 1941 when most of the local massacres took place), commemorative events were organized in the former Lithuanian shtetls of Biržai (Birzh in Yiddish), Dusetos (Dusát), Molėtai (Malát), Šeduva (Shádov), Ukmergė (Vilkomir) and others. These events may mark a turning

Reconciliation



point in Lithuanian society in accepting the victims of the Holocaust and the perpetrators of war crimes as part of Lithuanian social history with all the implications that that carries.

17 | International Cooperation

Transfers from the EU budget continue to be an important source of public investment in Lithuania, contributing to about one-third of the national budget and constituting over half of all capital public investment. While in real terms (comparative prices) transfers from EU structural funds will decrease somewhat from 2014-2020, this will be offset by higher direct payments in line with EU Common Agricultural Policy.

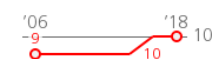
Lithuanian authorities are using EU support effectively. From the financial perspective of the EU, in 2007-2013, Lithuania's absorption rate of EU structural funds was the highest in the EU. However, in the 2014-2020 period, programming and disbursement experienced delays, and half way into the new period only about 29% of €9.9 billion in EU investments had been allocated and a meager 8.3% spent in Lithuania (data from the European Commission's DG REGIO; the corresponding EU averages are 27% and 3.2%, respectively). A synthetic counterfactual analysis shows that without EU membership (which offers both budgetary transfers and, even more importantly, the opportunities attendant to a single market), Lithuania's GDP since the beginning of EU membership would have been 13.7 percentage points lower (or 1.03% of GDP on an annual basis). At the same time, despite massive investments from the European Union Social Fund to improve its social stock, Lithuania has not been able to reduce social inequalities, which are among the highest in the EU.

Irregularities in utilizing EU financial support are not significant considering the overall amounts absorbed and, where present, are responded to quickly by the authorities. The process of absorption is being monitored by the European Commission and the State Audit Office, the supreme audit institution of Lithuania. The most recent (2016) report by the State Audit Office found the rate of ineligible expenditures to be 0.4%, or well below the threshold tolerated by the European Commission (2%).

Lithuania is regarded as a credible and reliable partner by the international community. It completed its transition to the status of a democracy and 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 in the format of the Eastern Partnership of the European Neighborhood Policy. Lithuania introduced the euro as its official currency in 2015, after having fulfilled the EU's convergence criteria. In 2014-2015, Lithuania was a non-permanent member of the U.N. Security Council, a first for a Baltic state.

Effective use of support

10



1

Credibility

10



1

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

In addition to its bilateral foreign policy agenda, Lithuania continues to cooperate with its Baltic neighbors within the framework of the Baltic Council and Baltic Parliamentary Assembly, and, together with Latvia and Estonia, as a member of the Nordic-Baltic Six (NB6) and the Nordic-Baltic Eight (NB8, including Iceland and Norway), as well as in the framework of the EU Strategy for the Baltic Sea Region (since 2009).

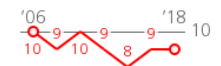
Despite Lithuania's Polish Electoral Action party membership in the ruling coalition in 2012 to 2014, Lithuania's bilateral relationship with its historical ally and neighboring state of Poland has not improved, although the countries cooperate very well in the within the EU's Eastern Partnership. But various bilateral issues have yet to be resolved, such as the right of persons belonging to the Polish minority in Lithuania to have their names written in official documents in correspondence to Polish-language spelling rules.

Lithuania is an active participant and promoter of the EU's engagement with its eastern neighbors under the Eastern Partnership Initiative. Together with Poland, Estonia and Latvia, Lithuania has staunchly supported Ukraine, Georgia and Moldova in their aspirations for European integration (new generation EU association agreements with these countries were signed in June 2014) and Ukraine in its fight against the Russian invasion in 2014. Its bilateral relationship with authoritarian Belarus has been pragmatic while in the context of the EU it has enabled the current leadership of Belarus to maintain a certain degree of maneuverability vis-à-vis Russia.

In 2011, Lithuania held the presidency of the Organization for Security and Cooperation in Europe (OSCE) and presided over the Council of the EU from July 1 to December 31, 2013. Lithuania has become a candidate for and is on track to become a member of the Organization for Economic Cooperation and Development (OECD) in 2018.

Regional cooperation

9



1

Strategic Outlook

Lithuania's economy is forecasted to continue to grow in the medium term, but at a much more modest rate than in the mid-2000s. Earlier growth allowed Lithuania to approach the average level of development in the EU. Fast demographic decline – there is an expected acceleration in the 1.3% annual population decline of the past decade – will not only add stress to public finances (an additional 2% of GDP peaking around 2040), but will necessitate significant improvements of human and technological capital, as well as continuous investments in order to sustain economic growth and help avoid the middle-income trap in Lithuania.

The new government was elected to office in October 2016 on the promise of creating a cleaner, more efficient administration capable of addressing the human and social capital problems currently faced by Lithuania. It is noteworthy that it did so without questioning democratic values, Lithuania's commitment to European integration or its obligations arising from the membership in the EU. The previous (post-austerity) government delivered where and when it mattered, namely, by maintaining fiscally prudent policies, introducing the euro as the country's sole currency, ending energy dependency on Russia, kickstarting a housing renovation program focused on increasing energy efficiency and starting to address the issues of defense capabilities and resistance to Russia's aggressive policies. However, it did not succeed in renewing the social contract through modernization of the Labor Code. In fact, social inequalities have only increased and educational performance deteriorated during the reporting period. It is no wonder that the voters chose to end the implied post-austerity stabilization approach, which postponed much-needed reforms.

The new social contract and accompanying policies to improve human and social capital offer a chance for the new governing majority, which for the first time since independence in 1990 is not being led by either of the traditional parties, Homeland Union (Christian Democrats of Lithuania) or Social Democrats. But this could still turn out to be a predicament as these policies and projects are more difficult to implement than hard infrastructure, despite generous support from the European Union's structural funds.

The external outlook is much more difficult to predict. The Lithuanian economy has withstood very well the economic standoff between the EU and Russia caused by Russia's aggression against Ukraine in 2014. It is well diversified and better integrated in various regional markets than it was a decade ago. Its growth in 2014 and 2015 was only somewhat slower than it could have been. The geopolitical crisis affected investors and local consumer confidence. At the same time, Russia's open rivalry with the international democratic community has other geopolitical implications as well, including military aspects for the NATO frontier state. NATO's collective security guarantees have been operationally scaled up to protect the Baltic States. Lithuania is increasing expenditures on military security – these will reach the 2% GDP minimum in 2018. While some advances have been already made to improve Lithuania's resilience against Russian

propaganda and other channels of influence, the effort is inevitably slow and therefore should be both continued and observed during the next reporting period.

Regarding internal affairs, issues related to human and social capital are likely to dominate political and policy agendas, as promised by new government, and rightly so, as they have previously been neglected. Entrenched and increasing social inequality must be addressed, even if there is little inspiration instilled by the work of previous governments (of various ideological leanings) about how this can be successfully done. The constraints are significant, namely, low (though somewhat improving) trust in public institutions, low civic empowerment, depleted social capital and an aging population (eventually in need of more public services). The fight against corruption (especially at the high level) finally seems to have gained momentum and the intolerance for corruption among individuals is increasing, but the fruits will become visible only in long term.

The other issues to follow in the future are almost the same as previously, namely, more efficient use of existing resources, and in particular efficiency of state-owned enterprises (especially in railways and forest management) and public procurement. However, improvement of the education system and its declining outcomes, as well as improved health care (addressing the quality gap between preventive health care and health care services) could be the policies that will determine the long-term competitive position of the country.